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The Global Economic Outlook and Business and Investment Opportunities for Overseas Koreans

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This final chapter discusses the global economic outlook with a particular focus on business and investment opportunities for overseas Koreans. Having, in the rest of the book, discussed overseas Koreans and their impact on both host and home economies, here we address the outlook for those economies and what opportunities might be presented as a result for overseas Koreans.

In the first section of this chapter, C. Fred Bergsten briefly discusses the United States. In the second section, Marcus Noland discusses Japan and North Korea. And in the third section, Il SaKong comments on the South Korean economy.

SaKong's experience particularly qualifies him to make observations on the South Korean economy. He was South Korea's minister of finance in the late 1980s and senior secretary to the president for economic affairs. More recently, he has served as Korea's ambassador for international economy and trade, and he has been a member of the President's Council of National Economic Affairs. He has had a series of major international responsibilities over the years as consultant to the IMF. He was chairman of the ASEM Vision Group, which provided advice to the Asia-Europe economic meetings. This group brought together 26 representatives from

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the ASEM countries and tried to envision what that new international institution could do.

SaKong also chaired a very innovative group a few years ago called the Emerging Markets Eminent Persons Group. There have been many eminent persons groups, but most of them have been among representatives of industrial countries and most of the discussion of the international financial architecture has been among industrial countries. SaKong put together a group to bring into that debate the perspectives of the emerging-market economies. Thus SaKong has had a very wide and active series of roles. He and C. Fred Bergsten have also for the past 8 years cochaired the Korea-United States 21st Century Council, which brings together top government and former government officials, private-sector leaders, and intellectuals from the two countries to help chart the relationship both between the countries bilaterally and their joint responsibilities in the international economy on an ongoing annual basis.

The United States

Because the purpose of this chapter is to offer thoughts that might be helpful to overseas Korean businesspeople, this section focuses less on the short run and more on the medium- to long-term outlook for the United States. It seems likely that any businessperson—in considering whether to do business and make investments in various parts of the world, or in choosing among the alternative locations—would be particularly interested in the medium- to long-term outlook and in the fundamental prospects for the various economies that are being considered.

In thinking about the United States, and in fact most countries, probably the single most important variable is the outlook for productivity growth. The main driver of any country's economic progress, in terms of output growth and particularly in terms of real incomes and standards of living, is its productivity. If it can achieve steady and rapid growth in productivity, then the outlook is rather good, and investments are worthwhile. The United States during the past 5 to 10 years has experienced a dramatic increase in its annual productivity growth. In fact, the major reason why the US economy did so well in the late 1990s, and in fact had quite a shallow recession and has had such a strong recovery in 2002, is the rapid growth of productivity.

That productivity growth is a fairly new phenomenon for the United States. From the early 1970s until the early 1990s, the United States in fact had very poor productivity performance. Its productivity was growing only at about 1 percent a year, and that was the underlying reason that there were so many doubts about the strength of the US economy all through the 1970s, 1980s, and into the early 1990s. It is hard to remember, but only 10 or 15 years ago, there were great doubts about the competitiveness and capabilities of the US economy. Many people around the world thought that Japan was not only far superior to the United States but also becoming a dominant force in the world. That of course has all reversed during the past decade.

In the cases of both Japan and Europe, productivity growth has actually been cut in half during the course of the past decade compared with the previous period, whereas the opposite has happened in the United States. US productivity growth has doubled or tripled, depending on how one measures it, during the past decade, particularly since the mid-1990s, compared with the previous 20 years. That pickup in US productivity growth was not unique to the boom of the late 1990s, during which its economy was growing so strongly. In fact, US productivity continued to grow rapidly right through the recession of 2001, and it continued very strongly during the first three quarters of 2002, when—despite press and other comments sometimes to the contrary—the US economy grew strongly and bounced back rapidly from the recession of a year earlier.

As was noted, productivity had grown by only about 1 percent a year in the 1970s and 1980s. During the period starting in about 1995, US productivity has grown between 2 and 3 percent a year, probably averaging about 2½ percent. Virtually every American economist who studies these issues now agrees that US productivity growth has experienced this dramatic increase and is likely to continue at this much higher level. There is some debate whether it is 2½ or 3 percent, but that is the range widely considered as the ongoing underpinning for the US economy.

Why is productivity growth so important? The simple reason is that economic growth, the expansion of output, is a simple sum of productive growth, which is labor productivity in most definitions, and the expansion of the labor supply. In the case of the United States, productivity is growing 2½ to 3 percent a year and the labor supply is growing between 1 and 1½ percent, so the prospect for medium- to long-run economic expansion in the United States is something like 3½ to 4 percent a year. That is rather impressive for a mature, high-income industrial economy like the United States. It is about double the rate of growth the country's economists and policymakers thought it was capable of back in the 1970s and 1980s and even in the early 1990s. At that time, the conventional wisdom was that output potential in the United States was only able to expand at about 2 percent a year. Now, the consensus is that the number is closer to 3½ to 4 percent, meaning that the prospects for the United States over the longer run are quite good.

It must be stressed that this is a supply-side picture of the economy, which does not mean that the United States will grow 3½ to 4 percent every year; the business cycle has not been repealed, and there still are recessions, as we saw in the United States a year ago. But as a medium- to long-run proposition, the crucial variable is productivity growth—what it implies for the expansion of the economy's output capacity—and in the

United States, that number has jumped quite sharply and is about $3\frac{1}{2}$ to 4 percent a year.

The interesting question is why that improvement happened all of a sudden in the United States, and even economists who study it closely are not really sure. There are different theses, but the broad picture is that it is a combination of two elements. One is of course the output of information technology (IT) products and the IT revolution. Investment in that sector of the economy expanded very rapidly in the second half of the 1990s and was a major element in the sharp pickup in total factor productivity and therefore the overall prospects for the US economy. However—and this is the important point—the IT revolution and the increased production of new technologies, were *not* the major reason why US productivity growth increased so sharply.

It was not the production of the new technologies that made the major difference; rather, it was the *utilization* of new technologies by a whole range of traditional industries—housing, automobiles, financial services, retail trade, and wholesale trade. Essentially, the "old" economy was learning to adjust to a new situation and use new tools—the computer revolution, the Internet, and the computer software applications that became so widespread in the 1990s. The ability of a whole range of US industries to adapt and apply these new technologies led to this sharp increase in overall US productivity and output growth. Indeed, if the main factor in productivity growth had been IT production, the country would not have gotten too much improvement in its overall economy, because the IT sector is a very small share of the total US economic picture (probably less than 10 percent of the economy as a whole). Rather, it was the transfer of those new technologies to the traditional sectors—a transfer that, for some reason, all of a sudden began to proliferate in the mid-1990s—that led to this sharp improvement in the productivity of the economy as a whole.

We do not fully understand why this technology transfer proliferated at this particular time, much less how much longer it is going to continue and at what pace. We do know, as we look back at the history of other technological revolutions, that new inventions of a fundamental nature, going back to the steam engine and the telephone and the airplane, take quite a long time to be commercialized and adapted to daily economic reality. But once they are applied in an economically meaningful sense, their impact is rather long-lasting and pervasive, and indeed the previous technological revolutions have often led not to just years but decades of better performance, as industry after industry learns how to use them, further refines the adaptation of the new technology, and fuels a continuing economic expansion of rather impressive dimensions. That is why many believe that the evidence for the widespread adaptation of new technologies in the United States in roughly the past 10 years may in fact result in a continuation of higher productivity growth and may even further accelerate that growth.

The main spokesperson for that point of view perhaps has been US Federal Reserve Chairman Alan Greenspan. Already by the mid-1990s, Greenspan was speaking more actively than probably anyone else, at least in US public life, about the productivity revolution and the increased potential for rapid economic growth that it provided in the United States. He in fact based monetary policy largely on that view, letting US unemployment rates decline very substantially below levels at which previous Federal Reserve Boards would have tightened monetary policy because of a fear of inflation. But he believed that the pickup in productivity growth would turn out to be lasting and that the US economy could run at a higher rate of growth and a lower level of unemployment without jeopardizing price stability and undermining the economic picture. It turned out that he was correct—fortunately so—and therefore the United States saw sharp economic growth and much lower unemployment in the late 1990s.

Of course, as with many new technology developments and periods, part of it was overdone. The IT sector itself became hugely overinvested, excess capacity developed, equity prices ran far beyond what was justified, and the bubble burst, leading to the sharp decline in the stock market. Despite that decline, however, the US economy has picked up very sharply in 2002.

In conclusion, it simply needs to be stressed that the United States has had three quarters of very strong economic growth in 2002. This needs to be noted because, if one listens to some media presentations, one would think that the United States was still in a recession. In fact, however, in 2002 its economy grew at an annual rate of 5 percent in the first quarter, domestic demand grew at an annual rate of 3 percent in the second quarter, and economic growth was probably about 4 percent in the third quarter. So for 2002 as a whole, the US economy has bounced back with an economic expansion of something like 4 percent. It may not continue quite at that level in the fourth quarter and going into 2003, but it will probably be at least in the range of 3 to 3½ percent going forward.

Yet the basic point is that the United States has experienced a sharp increase in productivity growth, which likely provides the basis for very promising economic performance during the coming years. The unemployment rate—which in the past tended to have a floor of about 6 percent; when the economy dropped below that level, inflation did tend to pick up and interest rates had to be raised—during this last expansion dropped to 4 percent and stayed there for a couple of years, and no inflation came into sight (and still has not). So it may be that the United States has moved—at least for a prolonged period—to a considerably lower level of unemployment, reflecting the higher productivity growth that underpins the performance of the economy as a whole.

For an international investor contemplating where to put his or her money during the next decade, it would therefore be good to give a fairly high priority to the United States. This is certainly not to suggest that the US economy is without problems. Its savings rate is too low, its public school system is far too weak, it is running a massive trade deficit (which is unsustainable), and the exchange rate of the dollar will have to come down further. But the basic underlying prospect for the US economy is strong, and as international investors, including overseas Koreans, consider what they might do with their own economic fortunes, it is a worthy country to consider.

Japan and North Korea

Japan faces four challenges. It has a weak banking system, it is experiencing deflation, it has fiscal problems, and there is a need for structural change. With regard to the banking system, estimates vary widely, but if one looks at private-sector estimates, the proportion of nonperforming loans in the Japanese banking system may be something of the order of 25 to 35 percent of GDP. If one assumes a recovery rate of about 50 percent, that means that the net cost of cleaning up the Japanese banking system—if that is ever undertaken—will be something on the same order of magnitude as has been experienced in South Korea. So far, Japan has not dealt with these things; instead it has experienced a provisioning-out profits pattern for a decade. With regard to Japanese bank supervision of more than 60 trillion yen in nonperforming loans—a figure greater than the size of the South Korean economy, the Canadian economy, or the Dutch and Belgian economies combined—unlike in South Korea, nonperforming loans in Japan continue to grow.

The second problem is monetary policy. Japan, as was mentioned, is experiencing deflation. It is the first major industrial country since the Great Depression to do so. The deflation that Japan is experiencing is not of the same magnitude as, say, that in the United States during the Great Depression, where the price level fell by 25 or 30 percent; nevertheless, it makes dealing with banking problems and other problems more difficult. The probable solution is inflation targeting. Unfortunately, there is disagreement within the Japanese government about the advisability of that policy, and the finance minister very recently once again made one of his periodic statements against such a policy.

The third problem is fiscal policy. Japanese fiscal policy is fundamentally opaque; that is to say, it is hard to understand. There is a small cottage industry in Tokyo that does nothing but try to figure out Japan's actual fiscal position. The IMF estimates that the ratio of gross debt to GDP will soon reach 150 percent. Unfortunately, Japan has a very extensive network of public-sector financial institutions that make loans to so-called third-sector projects. It has a number of underfunded liabilities and so on, and if all these are added together, and a guess is made as to how many of them are really bad, some researchers estimate that the actual fiscal burden is as high as 250 percent of GDP.

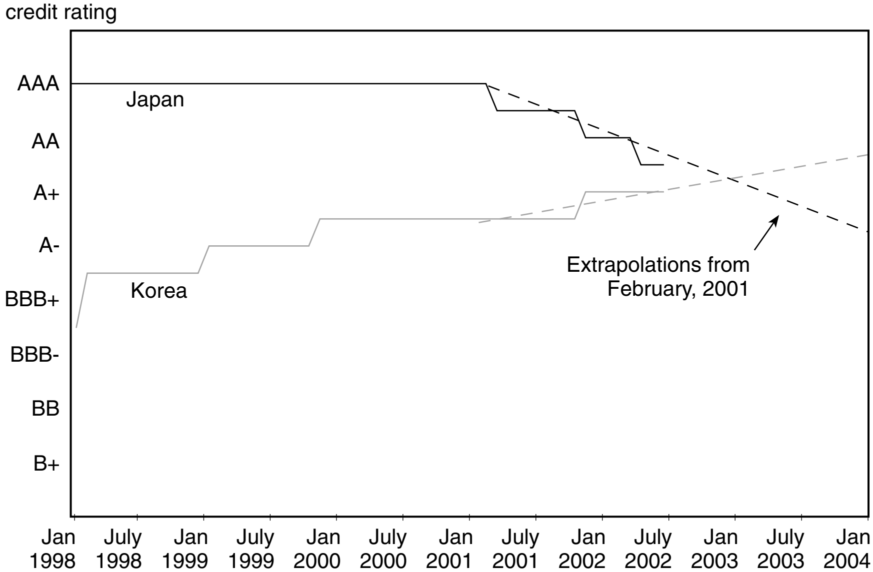
Japan thus faces a nasty squeeze. In the short run, to get the economy going again, one wants to spend money; however, spending on public funds will simply make the long-run problem of the fiscal deficit worse. Much has been made of the fact that, due to this fiscal deficit problem, Japanese sovereign debt today carries a rating lower than that of Botswana, a sub-Saharan African country with an HIV infection rate of about 25 percent in the adult population. But this is misleading. Botswana is a stable, well-governed country with enormous natural resource wealth. It is basically a big desert with a lot of minerals underneath it. One could think of it as a kind of sub-Saharan Saudi Arabia, except with better politics.

Rather than comparing Japan to Botswana, a more apt comparison is to South Korea. In this comparison between Japan and Korea, the ratings for the past few years show a stair-step coming down, which is Japan, and another stair-step going up, which is Korea (see figure 7.1). If one simply extrapolates the past year's experience, one would find that at the end of this year, the two lines cross. Now this is not to predict that, at the end of this year, South Korean sovereign debt will be rated more highly than Japanese sovereign debt, but it is simply to make the point that the trend is going in that direction. Having pointed out that the final challenge the Japanese face is a need for structural change, space precludes saying any more about that.

Having laid out these four challenges, or reasons to be gloomy about the Japanese economy, there are also two reasons for optimism. First, at least parts of official Japan are no longer in denial. For example, Japanese people engaging in professional conversations with Marcus Noland now are willing to state in front of other Japanese people something like this: "We have a real problem. We cannot compete against China in agriculture. How did you [meaning the United States] deal with agriculture adjustment issues?" Or, "In the Kansai region, we have many small and medium-sized enterprises. We simply cannot compete against low-cost Chinese manufacturers; how do you handle these kind of adjustment issues?" So the people, at least in the hinterlands, are not in denial. The problem is that politicians, or a significant part of the Liberal Democratic Party, still are in denial. And as one moves closer and closer to Tokyo and goes higher and higher in the power structure, the denial gets worse.

The second reason for optimism is that there are reasons to believe that, at least in part of the government, such denial is no longer prevalent. Recently, Japanese prime minister Junichiro Koizumi appointed Takenaka Heizo, who had been his economic adviser, to be head of the financial supervisory administration. And so there is hope that with Takenaka, a devout reformer in charge, there may be real action on these issues. And indeed, the fact that Japanese bank stocks fell by about 15 percent during

Figure 7.1 Japan and South Korea: Converging debt ratings



Source: Standard & Poor's sovereign credit rating list.

one week after Takenaka's appointment suggests that the markets seem to think that Takenaka may actually do something. That is a reason to be optimistic.

How can overseas Koreans make profitable investments in this situation? If Japan actually addresses these problems, there will be tremendous economic turmoil in Japan. And turmoil will create winners and losers. As is mentioned below, South Koreans have done rather well in many aspects of information technology. In particular, in certain software niches, there are actually Korean firms today that have penetrated the Japanese market and are making lots of money in Japan. And as Japan reforms its economy—generating in the long run both more growth and much structural change—those Korean firms are poised to benefit. However, in the short run, the crisis in Japan will push the yen down—to 160, 180, or 200 to the dollar—and that is going to cause problems for export-related Korean firms that are competing against Japan either in Japan, in Korea, or in third markets like the United States.

North Korea has challenges that are on a far greater scale than those facing Japan, and North Korea in the past few months has put on the table an economic reform package that basically has four policy components. (The comments here are basically taken from a more detailed paper by Marcus Noland, "Westbound Train Leaving the Station: Pyongyang on the Reform Track," which is available at http://www.iie.com.) The four components are marketization, inflation (if Japan has a deflation problem, North Korea is going to create an inflation problem), special economic zones, and aid seeking.

With regard to marketization, most people agree that it is a good thing. North Korea has announced a series of policies that appear to imitate the Chinese policies of the 1980s of essentially maintaining a dual price system, keeping the central plan in place but having marginal growth occur outside it according to market dictates. The problem is that it is not at all clear to what extent the North Korean government is truly committed to this policy. It is unclear, for example, whether managers will be able to hire, fire, and promote workers; whether failing enterprises will be allowed to close; and, if so, in the absence of any social safety net, how current and former workers in those enterprises will survive.

The second policy—inflation—is one that is a much less obviously desirable thing and has surprisingly attracted less attention, so let us look at it in a little more detail. North Koreans have announced what amounts to tremendous increases in administrative prices, far larger than, say, what China did when it began its reforms in November 1979. For example, at that time, the Chinese raised grain prices by about 25 percent. In comparison, North Koreans have announced price increases for grain on the order of 4,000 percent.

This policy is less likely to be successful in the North Korean case than in the Chinese or the Vietnamese cases. There are about half as many as people in the agriculture sector in North Korea today as there were in China in 1979 or Vietnam in 1989. In those two countries, more than 70 percent of the labor force was employed in agriculture; in North Korea, it is about half as much. That means that the part of the population that is going to benefit directly from the increase in relative prices of agriculture products is much smaller in North Korea.

Moreover, this policy means that it is also less likely to generate a large positive supply response, as it did in China and Vietnam. Agriculture was liberalized, relative prices were increased, and farmers began producing a lot more. The characteristics of North Korean agriculture is that it is much more input intensive; that is, North Korean agriculture relies much more on such factors as chemicals, fertilizers, and electrically driven irrigation, and it is a smaller part of the economy. Thus, one is less likely to get a massive positive supply response. As a consequence—and this is the important point—unlike in China or Vietnam, reform in North Korea is likely to create a substantial number of losers, that is, people who actually do not benefit from reform. And indeed, given the stressed nature of North Korean society, it would not be at all surprising if mortality rates in North Korea increase significantly. And there may be a real possibility of social unrest.

So why pursue this kind of inflation policy? The first reason is what economists call "money illusion." The North Korean government may be banking on the fact that, especially in North Korea, with people relatively unfamiliar with market economics, in the short run at least, pumping a lot of money into the economy and causing inflation will cause money illusion—meaning that people will think they are richer, even if they are not, and will begin in engaging in a lot of activity. That is to say, it will give a short-run boost to the economy but could have a detrimental impact in the long run. As John Maynard Keynes said, in the long run, we are all dead, and from the standpoint of a North Korean policymaker, that long run may have a rather short time horizon.

The second reason is politics. The inflation policy is a way for Kim Jong Il to reward his friends and punish his enemies. It is unnecessary, if one simply wants to change relative wage rates in North Korea, to have a high inflation rate. If policymakers think it is important to give government officials, military officials, or coal miners higher wages, that is easy to do: Just give them a 20 percent or 40 percent raise. One does not need to increase their salaries by a factor of 14 and increase the price level by a factor of 10. It is unnecessary, why do it? The generation of high inflation, and we are talking about really large numbers, hurts people who hold *won*. In socialist governments in the past, including in North Korea, this kind of administered inflation and its cousin, currency reform, have been used to attack traders and black marketeers who engage in economic activity outside state control and are thought to be people having large holdings in *won*.

The problem with this is that, having gone through this—this would be the fourth time in the history of North Korea that this has happened—the country's traders are not gullible. They get out of *won* as soon as they can into dollars, yen, or yuan. Indeed, even in rural areas on the agriculture cooperatives, people would prefer to hold trinkets purchased from Chinese peddlers to the local currency. So this blow, which can be seen to be aimed at people engaged in economic activity outside state control, is actually probably not going to hit the traders or the elites; it is going to hit the masses. Again, the result would be an increase in social differentiation, and potentially social unrest.

The final reason for the inflation policy is ignorance. As an economist, one is taught not to base arguments on the idea that people are not rational, but here is a reason for believing this; in the case of China, Marcus Noland's conversations with Chinese officials, in the early stages of Chinese economic reform, led him to believe that some officials, especially older, more senior ones, literally did not understand the very basis of a market economy. They thought a price or demand or supply was something fixed, that it was a point. They did not understand that demand and supply are schedules that relate quantities to prices.

For example, North Korean policymakers observe a price in the farmers' market for, say, rice and believe that they can administratively raise the price to that level and then simply provide people with lots more *won* to compensate them, without the original farmers' market price changing, they seem to actually believe this—though any economist knows that if one increases the price level by a factor of 10, and no additional supply comes on to the market, one has simply administratively created 900 percent inflation. This is something that they do not seem to understand. And in a political system as hierarchical as North Korea's, where the penalties for being on the wrong side of a political dispute could be quite severe, even people who have reservations about such a policy, or may understand the very basic economics through which one is simply creating inflation, may engage in what is called preference falsification. That is to say, they keep their heads down, and they do not say anything if that is what their bosses have decided to do.

With regard to the third component of the reforms, special economic zones, the one that has been in the news, especially in South Korea, is in the North Korean city of Sinuiju. In some sense, we should not be surprised by this; the North Koreans have been talking about doing something there since 1998, but this initiative seems to have been derailed, at least in the short run, by the selection of a somewhat shady Chinese businessman named Yang Bin as the head of it. He has now been placed under arrest by the Chinese government, and without Chinese government cooperation, obviously a special economic zone on China's border is not going to work. But if it did—suppose that those responsible can get a sort of Hong Kong North version of Tung Chee Hwa to run the zone, instead of Yang—then what would be the effects in Sinuiju? First would be the direct impact. The North Korean economy is so far down that even economic integration with a relatively backward part of the Chinese economy, such as the city of Dangdong, would actually be an improvement. So there would be some local progress.

In addition, if developments in that special economic zone were to be generalized to the rest of the economy, one could look at it as kind of pilot project or experiment, and then that would be another benefit. Finally—and this may actually be the most important part, given the political culture of North Korea—there is a reluctance to get ahead, because if policy changes and policymakers are on the wrong side, the penalties could be very, very severe. As a consequence, even if Kim Jong Il decided that he wanted to reform the economy, it could well be that he would have trouble getting the bureaucracy or the party to actually implement the reforms because the bureaucrats are risk-averse. They literally do not want to lose their heads if policy changes. Because the special economic zone has been established in Sinuiju, a city associated with the Kim family, and because such a big production has been made of Kim's personal connection to it, the zone may well be regarded within North Korea as a political gesture or signal that reform is acceptable, and it may in fact unlock the state apparatus, which has basically been reluctant to engage in reform for political reasons.

The fourth part of the plan is aid seeking, or passing the hat to Japan. The conventional wisdom is that, after the normalization of relations between Japan and North Korea, the Japanese government will make a financial transfer to North Korea on the order of $10 billion. And the issue, from the standpoint of North Korea, is whether that money can start coming in fast enough to put goods on the shelves as the dislocations of the marketization of the economy begin to bite. Unfortunately for the North Koreans, the public reaction in Japan to the recent revelations of the 1979 abductions and the probable killings of some of the abductees has been public revulsion; as a consequence, the process of normalization of relations between Japan and North Korea may be more protracted than either government expected. As a consequence, that $10 billion may be a long time coming, and it may not get to North Korea in time.

The bottom line is that North Korea has now moved from the realm of elite to mass politics. Unlike the diplomatic initiatives the North Koreans have engaged in for roughly the past four years, which only really affect a handful of elite officials, these economic changes affect every single person in the country and affect social and political realities on the ground. So internally, what is at stake now is far, far greater than what has been put at stake in the diplomatic initiatives.

The upside is that if the reforms work, there could be a significant improvement in North Korea's internal situation. Indeed, these reforms ultimately could lead to a process of political liberalization and modernization and to North Korea becoming a more normal country, more like South Korea. Of course, the negative outcome of the reforms could generate social unrest and ultimately political instability and the end of the regime. The bottom line is that the train has left the station, but it is unclear whether the engineer knows where the train is headed and whether he can keep it on the track. Overseas Koreans thinking about investing in North Korea therefore ought to be ready for some real turbulence along the way. This train may ultimately derail.

South Korea

South Korea watchers must have been surprised when the country ran into a serious financial crisis in late 1997. Then, adding to their surprise, Korea came out of the crisis faster than had generally been expected. After suffering a severe setback in 1998 when GDP shrunk by 6.7 percent, Korea's GDP grew by 10.9 percent in 1999. Then, in 2000, Korea continued its rapid recovery with GDP growth of 9.3 percent.

This section briefly touches on the recovery process and seeks to shed light on South Korea's future prospects and investment opportunities. As can be easily imagined, it was the Korean people themselves who were shocked the most by the crisis. Consequently, they had a sense of the crisis and they were ready to take bitter pills. The Korean government took advantage of this general atmosphere in implementing rather painful restructuring measures. In addition, an IMF rescue loan came with conditionalities of various structural adjustments. They also helped in implementing these painful measures in the sense that they depoliticized politically sensitive issues, such as labor and the *chaebol*.

Broadly speaking, the Korean economic recovery since the financial crisis has been primarily driven by an expansion of domestic demand, especially rapidly rising private consumption, which was facilitated by rapid increases in household debt. In 2001, for example, household debt increased by 28 percent.

The expansion of domestic demand was aided by expansionary monetary and fiscal policies that began in the second half of 1998. Monetary aggregates, such as M3, have increased by 14 percent annually. Interest rates were kept at low levels. At the same time, fiscal expenditures increased by 9.6 percent in 1999.

Because the South Korean recovery relied heavily on domestic demand expansion, Korea suffered less than other economies in the region in 2001 when the global economy slowed. In 2001, for example, while Korea grew by 3 percent, the Asian "tiger economies" of Singapore and Taiwan experienced negative growth, and Hong Kong had a zero growth rate.

Obviously, there are some downward risk factors for South Korea's short-term economic performance. Internationally, the weak US economic recovery and a possible war in Iraq, with its negative impact on oil prices, are two such factors. Domestically, the rapid rise in household debt is a concern. Korea's ratio of household debt to income is now reaching Western household averages. The ratio of household debt to financial assets is already higher than that for US households. Unless appropriate measures are taken, nonperforming household debt may become a problem for Korean financial institutions. Despite these downward risk factors, the Korean economy in 2003 is expected to grow by nearly 6 percent.

There are two main reasons why one can be very optimistic about the intermediate to long-term prospects for the South Korean economy. First, thanks to structural adjustments implemented since the 1997-98 financial crisis, the Korean economy today is fundamentally much stronger. There has been literally a sea change in Korea's economic structure. The financial crisis, although painful for most Koreans, was a blessing in disguise for the Korean economy. The crisis forced Korea to accelerate necessary economic structural adjustments. As a result, Korea's corporate and financial sectors today are much more efficient and competitive. The labor market, though still in need of further reform, is much more flexible, and the public sector has become much leaner.

The second reason for optimism is that the South Korean economy is already well attuned to the age of knowledge-based society. It is well known that Korea's broadband access and general Internet usage are already well ahead of many countries that belong to the Organization for Economic Cooperation and Development.

More important, for the first time in its history, South Korea is well positioned to face international competition. In the past, Korea suffered from a lack of arable land and limited natural resources. But in the age of the knowledge-based society, when knowledge is the most important strategic factor for a nation's competitiveness, Korea is well endowed with people who have the highest zeal for education. This gives Korea a competitive edge in the coming decades. For these two simple reasons, one can be bullish on Korea's future.