Successes of Globalization: the Case of Korea[*]

Anne O. Krueger

It is always a pleasure to be in Korea, to continue to watch and learn from the performance of the Korean economy and to see old friends and make new ones. My topic for today is one that essentially addresses what to me is a huge puzzle: as I shall attempt to demonstrate (as others have also done), there has been enormous progress in improving the opportunities and material conditions for much of mankind. That progress has been in significant part as a result of globalization. Given that, the puzzle is why there are so many critics of globalization when in fact most of the critics' goals would have been even more remote and unachievable had it not taken place? The critics should be on the defensive: yet somehow, the supporters of globalization have found the critics on the offensive and they have let themselves be on the defense. Jagdish Bhagwati has come out with a book in defense of globalization and I would argue that we need something stronger than that. And that is the case I will make today.

This topic is especially appropriate for Korea, as I shall argue. Korea's phenomenal economic success would not have been possible without a large number of government policy reforms and private initiatives, but even with all other things in place, Korea's performance would have been impossible without the country's globalization and integration into the world economy. Yet even in Korea, there have been repeated calls for more protectionist policies over the years, and it is puzzling why recognition of the role that globalization played has not been stronger than it is.

---

[*] Transcription of a speech given at the Distinguished Lecture Forum on Friday, December 14, 2007

In this talk, I will first discuss what is meant by globalization and then address the factual issue: there have been huge gains in economic well-being, first for industrial countries starting around l800, and then for almost all countries after the Second World War. The next step will be to show that globalization has been a prerequisite for these enormous gains.

Over the past two centuries, mankind's well-being has advanced enormously, by any measure. Life expectancies have risen dramatically, the incidence of debilitating illness has greatly diminished, literacy and educational attainments have increased remarkably, and, of course, real incomes have risen greatly. It is no exaggeration to say that the nature of life itself has changed qualitatively as well as quantitatively,

Moreover, the rate of improvement in these and other measures of well-being has accelerated in the sixty years since the Second World War. This is true not only of countries that did not significantly participate in the improvements prior to l945, but also of the industrial countries.

No one can claim that all is perfection, and there remain economic problems – including the abject poverty that still exists in parts of the world – but equally, it would be difficult to contend seriously that things have not improved. Indeed, as I shall argue later, it is possible if not probable that the changes have been so great that many simply take current well-being and living standards for granted and fail to recognize that life has not always been this way.

The increasing integration of the global economy been a necessary underpinning for much of the progress, but, sadly, many observers have blamed globalization for some of the world's remaining ills, rather than recognizing its role in enabling the advances that have been made to date. So, after sketching some of the key indicators of progress in economic well-being, I will address the role of globalization in enabling it.

After addressing these factual issues, I will consider some of the factors that have possibly led to the current malaise with globalization. I will conclude by sketching some of the policy responses that are badly needed, both to enable further progress and to meet some of the legitimate criticisms of globalization and the current state of the international economy.

A first step is to define what is meant by globalization. In its broadest definition, globalization means the ever-closer interaction of people over ever larger distances. This encompasses political and social interactions, as well as economic. Phrased that way, globalization has been occurring throughout recorded history. However, for today's talk, I shall focus only on economic aspects: and I shall focus on the increasing interaction and integration of economic activity over ever-longer distances.

On that definition, the Romans were great globalizers, as they built roads and shipped more goods further, especially by sea, to a much greater degree than had earlier been done. One might even nominate Alexander as an important globalizer!

But after the Romans there appears to have been little progress in improving transport routes or in further integration for almost fifteen hundred years. While there appear to have been some productivity increases starting around 1200 in manufacturing in northern Europe, population changes seem to have absorbed them, and it is quite possible that there was less integration in 1600 than there had been in Roman times. The economic historian Blanning reports that roads built by the Romans had deteriorated over the centuries, and that in consequence times and costs of transport were probably higher in 1600 than they had been fifteen or more centuries earlier. In other parts of the world, there does not appear to have been increased integration over those centuries, either.

Integration, in the sense of increasing economic interaction and integration over distances, started once again as transport and communications costs (both time and resources) began falling. Most travel was by road: in England, Blanning estimates that travel time from London to Manchester in 1700 was 90 hours; by 1750 it had fallen to 65 hours, and by 1800 it was 33 hours. While 33 hours looks incredibly long by today's standards (and the journey was arduous as it was mostly by foot or, at best, by coaches without springs), the improvements in earlier years must have seemed huge to contemporary travelers. It is estimated that most people never were more than 5-6 miles from their places of birth during their lifetimes.

Evidently, travel on the continent was even more arduous than in England. While water routes (the Rhine, in particular) were an alternative for much of what did move between places barge animals dictated the pace of travel inland, and prevailing winds set the pace for seagoing vessels. Even then, tolls were a heavy burden on river traffic, as Eli Hecksher so well documented.

Because the costs and difficulties of moving between places were so high, and because most productivity of persons engaged in agriculture (probably more than 90 percent of the population) was so low, there was very little interdependence. Most goods consumed had been produced within a short distance of the consumption point. We all know about the spice trade: but spices were among the few goods with a sufficiently high value-to-weight ratio to be economic for trade at longer distances. For the average person, what went on even a hundred miles away was probably of little relevance to their everyday life. In that sense, we can conclude that integration, and hence globalization, was minimal between Roman times and 1700 or thereabouts.

Economic historians estimate that living standards in l700 were little, if at all, better than they were two thousand or more years before. Indeed, Clark reports that for England (for which the best data are available), “Real wages in England showed remarkably little gain in the six hundred years from 1200 to l800. The fluctuations over that period are much more dramatic than any long-run upward trend. Thus in thirty-nine of the sixty decades between 12—and 1800 real wages for farm workers are estimated to be above their level in 1800. The highest real wages are found in the interval 1400-1549…” He also concludes “there is no sign of any improvement in material conditions for settled agrarian societies as we approach 1800. There was no gain between 1800BC and AD1800 – a period of 3600 years.”

By 1800, however, transport costs were falling, and trade between Europe and the western hemisphere had started. But, starting about 1870 – the date now chosen by most economic historians – the decline in transport costs became precipitous. Data given by Mohammed and Williamson indicate that, while the decline varied between routes and types of cargoes, but overall, real ocean freight rates declined of 78 percent between 1870-74 and l975-79. In addition to declining costs, transport times were much faster, while undoubtedly enabled shipment of goods that earlier could not be transported. And, of course, developments since the 1970s, have further reduced costs with containerization, and later the ability to ship at least some high value and/or perishable goods by air. Air transport now accounts for about 25% of the value of international trade in goods.

As well as transport, the cost, timeliness, and ease of communications is also crucial for many economic transactions, and, if anything, the drop in costs and pickup in speed in communications has been even more dramatic than in transport. It was 84 days after the Treaty of Nanjing before the report reached London in 1842, and 46 days before the Indian Mutiny of 1857 was reported. By contrast, news of Lincoln’s assassination reached London in 12 days in 1865.

And only 17 years later, the assassination of Alexander II in St. Petersburg was news in London in 1881 a half a day later; the Japanese earthquake of 189l was reported within a day. These sharp changes were of course attributable to the introduction of the telegraph and the telephone. It constituted a major revolution in communications. But costs were still high, especially for overseas calls (although as late as 1890 there was one telephone line for calls between New York and Chicago). One frequently cited and dramatic number is that a New York-to-London 3 minute telephone call cost $290 (in 2000 prices) in 1930 and cost only a few cents by 2000. Currently, of course, the price is even lower and the Internet makes instantaneous communications virtually cost-free.

Falling costs of transport and communications enabled increased integration of domestic economies as well as of the global economy. Transactions between distant parts of individual countries obviously became more economic as the costs and difficulties of doing business at a distance fell.

Until the Second World War, though, transport and communications costs were so high that increasing economic integration – globalization – was primarily the result of the technological and other changes that enabled transport and communications costs to fall so dramatically. With very high transport costs, tariff barriers did not constitute the biggest obstacle to trade: with a 20 percent tariff and transport costs of 50 percent, a reduction of the tariff to 10 percent – halving it, that is - would have resulted in a reduction in the imported price of a good of only about 6 percent. At the end of the Second World War, however, high barriers to trade imposed by governments constituted the more important deterrent for people in most countries. Removal of quantitative restrictions under the GATT, the WTO, and self-interest of countries, combined with multilateral and unilateral tariff reduction, brought about large reductions in costs of doing business across borders.

In the mid 1940s, it is estimated that the average tariff on manufactured goods among the industrial countries was between 45 and 50 percent, while transport costs for manufactured goods averaged around 20 percent. The calculus had changed and with it, international political economy. Successive rounds of trade liberalization under the GATT brought the average tariff among industrial countries on manufactures down to around 2 percent. Simultaneously, many developing countries, which had had (and still have) much higher trade barriers than the industrial countries, recognized the harm those measures inflicted on their economies and were dismantling their restrictions (both tariffs and quantitative restrictions on imports).

As a result of all these factors, the costs of trading at any given distance have fallen dramatically over the past two centuries. Whether that fall was greater in the twentieth century with the development of transport and communications via the Internet, airplanes and containerization, or in the 19th century with the telegraph, telephone, steam engine, is an open question. But the economics of doing business at a distance certainly changed.

The result has been increased economic integration worldwide. Whereas farmers and people in villages doing farm-related activities constituted over 90 percent of populations almost everywhere and were relatively self-sufficient in 1700, in advanced countries today fewer than 3 percent of the population is engaged in agricultural activities and, even then, they rely on goods produced at considerable distances both for consumption and for inputs (such as fertilizers and farm machinery) into production. Clark presents estimates that, prior to 1800, laborers (in England, a country for which the most reliable data seem to be available) are estimated to have spent 75 percent of their incomes on food and drink, l0 percent on clothing and bedding, and 25 percent on housing. Today, less than 20 percent of income is spent on food in industrial countries, and much of that 20 percent consists of services such as processing and restaurant-provided meals. Obviously, much of the 80 percent of nonfood expenditures (as well as the nonfood) originates from much greater distances, and has much greater variety than 200 years ago.

As a result, the degree to which workers and employers are integrated into the world economy is much, much greater. Not only is the share of goods and services entering international trade much greater now than it was earlier, but in addition, the speed with which events in far-flung parts of the world affects each economy has greatly accelerated. Interdependence has increased not only through the exchange of goods and services, but also because economic shifts anywhere in the world affect others much more directly and more quickly. And one very recent and unfortunate example of that has been the Subprime crisis in the United States and the way that has affected many other financial systems very, very fast.

The trend has been almost unrelentingly for increased global integration except for the period from 1914 to 1945, when the global economy disintegrated and with it, living standards fell sharply. The reversal started with World War 1, which raised the costs of shipping dramatically. While there was some recovery to prewar levels in the 1920s, the Great Depression of the 1930s and the policy measures associated with it (especially competitive devaluations and rising tariff barriers) continued the disintegration. But after the Second World War, the globalization resumed and economic integration has increased continuously.

There is little doubt that globalization will continue, barring a major geopolitical event or severe policy reversals. But one can question whether the pace of change, and the degree to which perceptions of interdependence have increased over the past several decades, will be sustained. The world is already so closely linked that it is difficult to imagine sustaining the pace of the past half-century.

Let me then turn to the changes in well-being over the past two centuries. That these improvements have been huge is unquestionable, but they are now so often taken for granted that it is worth reminding ourselves of them.

It is difficult to know where to start. One dramatic and telling statistic is that economic historians estimate that, as late as in 1900, only about 6-7 percent of the American population had incomes sufficient so that they would have been classified as above the poverty line by today's American standards. And real incomes in the richest industrial countries are estimated to be 10-20 times higher than they were in l800. Over that long time period, those whose incomes rose most rapidly were unskilled workers.

But if there are claims that living standards are "just material", there are other indicators. Life expectancies have increased enormously, and those increases have come about as real incomes have risen. If you know a country's real income you can very closely guess what its life expectancy is. Life expectancies at birth in the United Kingdom are estimated to have been 38 years in the last half of the 16th century, 35 years in the last half of the 17th century, and 38 years in the last half of the eighteenth century. Estimates for other countries and early times are similar: French life expectancy at birth is estimated to have been 28 years in the second half of the l8th century, the same as China's over the 5 centuries after 1300 and rural Egypt's over the period 11-257 (urban life expectancy is estimated to have been lower). Much of this low life expectancy resulted from high infant mortality rates, as well as deaths of those surviving birth but dying before the age of 15. By contrast, life expectancies in the rich countries today are approximately double those of earlier years, and continued to rise throughout the twentieth century. If anything demographers are saying there is acceleration in the rate of increase in life expectancy in countries.

Most people know that those in the industrial countries are better off today than were their parents, who in turn were better off than their parents, and so on. More observers question, or fail to recognize, the improvements in quality of life that have occurred in most other countries. Yet there have been enormous achievements in those countries that were identified as “developing” in the l950s.

The gains of developing countries, even in the first twenty-five years of development, were significantly greater than had been thought attainable. In surveying the first twenty-five years of development for the World Bank, Morawetz concluded “On average per capita income the developing countries grew more rapidly between 1950 and 1975 – 3.4 percent a year – than either they or the developed countries had done in any comparable period in the past. They thereby exceeded both official goals and private expectations…Increases in life expectancy that required a century of economic development in the industrialized countries have been achieved in the developing world in two or three decades. Progress has been made in the eradication of communicable diseases. And the proportion of adults in developing countries who are literate has increased substantially.” And that was up to l975. Economic growth has accelerated since 1975, while the rate of population growth has slowed. Indeed, over the past several years, developing countries as a group have achieved an average rate of economic growth well over 5 percent, contrasted with 2 percent in high-income countries.

Per capita incomes have risen rapidly in most, but not all, developing countries over the past several decades. Everyone here is familiar with the success of the East Asian “tigers” – Hong Kong, South Korea, Singapore, and Taiwan. Each experienced sustained rates of growth of real GDP and per capita incomes well above any the world had earlier witnessed, doubling per capita income every decade from 1960 into the 1990s. In so doing, their economies and the quality of their peoples’ lives were transformed. South Korea, as you know, went from being one of the poorest countries in Asia (and the world) as late as 1960, to its current classification as a rich country by the World Bank. South Korea’s living standards grew more in any decade prior to 1995 than British living standards did during the entire nineteenth century. One decade to one century and Britain was the most rapidly expanding economies of the nineteenth century. Other countries in Southeast Asia began following the Tigers' examples and growing rapidly in the l970s. China followed suit in the l980s and India began growing at accelerated rates in the l990s. In these and other emerging economies, even those failing to experience such rapid rates of growth, real incomes have risen at far higher rates than had been experienced in earlier years.

These higher incomes have been accompanied by dramatic changes in life expectancy. Life expectancy in India, for example, is estimated to have been around 30 years in the late l940s and was 64 years in 2005. And in Korea, life expectancy (with per capita income at around $20,000) in 2005 was estimated at 78 years, the same as the United States and one year less than the United Kingdom.

It is important to recognize that life expectancies have risen not only proportionately but absolutely more in developing countries than in developed countries. Moreover, those countries with more rapid economic growth have generally experienced greater increases in life expectancies than more slowly growing countries. Even in those developing countries where growth rates were discouragingly low, life expectancies and other health indicators were improving until the AIDS epidemic began taking its toll in the l990s. For many, life expectancies have risen even when per capita income growth has been anemic or virtually nonexistent.

Poverty reduction within individual developing countries has generally been greatest with more rapid per capita income growth. That poverty in China has been reduced by 300 million people is a widely-repeated statistic; poverty in India has begun dropping more rapidly as economic growth has accelerated. It is widely expected that the global Millennium Development Goals with respect to poverty reduction will have been met by 2015 because of the successes of China and India.

Literacy rates have also increased, and more so in countries with higher growth rates of per capita income over sustained periods. Whereas many poor countries had literacy rates of 20-30 percent in the late l940s, those same countries now report rates between 60 and 80 percent. While there are still many educational deficiencies including both the failure to provide universal primary education and the low quality of education in many cases, there can be little question that rising real incomes have contributed significantly to this result.

Some developing countries have not achieved rapid growth, and indeed, in some living standards actually fell in the last two decades of the twentieth century. To trace the reasons for their poor performance would take us too far afield, but one point would be it is not essential, not written anywhere that countries must grow, that is an outcome of what countries decide to do. And almost all of the poorly performing countries remained inner-oriented, remained dependent on primary commodity exports, and failed to undertake measures sufficient to enable them to integrate with the global economy.

To give an idea of what a dramatic difference growth can make, consider the relative positions of Ghana and South Korea. The relative positions of South Korea, a dramatic success story, and Ghana, a country which has experienced much greater economic difficulties have changed dramatically. In the 1950s, estimates of per capita incomes put that of Ghana more than two and a half times that of South Korea. By 2005, South Korean per capita income is estimated to be almost seven times that of Ghana! When discussions of poverty were held in the 1950s, most observers regarded Asia as the poorest continent: South Asia's 1950 average per capita income was estimated to have been $85, and East Asia's $130 (not including Japan), while Africa's was $170. Now, most East and many South Asian countries have living standards and life expectancies well above those of most SubSaharan African countries.

So, there is no question that globalization has been occurring or that many developing countries have achieved remarkable success in raising health, educational, and living standards in their countries. Those propositions take us immediately to the question of the role of globalization in achieving the enormous material progress, and accompanying improvements in economic well being, of the past two centuries

Three lines of argument, or proof, all point to the central role of increasing integration as a component of, certainly as a necessary condition for the tremendous increase in the efficiency, or productivity, of the global economy. The first is that no country, or group of countries, has for any considerable period of time sustained reasonable (or faster) rates of growth of real per capita incomes without integrating into the international economy as they did so. The second has to do with the economics of productivity gains, as first noted by Adam Smith: the size of the market is an important determinant of productivity. The third is the record of what happened to inner-oriented countries when they changed their economic policies

Let me elaborate briefly on each of these, only pausing first to note that, quite clearly, other factors such as innovation also contributed to growth and enabled the integration that took place. Without the introduction of the steam engine and many other productivity-enhancing innovations, there would have been no opportunity for integration. But, had authorities fought the technical changes that were occurring, as for example, by prohibiting imports of now-cheaper goods, increases in economic well being would have fallen far short of the major accomplishments of the past two centuries.

With that in mind, we turn to the first line of argument as to the role of economic integration. Every country that has grown rapidly has been increasingly integrated with the world economy as it did so. That trade has been an “engine of growth” has been recognized by all for the past half century. To be sure, integration with the rest of the world has generally been more crucial the smaller the domestic economy. But even among economies with large populations, trade in goods and services has generally increased as a percentage of GDP as the economy has grown. As a rule of thumb, the rate of growth of world GDP has been half that of the rate of world trade, year in, year out. It has been an almost fixed formula, trade had been an engine for all of us. For the world as a whole, trade as a percentage of GDP has increased over the past sixty years, and had been growing during the 19th century until 1913. It is estimated that trade volumes (the sum of imports plus exports) in 1800 were about 2 percent of global output, and about 22 percent in 1913. By 1938, that figure had fallen to 9 percent (below even the level of 1870). But since l945, the importance of trade has increased dramatically. It is estimated that trade (again, exports plus imports of goods and services) as a percentage of world GDP was 40.1 percent in 1990 and 58.3 percent in 2005.

Moreover, the growth of trade relative to real GDP has generally been most rapid for those growing most rapidly. This has been true of both industrial and of developing countries. During the European Union’s period of rapid growth, trade increased sharply as a proportion of GDP. The same has happened in the United States since growth rates accelerated in the mid-1990s. And, of course it has happened for the world as a whole.

But in developing countries where trade barriers were even higher, the association has been even stronger. As you know, when Korea embarked upon the export-oriented growth strategy, for example, exports were 3 percent of GDP. Less than thirty years later, during which time incomes had doubled every 7 years, exports constituted almost 40 percent of GDP. No one who even looks at

Korean economic history can doubt the major role that trade opening and integration with the world economy played.

Taiwan, Singapore, and Hong Kong recorded the same sorts of sharp increases in the role of trade. And countries that later accelerated growth, most notably India and China, have experienced share increases in the importance of trade for their economies. In the case of China, trade rose from almost zero in l980 to 63.5 per cent of GDP in 1995 and 70.7 percent in 2005; in India, over the 1990-to-2005 period, trade rose from16.5 percent of GDP to 36.7 percent. Accelerated growth reflects the facts that the earlier inner-oriented trade strategies had high costs and that globalization has large economic benefits. While other countries have liberalized more gradually and often to a lesser degree, the association between more openness and growth holds over the developing world as a whole.

The second set of linkages between growth of the relative importance of trade and economic well being of people, especially the poor, has to do with the effects of trade. In all countries, growth is faster when there is more competition; when trade barriers are reduced, competition is increased. For many developing countries, high barriers to trade conferred monopoly positions on the elite few, and kept the majority of the labor force in agriculture or the informal sector. Opening up to trade meant that entrepreneurs had to compete for business, often with dramatic increases in productivity. Often, new exports were manufactures, employing considerable unskilled labor where there was comparative advantage. At the same time, having the world for a market enabled producers to take advantage of economies of scale.

Much more could be said about the enormous progress in the international economy and the contributions of globalization to it. But I think I have said enough, especially before a globally-oriented Korean audience, to convince us that globalization has on net bestowed major benefits on those countries willing to take advantage of it. And Korea certainly did do that.

During the Korean Crisis, I sometimes heard from my Indian colleagues comments such as “we were really right to stay inner-orientated because we avoided the crisis.” And I had to point out to them that if they had the choice of having been in Korea or in India or by choosing a Korean or Indian growth rate, per capita income from 1960 or 1970, right through to the worst days of the crisis, they would have much preferred the Korean growth rate than the Indian, even with all the costs along the way. Even though things were not perfect, they came up much better than the countries that tried to cut themselves off. And on this tenth anniversary of the Korean Crisis it is worth thinking about.

But there remains a question: why, given all those benefits, which in this country have been so amply realized, is there not more support for the international economic system? Why are there such opponents to further liberalization? And why is there not much stronger support for the open multilateral system, especially through the Doha Round of trade negotiations?

One part of the answer is clearly that people everywhere have somewhat exaggerated fears of the unknown. In part, this is a natural reaction, but in part it originates in a failure to recognize the extent to which trade has been beneficial. While those in protected industries know who they are and fear the consequences of trade liberalization, it is not possible to know which new economic activities – new factories as export orders expand, entirely new products, and so on – will arise with further trade liberalization. So those in protected industries are vocal in their opposition to further liberalization, even in instances where they will benefit, while others who may be employed in expanding activities and gain probably do not even know who they are.

A second part of the answer is that those who are benefiting by the open multilateral trading system, and that includes exporters, believe that they have already benefited and may have little more to gain by further trade liberalization.

Up to a point, that belief may even be correct. But failure to achieve a satisfactory conclusion to the Doha Round will certainly constitute a setback for the open international economy and provide support for protectionists (who would reverse the trend toward integration) everywhere.

A third part of the answer is surely that many people are unaware of how much they have gained by trade liberalization. There can be little question, for example, that real incomes of most Koreans are greatly above what they would have been had trade liberalization not taken place. Yet, judging by some reports of reactions here to the proposed Korea-U.S. Free Trade Agreement, it seems a reasonable guess that many did not recognize the role of trade liberalization in Korea's economic success over the past fifty years.

A fourth part of the answer is that integrating further in the global economy has never been an entirely smooth process as it by definition involves change. Some people are much better off, and some are left behind – at least in the short run. Finding better ways to smooth adjustment and to facilitate change is certainly a high priority policy. In the Korean case, the financial crisis of l997-8 was certainly seen as a major cost of globalization. On the one hand, it certainly was, and there have since been many measures to strengthen the economy's ability to cope with changing international circumstances. On the other hand, it is also evidently true that, even with the very real hardships of the crisis almost all were much better off than they would have been had inner-oriented policies been followed after 1960: surely the result would have been much lower living standards.

Even with all of these considerations, however, it still remains a puzzle as to why there is not more support for globalization. It may be that economic education needs to be strengthened or that ways need to be found to indicate the extent of globalization's successes. But, in countries such as Korea where the gains from integration with the global economy have been huge, it is to be hoped that more leadership in international institutions such as the WTO will be forthcoming.

CONCLUSION

Let me conclude. The world is a very imperfect place. Millions of people live in miserable conditions, with poor health, poor nutrition, and little hope. But the world is a much better place than it was two centuries ago. Much has been learned about the process of economic growth and rising living standards, and policies needed to achieve them, over the past half century, and many have escaped poverty. The world is thus a much less imperfect place than it was. The now-industrial countries have living standards that would have been beyond recognition two hundred years ago. Globalization has been a major contributor and there is every prospect that integration will continue, and as that happens, living standards and attainable economic welfare will continue to improve.

But despite the enormous successes of the international economy, to date support for the open multilateral system has not been sufficiently strong to permit its successful continuation. The Doha Round of trade negotiations has not yet been completed, yet there are huge gains to be had by further liberalization in many areas. Antiglobalizers have been vocal, while most of those benefiting from globalization have remained silent. I was in Hong Kong and Cancun during the inter-ministerial meetings of the Doha Round and in both places the headline was the Korean farmers are protesting, not the Korean support but the farmers got the notice.

To be sure, there is still much to be learned and much to be done to make globalization function more smoothly. But in decrying the continued existence of poverty and other ills, the critics blame globalization, failing to recognize that poverty and its associated evils existed long before globalization. Efforts to reverse globalization, or to discourage those still-inner-oriented countries from embracing it, will diminish the prospects for those countries to accelerate their growth. For the world as a whole, a setback to globalization of the sort advocated by the antiglobalizers might succeed in reversing rising living standards in developing countries and reducing trade flows.

Without a healthy and growing international economy, the outlook for continued economic progress in the industrial countries would greatly diminish, and world economic growth would surely slow, if not grind to a halt. That would greatly reduce the prospects for countries just starting to embark on trade liberalization, and the very poor countries that have yet to alter policies. Stronger support for the open multilateral system is surely called for from the beneficiaries of globalization in order to diminish that risk.

Globalization is not a cure-all. But it is a necessary condition for continued economic progress. Attention needs to turn to finding policies to ease the adjustment process and increase the flexibility of economies to adapt to changing conditions. Trying to fight globalization would be to kill the potential for tackling the very problems that globalization's critics raise.

Questions & Answers

Q I have one question on excessive capital flows. As you know we are facing a big problem, especially in China and Korea and so on. East Asia has received a tremendous amount of capital flows in the last eight years. In 1990s we had tremendous amount of capital so we have had a big asset bubble in real estate and everywhere. And now the bubble has started to burst, the yen-carry trade has started and I think that next year there will be a substantial crash in the asset bubbles. So I would like to hear your comments on how we should improve this international architecture to control these excessive flows. And cyclical "boom and bust" cycle, the low interest rate pressured by US to improve the exchange-rate mechanism triggers the boom and then after some years it bursts again. How would you address the problem?

A That is an important question. I am not so sure there will be a crash next year. But I will leave that aside and address the important part of the question. Obviously you can't talk about everything that got us where we are in terms of improved economic performance but one of the ones has been improved functioning of the financial system. It has been absolutely critical and getting the financial system to be a better intermediary, to evaluate alternative risks has been a major part of its success over the past two centuries.

Now it is true we still have cycles but they are nothing when compared with the cycles of the 19th century, when a huge financial panic could lead to drops in income of some huge multiple of what we could get now. We have learned a lot, we do do better than we did, there is still a way to go. There is a lot of discussion, as we know in some of the press about whether the bubble should have been the subject of direct monetary policy or not in some of the industrialized countries among them the United States and the United Kingdom. I think that the verdict is still no but there is some doubt about it. I think the verdict is becoming clear that over the past few years there has been too much liquidity in world markets and that is what is the current conjuncture of things. And there are lessons in that. I did say that the world is still an imperfect place, there is still a lot to learn, there is still a lot to learn about international financial architecture of the financial systems, how the derivative markets integrate with each other, how they play on each other.

One of the major things behind the current uncertainties is that nobody knows who has what in terms of assets and liabilities on the balance sheets, nobody knows where the risk has been proportioned to, some of the banks have been surprised to discover that they have some of it and I think it is the unknown part of it that is the most important. And transparency is a big part of the solution. I don't think we will ever get to a world where there is perfectly smooth growth forever.

On the other hand, when was the last downturn? 2001 you might say. And before that 1992 maybe. 1992 to 2001 is nine years. Even if there is a downturn next year, 2001 to 2008, that's seven years. It used to be that recessions came in cycles of three and four years. We are doing better and we are learning. But there are still mistakes out there and we have to learn from them as we did the Asian Crisis and as we are from other things. So I don't think we have a perfect situation yet I do think we are doing better. But think back to 1992 and remember the chaos in European financial markets at that time, this is still minor in contrast to that. While there are some issues, we got the parameters so that the range of room is narrower.

Q Dr Krueger, thank you for your timely, hopeful and informative presentation. Allow me to ask you a general and simple question. Will Korea be able to achieve successful globalization within the early part of the 21th century in your view and if so how soon and to what extent.
And my last question is, will Korea's success of globalization achieve rapid and drastic economic development and increased trade volume, which will guarantee and benefit the well-being of its people.

A The record in Korea, so far, is very good. Policy makers in Korea, in my opinion, have been quite pragmatic and responded much more quickly than many other countries when they perceive things are not going quite as well as they should. The Korean people seem to have quite some pragmatic sense that some countries quite possibly don't have to the same degree. So I guess I think Korea will continue and I think Korea has done a lot by way of liberalizing. There is more to be done and it will happen soon. Will Korea be successful? Well, Korea is already successful and I believe that success will continue. Korea is already regarded as a rich country internationally, people forget that Korea used to be very poor. And when you tell Americans what the relativities were for per capita incomes in the 1950s and 1960s, they just don't believe it. Korea has had such huge successes. And I think there are lessons from that. The opening up of the economy has been so critical as a lesson that has been learnt. There are for all of us certain geopolitical kinds of uncertainties that could make it quite difficult, there is no doubt about that. But short of that, it seems to me that things will go forward in Korea, not always there will be periods when things will go more rapidly and when they will go more slowly. I hope to see movement on the capital account side because that will be an important and interesting issue for Korea.

Q While I am a supporter of globalization, I wish to play devil's advocate with this question. There are some findings that globalization might elevate income distribution or some gap in income distribution, so called bi-polarization. What do you think about that in some countries' case that even though globalization continues some income gaps might be increased? Would you make some comments on that?

A Well, first of all there has been a lot of work by a lot of economists in many countries. And I think there is pretty strong agreement, almost 100%, that what has happened in countries to income distribution has been more a function of technical change than of globalization per se. That the kind of technical change that we have had over the past thirty or forty years has increased the demand for skilled workers of various kinds, hi-tech, electronics and technicians of various kind and so on has decreased the demand for relatively less skilled workers. Bank clerks no longer exist, it use to be many of them sat in back rooms adding things up and so on, but all that has been taken over as has all functions of that kind. So that people with what use to be reasonable high-school degrees to take those jobs are now scarcer. There are several points to the policy answer, one part is quite clear, and certainly true for the United States, is the rate at which the population improves its educational attainment in qualification has increased.

There was an interesting study done 15 years ago, I don't know if it has been updated, in which people looked at what happened to relative skilled and unskilled workers in Canada and the United States and what happened to relative educational attainments between the two. In the United States, the relative between skilled and unskilled workers has gone up, so it was an increasing gap there and in Canada it had not. Interestingly Canada has increased its number of university graduates as technical people much more rapidly than in the United States. And if you put the two together, Canada kept the supply shifting towards skills with the demand that the United States had not quite done so. And that is that improving qualities in the education is important not only for income distribution but for the productivity growth itself. So I would see that as the central part of it.

The second thing though that I said in my talk is if you look at the gap between skilled and unskilled workers now, it is much less than it was a hundred years ago. What happened in fact, the skill gap, the differential in compensation was diminishing between skilled and unskilled workers until about 1980, and then it began increasing again. So it is larger than it was in 1980, but it is not what it was a hundred years ago yet. If the trend keeps up then we will get there. But again I would say we need the education, we need to bring more people and give them the opportunities so that they too can take the jobs that are increasing in demand. Some jobs just don't exist anymore.

Q The environmental issues and the income distribution issues were not that much discussed. According to some surveys Indians and Filipinos have a high happiness index, however you define it. So, how would you incorporate these issues?

A Well, the environment one is interesting because all the evidence I know is that people like a nice and clean environment but they also like to live. So they eat and if they have some money left over then they will go for a cleaner environment. And certainly that has been true in the industrial countries, that as they got richer they paid more attention to the environment and they have the resources to afford it. What per capita is it at which people begin to spend more on this and the evidence seems to be at about 5000 dollars. And if that is right, I know of no other evidence but it seems quite conclusive, if that is right, growth means that there will be more resources to put into offsetting whatever the environment harm is. It wasn't as if the environment harm was so great in London three or four hundred years ago, there are different kinds of problems but they are still there, it isn't as if low-income countries don't have environment issues they do. But what rich countries have is the resources in which to begin addressing them. And I think there are things to be done there.

In addition to that there are all sorts of things that can be done internationally along with sufficient cooperation. And there is much more talk, as you know, about some of those kinds of things, how you might get cap and trade systems, how you might get other things that would indeed bring down carbon dioxide emissions and so on. All of that has to be done, but the fact that we have an educated population, the fact that we have a relatively well-to-do people to a) have the education to appreciate the issue and b) the resources with which to tackle it which seems to me the reason why we are talking about it.

Now the happiness index really puzzles me. I do not know of any mass effort to migrate to India or the Philippines. People vote with their feet for what they want and they vote the other way. I just don't understand where that is coming from, it is so counter to everything we have seen. The United States has no barriers whatsoever. Everybody who wants to can leave. They may check up on if you pay on income tax but that is it. The United States is worrying about letting people in. Well, there are some other countries for which the opposite is true. Happiness index or no happiness index, I take how people vote with their feet which is a better indicator to what is going on.

Q In the course of globalization, I understand that digitalization is a critical factor and to some extent Korea has achieved dramatic progress in this regard. But we also humbly accept that Korea has much to do to achieve globalization. We would like to have your advice what are critical barriers for Korea to become a more globalized country.

A You said to some extent, I would say to a huge extent Korea has been already a success story. I think everybody here does not understand how well Korea has performed in relation to other countries. My first comment would be to that.

All of us have more to do. Just a moment ago we were discussing the financial issues and that is something that is a challenge for the United States. I think over the next five years we are going to see an outpouring, no matter what the outcome of the Subprimne crisis is, outpouring of postmortems, of people looking at what happened, the same as we did for the Asian crisis. Human beings are learning individuals and we are going to learn from what has happened and there is going to be a lot to learn from this. It is also true that as real income have gone up and as economies have become more complex, new issues have arisen and they always have to be addressed in some kind of policy format. At the moment you may have seen that even Martin Wolf, who is a very sensible commentator, coming out raising the issue of narrow banking, whether there will be a 100% backing of money in the banks again per se. These issues are all rising and it could very well be that we will see some reforms not just in Korea, not just in the United States but all of us as we learn more about that.

I don't want to talk about what is the next specific thing for Korea because I am not that current as to where things are but I would guess that more openness on capital income is important. And that what I have seen, and this is a very vague impression, the World Bank has this wonderful publication which is only impressionistic, called "Doing Business in…" and it has one each year. To my surprise, Korea does not come out as well in that as it should, it generally ranks between 20 and 30. Well, I would have thought that for Korea, given what it is doing, getting some of those provisions and barriers in the labor market and so on, so it is a more flexible economy is more important.

Comment Yesterday, I think most of you have read the piece in the newspapers that AT Kearney also published a FDI environment. Korea, I think ranked 28th. The first was China and India and the United States and UK and the list goes down, Korea 28th. In fact, the FDI last year was reduced and I think we can do better. As an absolute standard we are doing great, compared to other countries but I think if you take Korea on its own perspective we can do better by improving our business environment.

Q I have two questions. I agree that Korea needs to continue globalization in industries like agriculture. Korean government wants to give subsidies and protection of some kind even with the opening of the market. Do you support Korean government's efforts to subsidize and protect? And my second question is the Korea and US agreed an FTA but there is strong resistance in Congress. How can the US create an FTA with the US?

A Those are both good questions too. I think the lesson we are learning in general is that governments are very bad at deciding which industries they should support. That is not a function governments do very well. I think the lesson is that even if I might be a very good business person and I might go and set up a business, if the government tells you that they will support you, I won't do as well because I got the government behind me and my motivation is a little less. I think the government has so much to do that they are better at that than to pick the winners and losers, if they pick winners they very well much pick losers, not always. If you try to pick a hundred winners you might get one by chance, it is not universal, on the other hand the record is not good. I was just talking about education, the role of the government in education is important, the role the government plays in supporting research is important, the role of the government is making an appropriate regulatory framework which on the one hand lets people take initiatives and encourages competition but on the other hand does set a commercial code within which people can have reasonable expectations is hugely important. And my guess is that there is plenty there to keep the government busy without having their hands on trying to pick winners.

I still like to go back to 1980s when the Americans were very worried about Japanese competition and that High-Definition Television was supposed to be the next thing. Within the United States there was a big move to get the United States government into HDTV and that we should subsidize it to help it and prevent the Japanese from taking over. Well, somehow those of us on the side of free trade managed to win the argument by a small margin and the American government did not get into the game and guess what? The Japanese firms did not do too well and the American firms did quite well. It was one of those things where if the American government had of got in it would have done wonderful favor to the Japanese but it would not have done much for either the quality of the TV sets we all have now or the American companies in it. I guess that staying out of picking the winners in the individual industry game is quite important, providing a level playing field and all the things that go with that is equally as important, getting rid of barriers is huge.

The second thing was your question about the FTA. I wish I could explain why a strong economy like America is scared of stiff competition from countries like

Peru or Panama. There is something going on that is very strange and obviously doesn't seem to have much to do with the realities of the economies. However, it is also true that within the past week the Peruvian FTA went through Congress to even the surprise of the Administration. It got out of the committee, it was voted very fast and was done. I think that may tell something to the politicians even, that there is a lot of noise there and not much resistance that might not be as strong as some of the rhetoric says. Even some of the Congressmen who said less than good things about the Peruvian FTA went along and it looks as if the Colombian deal might be coming along.

One of the things that does hurt the US argument is when people like me say why are we for free trade and against this, they say "well, look, even people there are protesting, why should you want it? It hurts the workers in both countries." Well, I don't think it will hurt American workers and I also don't think it will hurt Korean workers, but if the Korean workers says that it does, it helps those who want to oppose it in America. So if you want to ask what Korea can do, to the extent that the evidence is there as to what the benefits could be and that could be made known. That will help, it can't hurt.

Q I want to play the devil's advocate here so I apologize in advance. My professors often put forward Korea as a successful example of protectionism. For example in the automobile industry in the beginning there was lots of subsidies for them and there was a very famous case where if a Korean bought a foreign car then they would get taxed on it. I assume you would mean that Korea would be further along than if they had these protectionist barriers. Would you care to comment on that?

A Well, it is my understanding that in the early days, you would know a lot more about it than I do, but in the early days of Korean rapid growth, while it is true that the government wanted to encourage exports, it would encourage anybody who could do it. Yes, there was the so-called credit subsidy, tax-subsidy, there was an exchange rate for so many won per dollar but it was absolute uniform per dollar per exports. It was not, we will pick this industry, we want this, and we don't want that. Things that got exported that nobody expected to, they got encouragement once they did it. It was almost as if there was an export theory in value, which at that time was probably not very wrong. Exports were 3% of GDP, imports were 13%, and of course you will need to shift resources to exports. And the incentives were very strong and that was right.

Now there have been efforts to encourage some industries, specifically some that have been more successful than others, you may know the heavy chemical industry drive that was not one of Korea's finer moments. But what I am arguing is that the Korean policy makers when it became clear that it was not doing what it should backed off quite quickly. They did not persist in quite the same way they would if they had been trying to make it work. And I think that was for Korea very fortunate and that is what I meant by pragmatism not that mistakes weren't made.

Automobiles, yes they were very highly taxed and so on and so forth. I think there was one time when they tried to open that, there was a Department of Transportation requirement that each foreign car had to be test driven 10,000 miles before it could be sold in the Korean market, all kinds of things happened there. But on the other hand, it is also true that the early efforts to get the industry going from what I know were not successful and it wasn't until later when Foreign Direct Investment was permitted that this was one of the shinning cases for the opening for the capital account and recognition that different companies have different core competencies and that you need to pull from where it is best. And until that happened some of the automobile industries did not do too well.

Q We have an election just a few days from now. And I heard that all the candidates are promising that if he is elected he will raise Korea's potential growth rate from the current 4 to 5% level to 7 or 8%. And many economists, as far as I know, are not quite assured about this. But personally I think there is ample room for Korea to improve. You have been watching and analyzing Korean economy for quite some time now, so you know the Korean economy quite well, so what is your view, as an economist, about this issue?

A Well I don't think the growth rate will go up so steeply by itself. But I can imagine, that a government committed to trying to do things to improve the function of the economy could make a difference. I mentioned the labor market, it is my impression that a divided labor market in Korea is a pretty strong drag on allocation of where resources go. And the United States is one of the biggest economies in the world and yet I still think its flexibility in the labor market is a very important trait. The smaller economies it is even more important. If you want to grow rapidly, you have to release resources from somewhere to somewhere else. It is my understanding that a fair amount of youth unemployment which is very unfortunate because that is when they should be getting all the training and all that and if they can't get good jobs they can't do that. And with all the restrictions and some of what it takes to get into formal employment a part of what is responsible there.

As I said, I am also surprised how many regulations that are there, which has Korea doing less well than it might in someone doing business. I guess some stream lining of that might do some difference. Again on capital account, there is some room for opening up. And my guess is that there are some pretty significant economies there. If the government was really determined to go after that much of an increase of the growth rate, I think they would have to look pretty wholeheartedly at some of these bottlenecks. Earlier on when Korea was pretty poor, there was a really all-out we want growth and there really was a willingness to identify the bottlenecks and to move directly on those. My sense is that there is still some of that but there are now a lot of other things that people think are important too and some of the things that might accelerate the growth rate might not come to the forefront. My guess is that the important one is labor although what about agriculture? I still think there are some huge deficiencies there that are hurting Korea both domestically and Korea’s bargaining position on trade issues internationally that again hurts the growth rate. So again, there is a lot there. It would be labor markets, it would be that kind of thing where the real action could be.