# Korea in the OECD Family

**Donald J. Johnston**

It is a pleasure to be back in Seoul today. It is not very often that I have the opportunity to speak at this early hour of the morning, certainly not in Paris. In fact, this is the only forum where I have been where one begins the morning at 7:00am with a breakfast. I think it is a very good precedent for some of us elsewhere, particularly in Paris. At our forum at the OECD in Paris, it is very unlikely that we would begin at 7:00am.
[*]

This is the Institute for Global Economics and many people in this room follow economics very closely. I run the Organization for Economic Cooperation and Development. Our economics department is, of course, central to our work. But our work also covers a vast number of areas, in fact all areas of public policy except defense.

This morning I will touch upon a few issues: one, the general global outlook as seen by the economists at the OECD. This is a rapidly changing scenario, as we all know. Secondly I would like to say a few things about Korea. Korea is a very significant member of the OECD. It is a recent member. Korea is, quite frankly, one of the bright shinning stars of the galaxy of OECD membership.

There are now 30 members in the OECD. It looks like the OECD is also poised for expansion, but no one knows quite how that is to be done to maintain its culture and working methods. There are strong demands coming from many countries, both in Europe and outside of Europe.

We do have work programs with many non-member countries. That has expanded quite dramatically since I first spoke here seven years ago. We now have work programs of one kind or another with 70 non-member countries. That takes our total to 100. So can see that the OECD has quite a global reach. We have very ambitious programs with China, Russia, Brazil, the Baltics, and the Balkans through the investment compact.

Before I get into the issues about Korea, it is clear to all of us that growth remains weak and hesitant. There are risks on the downside. But by and large the economics department at the OECD has been a bit more optimistic in its outlook than, say, the IMF. This has not been so true about the current year, but going forward. The general view at the OECD is that the cycle will pick up, and that 2004 will register substantially more growth than the current year.

The OECD predicts about 2.5% growth for the US. The US in fact recorded 1.9% from an annualized basis over the first few months this year. Also, everyone anticipates that the second half will be a much stronger half. So our prediction of 2.5% may not be too far off the mark.

---

[*] This is the transcription of a speech given at the Institute for Global Economics' Distinguished Lecture Forum on Friday, May 30, 2003.

Serious concerns are expressed about Europe, the euro-zone in general, and Germany in particular. It has shown great signs of weakness. Japan, as well, continues to be a weak party in global economic development going forward.

The divergence of growth across the world is of great concern. This was discussed in a very general way at the most recent OECD Ministerial. Up until the 1980s there was a convergence of growth. Now there is concern since the leading economies are growing at different rates. The US grows at one rate, the European economies grow at a lesser rate, and Japan grows at an even slower rate. This portends very serious circumstances for the future.

Our role at the OECD is to try to bring about convergence. At the OECD Ministerial we discussed how we could stimulate growth in all economies. How do we translate the productivity gains, measurable in the US from about 1995? How can those be used and exploited in a positive way in Europe and Japan? Of course, there is recognition that serious structural issues in both Japan and Europe hold back growth.

On the other hand, to be optimistic, there is in Europe a rising tide of public opinion, and especially at the political level, that change is necessary. Some of the fundamental structural problems, in labor markets for example, simply have to be addressed if Germany is to get back on a solid growth track. It needs to be the kind of locomotive we all expect it to be and feel it should be.

Deflation has also taken up a lot of space recently. The Japanese began discussing it some time ago when they began their deflationary period. As a global phenomenon, it has been largely dismissed, certainly by the US and other countries in the OECD. It was not seen as being a real possibility. Subsequently, there has been more concern about deflation. You can read the comments by Alan Greenspan. He at least talks about the issue, though he believes the any deflation will be manageable. Hopefully, the growth patterns we see emerging will counter that sort of thinking and confidence will be restored.

Quite frankly, the convergence of events has been quite extraordinary. We first had September 11. But it came at the end of a cycle, which coincided with the popping of the technology bubble. The stock markets then crashed to earth. The revelations then came to light of corporate mischief, corporate misdemeanors and corporate governance. These occurred not only in corporate boardrooms, but ranged right down to investment advisors and the conflicts of interest we saw. Could you have imagined blue chip firms on Wall Street being fined US$ 1.4 billion? Who would ever have anticipated this? It wasn't just the US. We had similar examples in Europe. And even Korea had its own problems.

The general public's confidence in equity markets was really shaken. A US member of Congress coming through Paris about a month ago asked what he could do to restore confidence. He said that his electors did not know where to put their savings. They did not know whom to rely on. From a confidence point of view, the system is really under siege.

Hopefully, confidence will return. Equity markets seem to be improving. I notice that here in Korea the won is strengthening and markets are strengthening. The signs are hopeful. But clearly we still have a lot of work to do at the OECD and elsewhere on issues like corporate governance reforms. We published principles of corporate governance in 1999. They are now largely accepted as the moral principles of the business world. The World Bank uses them in the developing world. China is using them.

After these scandals and revelations, the OECD Ministerial asked us to update our principles of corporate governance. They had to be broadened. When we developed these principles of corporate governance in 1999, we did not anticipate that they would have to stretch into the auditing world and other areas where there were no visible conflicts of interest. Such conflicts have since emerged. So this has not been an easy period.

Some refer to it as the “perfect storm” of the economy. All of these events converged, plus, of course, the Iraqi war, terrorism, corporate governance, and even the bubble. For all that, we still have growth. That should encourage us.

We have to keep in mind that the 1990s were exceptional. Perhaps the generation of young people involved in banking, finance and industry today is using the 1990s as its benchmark. In the 1990s, however, the growth was really quite exceptional. If one looks back a few years, certainly we could say that we are in dire straits. But the reality is we have to take a much longer look at a much longer timeframe. We cannot measure today simply on yesterday, but also against the day before yesterday. These cycles come and go. Personally, I am rather optimistic that the global economy is going to work its way through this phase.

I also think financial markets have been quite resilient. I think the banking sector has been quite resilient. There has been a great deal of criticism from some quarters on the use of derivatives. But, again, as Alan Greenspan has pointed out, the US banking sector has come out of this very difficult period with great resilience, largely because of spreading risk elsewhere. There is a question mark as to who is holding this risk. But I tend to be rather optimistic about the future.

I do not like to get into debates about whether growth is going to be 2.4%, 2.3% or 2.6%. The trend is what is important. In my experience, the numbers always turn out to be wrong, more or less. To debate at length whether the US is to grow at 2.5%, 2.2% or 2.7% is irrelevant. The important thing is that there is growth as far as we can see. It will pick up in 2004.

Let me now turn to Korea. There are some diagrams I have prepared that illustrate Korea’s progress. Korea has very good reason to be optimistic about the policy mix and policy choices ahead. They are extremely sensitive and will be extremely difficult.

My talk today is about Korea in the OECD family. Korea's accession to the OECD in 1996 represented the culmination of 35 years of really extraordinary growth. It was transformed from one of the poorest nations in the world to the 11th largest economy. Think about that figure. Many people do not fully appreciate that accomplishment. Korea is the 11th largest economy, and there are thirty governments represented in the OECD.

The per capita income was boosted in purchasing power parity terms from about one fifth (20%) of the OECD average in 1970 to more than half (50%) in 1996 when they joined. Then, Korea's recovery from the crisis was especially impressive. The severe crisis in 1997 obviously interrupted the convergence process toward the OECD average. The success in implementing a broad range of structural reforms helped achieve a remarkable turnaround. A turnaround, quite frankly, that is quite difficult to believe when looking back.

I remember when a contraction of about 6% occurred. We all debated whether Korea would subsequently see 1% or 2% growth. Even an 8% turnaround would have been wonderful. Korea ended up posting about an 11% turnaround in one year. That is unprecedented. I cannot recall any turnaround of that magnitude. As you know, growth has averaged about 7% per year since 1998. Implementing a new market-oriented framework, accelerating restructuring, and policies that maintained macroeconomic stability were all key to these successes. They all helped Korea maintain these high growth rates, which is continuing the convergence toward the OECD average.

Figure #1 shows income levels in Korea, and how they have been converging to the OECD average. Korea is now close to two thirds (66%) the OECD average, and almost two fifths (40%) that of the US. This is a remarkable accomplishment.

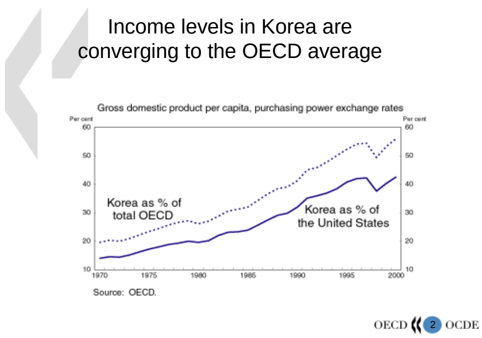



*Figure 1.*

The OECD Ministerial recently asked us to determine the composition of economic growth today in the 21st century, especially given that globalization and information & communication technologies play a large part in our lives. They wanted to know whether the mix of components has changed.

The study was well received. It found that there are seven key factors that seem to determine the rate of growth, and hence the rate of the convergence process. Figure #2 shows factors mentioned a moment ago: sound macroeconomic policies; investment in productive assets; openness to trade and investment; flexible labor markets; entrepreneurial climate; innovation creation and adoption; and human capital.

Factors that will determine the pace of convergence

| | Strength | Weakness |
|---|---|---|
| ▪Sound Macro Policies | | |
| ▪Investment in Productive Assets | | |
| ▪Openness to Trade and Investment | | |
| ▪Flexible Labour Markets | | |
| ▪Entrepreneurial Climate | | |
| ▪Innovation: Creation & Adoption | | |
| ▪Human Capital | | |

**How does Korea Stack Up?**

OECD 3 OCDE

*Figure 2.*

On the issue of Korea's economic fundamentals, the national debt looks good. Net government assets are 28.4% of GDP. The government budget is in surplus, of 3.9%. Current account balance also has a surplus, of 1.3%, and the rate of inflation is only 2.8%. In fact, Korea is one of only three countries in the OECD where the government is a net creditor. Other macroeconomic indicators are also positive. I would say that on the first test, the one of sound macroeconomic policies, Korea is doing very well.

KOREA'S ECONOMIC FUNDAMENTALS ARE SOUND

- **National Debt:**
  ***Net Government Assets 28.4 % of GDP***
- **Government Budget:**
  ***Surplus 3.9 % of GDP***
- **Current Account Balance:**
  ***Surplus 1.3 % of GDP***
- **Rate of Inflation:** ***2.8 %***

OECD 4 OCDE

*Figure 3.*

Korea also has a relatively small government. That is one reason for its strong financial position. When you look at general government expenditures as a percentage of GDP, you will see the euro-zone sits at about 45%. Then Japan and the US. And Korea comes in quite low. Spending as a share of GDP has been on a modest upward path since the 1980s, as seen in Figure #4. But it is still well below the euro-zone, Japan and the US.

In fact, Korea, at about 22% of GDP, had the second smallest government after Mexico when measured by expenditure, as seen in Figure #5.

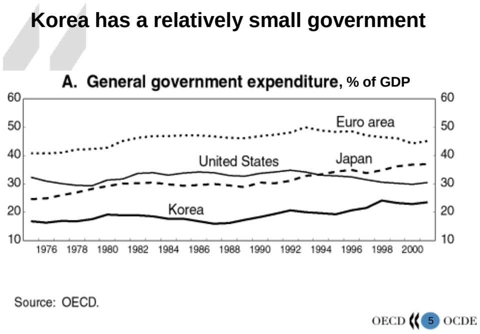



*Figure 4.*

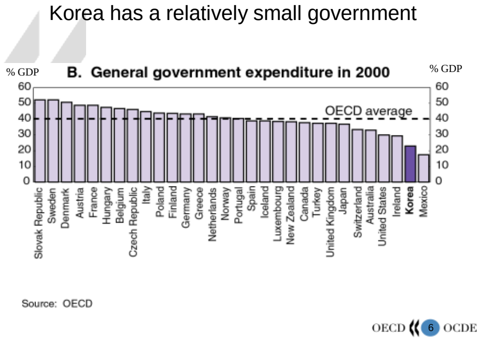



*Figure 5.*

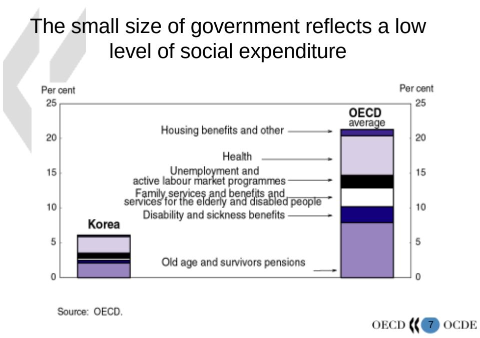



*Figure 6.*

There are reasons for this small government is the low level of social expenditure in Korea, as shown in Figure #6. That is partly due to the fact that the social safety net is only at the early stages of development here. For example, in the area of unemployment and active labor market programs, Korea spends less than 1% of GDP. This reflects the fact that unemployment is relatively low, at around 3%. But it also represents the fact that almost one third (33%) of employees, notably daily workers and part-time workers, are not eligible. Effectively, the unemployment insurance coverage is not very high.

We feel that this sort of coverage and the enforcement of the unemployment insurance system and essential. I am not talking about paying people to be on long-term unemployment benefits as we find in some European countries. The reality is that it makes a major contribution to enhance labor market flexibility.

Another factor responsible for the low level of social welfare spending is that Koreans at the present time have a relatively young population. Indeed, the share of the population that is over 65-years-old can be seen in Figure #7.

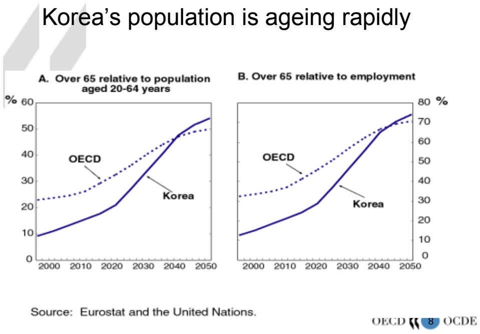



*Figure 7.*

That share is the lowest in the OECD, after Turkey and Mexico. However, you will see that the population will age very rapidly. The share of the population over 65-years-old is currently 7%. It will double to 14% over the next 20 years. This illustrates Korea's demographic reality: Korea has one of the sharpest demographic transitions in the OECD area. This means that public pension reform is going to be a major challenge. It will not be sustainable in its current format.

The rapid ageing of the population, combined of course with the potential burden posed by North Korea, suggests that Korea should be cautious in developing its social safety net.

Unemployment insurance is important. It makes a major contribution to labor market flexibility. But it is also very important to learn from the mistakes of European countries, in particular, which have chronic budget problems and weak work incentives as a result of their social safety nets.

Some of you may be familiar with a process at the OECD where we compare best practices. We learn from each other's best practices. I have always felt that we can learn more from each other's worst practices. There are many effective examples in front of us where we can see that there has been a development of social safety nets which have curbed incentives to work, had a major impact on employment, and a major impact on budgets.

As a former politician, I can tell you that it is a lot easier to give benefits than to take them away. For example, on my way here I had to fly a circuitous route through Prague and Frankfurt because there was an air traffic controller's strike in Paris. There has even been marching in the streets of Paris. There have been general shutdowns. There have been transit strikes. More than 500'000 people converged on Paris last week. This is all because Mr. Raffarin, France's prime minister, wants to increase by two-and-a-half years the required working period for public service workers before they receive full pension benefits, from thirty-seven-and-a-half years to forty years. The private sector already requires 40 years of work before they can receive full pension benefits. You can see from that example that politicians have to be very cautious. At the same time, though, the social safety net has to be improved for the reasons I mentioned and because of the demography.

Business and investment as a percentage of GDP is another factor that is important for economic growth. Here, Korea performs extraordinarily well, when compared to the OECD average. Korea has one of the highest business and investment percentages in the OECD. Of course, it has fallen substantially since the mid-1990s. But this is not necessarily unhealthy. Debt financed over-expansion by Korean firms, as you know, is one of the factors that made Korea vulnerable to the crisis of 1997. The lower level of investment is consistent with stronger balance sheets in the corporate sector.

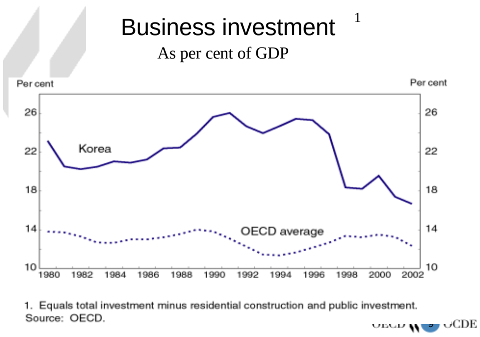



*Figure 8.*

As can be seen in Figure #9, Korea is one of the leaders in the world in the area of broadband subscribers. You can see in that diagram that Canada doesn't do too badly either, but it isn't even half of the penetration in Korea in terms of broadband. The US falls substantially below that.

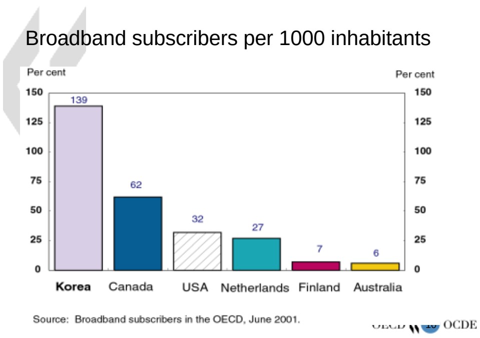



*Figure 9.*

Concerning foreign trade expansion—another one of the criteria to which I made reference—you can see in Figure #10 that, again, in terms of openness to trade, Korea has made significant strides. The share of imports to GDP has doubled over the past 30 years. Nevertheless, there are substantial trade barriers remaining, particularly in the agricultural and service sectors. We will hear a lot about this when we approach the next WTO round in Cancun, Mexico.

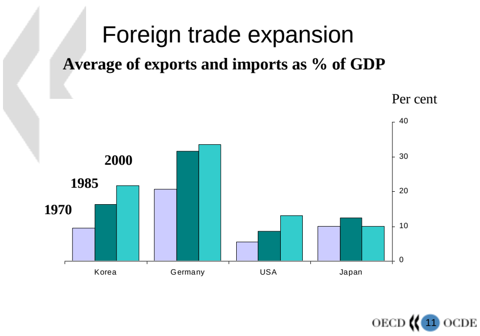



*Figure 10.*

Following the crisis, as most of you are aware, Korea changed its policy to foreign direct investment. Previously it played a minor role in the Korean economy. The new open attitude to foreign investors boosted inflows of FDI to around US$ 15 billion in 1999 and 200, as seen in Figure #11.

Since then, there has been a significant decline. This has occurred during a sharp contraction of global FDI. This trend is not unique to Korea. Indeed, world FDI fell by half. But in Korea, following the wage of restructuring, including mergers and acquisitions, FDI got a boost.

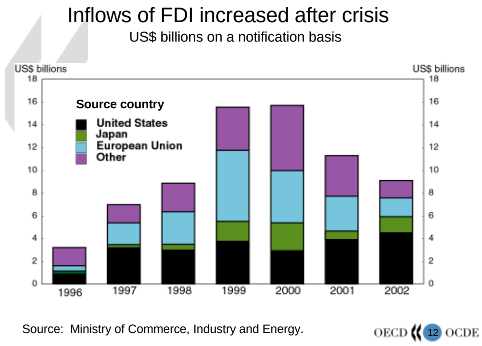



*Figure 11.*

However, if we look at total stock of FDI, as seen in Figure #12, it is still very low. It is one of the lowest in the OECD area. It is essential Korea make further progress in removing factors that discourage foreign investment inflows. This will also promote Korea's ambition to become, if you like, a "hub" for Northeast Asia. You can see in Figure #12 where Korea ranks in terms of FDI as a share of GDP. It is third from the bottom.

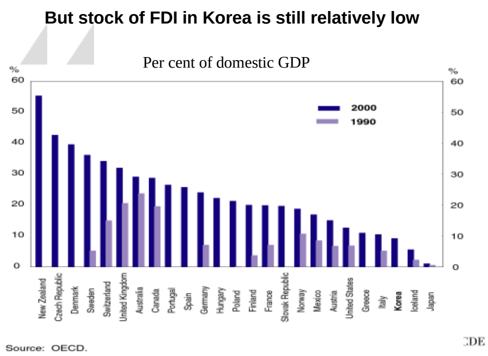



*Figure 12.*

According to our analysis, the Korean labor market is one of the major factors that discourages investment in Korea. Flexible labor markets are essential in economies with rapid structural change, such as Korea. As shown in Figure #13, Korea had the second most strict labor market in the OECD in the late 1990s. Employment flexibility is enhanced by more use of non-regular workers. Korea does have a relatively high rate of wage flexibility, as well. But a lot more work has to be done in this area.


*Figure 13.*

Korea has a very strong entrepreneurial climate. Figure #14 covers the issue of venture capital. Part of the indication of an entrepreneurial climate is the growth of venture capital. You can see in Figure #14 the extent to which, from 1995 to 2000, early stage and expansion financing as a percent of GDP accelerated in Korea. Of course, the US is way out ahead of most of us, but Korea stacks up in that regard very well.

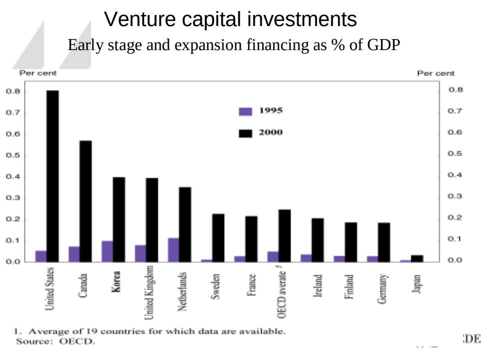



*Figure 14.*

R&D expenditures are also important to growth. Korea devotes a relatively high share of GDP to research and design, a total of about 2.7% of GDP. The private sector accounts for the bulk of that investment. R&D in other sectors and at universities also plays an important role (Figures #15 and #16). One of the challenges is to integrate the R&D efforts of the government institutes, the universities and the corporate sectors. This would make maximum synergies and maximum practicable application.

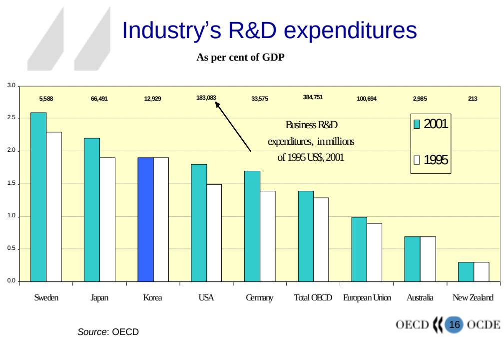



*Figure 15.*

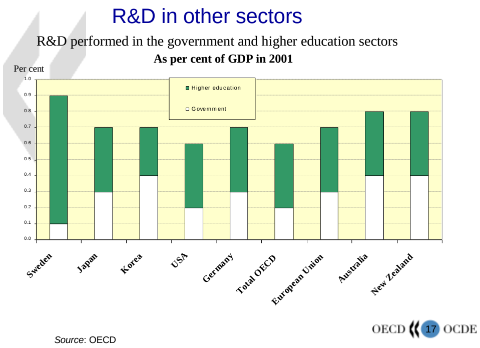



*Figure 16..*

Figure #17 is a very encouraging statistic for Korea. This is interesting because I hear a lot of criticism about the education system here. Yet, when the students were tested under the Program for International Student Assessment (PISA) test, they did very well. The PISA is a test of 15-year-old students across the OECD. It is a test of a magnitude and of a depth that has never been done before. It tested 265’000 teen-agers not just on how they did on their exams—maths, science, literacy—but how they actually applied their knowledge.

The results were quite surprising. In Figure #17 I included three countries only: Japan, Korea and the US. In reading, Korean students ranked 6$^{th}$ in the OECD. In maths, Koreans were ranked 2$^{nd}$ in the OECD. In sciences, Korean students ranked 1$^{st}$ in the OECD. The performance was absolutely stunning, not withstanding all the criticisms we hear.

This does not mean that further improvements are not necessary in adopting the education system to the demands of a knowledge-based economy. They clearly are. This crosses over into the area of student financing. I recall that Korean parents, with their great appetite for educating their children, spend almost as much privately as the amount spent publicly on education. So clearly issues have to be addressed.

I think we should be very gratified by the enormous potential of human capital in this country. Reforms to expand the scope of choice in schools and curriculum in this country are very important.

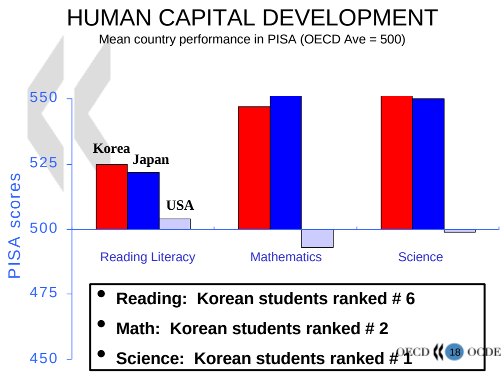



*Figure 17.*

If you look at Figure #18, you will see that overall educational attainment is also high. For people aged 25-34, Korea was second in the OECD in terms of percent of population with tertiary education, only behind Japan. Korea was right up there at the top in terms of number of college graduates.

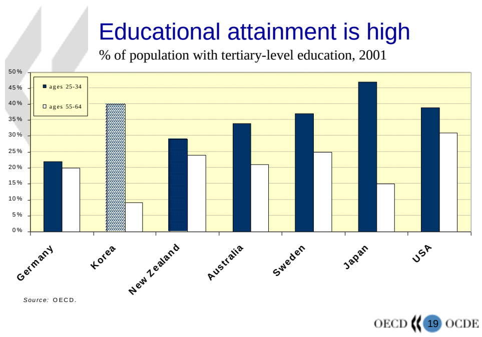



*Figure 18.*

Before I move into my conclusions, I would like to mention once again the issue of social expenditures. The bottom left triangle in Figure #19 represents economic growth and wealth creation. That is essential to economic and social progress. On the other hand, it has to be balanced by social stability and social cohesion. That is achieved through good governance.

This means that there has to be an effective transfer of benefits of growth to society as a whole. This does not mean cash or transfers. What it means in the most advanced and sophisticated way is the creation of good employment and well-paid jobs.

Economic growth, as we all know, is a product of the marriage of human capital, financial capital, and technology. The framework for the marriage is liberal markets supported by good governance, public and private, competition laws, fair taxation, and similar characteristics. In these areas Korea stacks up very well, but with a few problems.

On the social side, social cohesion depends upon the equitable transfer of wealth within society as a whole, good employment opportunities, good education, good health systems, good pension provisions, and good social security, including adequate unemployment and disability insurance.

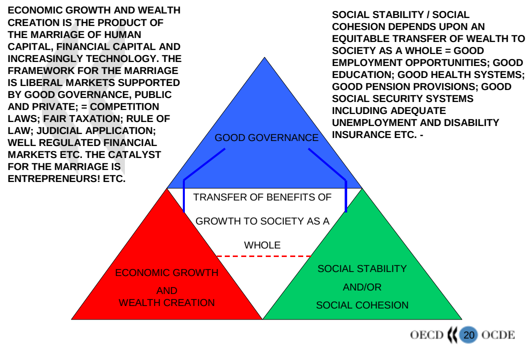
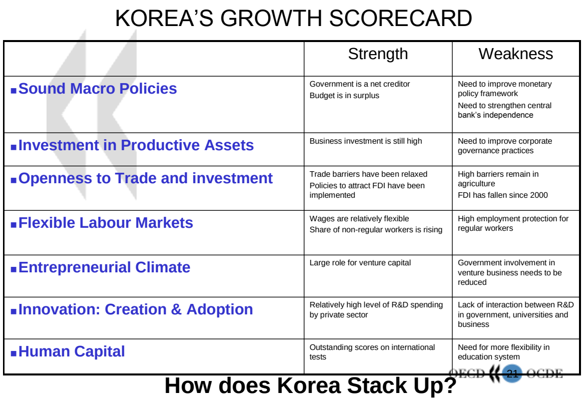



*Figure 19.*

So what is Korea's growth scorecard? How does Korea stack up? To answer this question, we can look at the combined analysis of the OECD's economics department and social affairs department (Figure #20). If we look first at macroeconomic policies, we see that the strength is that the government is a net creditor and the budget is in surplus. The weakness is that this country must improve its monetary policy framework, and strengthen the central bank's independence.

As for investment in productive assets, investment is still high, but Korea must still improve corporate governance practices. As we all know, this is not unique to Korea. In terms of openness to trade and investment, the trade barriers have been relaxed and policies to attract FDI have been implemented. But barriers remain high. There are high barriers in agriculture and services. In fact, FDI has fallen since 2000, for a variety of reasons.

In terms of flexible labor markets, Korean wages are relatively flexible. The share of non-regular workers is rising because of high employment protection for regular workers. This situation has to be addressed. In entrepreneurial climate, the large role of venture capital is a strength. But again, government involvement in the venture business needs to be reduced. The creation and adoption of innovation is at a relatively high level, as is R&D spending in the private sector. But a lack of interaction between government, universities and business is holding back innovation. Finally, Korea has outstanding international scores when it comes to human capital, but it needs to have more flexibility in the education system.



KOREA'S GROWTH SCORECARD

| | Strength | Weakness |
|---|---|---|
| ▪Sound Macro Policies | Government is a net creditor<br>Budget is in surplus | Need to improve monetary policy framework<br>Need to strengthen central bank's independence |
| ▪Investment in Productive Assets | Business investment is still high | Need to improve corporate governance practices |
| ▪Openness to Trade and investment | Trade barriers have been relaxed<br>Policies to attract FDI have been implemented | High barriers remain in agriculture<br>FDI has fallen since 2000 |
| ▪Flexible Labour Markets | Wages are relatively flexible<br>Share of non-regular workers is rising | High employment protection for regular workers |
| ▪Entrepreneurial Climate | Large role for venture capital | Government involvement in venture business needs to be reduced |
| ▪Innovation: Creation & Adoption | Relatively high level of R&D spending by private sector | Lack of interaction between R&D in government, universities and business |
| ▪Human Capital | Outstanding scores on international tests | Need for more flexibility in education system |

How does Korea Stack Up?
OECD 21 OCDE

*Figure 20.*

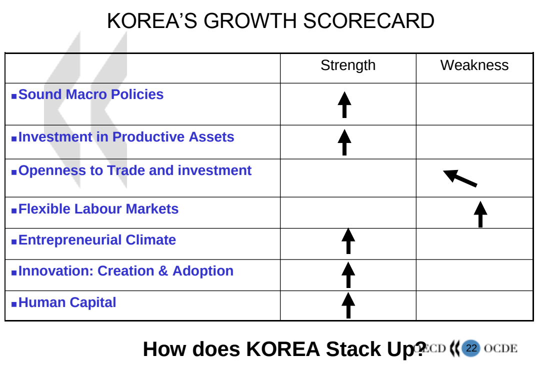



*Figure 21.*

So on the whole, if we look at the overall scorecard (Figure #21), sound macroeconomic policies are a strength, investment in productive assets is a strength, entrepreneurial climate is a strength, creation and adoption of innovation is a strength, and human capital is a strength. But Korea's openness to trade and investment is a weakness, though leaning toward a strength, and the inflexible labor markets are also a weakness. Those are the messages that come out of the OECD concerning Korea.

But I must say that there are very few countries in the OECD that could produce a scorecard as positive as this. That, I think, should be very encouraging going forward. Thank you very much.

## Questions & Answers

**Q** The one point I think you have omitted in your presentation is political stability in South Korea. The current government is handling a lot of forces arising from a lot of social interest groups. But these forces give foreigners the wrong impression of the country. How do you evaluate Korea’s political/economic status and the government’s ability to handle these various voices that might hinder foreigners’ arrival in Korea?

**A** That is best answered by you and by people here. It is very difficult for me to make a judgment on this. Korea now has a new president with a very ambitious program. I followed his progress closely at the inauguration. In fact, I am even coming back here on June 30 for a major economic conference. I am not in a position to judge what the policies are within the parties or within the political framework itself. That is best left to you.

The reality is that Korea has done very well through some very critical and difficult periods in recent years, as we can see from the evidence. How will that affect foreign direct investment? Well, Korea will be a very attractive country for FDI if these other issues are eliminated. Note that FDI has not yet returned to levels we would have expected for reasons that are totally unrelated to the current situation in Korea. Labor market flexibility, for example, has huge problems with unions. I know this has been a difficult problem for a long period of time. If Korea were able to develop a strong tri-partite relationship with the unions, I think this would be helpful.

That is what we saw in Ireland. They developed a consensus looking forward, which I would think is something Korea should probably try to achieve. But I have not followed the labor situation here in Korea closely.

**Q** You briefly mentioned the word “North Korea”. How much do you think the nuclear crisis will affect South Korea’s economy in the future?

**A** I can’t really answer that question. Many observers attributed a weakness in the South Korean economy to this so-called “threat”. I gather from my discussions with the government that the situation has improved since I was here for the inauguration. At that time, North Korea had just launched a missile into the sea.

I cannot foretell. But I am very optimistic about the evolution of that situation if these tripartite discussions can be launched. It is a bit beyond the scope of our work at the OECD.

Some years ago, before this most recent nuclear threat was revealed, I made a proposition to then-President Kim Daejung. The OECD could effectively play a role in analyzing the whole North Korean economy. We were to look at all the strengths and weaknesses of North Korea, just as we did in China, Russia and Brazil. This would then provide you with a platform upon which you could begin to build economic and social reform. My understanding is that there is not a lot of knowledge about what any comparative advantages might be in North Korea. We want to know what has to be done if they are really interested in developing their economy, as the Chinese certainly are.

The collective expertise of all OECD members, channeled through the OECD departments, is a very effective tool. It is also a very user-friendly process. We work with the governments, with the Russians, with the Chinese and with the Brazilians. We work together and try to come up with an overall assessment of what steps must be taken in what order.

Unfortunately, after then-President Kim and I had that discussion, and I had made available the work we had done on China—which I thought might be encouraging for North Koreans—it was almost that very day that the announcement came that North Korea had this nuclear program. So everything is on ice. And in any event, this proposal would have to be approved by the member countries.

**Q** Several times you spoke about how you believe the global economy's growth cycle will pick up next year. I'm not clear on exactly why you think that.

**A** Did you use the term "cycle"? That is basically what all economists are saying. The world has never moved in a linear fashion. We have always had cycles. This one, many in the OECD believe, has started to run its course. The capital investment overhang cycle in certain sectors in the US in particular has been worked out pretty well, except perhaps in some of the telecoms and other sectors. As confidence returns, and consumer demand increases, we will fragilely move back to a solid growth pattern.

One thing that would make a great contribution to that would be a successful round in multilateral trade negotiations in Cancun. It would be psychologically very positive. It would go a long way toward help restoring confidence in the potential for multilateral trade and investment expansion on a global basis. There are a lot of issues on the up side, which could contribute significantly toward bringing about a strengthening world economy. That is not to say there aren't down side risks, though. There obviously are.

**Q** Let me ask you one question about the general trend of globalization and necessary changes in institutions. Generally in the age of globalization, incomes increasingly diverge between the rich and poor countries. Do you see a convergence trend among OECD countries in terms of GDP? Secondly, do you see a convergence trend in institutions across the OECD? We often say that in globalization, institutions have to be aligned with global standards. But I know that European countries have maintained many unique institutions, especially with social security systems and so forth.

In Korea, at first we introduced a system that was similar to that of the US and other countries. But these days we may have to experiment with institutions, such as social welfare. Politicians must be cautious when expanding the social safety net. I would like to hear your views on this.

**A** Globalization, expressed in terms of trade and investment liberalization, matter and open markets matter. The wealth creation generated by trade and investment is tangible. It is measurable. In fact, we have measured. We have gone back and done economic models that show how wealth was created, in all countries that have participated in globalization.

I could put up some charts that would show you the difference between countries that have been open to trade and investment and those that have been closed. Even on a unilateral basis, those who open have done better.

But how has that wealth been distributed within the member countries? In other words, in the US there has been a lot of debate about globalization. There is a saying: it might be good for Wall Street, but is it good for Main Street? In other words, is the wealth generated from globalization being accrued to a few or is it being broadly spread across society, usually in the form of high-paying jobs.

Part of our job is to show where these benefits have gone, and where they haven't. It is not evident to most people in the US or Europe, but a lot of the benefits are represented in the price and choice of consumer products. Today, there are huge benefits to families all over the world in terms of consumer products which have been pouring in because of free trade. There are so many consumer choices now, it is sometimes difficult to choose what you want to buy.

There are huge benefits. Therefore, in time, there is bound to be a convergence. There will always be rich people and poor people, though. The issue of poverty and how you measure it is an entirely separate issue which we could get into with some of the sociologists present. We don't use absolute terms when measuring poverty. We use relative terms.

In any event, the proof is there: open trade benefits. But the question is whether or not governments are able to adopt the necessary policies to ensure that their own citizens fully participate. Those who lose their job must be re-trained and re-skilled. That is where Japan and Korea have an advantage. In Europe as you know, and in the US and Canada, it is the low skilled who have suffered from globalization. It is the low skilled, who are somewhat older, who have a hard time re-integrating into the work force. They have little understanding of the knowledge-based economies. They have to go down to lower level service jobs. That is why countries must have very good programs for either early retirement, or re-skilling of people who are young enough. We are in a transition period that is creating these very real challenges for domestic policy makers.

On your other question, I do not think every country will end up with the same models or the same institutions. The triangle in Figure #19 has to be kept in balance. Countries have different approaches. For example, the US would never tolerate the individual tax rate that Danes pay. The Danes pay one of the highest tax rates in the world. On the other hand, they have public goods. It is more of a homogeneous society, which helps. Education is paid for. Health is paid for. It is not an individual choice, but that system works. It keeps social cohesion and economic growth in balance. You cannot transfer that model to the US, and you could not transfer the US model to Denmark.

Canada is an interesting example because it is somewhere in between. It is between the European social model and the US. It has universal health care and social security systems, in place for some years. These are richer than the US systems, but not as rich as the European systems. And even there, politicians have to make changes in order to claw back some benefits.

I do not think we will ever see a "one shoe fits all". Countries are too different. If they are able to maintain that balance, with wealth, then there systems are working and are effective. You could argue that Korea today sits only at per capita GDP of US$ 10'000. But you didn't mention the trend line. That is what is significant: Korea's growth. Korea was one of the poorest countries in the world. In fact, Ernesto Zedillo, a former president of Mexico, used to berate his population. He would point to a chart where Mexico had a higher per capita GDP than Korea. He would ask what happened here. Why have we not been able to do what the Koreans have done, he would ask. Bear in mind that Korea is a very encouraging example to other countries. The record is very solid.

**Q** Foreign direct investment brings benefits in at least two areas. One is the injection of capital that comes in. The other area is the learning effect, where new companies perhaps bring different and new skills into an economy. Certainly in Britain we are very conscious of the impact that second effect had. Has the OECD done any study on the benefits of foreign direct investment? In what areas is FDI most valuable to an economy?

**A** Your point is absolutely right. As much as we talk about foreign direct investment, there is hardly a country one can think of where the actual capital is going to exceed that of what would be derived from domestic savings. Why do the Chinese want FDI? China has the highest per capita savings rate of any country in the world. Their challenge is to channel that into productive sectors. FDI has two major benefits. It not only brings in technology, but also managerial skills. That is one of the great attractions of FDI. Also, it provides competition for state-owned enterprises. They have to deal with their SOEs. It is not an easy issue. One way to deal with them is to bring in competitive foreign enterprises, which will hopefully have a spillover effect in terms of technology, efficiency, and managerial skills into state-owned sectors. In almost every instance, the accompanying benefits of FDI are far greater than the actual capital.