State of the World Economy, 2011-2012:

Whither or Wither?

US•KOREA INSTITUTE AT SAIS

한국금융연구원 KOREA INSTITUTE OF FINANCE

SAIS Asian Studies Program

중앙일보

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On November 18, 2010, the U.S.-Korea Institute at SAIS and the Korea Institute of Finance, sponsored by the Asian Studies Program at SAIS and the *JoongAng Ilbo*, hosted the one-day conference, "State of the World Economy, 2011-2012: Whither or Wither?" at the Paul H. Nitze School of Advanced International Studies (SAIS) in Washington, D.C.

This volume contains the speeches and papers that were presented that day and subsequently further refined by the authors to reflect discussions during the conference.

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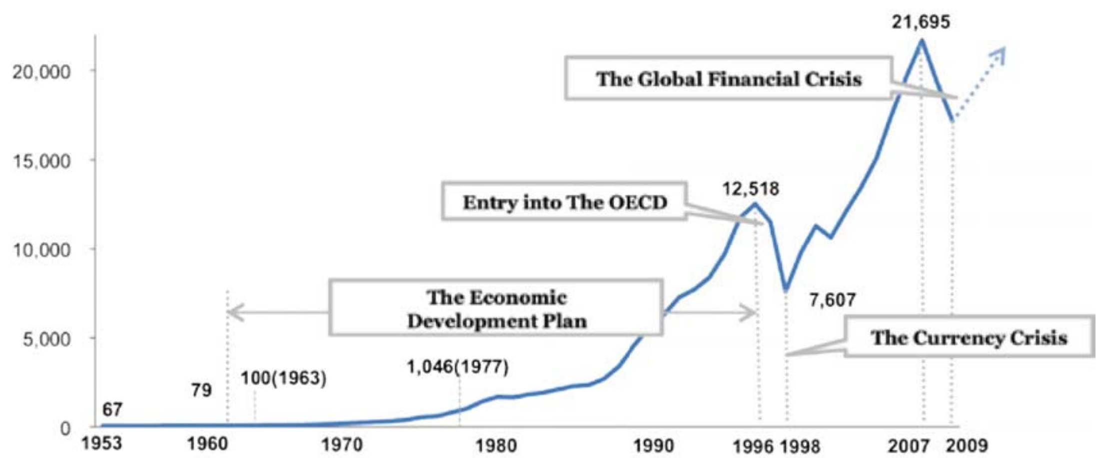
The Korean Economy: Status and Tasks

Min Chang
Korea Institute of Finance

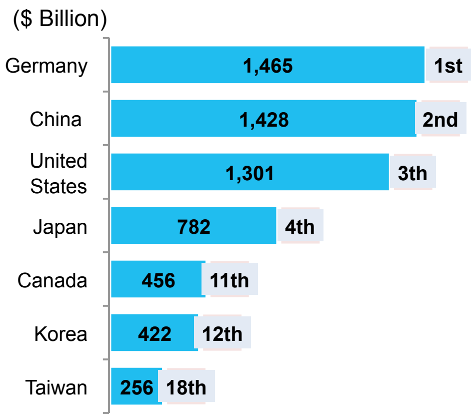
Stretching back to its 1960 economic development plan, Korea has managed nothing short of remarkable growth. Lacking resources and having only a tiny domestic market, Korea pursued a manufacturing and export-led growth model and made a zealous push for education that produced the skilled labor instrumental for the efficient operation of large-scale production systems. Alongside this, Korea wisely got past the political instabilities and troubles following Korea's liberation from Japan in 1945 and gradually moved towards a democratic system, which also helped lead to the progression of economic development known as the "Han River miracle." Buoyed by industrialization and democratization, Korea's per capita national income went from $79 in 1960 to $21,695 in 2007, right before the onset of the global financial crisis. Korea in turn became an OECD member nation in 1996, the first case of a developing economy joining the ranks of the advanced economies through successful development—a meaningful achievement in terms of world economic history.

Per Capita National Income (US$)



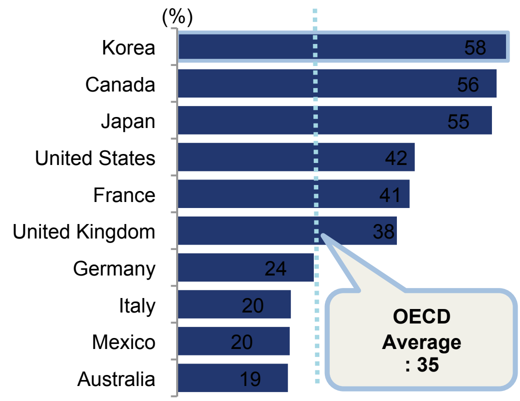
Source: Bank of Korea.

Size of Exports (Ranking)



Source: WTO.

The Tertiary Education Rate



Source: OECD.

Looking at the Korean economy today, it has secured its place as a mid-sized nation with a top-tier economy. As of 2008, Korea’s GDP was ranked fifteenth worldwide, approaching $1 trillion, and twelfth worldwide, with $400 billion in exports. In terms of human resources, the population is reaching 50 million and tertiary school finishing rates of 58% are far above the OECD average of 35%.

Industrial competitiveness is also evenly balanced between traditional manufacturing, which has benefited from the long-held export-led growth policies, and new technology industries focused on IT. Korea’s shipbuilding, display production, mobile phones, semiconductors, and automobiles are globally competitive and drive the Korean economy. And thanks to Korea’s substantial science and technology R&D expenditures, it ranked fourth in 2007 in patents, after the United States, Japan, and China. Considering that Korea has been highly visible in the areas of culture and sports as well, Korea can be said to have built a secure position in various areas, from the economy to science/technology, and from culture to sports.

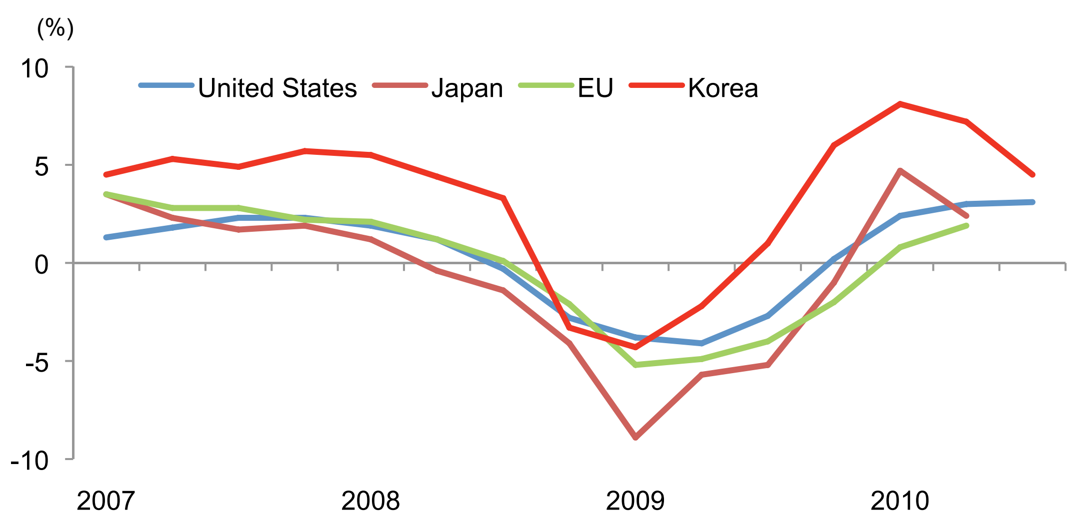
The Market Share of New Technology Industries (%)

	2005	2006	2007	2008	2009
DRAM	47.3	44.8	49.0	49.6	61.0
Mobile phones	19.4	18.1	20.7	24.5	30.6
Automobiles	4.3	4.5	4.8	5.1	7.3
Shipbuilding	35.6	35.2	35.6	33.8	34.4
TV	19.6	24.3	28.2	33.7	36.1

Source: Samsung Economic Research Institute.

Moreover, as the G-20 host country in 2010, Korea has taken a big step forward in terms of economic diplomacy, playing a bridge role between emerging and advanced economies. The 2010 G-20 Summit in Seoul produced a major agreement on currency revaluations and the adjustment of balance-of-payments surpluses to alleviate the imbalances that were at the root of the global financial crisis. In addition, with greater IMF quotas allocated for emerging market countries, the long-running dispute over the reform of international financial organizations took a big leap forward. Korea's experience in rising from a developing country to the ranks of the advanced nations was a major help in producing such agreements and coordinating understanding between emerging and advanced economies. And having recent experience as both an emerging and an advanced economy was undeniably of immense help in allowing Korea to see both sides' issues and concerns.

Growth Rates of Major Economies



Source: Bloomberg, Bank of Korea.

In this respect, Korea's rapid recovery from the global financial crisis also worked as a factor elevating Korea's role on the issues of ushering in a new global financial order and constructing a global financial safety net. The Korean economy grew 0.2% in 2009, as international financial markets contracted and global demand fell alongside the global financial crisis. However, based on its experience during the 1997 currency crisis, Korea responded to the credit crunch in the financial markets with aggressive monetary and fiscal policies, injecting liquidity, and restructuring insolvent firms. As a result, Korea is set to achieve growth in the 6% range in 2010. This will be the highest growth rate in the OECD, and has occurred as exports have been buoyed by robust growth in export-market emerging economies, and as domestic demand has recovered from soaring capital investment and the continued recovery of private consumption.

Next year as well, the Korean economy is anticipated to see growth near its potential levels in the mid-4% range on the strength of the continued recovery of the global economy—led by emerging markets and by the increasing vigor of Korea's private sector. Looking at expenditures, private consumption is expected to rise substantially on the strength of a falling exchange rate as well as rising real purchasing power from better income thanks to the economic recovery and rising asset prices. Capital investment, despite growing a robust 25% in 2010 year-on-year, should revert to the more typical 6% range, as IT companies expand investment. Conversely, it is harder to foresee a recovery in construction investment, since the longer-term outlook for the housing market has been cloudy amid a slowdown in private home construction. The exports that drive Korea's growth, however, should see robust growth next year as well. This is based on further robust growth projected for emerging markets, despite the potential for more delay in the recovery of advanced economies, as well as considerable uncertainties over currency valuations and other issues.

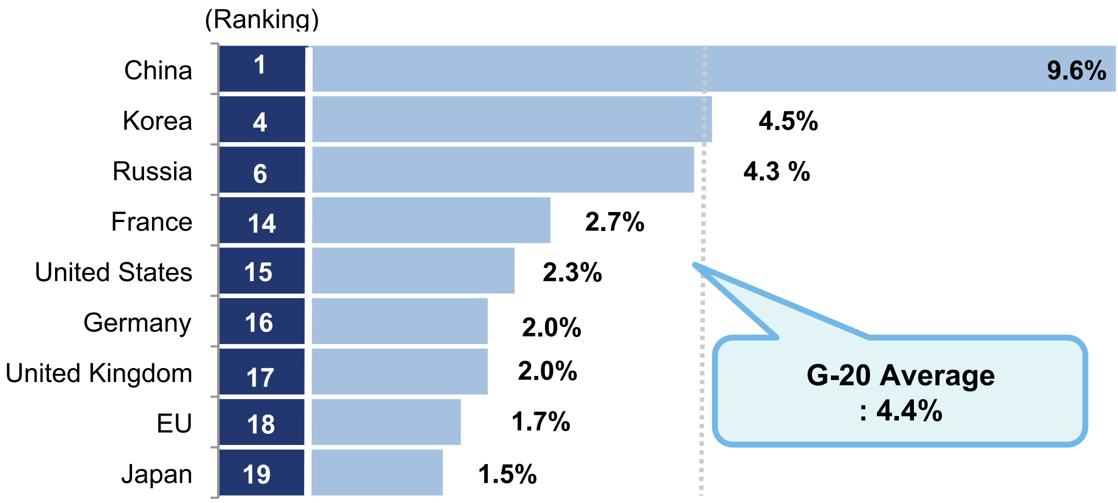
Economic Growth Forecast (%)

	2008	2009	2010	2011
GDP	2.3	0.2	6.0	4.4
Final Consumption	2.0	1.3	3.6	3.5
(Private Sector)	(1.3)	(0.2)	(3.8)	(3.4)
Gross Fixed Capital Formation	△1.9	△0.2	7.8	2.8
(Construction)	(△2.8)	(4.4)	(0.0)	(0.7)
(Equipment)	(△1.0)	(△9.1)	(24.6)	(6.6)
Total Exports	6.6	△0.8	13.3	9.0
Total Imports	4.4	△8.2	16.8	10.3

Source: Bank of Korea; KIF forecasts beyond second half of 2010.

Even looking at longer-term conditions, the Korean economy has a high chance of getting back to potential growth levels, assuming no unforeseen variables. Above all, Korea's largest export market, China, is highly likely to continue on a robust growth track, which should have a positive effect on a Korean economy becoming ever more tilted towards exports to China. The high competitiveness of Korea's leading export industries, such as IT and automobiles, also suggests that Korea will maintain its export competitiveness. Furthermore, as the domestic

G-20 Countries' GDP Forecast in 2011



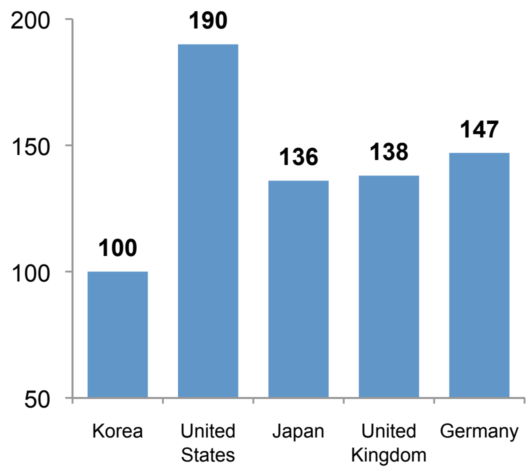
Source: IMF.

market gradually matures based on service industries, this is anticipated to bolster the economic growth base. These domestic and external economic conditions hint that the Korean economy is highly likely to continue on a stable growth track.

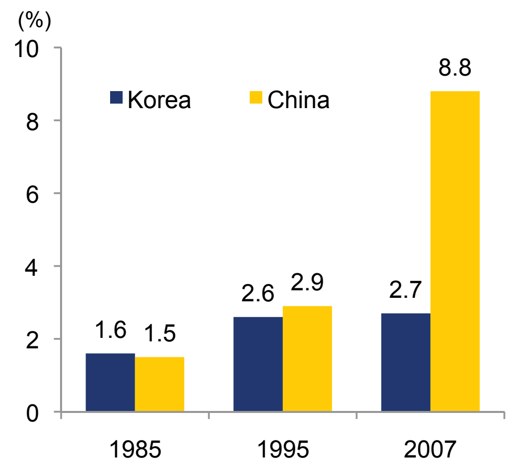
However, behind these projections lie a lot of uncertainties. The biggest is over whether the Korean economy can fully complete its transition from emerging to advanced economy. In spite of the economic development thus far, Korea still has slow productivity gains from its lack of original technology, and a persisting technology gap with advanced economies, making it hard to compete. Meanwhile, China and other emerging markets are encroaching on Korea's export competitiveness with low-cost products. There are concerns that if Korea is not careful, it could be facing a "Nutcracker" situation.

However, even before genuinely ascending to the ranks of an advanced economy, the symptoms of being an advanced economy have already begun to appear, implying that the path forward will not be all smooth sailing. As time passes, the slump in investment, low birthrates, and a rapidly aging population may considerably hamper the dynamism of the Korean economy. Of course, such things are inevitable consequences of development. As consumer spending growth slowed and the gross capital formation ratio fell off sharply during the 1990s, economic growth entered into a downward trajectory. Final consumption grew around 8% during the 1980s, but this fell to the 5% range in the 1990s and down to the 4% level in the 2000s. Average annual gross capital formation growth also fell from around 14% in the 1980s, to 5% in the 1990s, and just 3% in the 2000s. As a result, annual economic growth went from 9% in the 1980s to 6% in the 1990s to 4% in the 2000s. As manufacturing has transferred production overseas

Productivity of Major Economies ('96-06)



Korea/China Share of Global Exports



to cut costs and develop new markets and as Korea has struggled to uncover new growth industries, capital investment has been consistently falling. Declining labor supply from changing demographics and less accumulation of human and physical capital could act as factors pushing down Korea's potential growth rates.

GDP Growth and Total Factor Productivity (TFP) Growth

Period	GDP Growth	Capital Growth	Labor Growth	TFP Growth
1985-90	9.2%	11.3%	2.3%	3.8%
1990-95	7.5%	11.4%	2.5%	1.9%
1995-00	4.3%	6.6%	0.1%	1.8%
2000-05	4.5%	4.7%	0.0%	2.8%

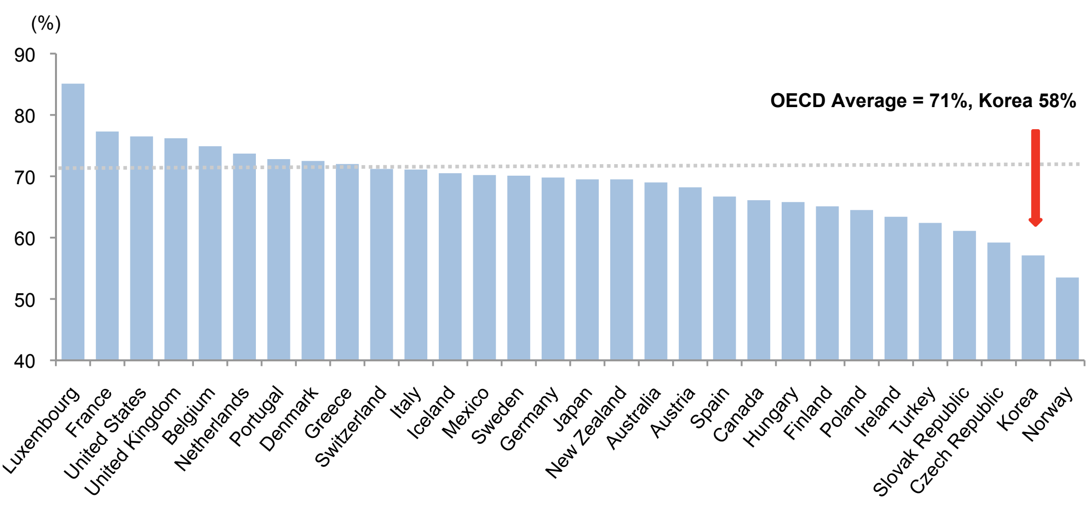
Source: Bank of Korea.

In terms of Korea's industrial structure, domestic demand has been weak, as export-led growth has persisted for a long time, deepening reliance on the external sector. In most advanced economies, services constitute over 70% of GDP, but this figure has not reached 60% in Korea yet. With this immaturity of domestic-oriented industries, the development of services able to provide many jobs has been inadequate, and intermediate materials industries have been tepid, leading to persistently weak linkages between growth and jobs. As a result, the so-called jobless growth phenomenon of limited employment gains, despite high levels of economic growth, continues to become more apparent.

In terms of the structure of service industries in Korea, consumers are increasingly frustrated by the fact that high value-added sectors such as law, healthcare, and education enjoy excess returns thanks to regulatory entry barriers. The OECD's Korea Report (2008) ranked Korea's non-manufacturing regulations as fifth-strictest in the OECD, and found entry barriers in around a third of Korea's 543 service industry sectors. In contrast, the wholesale/retail, food and beverage, and lodging industries have excessive entry low returns, aggravating social instability. The result is that Korea's service industry labor productivity is well below the standards of major advanced economies. Based on 2006, if the value-added generated by Korea's service industry workers is set at 100, the same number would be 227 for the United States, more than double that of Korea, and 192 in France. Korea's manufacturing labor productivity score of 172 also can give an idea of how low service industry productivity is. In this environment, as market opening puts long-protected domestic sectors in competition with foreign firms, their poor competitiveness will further stunt domestic sector growth and further exacerbate its gap with the export sector.

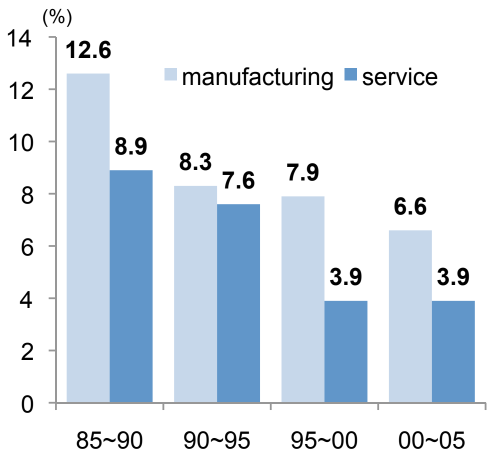
In addition, export-led growth has relatively impaired the development of SMEs (small and medium enterprises) by fostering large conglomerates that focus on manufacturing exports.

Services as Share of GDP in OECD Countries



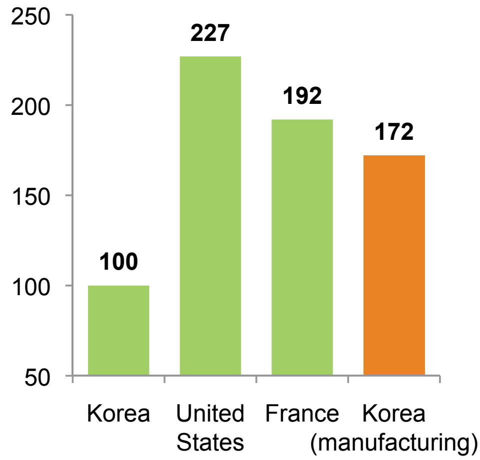
Source: OECD.

Manufacturing/Service Industry Growth



Source: Bank of Korea.

Service Industry Productivity (2006)



Source: OECD.

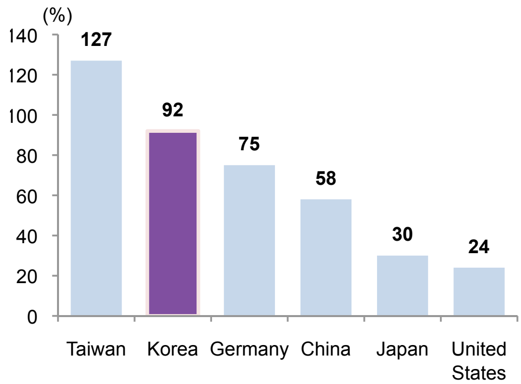
Based on 2002 figures of countries' labor productivity of SMEs versus large companies, Korea's figure of just 34.5% shows a major gap compared to the U.S. figure of 58.3%, the Japanese figure of 53.2%, the German figure of 63.1%, and the Italian figure of 65.1%.[1] SMEs are less productive and less capable of paying wages, which acts as an obstacle to hiring highly skilled labor or professionals, which can reinforce a vicious circle of declining productivity. As Korea's industrial structure gradually moves towards IT and other industries that are poor at job creation, if large companies' share of employment falls, we would see further polarization between workers at large enterprises and workers at SMEs.

Above all, the persistence of an export-led growth model deepens Korea's external reliance and makes it quite vulnerable to external shocks. Korea's trade/GDP ratio of 70% as of 2007 was far higher than the United States' 23%, Japan's 31%, or France's 45%. As a result, when external demand contracted rapidly during the recent global financial crisis, Korea's economic growth plunged even though Korea's financial industry did not take a direct blow.

Shifting from an export-led to domestic-led economic structure will not only be a challenge, but, given Korea's limited domestic market, in all likelihood is not so desirable. Therefore, exports may be emphasized going forward as well, but only alongside policies to strengthen the domestic market. Considering that China, Korea's top export market, should grow for a considerable period ahead, the chances are good that Korea will continue to become more reliant on it. Yet while China's growth does benefit Korea, its negative potential impact may as

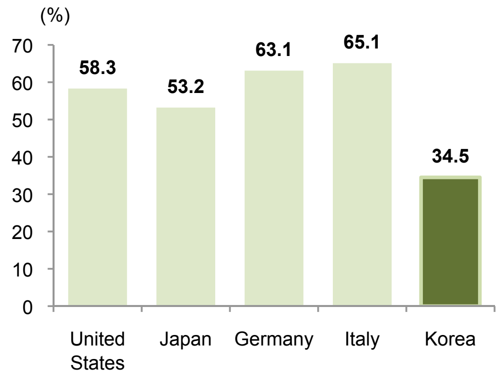
1 KDI, "Korea's Economic Development Path after the Global Financial Crisis" (2009).

External Dependence by Country (2008 basis)



Source: Korea Development Institute.

Levels Labor Productivity of SMEs vs. Large Companies



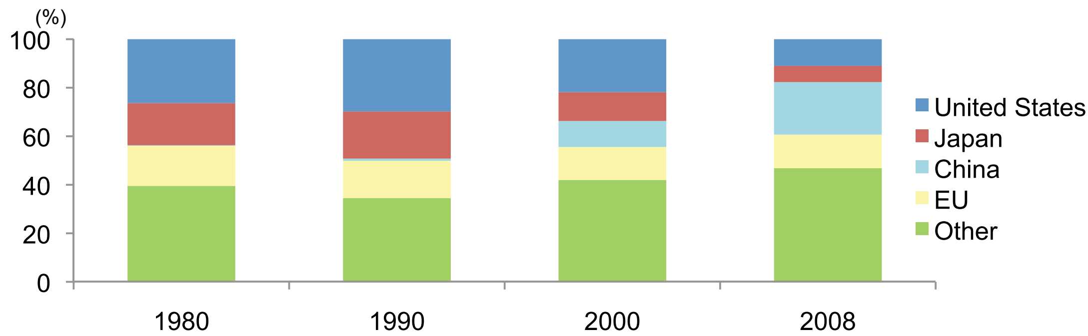
Source: Korea Development Institute.

well. Specifically, if Korea's growth is largely determined by how China is doing, this inflates the risk that the considerable vulnerabilities that are still present in the Chinese economy could be readily transferred to Korea.

Korea is also not taking sufficient steps against future risk factors such as the low birthrate, aging population, and climate. Korea's current birthrate of 1.2 is the lowest in the world, while the rate of aging is much faster than in other advanced economies. An aging society where 14% of the population will be over 65 is anticipated by 2018, and an aged society is expected by 2026, in which 20% of the population is over 65. As a result, the 65-and-older demographic will rise from 13% of the economically active population in 2005 to 22% by 2020 and 72% by 2050. In advanced economies, this ratio was higher than Korea's in 2005 and 2020 at 23% and 29%, respectively, but this gradually shifts, with the 2050 figure of 45%, well below that of Korea. This rapid aging suggests that Korea's economic dynamism in terms of manpower will gradually fall off faster than in advanced economies. As the elderly dependence ratio rises and the savings capacity falls, the Korean economy's ability to accumulate capital could be eroded. The aging demographic is thus expected to bring about structural changes, such as a drop in the economically active population and shifts in housing demand.

Along with this, the polarization of the economic system brought about by further growth and internationalization is an area worthy of attention. As the fruits of economic growth become allocated unevenly, this will make divides among households and companies more distinct. After the 1997 currency crisis, Korea's employment programs were altered to weaken the concept of lifetime employment, expanding the gap between contract and regular employees, and, in turn,

Korean Exports by Country



Source: The Korea International Trade Association.

the income gap between households, intensifying income inequality. Further, as mentioned above, the long-pursued export-led growth model helped widen the differences between exporters and domestic-focused companies, as well as the wage gaps between such companies' workers. This means that the gap has widened between export-focused large enterprises and SMEs focused on the domestic market. This polarization has coincided with the poor employment conditions and fall in jobs for the youth since the currency crisis, to bring about an erosion of the middle class and compromised social stability.

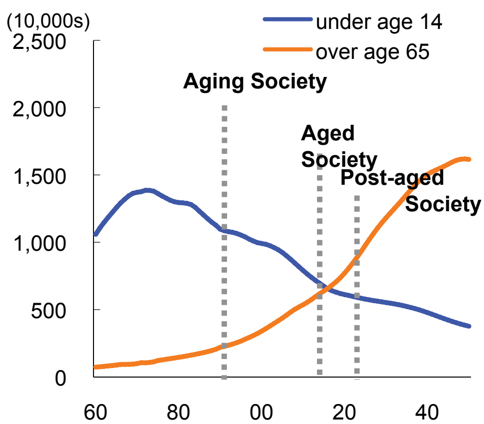
Beyond this, energy-use regulations are expected to tighten from climate change amid the intensifying global rush to secure resources, which is highly likely to pose an obstacle for the Korean economy. Korea lacks natural resources and is heavily reliant on energy imports, but its industrial structure is quite energy-intensive. This makes Korea highly vulnerable to an energy crisis, so making the economy more energy-efficient will be imperative going forward.

The changes in the world economic environment following the global financial crisis will also affect Korea greatly. Most countries saw a fall-off in their potential growth rates as they went through the crisis. The economic slowdown from the crisis was a more severe and longer-lasting shock than a typical slowdown, and also harmed growth potential, making countries unable to get back to pre-crisis levels.[2]

Considering the massive damage incurred by the United States and other advanced

2 Cerra and Saxana (2007).

Future Aging Patterns



Pace of Aging by Country (year)

Country	Aging →Aged (7%→14%)	Aged → Post-aged (14%→20%)
Korea	**18 (2018)**	**8 (2026)**
Japan	24 (1994)	12 (2006)
U.S.	73 (2015)	21 (2036)
Germany	40 (1972)	37 (2009)
France	115 (1981)	39 (2018)

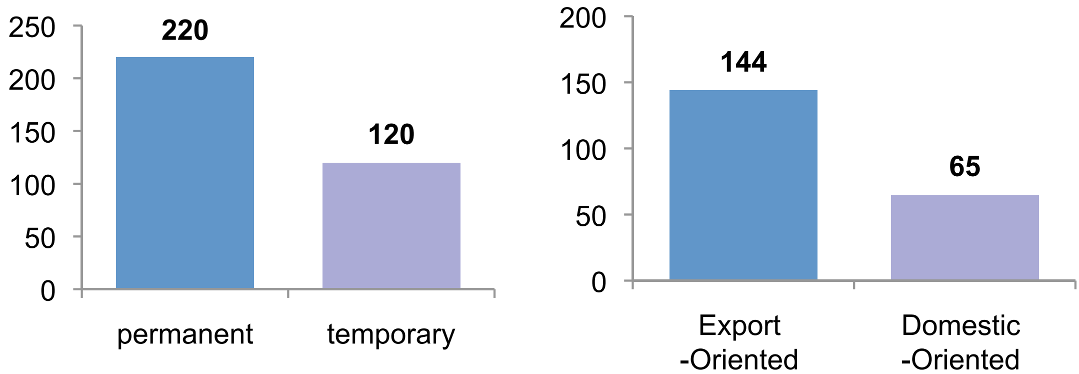
Source: Statistics Korea.

economies from the recent crisis, such economies' growth potential underwent a relatively major hit. Also, as they bring down the household sector's excessive liabilities, which was a core cause of the crisis, such economies' household sectors will be shifting from deficit to surplus, which means that there will be limits as to how much the United States can act as the world's consumer. This could hamper growth momentum in an export-dependent country such as Korea. Korea has been diversifying its export market, with China now Korea's biggest customer, but without demand from the United States and other advanced economies, Korea's export-dependent model will place major limitations on growth.

The high probability of a fundamental shift in international capital flows is also a noticeable change. With advanced economies expected to need a great deal of time to truly get back on track, their post-crisis policy measures to tackle stubborn employment conditions and raise productivity will be quite limited. With fiscal deficits reaching their ceilings, fiscal policy is no longer much of an option, while policy rates are already near zero levels. Owing to such limitations, governments in advanced economies have been relying on quantitative easing and currency revaluations to boost exports. However, with these QE policies, advanced economies' private sectors are, unlike in the past, stockpiling surplus capital, which should lead to a lasting abundance of global liquidity. As a result, global liquidity is highly likely to continue to flow into emerging-market treasury bonds in search of appropriate yields as well as stability.

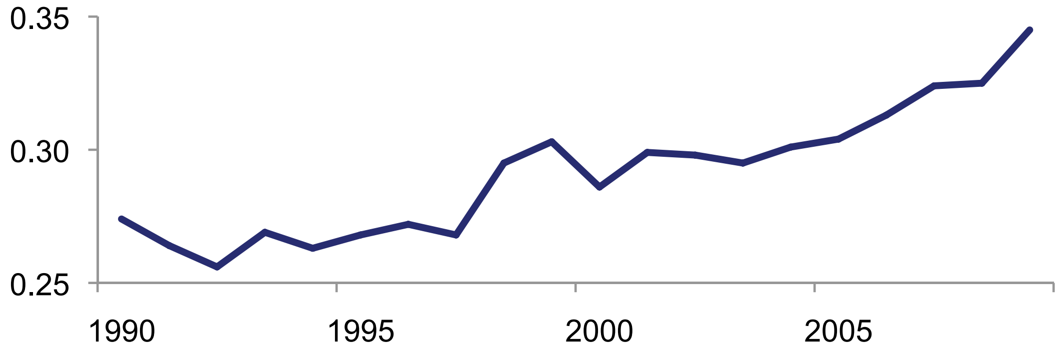
If capital continues to flow into emerging markets, this will increase the upward pressure on

Comparison of Regular/Non-Regular Employees and Exporters/ Domestic-Oriented Firms



*wages (10,000 won, 2009.8) * added value per employee (manufacturing, million won, 2008)

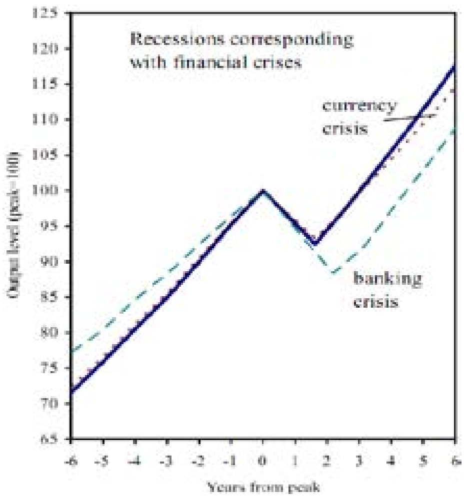
Gini Coefficient



Source: Statistics Korea.

Pre-/Post-Crisis GDP Trends

<World Bank Data Findings>



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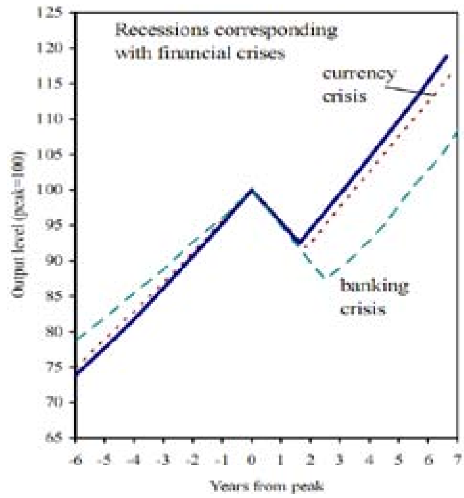
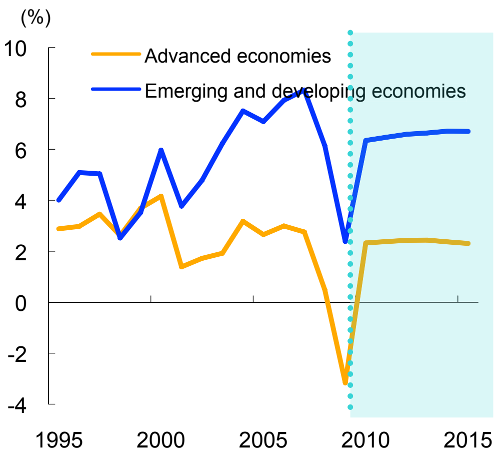


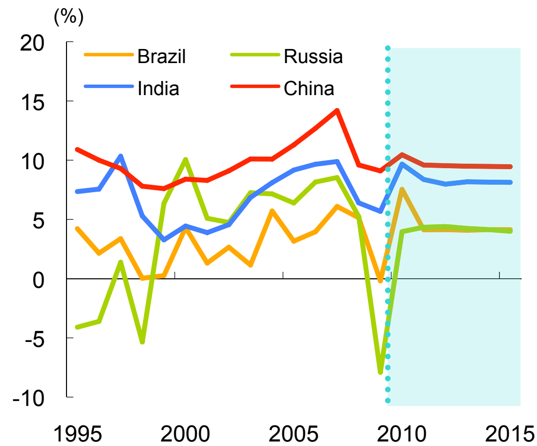
Source: Cerra and Saxena (2007).

their currencies and work to lower market rates. This will make it very hard to conduct economic policy in emerging markets that are heavily dependent on exports and that are sensitive to foreign exchange conditions. If countries freeze or lower policy rates to defend their currencies, plummeting market rates will increase upward pressure on goods' prices and raise the chances of an asset bubble. Conversely, if policy rates are raised to pull market rates upward or relieve pressure on prices, this will attract liquidity inflows and risk accelerating the appreciation of their currencies. As the United States experienced in the early and mid 2000s, large inflows of foreign currency create the conundrum of falling long-term rates, even with policy rate hikes, which can dramatically limit the effectiveness of monetary policy. Care must be taken that the shift in international capital flows after the global crisis does not transfer advanced economies' risks to emerging markets, both by impairing the effectiveness of emerging markets' monetary policies and by making their policy choices more difficult.

More fundamentally, the fact that the dynamics of the global economy could be changing is a variable that must be taken into account. Following the global financial crisis, the G-20 has emerged to replace the G-7 as the leading forum for discussions on the global economy, and emerging markets such as China and India have won greater roles at the IMF and other international financial organizations. According to a 2009 report by the Carnegie Foundation, China will overtake the United States in 2032 as the world's biggest economic power, and by 2050, will have 120% of the United States' productive capacity. Further, the drivers of the global economy will expand from the G-7 countries to the four BRICs countries and Mexico, which are expected to account for 60% of global growth over the next 40 years. As a result, the global economic system will see power move away from American hegemony and gradually towards

Growth Forecasts

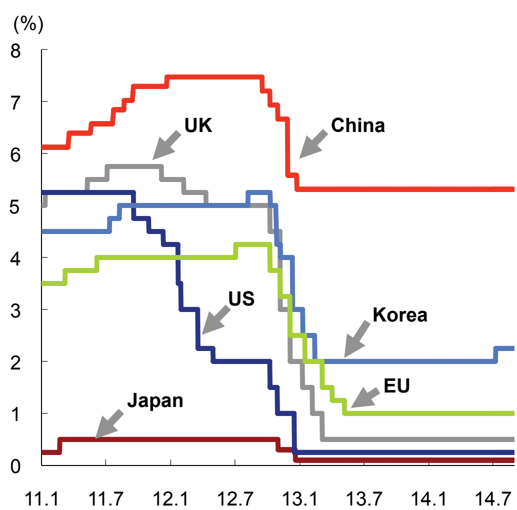


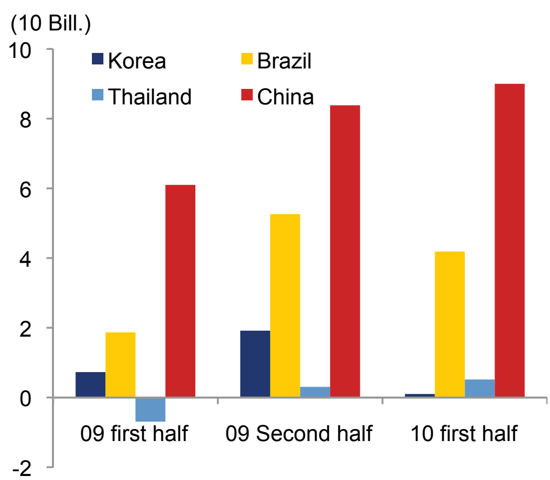


Source: IMF.

Policy Rates by Country

Emerging Market Capital Inflows





Source: Bank of Korea, Bloomberg.

Source: Bank of Korea, Bloomberg.

emerging-market and resource-rich countries, making for more of a multipolar system. With the rise of China, the future structural dynamics of the global economy are also expected to shift to a G-2 system led by the United States and China. Along with this, the possibility cannot be eliminated that, with the United States—the epicenter of the latest crisis—continuing monetary easing policies, confidence in the dollar may weaken and produce a shift in the key currency structure over the long run. In the near-term, the dollar will not lose its status as the key currency, but as SDRs, the euro, and the RMB gradually gain prominence, this could weaken the dollar's position and lead to a system of multiple key currencies.

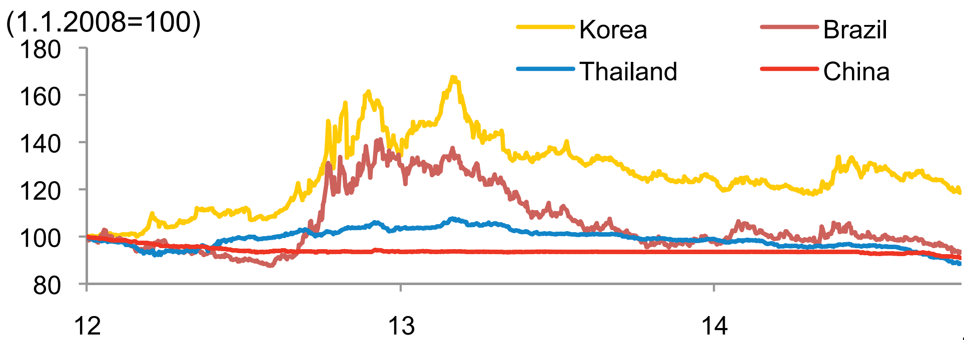
Beyond this, as competition for resources and energy intensifies, Korea and other emerging-market countries must consider the importance of adjusting to a low-carbon, green model as the driver of national economic growth. Resource productivity will be pivotal going forward, and those countries that rapidly take on the low-carbon, environmentally friendly paradigm will emerge as the victors. The IEA is projecting that investment in R&D, supply, and equipment manufacture related to renewable energy technologies will total $299 trillion by 2050. In light of this, the energy market based on new technologies such as hydrogen fuel cells or solar power is highly likely to emerge as a giant industry, surpassing the IT industry.

As such, the domestic and external conditions facing the Korean economy present both reasons for optimism and challenges that will have to be met. Changes in external conditions are quite likely to serve as an opportunity for Korea as it moves from an emerging to an advanced economy. With the recovery of advanced economies from the global financial crisis lagging behind that of emerging economies, global companies are putting off investment and innovation. Korean companies in the process of globalizing in areas such as IT and automobiles can use this as a chance to be able to emerge as global winners by raising their competitiveness through investment and by expanding market share. Further, with Korea now searching for new growth industries, the shift to a low-carbon, environmentally friendly economy should mean creating new markets and new demand. Currently, the Korean economy holds competitiveness in semiconductors, the IT industry, and the like. If these technologies are retooled for the green industry in a way that achieves synergy, Korea will be able to secure global competitiveness in the green industry. Green-industry growth involves switching from the current high-cost, high energy-input structure to a low-cost, low energy-use structure, so we can expect this shift to also boost the efficiency of the domestic market.

Also, the movement of the global economy to a multipolar framework will serve as an opportunity for the Korean economy by allowing Korea to play a bigger role in the international community. Using its economic might to boost its role in international organizations, Korea can move towards a role of policy setter rather than receiver in shaping the global economic order. Furthermore, in the long run, the growth of East Asia, which it appears will become a critical center of the global economy, should also serve as an opportunity for Korea. As economic consolidation accelerates in the region, this can be expected to help shore up Korea's weak domestic demand base, while Korea should be able to obtain greater economic stability through the building of a regional financial safety net and framework for financial cooperation to prevent the spread of global financial crises to regional and domestic financial markets.

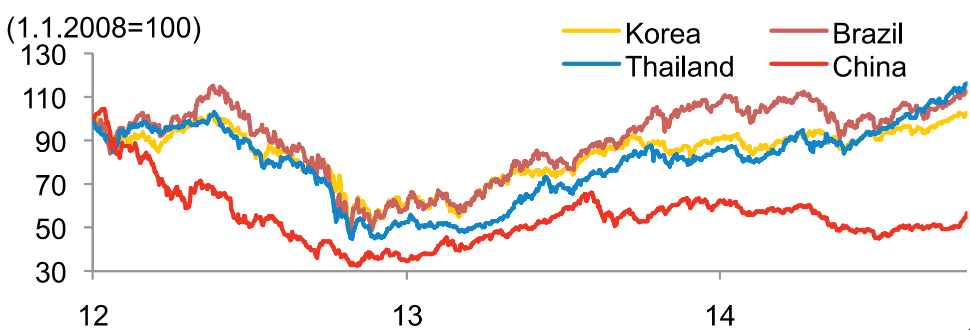
In spite of these positive effects, as Korea becomes more and more dependent on China, this will raise its vulnerability to the external sector. The deepening reliance on China raises the likelihood that instability in the Chinese economy will spread to Korea. China is now maintaining

Emerging Market Exchange Rates vs. U.S. Dollar



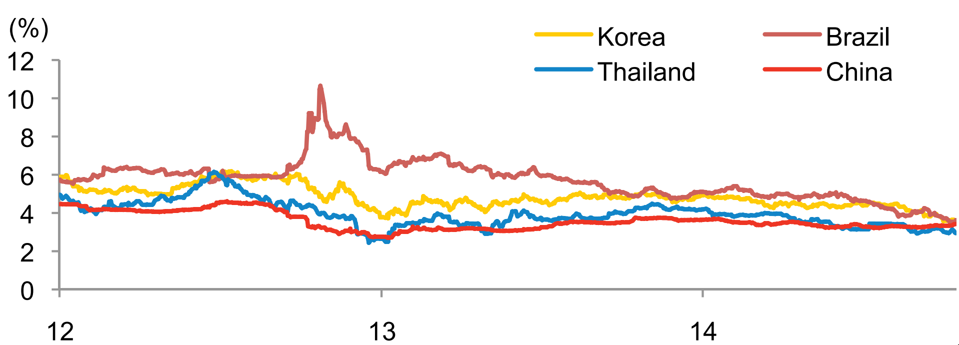
Source: Bank of Korea, Bloomberg.

Stock Prices in Emerging Markets



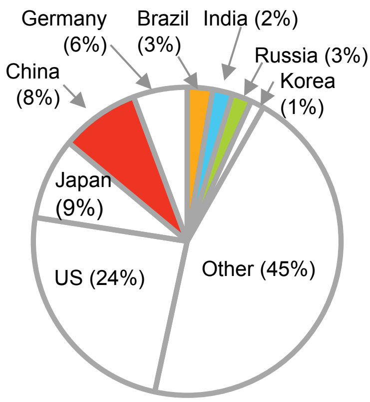
Source: Bank of Korea, Bloomberg.

Long-Term Bond Yields in Emerging Markets

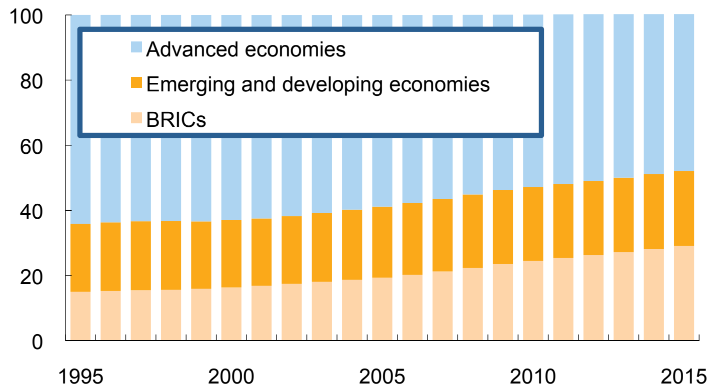


Source: Bank of Korea, Bloomberg.

Global GDP Share by Country



Source: IMF.



Source: IMF.

high growth levels, but its socioeconomic structure presents many uncertainties, so if the potential risk from changes in circumstances comes to bear, the shock will be transferred to Korea as well. In such a case, Korea's real sector could rapidly contract from a plunge in exports to China. As such, Korea must adjust to changes in external conditions to join the ranks of the advanced economies, while also enhancing its ability to absorb external shocks by bolstering its domestic demand base and diversifying its export markets.

As mentioned above, Korea will also have to resolve a lot of domestic tasks in order to achieve sustained, stable growth. First, it will have to address the vulnerabilities in its financial system brought to light during the global financial crisis. It must enhance financial supervisory functions to be able to evaluate and manage financial risks preemptively, while the government, the Bank of Korea, and supervisory bodies will need to build an intimate cooperative framework. Along with this, the Korean financial industry must continue to move forward with globalization. With its heavy external dependence, Korea will find it very hard to escape from having both its domestic financial markets and its real sector affected by changing conditions in international financial markets without the globalization of the financial industry. And as investment in future growth drivers centered on the green industry is increased, the structure of the future Korean economy will have to switch to low-carbon, green growth and focus on developing core technologies related to renewable energy. As stated above, Korea must leverage its technological prowess in the IT and semiconductor industries for use in green technologies to foster linkages between companies and industries and to obtain global competitiveness in such areas as efficient energy technologies.

Korea must also endeavor to escape from its long-held export-led growth policies and move towards balanced growth between export- and domestic-oriented industries. Creating a virtuous circle of enhancing the competitiveness of manufacturing exports and service industries must be done through cultivating service industries that serve as an intermediate role for the manufacturing industry. Developing services not only bolsters the domestic market and helps boost employment, it can also be expected to help relieve pressure on chronic balance-of-payments deficits. Narrowing the divide between large companies and SMEs is also a task that must be taken on. Korea must put in place the foundation for SMEs to be able to grow into large companies by supporting new ventures or SMEs still in their growth/expansion phase and by supporting overseas investment by those SMEs already possessing global competitiveness. Improving the labor market by enhancing its flexibility and establishing sound labor relations is another issue that must be tackled. Moreover, greater labor flexibility will be of help in addressing the youth unemployment problem.

Labor Regulations and Employment Rates of Major Economies

	U.S.	UK	Japan	Germany	France	Korea
IMD Labor Regulations Index	6.3	5.1	5.8	3.1	3.2	2.1
Employment Rate (%)	70.9	72.7	70.7	70.2	64.6	63.8

Source: Statistics Korea, IMD.

Since Korea's growth momentum will be severely impeded in the long run if it does not take steps regarding its low birthrate and aging population, these problems require preemptive responses. Korea's stockpile of human capital will be seriously hampered if low birthrates become entrenched, so it must improve structural problems that span the entire society, such as offering more incentives for having children and tackling discrimination against women in the work culture. An aging population is an unavoidable phenomenon that all advanced economies are going through. It requires parallel development of services such as medical care and nursing, and it also will require a more flexible labor market to facilitate the absorption of all levels of labor.

As can be seen, Korea has a number of tasks it must address in order to sustain stable growth and truly join the ranks of the advanced economies. If such tasks are approached with short-term stopgap measures rather than fundamental solutions, growth may be maintained temporarily on the back of the global economy, but eventually, a low-growth, low-employment structure will become established, and as social polarization worsens, this could easily erode social stability. Further, if Korea sticks resolutely to an export-led model, it will become increasingly vulnerable to external shocks, with external risks spreading to Korea and impeding stable growth. This would mean Korea would not be able to get out of a Nutcracker situation, in which it is unable to truly become an advanced economy, yet is being passed by less-developed markets. This is why it is now an especially critical time to think deeply about how to resolve the tasks now facing the Korean economy.

State of the World Economy, 2011-2012:

Whither or Wither?

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On November 18, 2010, the U.S.-Korea Institute at SAIS and the Korea Institute of Finance, sponsored by the Asian Studies Program at SAIS and the *JoongAng Ilbo*, hosted the one-day conference, "State of the World Economy, 2011-2012: Whither or Wither?" at the Paul H. Nitze School of Advanced International Studies (SAIS) in Washington, D.C.

This volume contains the speeches and papers that were presented that day and subsequently further refined by the authors to reflect discussions during the conference.

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