

THE BROOKINGS INSTITUTION
CENTER FOR NORTHEAST ASIAN POLICY STUDIES

THE SOUTH KOREAN ECONOMY
UNDER A NEW GOVERNMENT:
CHALLENGES AND PROSPECTS

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The Brookings Institution
September 19, 2013
Washington, DC

[Transcript prepared from an audio recording]

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PROCEEDINGS

RICHARD BUSH: Ladies and gentlemen, I'm Richard Bush. I'm the director of the Center for Northeast Asian Policy Studies and I think we should get started.

Thank you all for coming. This is the first public CNAPS event in the new program year, and we're pleased to focus on the Korean economy under the new Park Geun-hye government, and it's a particular pleasure to welcome Dr. Choi Byung-il to Brookings. He's the president of the Korean Economic Research Institution. I think you've seen his bio, so there's no need for me to repeat it but he is a highly respected economist in Korea and so we couldn't ask anybody who is better qualified to talk about this topic.

I need to thank our good friend Richard Chin for making this possible. He and Dr. Choi are good and old friends. So without further ado, Dr. Choi, please.

BYUNG-IL CHOI: Good afternoon. I am very privileged and honored to be here on this weather-perfect day. And thank you, Dr. Bush, for inviting me to Brookings. I think I've been to Brookings several times but mainly as an audience, listening to what other people have to say. But today I will give some of my own assessment perspective about the current status of the Korean economy and where it's heading. So I have the title "The Korean Economy under a New Government: Challenges and Prospects."

I plan to spend very much limited time for my talking because I'm interested in engaging with you what questions you may have.

I will start with the following question: last year there was a time of judgment for Korean citizens because Korean people were given two chances of expressing their political opinion. Last April there was the General Assembly selecting about 300 lawmakers, and last December there was a presidential election under which Korean people selected a one-term president; the term will last the next five years. So that is a quite unprecedented coincidence of timing where Korean people have two main elections in one single year.

And very remarkably, whether the people were coming from the ruling party or opposition party, ordinary citizens, they couldn't find any major difference in terms of platform. So all the people, they were promising more welfare, more free welfare. And most candidates promised more distribution, but they (inaudible) slow in the start, so-called "economic democratization." So those two were the main campaign platforms in the General Assembly and presidential elections.

And also, remarkably, when you consider all previous presidential elections, every candidate from major political party, they are promising some sort of

numbers. For instance, during my time, if I'm going to be elected, I promise I will elevate the status of Korea to a G7, for instance, and I promise like in 40,000 USD per income by the end of my term. Those sorts of things. And to make it possible, I promise 7 percent (inaudible). But this time, all the major candidates, they were silent on numbers. Instead, they were promising free welfare and economic democratizations.

So why was that happening? How can we understand? What is going on in the Korean economy? So my assessment is there is a growing concern among policymakers and opinion leaders, and also average citizens, the conventional Korean economic model, which has been leading Korean for the past six decades, is coming to an end. Why is it coming to an end? I think that's the question. So is it the end of the road for conventional Korean economic model? So that's the beginning of my talk.

Well, it doesn't require too much explanation. The past six decades of Korean economic development cannot be explained without using words like miracle. That's not my expression but what global citizens are saying, miracle. We are from a war-torn country and we had to dig up the ground to ask for something. And we (inaudible) becoming a major economy, having all this petrochemical, shipbuilding, automobiles, and so on. And also world-class IT sectors. And then overcoming the 1997 financial crisis and was very effectively dealing with the 2008 global financial crisis and becoming a member of the G20. So Korea's place in the world is unmistakable. Korea has become a G15 in terms of economic status and G7 (inaudible). So obviously, trade has been leading Korea up to this far.

And in terms of ordinary citizens' living standards, when you see the right hand side measuring by prosperity, Korean citizens' living standard is comparable to Japan and France. So by any measure Korea is now at the very early stage of an advanced economy.

But it looks like people are not quite happy about this and there are many second thoughts about the continuing possibility of registering impressive growth year after year from now on. But I think this is not just the emotional reflection because major research organizations, including mine, KERI, we are projecting the year of low economic growth is here to stay. But this is what is happening in Korea the past 12 and 13 years. You see the economic growth rate has been declining and if you show this data to major economists, they will tell you it's not a surprise because there is a low gravity economic development, something like in the early days when countries are so poor that you can simply, by working long hours and working hard, investing a bit more, we can improve destiny. And that will come to an end like diminishing scales.

So unlike other countries where that diminishing point has come early, the Korean case was rather different. The moment of truth is just coming late but no surprise here. But the important thing is why the past six decades of Korean economic growth has been so much in a condensed economic growth. Now, our downhill is going to be very much condensed. So that's quite worrisome.

According to OECD projections and IMF projections, Korea's economic growth potential will have a very slippery slope, starting to have annual 3 percent and then becoming 2 percent toward the year 2036, 2034. Now the annual economic growth rate is something between 0 to 1 percent. So you can see the speed of decline is much faster. So this is a mirror image. The speed of Korea's rising was so fast, then another mirror image reflection is Korea's slide is going to be too fast. But that is a major concern.

To make matters worse, Korea is going to be a very, very aging society, and speed of aging is rapid. You can see here around the year 2020, the total number of productive aging population measured between 15 years to 64 years, they are going to reach the peak, and from that minute on they will be steadily declining. And also, that solid line is telling you the aging ratio. So that means around the year 2030, around 25 percent of people, like one out of four in the street, will be at least 65 years old. This speed is the fastest in the world. Before Korea it was Japan. Japan took 36 years from aging to super aging society. Aging society means the time where more than 7 percent are becoming 65 years old, and aging society means for 10 percent, and super at 20 percent. So the case of Korea, Korea becoming an aging society in 2000, and then within five years from now an aging society, and under the biggest end user assumption, Korea will become a super age society in the year 2026. So the time between Korea's entry to aging society to super age society, 26 years. Japan was 36 years.

How remarkable that is, we can see the case of France. France is taking one and a half centuries to experience that sort of transition. Suppose we were given one and a half centuries. We're talking five generations. So during five generations you have this change. Then people in their generation, they're not going to realize are we going to lose dynamism or not? And also, people, they can have some sort of preparations in anticipation. But speed is so rapid and I don't think this is consolation, but China is also following Korea in terms of a very rapidly aging society. So it looks like Korea and China are competing in this very gloomy race. And the implication is far-reaching.

Another thing is there is a wider spread concern in Korean society, so-called dissatisfaction with widening disparity, but Korean people, we call it bipolarization. Bipolarization means you have two (inaudible) -- very rich people and very poor people. They are taking the lion's share of society. And how severe is that problem? Well, if there is an accountant in this room, they will tell me the Gini coefficient is a very insufficient measure to measure income disparity but we do not have a very effective measure so I'm going to use Gini coefficient and also income ratio. The solid line is indicating the evolution of the Gini coefficient in the past 11 years, so that number has increased from 0.26 to 0.29, and there has been some steady increase, and at that time, between the year 2002 and 2007, that was experiencing very speedy deterioration of income distribution. Somehow, that coincided with the timing of Korea as a most radical left-leaning government speaking for more distribution. So the government asking for and promising for and actually implemented the most fundamental, drastic redistribution, but what happened was very much the opposite.

The previous government, Lee Myung-bak government, he became president under the mandate of "I'll rescue the Korean economy." But to the minds of older people, they are complaining because they (inaudible) in terms of distribution, didn't radically improve. For their consolation, it didn't get even worse but I don't think that's consolation. So at the time of national elections and presidential elections, people are asking for more distribution equality.

Another ratio I think is much more important. Debt ratio to income is measuring how much income is having, the top 20 percent of people measured by the bottom 20 percent of people. That is measured by a less solid line and then you see within the time duration of 12 years, the debt ratio was increased from 0.4 to almost to 5. So in Korean society this has become a very, very serious concern.

Another concern of bipolarization is increasing discrepancy between big business and small business, big companies versus small and medium-size enterprises. So while productivity of large corporations has been increased but the debt of small and medium enterprise is steadily declining, thereby the wage rate is just a mirror image of debt. And this is just explaining what I'm saying.

So because of all this happening, there is a growing concern in South Korea right now, is South Korea becoming the next Japan in a bad sense? Japan underwent lost decades, two lost decades. They lost two decades. Something similar is happening in South Korea, so there was a growing concern. And the economic commentators, they are ready to indicate their remarkable resemblance between in South Korea right now, number one, housing price. Because Japan's "Lost Decade" started with the real estate bubble was a bust. And so that red solid line was showing what had happened in Japan. And Korea was having asset price increase up to this far, but this day the Korean real estate market is in such a doldrums and most people are expecting decline. But the question is are we going to hard landing or soft landing? In case we have hard landing, then (inaudible).

In other similarities, the very productive people -- and don't mistake me. This is not my work. Very productive people -- don't blame me -- aged between 35 to 54 are considered a very productive population. And in the case of Japan, there was a very steady declining once they reached the peak around the year 1980, 1984, something. And something similar is projected to happen in South Korea. And also, by implication, total labor supply and total working hours in Korea are going to have a very steady decline. This is following the footsteps of Japan. So there is a growing concern Korea might become another victim to deflation, caused by asset deflation.

I think all this was indicating and telling to political hopefuls to say something more on distribution, but not much on economic growth, which is considered a favor to big business or exporting companies and wealthy people. And Korean president, Park Geun-hye, who became elected as president, she promised among other things (inaudible) five major (inaudible). I don't think there is some priority in this but she talked

about economic democratizations and also she was promising to promote creative economy. Now, there was two target numbers – she promised by the end of her term 70 percent employment rate and also the middle class is going to restore to 70 percent. And she promised much more free welfare.

But I think the Korean President Park, she's talking about economizations. We need to understand what she's meaning in proper context. So in 2009, she came to Stanford to give a speech and she came up with the words "disciplined capitalism." When you consider the year 2009, that was in the wake of 2008 global financial crisis, so there was very much a reflection on lax financial regulation, and so she was thinking that there must be some proper role of government. And so instead of deregulation, and instead of regulatory reform, she was very stubborn in strengthening and regulating financial sectors, including the form of prudential regulations. And also, she tended to believe we need to protect very much economically-weakened, vulnerable people, and she mentioned the importance of communicants. And also, she mentioned very severely the importance of corporate ethic.

I think this is why she's meaning disciplined capitals. So this idea was being formulated in the Korean context so that she came up with the idea of economic democratization. And two 70 percent target numbers, and I'll give some glimpse of how uphill road she needs to climb because right now the employment rate in South Korea is about 64 percent. So she is promising within five years she is going to increase to 70 percent. It is a very daunting challenge because in the meantime, population growth, even though very slow, but it will be still continuing. And more and more people in the job market, but the economy is less performing. So there will be more discrepancy and she needs to close the gap. The current percent of middle class is about 64 percent, so these two measures by no means are an easy task.

To make this happen it looks like she is very keen on the idea of paradigm change, paradigm shift. And this paradigm change and paradigm shift, she came up with like a creative economy, but no one knows the exact meaning of creative economy, including myself. We continue to discuss. But motivation is very simple because early days, as I mentioned to you, you can improve. You can invest by working long hours, by investing more and saving, saving. But those early days, 1960, 1970, and there was something done by -- practiced by very early stages of emerging economy. But Korea is now into the stage of the more capital accumulation, more investment, more efficiency in product and process is driving and creating more value-added.

But I think that is also coming to an end because inside Korea we have a very depressed economy and most big businesses are making an investment not in Korea but outside of Korea because of high growth potential and less growth potential in domestic economy. So because of that the road is coming to an end as long as you're confined to efficiency-driven economy. So she is coming with the idea of creative economy and something similar in the context of innovation-driven economy. According to World Economy Forum, they have some sort of definition in the economy where

innovative activity is more than 30 percent. They call it innovation-driven economy. I think Korea is a bit falling short on that innovative economy. But how we can turn around the economy from input-driven and efficiency-driven to creative-innovation driven economy? We have a very, very tough challenge.

So if you ask me the prospect of GHnomics, Geun-hye-nomics I think there are three important components or three important litmus tests. Number one -- actually, number three. Will they have an economic reform? Because in Korea right now, we have some sectors. We have much room for improving efficiency. There is a public sector and quasi-public sector. But because of their interesting political economy, there is not seriousness of making reform in those sectors. And to have economic reform in those sectors you need to fight with the strong leg union and also you need to deal with government obstruction. But the one-time president, in five years, whether the president can be very serious about economic reform in those sectors, is something to be seen.

And second, are we going to have strong, small but effective government? In Korea, ever since the 1997 financial crisis, we have had an endless debate, desirable relations between government and market, and one persons are saying the role of government should be just rule-setting and referee and enforcing rules and then just keep away from the market. We all (inaudible). Other people are saying, look, the market is not perfect and prone to make mistakes, failures. The government needs to intervene. And asking for a more active role of government, including welfare policies. But here, what I'm saying is not something between but in creating -- in making a creative economy -- in creating the frame of the creative economy, whether or not government can self-appoint itself a very proper role of creating proper framework and then leave most things to (inaudible) entrepreneurship. That's one way.

Last but not least, things really got to leadership but by all measures, while she has demonstrated the past six or seven months whether she is at full grasp of economic issues, I don't think the president needs to have a full grasp of all this economic intelligence, but show some leadership when it matters, appointing key cabinet members and appointing key, you know, the President's persons and giving some proper clue and giving delegations, my grading is very disappointing. Even though the past six months' performance cannot be the final grade but I have certain worry.

So having this in mind, let me deal with some kind of very important under current Korean economy, under which the current president and also any next president should play the game. Well, this is a very interesting survey conducted by Joongang Daily, one of large economic daily in Korea. They had two questions. And we have two colors of response and two countries. One color for country A and another color, a red color for country B. The first question was the survey asked a question, a very simple question. Why are you running your company? And in a blue color country, about 65 percent of people responded I'm running my company to contribute to society, to contribute to the nation. But red colored country, over 60 percent of people are responding to make money. So one country is China, another country is Korea. Can you guess which

country is which? Blue is Korea.

SPEAKER: Blue is Korea.

DR. CHOI: Then, see, the next question. The next question asked people -- the same people -- what if somehow you passed away, what should happen to your accumulated wealth? Korean people responded, alarming at 78 percent of people, money should be paid back to society. China, 64 percent of people, none of your concern.

So the joke in Asia, it is puzzling why Koreans are having a market economy and why Chinese people start with Communist. (*Laughter*) And also, that is, you know, so easy to understand ever since Deng Xiaoping wide-open Chinese economy even though he is having (inaudible). So this is under current. And this is a survey conducted in the year 2006. And KERI, my organization, we are conducting a similar survey on an annual basis and this hasn't changed. This hasn't changed.

Another thing very much related to my context is what entrepreneurship in Korea has much, much to be promoting. There was an international organization studying entrepreneurship. According to the study, there is a very important positive correlation between measure of entrepreneurship GDI and economic fortune per capita personal income. And that correlation according to them is up to 82.5 percent. So that red line is showing correlation. If you have higher entrepreneurship, you are having more high personal income. And Korea is located outside of that curve. The implication is with the same personal income, Korea's entrepreneurship is falling short compared to other countries. That discrepancy, how can you explain? That is, Korea is good at (inaudible) something, like improving efficiencies and so on.

So according to the study, there were seven groups of countries measured by GDI. The countries located to the right hand side -- USA, Denmark, Sweden, and Australia, they are so-called grade A countries when it comes to entrepreneurship and Canada and Germany is maybe A minus. So in that measure, Korea's entrepreneurship is given a C, something comparable to China, Malaysia, where most Koreans don't want to associate with when it comes to entrepreneurship.

So you have a very strong anti-corporate sentiment on the one hand and lack of entrepreneurship for various reasons, and then how can you imagine to create a creative economy? I think that is not an easy task. And also, this government is telling the people Korea is too much dependent on trade and there is difficulty of improving further on the trade front because emerging countries are rapidly closing the gap and advanced country including (inaudible), they're showing all the measure of protectionism. So Korea is being squeezed. Not much room to improve on the trade front. And because of that, these people are saying that we need to boost domestic demand. But domestic demand has been sluggish during the past decade, so how can you do it?

And also, too much reliance on trade. I have second thoughts. I don't

really agree with those people saying that Korea is too much dependent on trade because when you see there is another country that has a much higher trade dependence, and also, this is my analysis, when you can see Korea as the power in manufacturing base, then there's much room to improve Korea because there is a location of Korea and trend line.

And also, there is growing concern, as I mentioned, that the Korean economy is failing to create more jobs. That's true. Korea is becoming the nation with heavy chemical industry and IT industry and where the local demand has been very sluggish, you don't have much effective growth potential, then Korean big business, without having global orientation, they don't have effective green room for creating value.

So in the case of Hyundai Motors, in the past five years, the global market share has been steadily increasing but inside Korea there has been anything (inaudible). And that is very telling. In the case of Samsung Electronics, most of the investment, new investment is made outside Korea. And as of now, as I'm speaking, capital outflow out of Korea and inflow into Korea, outflow is much more important by ratio of four to one or five to one, but that trend was not the case until the year 2002, 2003. So this is very recent. It's not simply because of political uncertainty but economic fundamentals are driving major Korean companies, pushing towards foreign companies for a new source of making profit.

And also, bipolarization, we have very inconvenient truth because, as I mentioned earlier, there was a growing concern among Koreans' income distribution is something wrong. But if you have an international perspective, I will show you the two diagrams. This is in Asian countries. So there are two time periods between those two -- 1995 and the year 2011. So these countries are showing very remarkable economy growth and somehow, you know, the term Gini coefficient, there is deterioration but when you compare with any of those countries you cannot blame South Korea. And also, if you are going to compare with typical OECD countries, Korea is doing quite well. So, for instance, after you pay tax, disposable income, Korea's Gini coefficient in late 2000 0.315 and it's about OECD efforts. That's why Korean people are feeling that way, so it requires bad explanations going beyond economic loss.

So obviously, Korea, new president, new government. They are saying that we need to change our paradigm. So far, the (inaudible) has been that we are very good at following very fast. We are good at imitating foreign economies and we reverse engineer and make better, more effectively, with good designers. So, so-called fast following. And that effectiveness and sustainability is coming to a record end. We need to change to early innovators. This is a very, very difficult task. But if Korean business is not quite effective on this, then I think it all will come to an end (inaudible) going to finish.

And also, while Korea has a world-class manufacturing base but the situation of the service sector is very, very poor and backwards. And the service sector is representing about 70 percent of jobs but they are creating only 59 percent of value-added. So there is backwardness in service sectors for various reasons, including government

regulation, which is not promoting entrepreneurship but rather to rent-seeking behavior.

So what I'm advising and preaching to the president is we need to have an outward perspective, out-looking perspective that from Korea, if you have a two-hour flight time zone, about 300 million people, and wealthy people open their big wallet to spend more. The question is whether or not we have very effective tourism plus some effective industry so that foreigners come to Korea conveniently and finding Korea an interesting destination to come and shop and spend their money. And we need to have some kind of very impressive and draconian measures, so to speak. But I don't think that is going to easily happen.

And last but not least, as I mentioned, the conventional wisdom as Korea's global orientation is driving Korea up this far, but somehow it's become very difficult in recent times because WTO, which needs to create more free trade and free trade or fair trade based on rules, not effective (inaudible), so country after country, starting with the U.S. and EU, they are starting to have a bilateral kind of arrangement in the name of FTA. And somehow, some years ago, Korea's most radical left-leaning government – the Roh Moo-hyun government – had a vision of having the KORUS FTA. And so they thought ideally it's not going to make people to be fair effectively. So they came up with a vision of KORUS FTA. And because Korea was able to have KORUS FTA, they had political willingness to reform very much protected (inaudible). And that was leading to Korea's ambition to have FTAs with the EU and ASEAN and so on.

But again, on these matters, this is a very important legacy, not just conducted by previous government but the past two or three consecutive governments ranging from right to left- leaning ideology, but somehow current government looks like they are all of a sudden totally ignoring the past history when it comes to trade entrepreneurship. It's showing very much inward-looking trade. So I'm telling them, you know, tailor some race between tortoise and hares and so telling them in the end steady and slow wins the race. And I think, you know, without having this global orientation, as I mentioned, it is so difficult to have political reform when fighting with labor unions and difficulty of turning around service sectors so it looks like despite all that's said and done, trade is one, and perhaps the one and only way of improving Korea's destiny. But somehow that is a very rare commodity, and so in that reason I have an assessment that I have some feeling it is going to very, very -- as it turns out, today is Chuseok holiday, the biggest holiday in Korea, and we Koreans make a wish on full moon for good health, happiness, and prosperity. I think I will do something similar tonight with the full moon and for successful navigation of the Korean economy. On that note, I'm going to finish.

Thank you very much.

(Applause)

DR. BUSH: Thank you very much, Dr. Choi. That was a really great presentation. It was well organized. It was clear, well-illustrated, data-rich, but also sober

and balanced. So we want to thank you very much. I think we all learned a lot.

We will open it up to questions now. I'll field the questions. When you -- when I call on you, if necessary, identify yourself, where you're from, and wait for the mic. And we'll go from there.

So Mike Billington first, right up here.

QUESTIONS: Hi, thanks a lot. Mike Billington. I'm with the Executive Intelligence Review. Two issues. Both on investments outside of Korea but I think reflecting the internal economy.

One is the whole nuclear industry. Korea has taken a great lead globally in becoming a nuclear exporter, but you're having some problems domestically with -- not as bad as Japan's, but perhaps undermining some of this nuclear development. I wonder if you could address that.

And secondly, some of your industries and your government are looking to working with the Russians and the Chinese and the Japanese potentially on the great frontier of the Russian Far East. I know they're working on rail development and other things with the Russians. And I think this is -- if we look at that as a new frontier for all of Asia, all the world really, then you have a perspective for how to have a new era of high-level growth rather than this kind of stagnating perspective that you have.

DR. CHOI: Thank you for the question. I think for the second question the answer is quite oblivious. I think the past Korean government, starting with Roh Tae-woo, they all have -- in a sense they have so-called Nordic politics, orientation toward Russia and Central Asia and so on. I think destiny is quite obvious but the thing is whether or not we have very effective, smooth diplomacy. For instance, Russia, especially with President Putin. I had a chance to meet with him last year, in September, in Vladivostok, and I have some feeling that even though Russia is standing for much more market economy, but what is being said and what is done, they have certain room for it to be improving. So for that reason Korean diplomacy and business peoples are having certain difficulty, and I have some old episode of Korean businesses making investments in Russia and some discrepancy between rulebook and practice and so on. So that is something. But again, I think Korean entrepreneurs can be very vigilant in that regard and my prospects are very much hopeful.

Regarding your first question, nuclear energy, I think there is a consensus in Korea and the opinion circles that it is very important, the blue ocean. And to make it very successful we need a very solid domestic base. As you mentioned, we have a very much interesting debate going on inside Korea. So whether or not it is very effective management of that issue and whether or not we can effectively create much more room in a foreign venue in something, we can expect.

DR. BUSH: Dr. Choi, I need to apologize to you and to Sean Connell. I was traveling last week in Asia and so I'm very jetlagged and half asleep or three-quarters asleep. So I should have called on Sean before we took questions. So please. And I apologize.

SEAN CONNELL: Well, thank you, Dr. Bush, and thank you, Dr. Choi, for a very interesting and I think very timely presentation. I'm Sean Connell, visiting Japan studies fellow with the East-West Center, but despite my Japan title, have been engaged on Korean economic issues for about the past decade. So it's a real pleasure to be with you all this afternoon at Brookings.

I apologize for interrupting the question-answer period, so I'll keep some of my thoughts and observations and Dr. Choi's comments brief because there's a lot of collective expertise in the room this afternoon and I'm very eager to hear your thoughts and observations as well.

Dr. Choi mentioned that for the term "creative economy" which is really been a catch phrase of the Park Geun-hye government that nobody really knows what it means. And back in the spring I had the chance to make a couple of visits to Seoul soon after the Park administration took office to get a sense to what the government's plans were, where this might be going, and that was pretty much the same consensus that I heard, too. Well, what does it mean? And really, the meaning seems to be evolving.

But those conversations stepped a little bit further back into some of the broader contextual issues that Dr. Choi spoke about and I think are probably more useful when looking at the broader question of innovation-driven growth, strategies, and the approach Korea is trying to do in this regard, which is something I've been looking at the last year both in the context of Korea and Japan.

Dr. Choi presented three questions about the prospects for GHnomics, bringing to mind the MBnomincs, which was very number-driven five years ago. And really to his first question of how strong and clear the president's leadership will be, I'll mention that just in initial observation that it is very encouraging I think that the Park government is pushing so strongly and very vocally the importance of this creative economy concept, you know, however you want to define it. And the underlying importance of needing to make this shift or more fully recognizing the shift has taken place of being a catch-up economy. Between an economy that is there and needs to more fully take advantage of its own innovative resources, research and development capabilities, intellectual capabilities, to pioneer new industries, services, and ideas.

This is a positive thing. It's a natural progression, and also a very challenging shift to make. And having this high level commitment I think is going to be very important for building broader public support around this goal which is going to take far longer than Park's own term in office and could require some pretty challenging, both politically and economically, measures in reforms down the road. And also many attitude

changes as well which I'll get to in a minute.

So I think one important question moving forward is also will the government continue to be clear? Will it become more clear in its messaging? Will it remain very strong in its commitment, though flexible to changing conditions both domestically and globally, in order to forge the needed consensus both within the government, with the broader private sector in business community, and with the Korean public in order to advance this agenda.

Stepping back again to not the term creative economy and whatever it may mean, but the broader context of what constitutes the innovation ecosystem of Korea than that of another country, there's broad consensus amongst OECD member countries in many research circles that successful policies require not just the traditional science and technology in research and development approaches, but really looking at everything involved in getting the fundamentals right. So this includes certainly research. Obviously, the education system, both K-12, postsecondary, and also workforce and vocational training.

Getting into both physical and regulatory infrastructure. So certainly the physical infrastructure, the information technology capabilities which were having a huge impact on productivity, as well as the regulatory environment in which business is taking place. And then policies ranging from labor mobility, taxes, trade and investment openness, intellectual property standards, and also the general business environment, which is a key thing, especially for startups and small and medium enterprises.

There has been a lot of focus in the initial months of the Park administration about startups, about encouraging entrepreneurship. For those of you who have looked through the specific proposals that the government rolled out back in May and June relating to the creative economy action plan and a very interesting sort of financing measures that were announced on May 15th, you'll note there's been a lot of focus on this. President Park has had very heavily publicized meetings with many famous U.S. entrepreneurs. And there's some interesting statistics. Dr. Choi spoke about some of these that relate to entrepreneurship. And last year the Global Entrepreneurship Monitor, which conducts the world's largest survey of attitudes and views on entrepreneurship, did find relatively positive views amongst Korean respondents to entrepreneurship.

To share some figures, 59 percent of respondents in Korea viewed entrepreneurship as a good career choice, and 70 percent agree that entrepreneurs in Korea received a high social status. However, there were comparatively negative views of perceived opportunities for entrepreneurship -- whether to start a firm where one lived; having the necessary skills, knowledge, and abilities to successfully do this; and also a relatively high fear of failure.

I will not that these figures are significantly more positive across the board than those in Japan, which is also -- you see many efforts over the last few years to really

encourage more startups and entrepreneurship. And the policies that the Park government have rolled out address some of the challenges that have been raised, access to finance and the kind of financing. There are proposals that have been made to encourage mentorship, training and proving human resources and skills.

But there's another factor, too, which is one that goes outside the realm of economics and that's societal and cultural attitudes. One thing that has come up in many conversations I've had with friends and colleagues in Korea or who have done a lot of business there is the heavy pressure that particularly young people feel to seek employment with larger companies for the job security and stability that that brings. And this is not specific or exclusive to Korea; this is a challenge in many other places, not just in Asia; also in Europe if one looks at the studies. But it is a really critical factor at a time when for all the tools that are being created for things that are being done to try to promote this, you know, what is it going to take to change views and mindsets so that people are more willing to take risks? The concrete proposals speak about reducing fear of failure, and I'll be interested to see how that can be done through government policy. And how all the stakeholders involved can really work to address these issues.

More specifically, this gets into some really other challenging issues that Dr. Choi spoke about. For example, labor reforms is the scenario that the government is willing to jump into. It's been very, very difficult and labor mobility could be a very constraining factor in the ability to do some of this.

Educational reform, another issue that many experts in Korea have spoken as necessary that the previous administration has tried to take on, these are some really difficult issues and it's going to take a very long time, again, probably past the term of the Park administration to address this. And so can these foundations be built through some of these efforts I think is a really interesting question.

One other thing I'd like to bring up before jumping into the discussion, I'd be interested to hear thoughts on this as well, are the potential linkages to these efforts, to this goal of the Park administration to really make this paradigm shift and the trade agenda. And I'll single out the KORUS FTA, which has been in effect for just over one year now. And I mention this because there are several sections of KORUS that really intersection with many aspects of Korea's innovation ecosystem. This ranges from strengthening intellectual property protections and enforcement. Many provisions that relate to standards, opening the standards formulation opportunities, not just to Korean firms but also to US and EU firms as I'm pretty sure those provisions are also included in the Korea-EU free trade agreement. Provisions that bring Korean standards more in line with international standards and best practices. And then much more broader areas ranging from opening new sectors to investment, competition, policy, reforms, and customs procedures. And why these matter in part is because there is a very long history of literature and study that shows the ways in which trade and investment are major drivers and facilitators of innovation, both by encouraging new competition out of which comes new ideas. Also, by opening doors in two directions, not just for outside firms to come to

the Korean market and compete, but new access for Korean companies that may have some very innovative new products, services, and ideas to jump in the global markets with which they have these agreements and take advantage of them.

And one question I have is to what extent is the Park government or people in the broader business community really thinking about in which ways do these linkages exist or could there be? This is important also I think if Korea makes a decision to jump into the Transpacific Partnership negotiations, the provisions of which are based on KORUS and expansion in new areas that also relate to the scenarios again, such as standards, supply chain, regulatory coherence, and some of these areas.

I'll stop there, but I'm very interested to hear the thoughts and ideas that all of you have. Thank you.

(Applause)

DR. BUSH: Thank you, Sean. Sorry to have skipped over. Do you want to respond to anything that Sean said?

DR. CHOI: (Inaudible)

DR. BUSH: Okay, fine. I saw Dave Fitzgerald's hand before, so I don't want to skip over him.

QUESTION: Yes, Dave Fitzgerald, retired Foreign Service. Thank you for your presentation. I have a question. You didn't mention much about female labor participation and I know it's a big issue in Japan at this time. Could you comment on that in the South Korean context?

DR. CHOI: Thank you very much. Thank you for the question. Actually, I was expecting that question because when I was saying that Korea's growth potential is on the way toward very steady decline, projecting annual 3 percent as potential growth and also the 2 percent and so on, people like me are very much proponents of increasing at least 1 percent point growth rate. And people are asking me how can you fix the problem? How can you do it without going through that difficult question of service big bang and so on which would take a lot of time. And the very clear cut and obvious answer is you have doors open, that is how you can improve women's participation to economic activity. And because in Korea about 80 percent of high-schoolers end with college, the highest in the world. Japan is behind by 10 percent and most Nordic countries are 30 percent. And women, they have jobs and there are no entry barriers compared to men, so all this glass ceiling, at least at the entry level, is broken in Korean society.

But what is happening is toward marriage and also toward having a family there is a steady exit from the company and then no turning back. They are not returning. Why? Mainly, the child care costs in Korea are very high and also it has to do with

parents' rising expectations and also private education outside of elementary school is very important but very high. So most career women, they decide not to go back to the company workplace but continue to raise kids. And so we need to have those well-educated career women who started their work going back to the company and there is very important work to be done, including along the form of more flexible form of work contract. Most jobs in Korea are very clerical and simple. Regular jobs, that's the way how labor union and management are defining and most labor unions, their aim is (inaudible) turn into regular job but that is impossible because when you consider growth potentials and economic performance and so on.

And so to have all these women going back, returning back to their work after they are having kids and so on, you have a lot of room to improve. But it is not just an economic solution. I'm telling you that education reform and more flexible welfare reform and most significantly labor reform, allowing a more form of flexible reform of the working environment with some flexible hours, like instead of 9 to 5, perhaps they're free for late hours reporting the company and they're working some portion back at home and so on. But labor unions stand in the way. And that's one very easy way you have to do it. Suppose the president wants to have a 70 percent employment rate by the end of her term and there are only two possible ways. One is to have more women back to work and secondly, increase jobs in the public sectors. But to have more in the public sectors you have to generate more tax revenue but you have a sluggish economy. How can you do it? So the second way is very, very difficult. So the first way is very important.

And in terms of numbers, the women's participation, high, well-educated women's participation economy in Korea is very left behind, even behind -- I don't think words like even is a proper context but we Koreans have always very much a competitive spirit with Japan, even behind Japan.

DR. BUSH: Speaking of Japan, next week, I think it's on Wednesday, we're going to have a major program on that very subject with respect to Japan -- Women in the Workforce. And the convener is Mireya, whom I will call on for the next question.

QUESTION: Thank you very much. Mireya Solis, senior fellow here at Brookings. Thank you so much for such an excellent presentation.

My question, Mr. Choi, is tonight is a full moon when you make your wish for Korean (inaudible) are you going to wish for Korea joining the TPP? And I ask this because I share with you -- this keeps going on and off, the volume -- I just finished a paper on this and I share with you your concern. I mean, I think that if you think about the origin of a very active Korean trade policy, the concern was to use these trade agreements as an instrument for structural reform. There was this very centralized way of decision-making where you actually gave the decisions to the Minister of Foreign Affairs and Trade and they had the strategic vision, and now when I was hearing at your presentation these messages that perhaps Korea is over-reliant on trade and that the emphasis should be on welfare and not structural reform, and then another element that I noted recently, this

bureaucratic reshuffling where the trade authority has been given now to the commerce ministry which in the past was not an advocate of really ambitious trade agreements makes me wonder what is the future regarding the TPP decision. In this paper I actually strongly advocate it's in Korea's interest to join, and I think that one simple advantage is it would have greater bargaining power in the FTAs it's participating in with China and Japan and so forth. And I actually made my staff hurry a great deal to try to get this published as soon as possible thinking a decision was coming any time and now that I'm here today I'm thinking, well, maybe I made them work too hard and it was not necessary.

So I wonder what is the thinking? And if you can share with us if we should expect a Korean decision on TPP soon or not. Thank you.

DR. CHOI: Well, I appreciate the question. I wrote an article and this is published in KERI, so you can go into it and search for it. The title was "It's Time to Act: Jump on TPP." That's the title, my writing. When? February of this year. So that's right after I was in Tokyo. I saw that Shinzo Abe was announcing live from Washington, D.C. He was telling the Japanese people I just finished my talk with Obama and Japan is now ready to join TPP talks. So my argument was very simple. Before Japan was making a bold decision to jump on TPP talks, it was something happening across the river. But now the river is on fire and you have no room to delay our decision. And I had that sort of orientation. So if I was the Trade Minister, I wouldn't hesitate to make it happen.

But in Korea right now, as you mentioned properly, there was a bureaucratic reshuffling and there was no negotiating authority once upon we enjoyed like Office of Trade Negotiating under the aegis of Minister of Foreign Trade -- Ministry of Foreign Affairs and Trade, so this government, they abolished that organization and sort of they created some physical integration with the Minister of Industry. So this previous industry is dealing with trade issues. Obviously, there is a recasting. This ministry is going to have some inward-looking perspective. And also, we do not have any chemical integration between the Ministry of Industry and Ministry of Trade Negotiation. And even though they had previous trade negotiations but they're working under different orientation. The idea was that is also related to the President and motivation, the concept of community and discipline capitalism under which she speaks very highly about preserving the importance of virtue of communityship and here community means small and medium entrepreneurs, businessmen. All of a sudden their life is in jeopardy by government's abrupt decision to open to very strong, to their minds, very strong foreign market forces.

And I think economic matter is not black and white and most economic issues we are dealing with are located in gray zones. We economists strive for margins, right? So between 49 to 51 percent. If we have 2 percent we just go forward. But politicians, they have a tendency to see black and white and even if you have 40 percent bad, 60 percent good, they don't do it because 40 percent is so big. And that is what is happening in Korea when I say they tend to have an inward look.

So I advise the Korean president you take TPP, especially after Japan's decision to join TPP talks very seriously, and I make this vocal because I was invited to the first cabinet meeting as an observer. So I was very outspoken and then I was criticized by the trade minister because I'm totally ignorant of all the shifts by Korea's small business.

But right now the tide is changing in the Korean cabinet, so I think it's just a matter of time before the Korean government will announce something very positive. But before that the official line was we still study very cautiously but I think that will change into more positive affirmative (inaudible). Something will happen.

DR. BUSH: Thank you. Garrett Mitchell, and then we'll go into the back. Maybe let's take three questions and real quickly together and then you can answer them together.

QUESTION: I could just ask all three.

DR. CHOI: That's monopolization. No good.

QUESTION: I'm Garrett Mitchell and I write the Mitchell Report. I'm struck by the second of those five bullet points of President Park's agenda about the creative economy because whenever I hear terms like creative economy or new paradigm or power of synergy I say to myself I have the feeling there is no meat on these bones. Those are convenient catch phrases that often imply nothing but very little substance components to go along with it.

So my question is whether you can put some meat on the bones of what President Park means by creative economy. And the steps by which Korea is currently moving in that direction. Let me just give two examples. I'd be interested to know to what extent there is an emphasis being placed on research and development both in the corporate sector and assuming that you have -- which may be wrong -- the kind of relationships that we have in this country between the university and government. Where is that factor?

And related to that, I'm curious to know whether Korea is holding onto its best and brightest. Or are they seeking employment and life elsewhere?

DR. BUSH: Okay. Ken Yates.

QUESTION: I'm Ken Yates with Jefferson Waterman International. Question about our (inaudible). I'm concerned about your categorization of the elderly (inaudible) and that there's a buy date in place. That bothers me a lot. But I think there's a big resource. I do know that in Korea after you've hit 60, continued working is a very big problem. And if you hit 70, you're really out of it. So it's kind of a loss of capability, experience, and just the wisdom that comes, like barnacles on a ship, but they come there.

My question though is I was in Korea in the late '60s when Park Chung-hee was still in office, and at that time there was a program called *Saemaul Undong*. And *Saemaul Undong*, the New Community Movement had the great involvement by Park Chung-hee. She wrote the song or was credited for it. She and her mother. And that movement sounds to me like something like your creative economy or your creative capitalism, whatever she wants to call it. Is this a rerun actually?

DR. BUSH: Okay. Troy Stangarone.

QUESTION: Troy Stangarone with the Korea Economic Institute. So if Korea is going to move beyond its current economic state into an innovative, creative, whatever we want to call it economy, you know, entrepreneurship is going to play a large role. And I was listening to some of Sean's statistics about sort of the positive way entrepreneurship is seen in Korea and I guess I'd like to dig a little deeper because there's a lot of things if you ask people what they think about it they'll say that they like it because there are a lot of things people like, but culturally, you know, entrepreneurship requires failure.

I was out in Silicon Valley a few weeks ago and they were talking about how if you haven't failed at five businesses or something you're not really a success anyway. So one of the things that I guess I wonder is, you can't change a culture overnight the way people perceive failure within a society, but you can change the rules under which they perform. So one of the things that works in the United States is that bankruptcy is something that's actually fairly easy. You can still get loans after failure at one, two, three, four businesses to try and try again. You know, structurally, where is Korea now and what do you think Korea needs to do to take and create the structural environment needed for entrepreneurship to flourish, not necessarily the cultural environment?

DR. BUSH: I think my understanding is that for our whole economic history business failure has been a prominent and accepted thing. So why don't you answer those questions and respond in any way that you want to respond to Sean.

DR. CHOI: Okay. Let me start with the first question asked by the gentleman in the front seat.

For a creative economy, how we create any meat to the bone. Well, I think motivation is quite obvious. For instance, including myself, we've always been praising and telling my friends in foreign countries, look, Korea, even though we were very late in industrialization, we are very first to move the country in terms of wiring the nation with IT and so on. But while we are strong on hardware, when it comes to software and providing content, running on the network, quite shallow. So there is so much room to be improved. And so there was very, you know, detailed autopsy and detailed scrutiny of what's wrong. For instance, because we are not targeting the global market, simply we are handicapped by having small domestic market based on Korean language. So there is an example that we can create something like the Korean version of Phantom of the Opera.

When you think of Phantom of the Opera, that is based on a French source but all the music and ideas, money that was having all this commercial success, it was related to the West End London and British finance and so on.

So I think there is enormous possibility if Korea can seize upon that the technical infrastructure which is built on, then much more vast opportunities. So the president started to talk about the fusions and consolidations by removing and breaking barriers in different ministries. In order to make it happen, I don't think Korea is an exception, but I think Korea is very much the prime example where each ministry, they have very much detailed regulation with so much ambiguous interpretation. And so because of that, most entrepreneurs tend to be rent-seeking rather than pie-creating.

So that is related to Troy's question, the last question, what is the current status of entrepreneurship in Korea right now? So if I touch upon that question, in Korean society there is a very interesting social perception toward the success and failure. If you fail, there is stigma. So not much of a second chance is given, even though he failed, she failed because of bad luck and so on, but we call it tough luck and just go on.

And also, success is not viewed as it is but somehow we all tend to believe and think something must be behind the political connection and so on, so people tend to see a lot of jealousy. But I think that is, you know, some cultural complex which drove Korea up this far. For instance, we have very prominent Korean, the woman golfer, Se-Ri Park but at the time she was playing for LPGA, no one is thinking that we'll have a generation of so-called "Se-Ri Kids." So when you see the LPGA in top rank, top 10 on the board on the final day, you have a list of five to six Korean kids, but at least 10 or 15 years younger than Se-Ri Pak. And they are driven by their parents' motivation. If Se-Ri can do it, why you cannot do it? A sense of jealousy.

So here what I'm saying is even though there is a certain undeniable perception in Korea, success is not viewed rightly, but if you have effective rule enforcement and some good and right and correct episode after another episode, then that perception can be changing. And also, the current government, they talk long on how we can allow some financing system and regal and banking loan -- bank loan regulations which allow some honest -- I do not know what this means, but honest failure. So we have that kind of discussion.

But going back to R&D, do you know when it comes to R&D -- the absolute number R&D Korea's G4 in the world? Korean economy, some number like I mentioned G15, G7, but absolute amount of R&D spent by Korea is number four in the world. And when you measure intensity, the total expense R&D divided by GDP, Korea is number one. Only competition is Israel. But in Israel, they have so much R&D on defense, so if you rule it out, Korea is number one. But it took almost two decades for that intense R&D to bear fruit. So here creative economy, what I'm telling the Korean government, is you shouldn't have that sort of short-termism. You could achieve all the things within five years -- it is impossible because when you concede Korea is building up

the heavy chemical IT industry, it took a combination of government drive, entrepreneurship, access to global market, and two decades, R&D. Intensive R&D. So that is something, if you are lucky, in lucky case at least two decades. Then we are expecting four different presidents. So do we have that sort of patience? I think that's the question.

And the question of aging society, I think we have a very deep debate going on in Korea right now because there was a very obvious, inevitable social request. We need to extend mandatory retirement age. Right now, most companies are 59 or 60 and public jobs, 60 and so on. To extend to 65 something. But here again, labor unions are standing in the way because they're requesting wage increase based on seniority. I don't deny more senior persons, they tend to have more experience, but when it comes to productivity, I'm not quite so sure. So unless you have a very sliding scale, then it is impossible to ask the Korean CEOs to bear the burden of extending retirement age including cost implication. So in case they have a much more flexible arrangement, you have more years to work for but instead you have to embrace a different wage arrangement. So here again, the institutional rigidity, especially labor union, is a very, very important concern.

The reason why I'm not quite absolutely optimistic about the future of the next five years of current Korea leadership is number one, this government, they don't take labor union issues very seriously. This is I think perhaps the last time Korea can have time to deal with labor unions. I'm not saying you have to destroy or you have to abolish all the labor unions, but somehow asking them and telling them and getting them to know that this is perhaps the last time to make effective reform so that all of us can have more, you know, bigger and renewable economic life.

And the second reason why I'm not quite positive is somehow this government, as I mentioned during my talk, very less enthusiastic about fundamental reform on public and quasi-public sectors. For that, a lot of jobs are being created and most Korean college graduates want to go into a public sector job because that is going to secure them a very stable job over a long time, not much work stress, intensity, and so on. But efficiency is obviously very, very low. And this sector tends to be very ineffective and adding certain burden. Korea is, as I mentioned, a globally oriented country. That means when other things are very good on a global scale, this is going to be very much boosted, but some things are happening and the Korean economy is facing a head wind, then this is very much vulnerable. So we have two different sides of coins.

As long as this government, Korean government has financial solidarity, a soundness, the government has one additional weapon to deal with the economic crisis. But suppose you have ineffective public sectors without much room for reform, then you have the debt ratio to GDP is going to be staggering high. Right now, the Korean economy is pure, very solid government debt to GDP is 40 percent, but if you add public and quasi-public sectors, that is way over 100 percent. And when you add up Korea's most rapidly aging trend, then more expenditure towards elderly people. And then when you consider

some eventual possibility of reunification, then this is -- we are asking some exploding trend. So for that reason debt reform is so important and I don't think we have any time to lose.

And finally, relating to Sean's question, especially potential of the KORUS FTA, there are some good and bad aspects that if I deal with the bad aspect, KORUS FTA in the beginning, it was sold to many people that we were going to open up service sectors. So service, big bang in my terminology. But that didn't happen because government was very much afraid of losing the momentum of having a deal with the USA because many Koreans left-leaning NGOs and political parties and medias, they are saying that education is not for free. They are saying that medical service is not for free. But they are saying if you open up these sectors, then all the benefits will accrue to wealthy and might people and thereby destroying solid base for ordinary people. I don't think that stands up to solid economic analysis, but somehow we economists, we failed to convince these people. I don't think it's a matter of discussion -- to them that's a matter of ideological question but there is so much ideological driven. So because of that reason, so far Korean government, even the most Right-wing Korean government, previous government, they failed to create the vision of service big bang on the base market opening. But some positive aspect of the KORUS FTA, because Korea was able to negotiate KORUS FTA, I think that opened Pandora's box in the Korean economy, something Japanese people didn't have until (inaudible).

When I was teaching my students at college, I was telling them, well, FTA, this is something that can be done by other countries except two governments in the world -- the Korean government and the Japanese government. They will never, ever be able to do it because this is something to commit suicide. You're asking (inaudible) country to compete with apparently very strong might people but that's perception. So because of that, the Korean government, they are talking about agricultural sector's reform and opening up. And also, they are talking about how we can effectively deal with market and trade adjustment. And I had a lot of visitors from Japan once Korea had FTA with U.S., and all of them had a single and the same question. The question was how did you do it? And something, you know, a sense of disbelief. Are you serious? But the flip side of the coin was if you're really serious, then how could you convince, how could you persuade farmers because we couldn't persuade farmers.

I think the politician Abe is doing something very interesting and so this is where the future lies. But even if KORUS was done in a very symbolic matters, and as I mentioned, that opened Pandora's box, but that requires very steady and continuity, but all of a sudden we start to have, as I mentioned, inward-looking tendency and that's quite worrisome. And as long as Korean current government tend to very much inward-looking perspective where trade entrepreneurship has paved up this far and at the same time Japan is returning very quickly and making roaring voice and China is doing something very interesting but also both countries, they are conscious about their place in the global scale, but somehow Korean leadership is (inaudible) that would make an enormous difference in the next five years.

DR. BUSH: Okay. We've come to the end of our time. Thank you all for coming and for your great questions. Thank you very much, Sean, for your comments. Thank you especially, Dr. Choi, for a really great presentation, and I hope you have a good Chuseok holiday.

DR. CHOI: Thank you. Thank you very much.

(Applause)

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