

Seung Park: The Asian economy in the 21st century

Speech by Mr Seung Park, Governor of the Bank of Korea, at the Korea Economic Institute of America, Washington DC, 26 September 2005.

* * *

I. Greetings

President Joseph Winder of the Korea Economic Institute of America,
Director Richard Bush III of the Brookings Institution,
Ladies and Gentlemen,

I am delighted to be here today at the joint invitation of the Brookings Institution and the KEI. I particularly welcome the chance to meet again with President Winder and all members of the KEI after one year has gone by. I also feel myself privileged to meet Director Bush of the world renowned think-tank, the Brookings Institution, and all those associated with it.

Today I would like to speak to members of your two institutions, which act to build bridges between the United States and Asia, including Korea, on the theme of 'the Asian Economy in the 21st Century.'

I am sure that all members of this distinguished company will have remarked that nowadays, wherever senior figures involved in economic affairs get together, the topic of conversation quickly turns to the Chinese and Indian economies. World interest is now focused on China and India, which have recently continued to show rapid economic development, following on from Japan, which has grown to be the world's second largest economic power, and the four Asian dragons including Korea, which experienced a successful process of industrialization within a very short period of time. Strikingly, several experts foresee that before too long the Asian economy will eclipse those of North America and Europe in terms of economic scale.

At the Bank of Korea, we have been carrying out research into the progress of economic development in the Asian region over the next half-century. We are now almost ready to wrap up this research, and today I would like to speak about the Asian economy of yesterday, that of today and that of tomorrow, based on the statistical forecasts derived in the course of the research.

II. Why did the Asian economy suffer long-term stagnation?

From historical perspective, Asia witnessed the meteoric rise of three of the four great human civilizations of antiquity. In many and arguably most aspects of science, culture and so on, it was ahead of the Western world. In spite of the brilliance of these ancient civilizations, until about 50 years ago most Asian regions had sunk deeply into poverty and their development presented a picture of stagnation. On the other hand, although not the origin of human civilization, the Western world, which lagged far behind in its historical development, became an advanced region. How did such an irony of history come about? Why did Asia miss out on industrialization?

To my mind, the Asian countries, unlike the Western countries, were unable to respond adequately to the challenges and changes of a new civilization. For a long time, the Asian countries were unable to respond suitably to the changes in economic and social environment.

Firstly, Asia was densely populated compared to other continents. This made the intensive farming of small plots of land inevitable. Accordingly, it was scarcely feasible to accumulate a surplus from agriculture or to expand markets. In such a situation successful industrialization was necessarily difficult.

Secondly, Buddhism or Confucianism that flourished in most regions of Asia also hindered industrialization. As you may know very well, these two religions share very static philosophies in seeking quiescence and avoiding harsh reality. They place greater emphasis on spirit rather than on material, and favor the Middle Way tolerating the coexistence of the strong and the weak over rational choices and the exclusive pursuit of self-interest. Accordingly, honest poverty is respected and only those physical possessions required for subsistence recognized as desirable. Moreover, the accumulation of the wealth was considered as immoral.

Lastly, history and tradition, being deeply rooted in the Asian region, consequently put up considerable resistance to change. The primacy of agriculture in Confucianism or the Hindu caste system together with other systems of social discrimination can be taken as examples of this. Such clinging to culture and tradition appears to stand in the way of a fresh response to changes in the economic environment. This is similar to the simple fact that it is much quicker to build a new town rather than to redevelop one that has been in existence for a long time.

In contrast to the situation in Asia where economic development was long at a standstill, the Western world witnessed the spreading of the industrial revolution starting from Britain in the mid-18th century, and accompanied by a rapid shift from agrarian societies to industrial ones. There was a big increase in the economic power of those countries that had already undergone successful industrialization and they underwent a shift toward imperialism. With the expansion of imperialism the Asian countries were degraded to colonies of the Western powers. And although they had natural resources, they were unable to respond effectively to industrialization so that the Asian countries saw a weakening of their economic and military power, finding themselves the plunder of imperialism. They sank more deeply into poverty and industrialization came to be looked upon as being exclusive to the Western powers.

III. The background to the high growth of the Asian economy

This being the case, how did the Asian economy, dormant for so long, achieve the dynamic economic growth that it now displays? Let me now tell you my version of what has happened.

After the Second World War the more open international order came into being and the way was clear for solving the problems of shortages of capital and technology through their importation. Asia's abundant human resources that had previously stood in the way of development, combined with the advanced countries' capital and technology, metamorphosed into the driving force for industrialization.

In this way, the Asian economy came to exemplify Arthur Lewis's model of development through the harnessing of the productive power of its excess population. In a paper published in 1954, Professor Lewis pointed out that, in the case of an economy with overpopulation, once capital is supplied through the import of foreign savings, for example, and combined with the domestic low-waged human resources, an economic environment of low wage cost with high return in industrial sector would be formed, making it possible to achieve high growth.

Notably not only is the Asian region's supply of labor practically unlimited, but it is well educated and shows a strong tendency toward the virtue of self-discipline thanks to the influence of religion and education. Consequently once industrialization had been set in motion, the overpopulation of the Asian region confirmed more than the predictions of Lewis's model by transforming itself into an engine of growth dynamism. Such characteristics of human resources of the region also seem to explain the fact that the Asian countries are showing a high degree of responsiveness in tune with the knowledge-based and information industry era of the 21st century.

Besides this, the Asian region only started its industrialization more than a century later than the West. The time needed for economic development could therefore be greatly shortened through the late-comer advantage of imitation. The Asian countries could achieve within a period of only 50 years what it had taken the Western countries some 100-150 years to do. This point was well explained by Alexander Gerschenkron in his development theory of relative backwardness. In his seminal work published in 1966, Professor Gerschenkron pointed out that the greater a country's degree of backwardness compared to the advanced countries and the more belated its outset of industrialization, the greater would be the pace of progress once the process began.

To sum up, nowadays the Asian economy's process of development can be said to successfully exemplify the development theories put forward by Professor Lewis and Professor Gerschenkron.

IV. Characteristic features of Asia's economic development

What characteristics distinguish the process of economic development in the Asian region as compared to other regions? Let me run through a summary of these features.

Firstly, the major resource that Asia has in abundance is low-cost labor force. In contrast to the human resources of other region, those of Asia are relatively well educated and possess a higher degree of moral discipline.

Secondly, the needed capital and technology whose domestic supply was problematic has largely been introduced from abroad. It was possible to shorten the length of time needed for development by maximizing late-comer advantage in imitating advanced countries' technology and systems. This is one of the fruits of economic openness.

Thirdly, the products manufactured by combining domestic labor and imported capital and technology targeted mostly on export market rather than on local market.

Lastly, governments have played an activist role by, for example, setting up plans and lending support for development rather than just leaving things to the free play of the markets.

While making the most of late-comer advantage, Asia's economic development has proceeded in file order, moving from Japan, to Korea and then to China and India lately.

1. Japan

Japan's industrialization began in the latter part of the 19th century, about 120 years after that of Britain. Spurred on by the Meiji Restoration in 1868, feudalism was cast aside and a modern country came to be established with power centrally concentrated. A national development strategy was put in place under government direction. This involved the introduction of capital and technology from the advanced countries of the Western world, the active encouragement of trade and the forced savings on the part of the agricultural sector for the success of the modernization policies. These placed Japan at the forefront of Asian industrialization.

After the Second World War, on the foundation of its plentiful labor power and high savings rate, Japan successfully promoted major key industries, turning itself into a global manufacturing base. In the course of this, it registered continued high growth rates, averaging over nine per cent annually in the years of 1950-73. By 1967 it had become second only to the United States as an economic power. After the collapse of the bubble economy in the early part of the 1990s, though, Japan's growth stalled out, with GDP growth marking time at an average 1% level for some 10 years. Even so, Japan still remains the world's second economic powerhouse on the basis of its strong manufacturing competitiveness.

2. Korea

Korea began industrialization at the start of the 1960s when Japan was already entering the ranks of the advanced countries. Although lacking many resources for development, Korea had the abundant underutilized manpower of its rural areas. Consequently, it put in place a government-led development strategy, also involving the import of capital and technology and a drive for exports. From the late 1970s it embarked on heavy and chemical industrialization on the basis of the success of its light industries. In consequence, from the early 1990s Korea was able to become internationally competitive in the steel, shipbuilding and petrochemical sectors. More recently it has gained a competitive edge in the automobile industry, and in a range of fields in the information technology industry including semiconductors and mobile phones. Korea's per capita GDP stood at merely \$80 in 1960. However, it has grown by an average of over 7% a year for a period of some 40 years, to rank 11th in terms of economic scale worldwide, and its per capita GDP is running at the \$17,000 level in 2005.

What is even more striking about this achievement is that the Korean economy's success came despite its having been a backward agricultural country that had suffered under colonial rule and from the Korean War, which devastated the country, and despite its lack of capital and natural resources.

3. China

China, the slumbering giant, shifted to a full-blown stage of industrialization at the end of the 1970s with the introduction of market economic principles to its socialist system. The low-cost labor force acted as the fundamental driving force for economic growth. Imports were relied on for capital and technology, and a growth strategy of government direction coupled with dependency on exports as the engine of growth was adopted. This can be seen as essentially similar to the growth model chosen by the four Asian dragons including Korea.

As a result China has been able to maintain outstanding growth averaging over 9% a year from the end of the 1970s until the present day. The scale of its external trade has risen from 25th in the world ranking at the end of the 1970s to stand third in 2004, trailing only the United States and Germany. In terms of the scale of its production and exports, it already ranks first in the electronic household appliance, textiles, clothing, footwear and iron and steel sectors. China has risen to become the 'workshop of the world' nowadays, and it accounts for the seventh largest share of the global economy. It also holds the world's second largest foreign exchange reserves, trailing only Japan. This means it is well on its way to having a substantial influence in the international financial markets.

4. India

Around the year 1991, India finally abandoned its long cherished system of a planned and self-reliant economic system. With the promotion of its New Industrial Policy, industrialization based on the market mechanism and economic openness really got underway. The framework of India's development model broadly coincided with those of the Asian countries already described in that it relied on low-wage human resources and on imports of capital and technology.

India's potential became all the more obvious with the advent of the knowledge and information technology era. Barriers of space for the delivery of services were dissolved by the information technology revolution, and international outsourcing became a sharply increasing worldwide trend. India readily adapted to these environmental changes. As well as its abundant low cost manpower and outstanding scientific and engineering human resources, the country's historical and cultural legacy of the common use of English could also be transformed into a competitive strength. In this way, by 2004 India has emerged as the world's 10th largest economy in terms of scale.

V. The Asian economy's prospects in the world

1. The Asian economy's growth potential

I would now like to talk about the likelihood of the Asian economy's high growth being sustained. This question is directly linked to the Asian economy's growth potential.

The high growth of Japan after the war and that of Korea from the 1960s is frequently termed a 'miracle.' Although the industrialization of China and India so far holds out brilliant promise, it may still be thought of as something of a 'vast experiment in economic development', given that so much uncertainty surrounds its future course. The population of China and India together makes up one third of the world. In recent history there is no example of a country on this scale successfully carrying out industrialization.

Besides this, the two countries have a strong tradition of socialism. This has been pointed out by some as a factor underlying the uncertainty. The historical experience has been that the development of a market economy has tended to prompt demands for a change toward greater political and social democracy. Apart from this we cannot exclude the possibility of stumbling blocks in the path to continued economic growth. They may accompany the course of industrialization in the form of a widening gap between rich and poor, environmental and energy problems and the possibility of financial insolvencies. Geopolitical risks are also obviously present.

Despite these possible caveats, I would like to emphasize the stronger probability that by the mid-21st century they will rank as economic powers on a par with the United States.

I think it is possible firstly because, in case of China and India, the economic growth models of Professor Lewis and Professor Gerschenkron can be applied for some considerable time to come. Both China and India possess large-scale reserves of unemployed and underemployed labor that have not committed as inputs to economic development. Besides this, although it is very difficult to get industrialization started, once it is underway it moves forward at a rapid pace. Korea and other countries demonstrate the validity of Gerschenkron's argument and it also appears to apply in the case of China and India.

Secondly, and in contrast to the past, Asia shows a high degree of adaptability to the rapidly shifting economic environment. The market order has been realigned since the 1990s through the IT revolution and the rapid progress of globalization. Competition has become fierce just in order to

survive and new technology sectors such as IT, biotechnology and nanotechnology have rapidly spread while the previous smokestack industries are being squeezed out. The Asian countries, however, have not trailed behind the advanced countries in some of these areas, which is a stark contrast with the industrialization period in the past.

Japan and Korea are already competing with global producers at the forefront of the IT industry. Japan is already at the leading edge, and devoting huge efforts to catch up or overhaul the United States, in sectors such as nanotechnology, biotechnology and aerospace. Korea too is throwing itself into the search for new growth momentum in new areas of technology. The recent news of the stem cell research of Woo Suk Hwang, Seoul National University Professor, astonished the world.

China and India, with their vast high-quality human resources, are seeing the rapid growth of their new technology industries such as information technology. These two countries graduate half a million trained engineers and scientists every year, eight times the number emerging from the US colleges. China already ranks second only to the United States as a producer of IT hardware. It has the scientific and technological capacity for the launching of manned spacecraft. For its part, India boasts world-class competitiveness in the IT-based service sectors so that already by 2002 software and IT related services accounted for a greater share of exports than textile products. It is a further testimony to the scientific and technological capacity of India that 100 out of the Fortune 500 companies had already established an R&D centre there.

The Asian economy possesses an almost limitless supply of human resources together with its late-comer advantage. At the same time it has shown itself well able to adapt to the changes in the economic environment. Before too long there is a good likelihood that it will rise to a position alongside North America and Europe.

2. *Asia's weight in the global economy*

With all of its vast growth potential, what will Asia's part in the global economy look like in the future? Let me say something about this question now.

As of 2003 the population of Asia, excluding Russia and the Middle East, made up roughly half the world total. Asia's GDP, however, accounted for only 23% of that of the world. In contrast, three North American countries (the US, Canada and Mexico) and Europe had 7% and 6% of the world's population respectively, but accounted for 34% and 29% of world GDP. In other words, while the combined share of North America and Europe in world population was merely 13%, they accounted for two-thirds of world GDP.

As I mentioned earlier, however, there are big future changes in the world economic map coming, in line with the continuing development of the Asian region. Asia's dynamism began to reveal itself as long ago as the 1970s, and since that time Asia's rate of economic growth has been considerably higher than the world average. Since the 1980s, strikingly, average Asian GDP growth has been double the global average, making Asia a locomotive of world growth. Asia's exports have increased by an average of about 9% a year since the 1970s, some 3 percentage points above the global average. Asia's weight in the global economy has consequently risen continuously from 12% in 1960 to 14.5% in 1970, 17% in 1980 and 23% in 2003.

These trends are likely to continue, as well. According to a study by the Bank of Korea, in the latter part of the 2010s, the scale of the Asian economy will be similar to that of the pre-enlargement EU. In the first half of the 2020s, it will match that of the three North American countries. Picturing the world economy in 2040, Asia's share in world GDP is forecast to be 42%, while the shares of North America, Europe, and Other regions are expected to be 23%, 16%, and 20% respectively. Meanwhile, in terms of per capita GDP, as of 2003 Asia recorded an average of \$2,400 - less than one-tenth of the average \$29,000 in North America and \$27,000 in Europe. By around 2040, however, this difference is likely to be greatly reduced with Asian per capita GDP being expected to be one-fourth of the figure in North America or in Europe.

Looking at the big picture by country, in terms of overall national GDP, China is forecast to overtake Japan by around 2020 and be on a par with the US by approximately 2040, to account for about 1/5 of global GDP. India would overtake Japan by about 2030, and by 2050 or so is projected matching Europe's 12% global GDP share. By about 2040, Korea's share in global GDP is forecast to have increased slightly to 2% from 1.7% in 2003, while that of Japan, due to its relatively slow growth, is estimated to have shrunk to about half its current 12% share. In terms of per capita GDP, by around

2040, China is expected to be 1/4 of the figure in the US or in Japan, and 1/3 of that in Korea, while Indian per capita GDP is, like today, estimated to be half of the figure in China.

3. *The effect of the rise of the Asian economy on the world economy*

How then will this high growth of the Asian economy influence the world economy? It is already having a big impact on the global economy and this will increase in the future. This is because Asia can offer an inexhaustible supply of labor to the world economy, which is rapidly integrating under the influence of information technology development and economic openness. A vast market that was once self-sufficient is joining the world economy. A number of effects are expected to arise from the integration of the Asian economy with the open world economic order.

First of all, labor costs will be reduced. With the lowering of the capital-labor ratio, the returns to capital will be augmented. In addition, a huge consumer market will emerge. Furthermore, from China, the manufacturing workshop of the world, and India, the source of the provision of services, a flow of inexpensive goods and services will flow out to the world, heralding an age of low prices.

Such changes in the economic environment will undoubtedly have a large impact on the world economy. The world economy will be rejuvenated and gain new growth momentum. From a worldwide perspective, investment will be boosted thanks to the lowering of labor input costs and the raising of the returns to capital, and through the coming into being of a vast market with huge effective demand.

Secondly, welfare will be enhanced for the common people around the world. Clearly standards of living will be greatly improved in China and India, which make up one third of the world's population, with the raising of income levels for their own citizens. At the same time, the supply of low-priced goods and services will act to boost effective disposable incomes throughout the world.

There will also be less welcome effects. There is the likelihood of a worsening of income distribution. In the advanced countries and today's NIEs, there will be a deepening of the income gap between expert and skilled workers on the one hand, and manual and unskilled workers on the other. The rise of the Gini coefficient of the OECD countries by about two percentage points over the last 10 years or so to stand at 29.1% in 2000 is said to be caused by the supply of low-cost labor power from China and India. However, this should not be seen purely negatively, provided that the imbalance is due to the faster increase in incomes on the part of high income earners while income as a whole rises. This kind of negative effects should disappear in time as they are transitional phenomena arising in the course of the entry of these vast countries into the global market economy.

VI. Closing remarks

Drawing to the end of my speech, I should like to round off with some concluding remarks.

The Asian economy can maintain its dynamic development in the 21st century, becoming the driving force for world economic growth. Before too long the scale of the Asian economy will be on a par with those of Europe and North America. Having played only a minor supporting role on the world economic stage for a long time, Asia should now assume a major role jointly with Europe and North America. In this connection, the peoples of Asia must strive to carry out the responsibilities befitting that leading role. These include maintaining and enlarging their economic openness and mutual cooperation to ensure the sustained development of the world economy. The states of other regions, meanwhile, should take advantage of the dynamism of the Asian economy as a new frontier for their economic development.

A pressing task for the world of the 21st-century is to bring about international cooperation directed toward the raising of living standards and welfare for all. This must replace the pattern of development of state power for the purpose of aggressive attacks on other countries and to exercise control over them, as we have sometimes witnessed in the past. In this regard, the highest value should in the future be placed on economic rather than military power. In today's open world economic order, what is needed to push world economic development forward is not an exclusive monopoly on economic power, but efforts to share economic power together with neighbors. In closing, I would like to stress again the great importance of cooperative and complementary relationships between the Asian economy, driving global economic growth in the 21st century, and other regions, which should make full use of the opportunities presented by this Asian dynamism.