# KOREA'S ECONOMY

2011

a publication of the Korea Economic Institute and the Korea Institute for International Economic Policy

Volume 27

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Printed in the United States of America.



ISSN 1054-6944




Volume 27

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# KOREA ECONOMIC INSTITUTE

July 2011

Dear Readers,

This year's edition of *Korea's Economy* introduces a wide range of changes to one of The Korea Economic Institute's (KEI) premier publications. Beyond the changes you will immediately notice with the new cover, KEI has introduced a series of short commentaries by leading scholars and officials to this year's publication.

The new commentaries are designed to help give readers a short and thoughtful introduction to different topics explored in this year's edition. We consider ourselves fortunate to have some of the world's leading scholars and thinkers such as Paul Volcker, SaKong Il, Fred Bergsten, and Chae Wook contribute their insights to this year's endeavor.

As many of you well know, last year was an important year for Korea as it hosted the G-20 leaders' summit in Seoul. In honor of this historic event, KEI has included a special section dedicated to the Seoul Summit that features articles looking at both the accomplishments of the summit and how the developing world views Korea's efforts to place the issue of development on the G-20 agenda.

This year's edition also includes a look at an issue of growing importance in Korea – Green Growth. This section explores the efforts Korea has made to date and the how to handle the key issue of financing green projects. Other issues examined in this edition include the growing economic relationship between the two Koreas and China and the continued challenges and opportunities that Korea faces in the global economy.

We hope that you enjoy the changes that we have introduced in this edition of *Korea's Economy*. We look forward to continuing to enhance this publication in the years ahead to provide the best possible insights into Korea's economic relations.

Charles L. (Jack) Pritchard
President

Troy Stangarone
Director of Congressional Affairs and Trade
Editor – *Korea's Economy*

# ACHIEVEMENTS IN SEOUL AND KOREA'S ROLE IN THE G-20

*By Choi Heenam*

Domestically, the decision for Korea to take on the presidency of the Group of 20 (G-20) in 2010 was received with both excitement and concern. It was the first presidency by a country not a member of the Group of Seven. There was also skepticism that, as the world economy recovers, the sense of urgency for G-20 actions would weaken, slowing the momentum for close policy coordination among G-20 members. Against this backdrop, Korea embarked on its year of presidency and took on the challenge of alleviating such concerns and reaffirming the G-20 as the premier forum for international economic cooperation.

The Seoul summit, which marked the end of Korea's presidency, was a success. We were able to draw meaningful conclusions on all issues on the agenda that, for many of us, seemed like a daunting challenge to begin with. Such success is a testament to Korea's capacity as a global leader as well as to the importance of the G-20 in addressing global challenges.

## Key Achievements of the Seoul Summit

One of the most rewarding outcomes of the Seoul summit was that we successfully delivered on *all* the commitments made at previous summits.

For instance, we reached agreement on the International Monetary Fund (IMF) quota and governance reform. This was a very difficult reform to achieve as it was often viewed among member nations as a zero-sum game.

We also delivered on the core elements of the new financial regulatory framework: we adopted a new bank capital and liquidity framework (Basel III) and endorsed a policy framework to reduce moral hazard risks posed by systemically important financial institutions (SIFIs) and to address the too-big-to-fail problem.

The G-20 was originally scheduled to complete the new financial regulatory framework by the end of 2010 and the IMF quota and governance reform by early 2011. But we were able to bring forward the deadlines and reach agreement on these issues at the Seoul summit in November 2010.

In short, we were able to demonstrate at the Seoul summit that the G-20 delivers and delivers on time. This is the best way of ensuring the G-20's legitimacy and demonstrating its effectiveness.

Second, at the Seoul summit, the G-20 strengthened its ability to carry out and achieve macroeconomic policy coordination in the face of the many challenges that emerged, alleviating concerns and uncertainties about the framework and its mutual assessment process.

The world economy showed signs of a slowdown in the second half of 2010, just months before the Seoul summit. Concerns rose as to the possibility of the recovery losing momentum and of a "double dip." This would have implications for the macroeconomic policy commitments made in Toronto, especially the fiscal consolidation commitment.

In October 2010, however, the Brazilian finance minister, Guido Mantega, noted his concerns about the "currency wars" (also described as "competitive devaluation"), and soon it became a headline issue. Many predicted that the success of the Seoul summit would depend on our capacity to achieve policy coordination to address global imbalances aggravated by exchange rates that do not reflect market fundamentals.[1]

1. The United States also sparked the current currency wars by telling China in September 2010 that it needs to let the yuan appreciate in value and by announcing its intention to let the dollar slide. In early September, Secretary of the Treasury Timothy Geithner ruffled feathers in Beijing by criticizing China's manipulation of the yuan, which is worth less than it would be if the Chinese did not buy billions of dollars of U.S. debt.

Pessimists said that because of the looming fears of a global depression it would be possible for the G-20 to muster policy coordination in the immediate aftermath of the subprime crisis, but effective and plausible resolution of the currency wars and global imbalance issues would be far more difficult because members' positions and interests were much more divergent and firmer with respect to these matters.

At the Seoul summit, however, leaders agreed to maintain current account balances at sustainable levels and establish indicative guidelines to help with that process under the French presidency.

It would have been impossible to reach this agreement without strong belief among the leaders that coordinated policy actions are essential to achieving strong, sustainable, and balanced growth for the global economy.

The third main achievement of the Seoul summit was that it demonstrated the scope of G-20 policy coordination as not being confined to crisis management, but embracing the global economic management *beyond crisis in the long-term.*

*"In this sense, France and Korea are in the same boat. A successful Cannes summit will be very important not only to France and the G-20 but to Korea as well."*

Korea, for example, placed development at the center of the G-20 agenda for the first time. By doing so, Korea helped to demonstrate the G-20's leadership as the premier forum for international economic cooperation—and one that actively engages with all the stakeholders in the global economy, not just with members of the G-20.

We strove to be a proactive chair by, for example, actively promoting the establishment of global safety nets, including the adoption of the IMF's new lending facilities such as the flexible credit line (FCL), precautionary credit line (PCL), and multicountry FCL and proposing a viable option to alleviate the currency wars debate.

It is clear, however, that the ultimate verdict on previous G-20 summits and, in particular, the Seoul summit hinges on the results of the Cannes summit. This is because we need to deliver at the Cannes summit on many issues agreed at the Seoul summit.

In this sense, France and Korea are in the same boat. A successful Cannes summit will be very important not only to France and the G-20 but to Korea as well.

## Issues Central to the Seoul Summit and for the Future

Certain issues were central to the Seoul summit agenda and have been passed on to France to be further developed and agreed under the French presidency.

These issues include developing indicative guidelines for addressing global imbalances and committing to further policy actions, strengthening global financial safety nets, implementing the Multi-Year Action Plan on Development,[2] and following through with the commitment on the World Trade Organization Doha Development Agenda (DDA).

### *Global Imbalances and Indicative Guidelines*

In the first half of 2011, the G-20 focused on developing and agreeing to indicative guidelines to assess persistently large current account imbalances, as promised by leaders in Seoul.

Just as uncertainties from the financial crisis in southern Europe loomed large at the Toronto summit, the centrality of the currency tensions immediately prior to the Seoul summit focused the G-20 to reach a political consensus on how to address such tensions. However, global imbalances, measured as the sum in absolute terms of the current account positions of the world's major countries, have exhibited a sharp upward swing during the past 40 years (see ***Figure 1***).

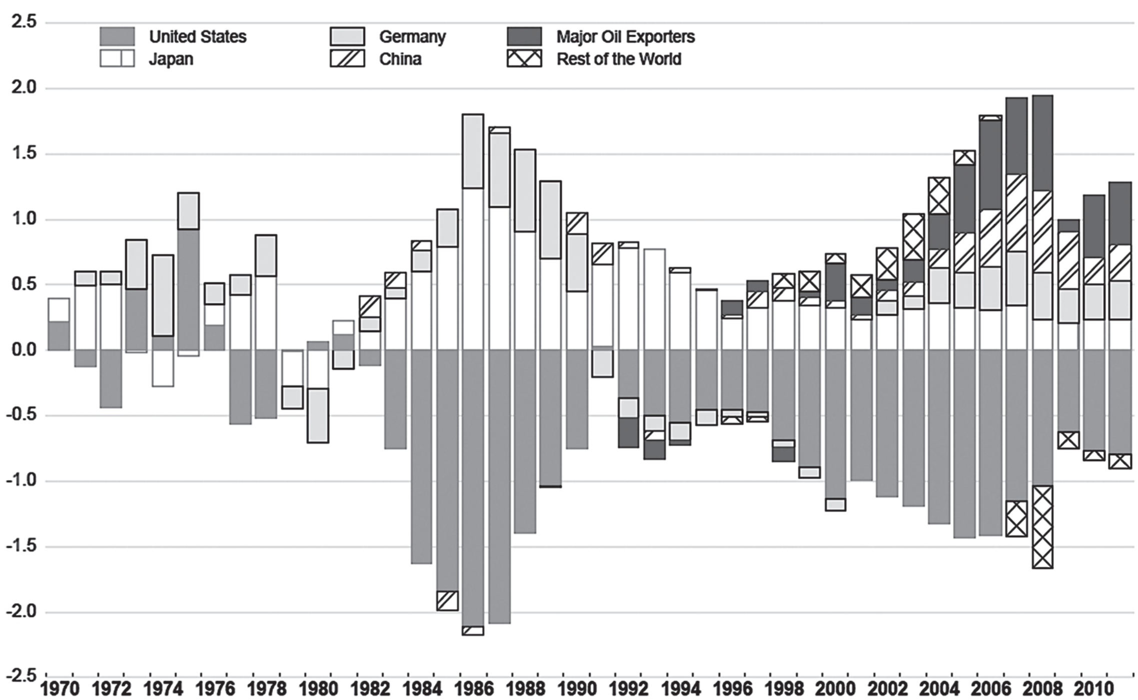
2. "Multi-Year Action Plan on Development," Annex 2, Group of 20, http://media.seoulsummit.kr/contents/dlobo/E4._ANNEX2.pdf.

That is why Korea, with strong support from the United States, proposed a current account targeting at 4 percent of GDP as a solution. This figure was based on economic forecasts submitted by the members as part of the mutual assessment process (MAP) exercise. Most of the non-oil-producing nations estimated that their current account balance for the next several years would be in the range of 4 percent. Similar to an inflation target band, a numeric guidance can help policymakers focus their efforts.

There was some criticism that these forecasts were too optimistic, but it seemed that if the G-20 members could agree to try to abide by their forecasts the global imbalance could be largely reduced. In addition, it seemed more productive to spend more time discussing all the underlying factors causing global imbalances instead of just exchange rate issues. This would provide freedom in the choice of policy instruments as it would be up to each country to choose the policies it wanted to pursue to maintain a band of sustainable current account balances. A country could act through, for example, structural policies, exchange rate policies, or policies to change domestic demand. Therefore, it could alleviate tensions around currencies without calling for commitments to any specific exchange rate policy in the short run.

The opponents of this proposal argued that the proposed numerical targets or ranges for the current account balances were arbitrary, and the G-20 was not likely to reach consensus on a current account target zone. They said, because policymakers have little or no control over the current account balances, policies should focus on addressing the underlying distortions behind the imbalances, not the implications. And they said it was not easy for a country to unilaterally enforce or implement current account targets, as current account balances come from bilateral or multilateral relations.

***Figure 1.*** **Global Imbalances, 1970–2011**




Sources: Luiz de Mello and Pier Carlo Padoan, "Are Global Imbalances Sustainable? Post-Crisis Scenarios," Economics Department Working Paper no. 795, Organization for Economic Cooperation and Development (OECD), 2010; original sources are *Economic Outlook,* no. 87 (Paris: OECD, 2010), and national sources.
Note: Data show current account balances as percentage of world GDP. Data for 2010–11 are projections from the OECD *Economic Outlook*, no. 87, database.

After a long and heated debate, the proposal to include a numeric target or indicator was not approved. Instead, recognizing the need to cooperate to resolve global imbalances and using a full range of policies, the ministers and governors agreed on a mechanism to examine persistently large imbalances in current accounts, taking into account national or regional circumstances, assessed against "indicative guidelines" that were to be defined. Building on the progress made by the ministers and governors, the leaders specifically agreed that:

> *These indicative guidelines composed of a range of indicators would serve as a mechanism to facilitate timely identification of large imbalances that require preventive and corrective actions to be taken. To support our efforts toward meeting these commitments, we call on our Framework Working Group, with technical support from the IMF and other international organizations, to develop these indicative guidelines, with progress to be discussed by our Finance Ministers and Central Bank Governors in the first half of 2011; and, in Gyeongju, our Finance Ministers and Central Bank Governors called on the IMF to provide an assessment as part of the MAP on the progress toward external sustainability and the consistency of fiscal, monetary, financial sector, structural, exchange rate and other policies. In light of this, the first such assessment, to be based on the above mentioned indicative guidelines, will be initiated and undertaken in due course under the French Presidency.*[3]

By agreeing to develop guidelines to adjust undesirable excessive current account imbalances, the Seoul declaration made it clear that both deficit and surplus nations have responsibility to make adjustments. In particular, countries with reserve currencies need to make policy adjustments when their excessive deficits continue. Under the French presidency, the task of building a new international monetary system must include a search for a good macroeconomic adjustment mechanism that facilitates balance of payment adjustments.

At the 14–15 April 2011 meeting of G-20 finance ministers and central bank governors, the ministers and governors agreed on a set of indicative guidelines and completed the first step to address persistently large imbalances. Now they can launch the second step of this process with an in-depth assessment of the nature of these imbalances and the root causes of impediments to adjustment.

A set of indicators that was agreed at the February meetings are (1) public debt and fiscal deficits, and private savings rate and private debt; and (2) the external imbalance composed of the trade balance and net investment income flows and transfers while taking due consideration of exchange rate, fiscal, monetary, and other policies. The guidelines establish reference values for each available indicator, allowing for identification of countries for the second step. Four approaches based on economic models and statistical approaches are used to measure against reference values.

In carrying out assessments, the G-20 will take due account of the exchange rate and monetary policy frameworks of members. For members of the euro area, this assessment will involve appropriate authorities under their governance framework. National circumstances will also be taken into account. As part of the assessment, the IMF will carry out independent analysis using IMF forecast data, while countries' own assessments can use their national data. For identification of countries to move to the second stage, the selection rules also include G-20 countries that account for more than 5 percent of G-20 GDP (on market exchange rates or purchasing power parity [PPP] exchange rates), reflecting greater potential for spillover effects from larger economies.

On the basis of second-stage assessments, the IMF assessment on progress toward external sustainability, and other aspects of our mutual assessment process, ministers and governors can agree on corrective and preventive measures that will form part of the 2011 action plan to ensure strong, sustainable, and balanced growth, to be discussed by leaders at the Cannes sum-

3. "The G20 Seoul Summit Leaders' Declaration, November 11–12, 2010," Section 9, Group of 20, www.g20.org/Documents2010/11/seoulsummit_declaration.pdf. Emphasis added by author.

mit. The G-20 appears to be following its timeline very closely.

### *Global Financial Safety Nets and International Monetary System Reforms*

Last year, we focused on the IMF's crisis prevention toolkit by enhancing the FCL and establishing the PCL. FCL enables members with very strong policy fundamentals and frameworks to gain access to contingent financing without conditionality beyond initial qualifications. PCL provides a credit line for members with sound economic fundamentals and frameworks but moderate vulnerabilities, which combines ex ante qualification requirements with focused ex post conditionality. Korea was forced to take the IMF's bailout package during the Asian financial crisis of 1997 because such instruments did not exist. As such, Korea is proud of the leadership role the country played in drawing agreements on global financial safety nets. If there had been a precautionary mechanism, the recession in Korea and the pain Koreans had to endure could have been less severe or even prevented altogether.

In particular, the introduction of the multicountry FCLs to provide precautionary liquidity simultaneously to many countries exposed to the common shock marked an important step toward resolving the first-mover problem, when countries hesitate to request the IMF's financial support because of the fear of being stigmatized. Agreement to double the IMF's quota resources further strengthened its ability to act as a global safety net.

There is still more to be done. The Cannes summit must focus on two additional global financial safety net issues that leaders introduced in the declaration at Seoul. We must further explore a structural approach to cope with shocks of a systemic nature and ways to improve collaboration between regional financing arrangements and the IMF.

At the Seoul summit, leaders also agreed to work further to build a more stable and resilient international monetary system. Therefore, the Cannes summit will focus on consideration of a new international monetary system (IMS). Currently, the G-20 working group on IMS defines the IMS as a set of rules and institutions for international payments, comprising the reserve currencies, exchange rates, financial and monetary regimes of countries, and the institutions that are in charge of overseeing their functioning at domestic and global levels. Within this definition are specific issues such as the definition and measurement of global liquidity, international reserves, the role and composition of the special drawing rights, financial safety nets, capital flow management, effective surveillance of cross-border capital flows, and the role of developing local capital markets. Given the huge array of issues on hand, it will be interesting to see what ultimately gets delivered at the Cannes summit.

### *Development*

Some African leaders expressed their appreciation by commenting that the Seoul Development Consensus for Shared Growth is not only the "Seoul consensus" but also embodies the "African consensus," demonstrating the importance of this agenda at the G-20.

The Seoul consensus reflects the view that inclusive growth is overwhelmingly the single biggest contributor to poverty reduction.[4] The Seoul consensus is an attempt to ensure that international development efforts are appropriately focused on economic factors such as infrastructure, private investment, and capacity in achieving poverty reduction through growth.

The presence in the G-20 of countries such as Korea, China, India, and Brazil, which have most recent and vivid experience of many different types of development models and issues, meant that the G-20 was able to provide practical—not just rhetorical—recognition of the fact that there is no single model for growth and development.

To ensure that the Seoul summit's discussions on development do not culminate in a mere announcement of an initiative or a "photo opportunity" and that our efforts deliver tangible progress, the voice of developing countries must be given priority.

4. "Seoul Development Consensus for Shared Growth," Annex 1, Group of 20, www.g20.org/Documents2010/11/seoulsummit_annexes.pdf.

Accordingly, President Lee Myung-bak advocated a consumer-oriented approach based on extensive inquiry into what developing countries themselves are looking for.

The Seoul consensus reflects the view that low-income countries (LICs) are an important part of the solution to the global imbalances as new sources of aggregate demand and should be treated as equal partners for achieving a more resilient and balanced global economy. This is based on the fact that economic growth is the most effective means of achieving the Millennium Development Goals although growth alone is not sufficient. The role of public interventions must also be reemphasized in achieving growth in the LICs; in particular, it is important in addressing bottlenecks in infrastructure investment—especially bottlenecks to regional infrastructure. These needs are extremely urgent and must be given top priority.

Views articulated in the Seoul consensus reflect the consistent message we received from our developing country partners in Africa and elsewhere.

To ensure effective implementation of the ideas expressed in the Seoul consensus, the G-20 has drawn up the Multi-Year Action Plan in nine key pillars of economic growth, including infrastructure, food security, and human resources development.

These action plans have concrete timelines and implementation mandates for G-20 members and relevant international organizations, most of which will have a delivery or reporting deadline of the Cannes summit.

To accomplish such numerous tasks within such a tight timeline will not be easy, but we know it is possible. Just look at the 47-item multiyear agenda on financial regulatory reforms that was announced at the Washington summit. We successfully delivered on it at the London and subsequent summits.

Among the nine key pillars, France has expressed special interest in food security, particularly with regard to food price volatility as a subset of commodity price volatility. The focus of the Seoul consensus, however, was on key economic drivers and on tackling key bottlenecks to inclusive growth.

Therefore, infrastructure should continue to be emphasized and prioritized, given the particular importance LICs have placed on this pillar—the importance they have clearly communicated to the G-20. In that regard, the G-20 High Level Panel will be making recommendations on facilitating more infrastructure investment financing and reviewing multilateral development banks' policies related to infrastructure development by September this year.

To ensure the continued incorporation of developing countries' concerns, the Cannes summit could also consider linking the Multi-Year Action Plan with the outcomes of two other important events in 2011: the Fourth United Nations Conference on the Least Developed Countries in Istanbul, Turkey, in May 2011, and the Fourth High Level Forum on Aid Effectiveness in Busan, Korea, in November 2011.

***Trade, Energy, Climate Change, Anticorruption***

Although it received less coverage in the media, the Seoul summit produced another important outcome regarding the WTO DDA. Concrete agreement was reached by the leaders, who expressed the need to complete the end game, called for engagement in across-the-board negotiations to bring the DDA to a prompt and successful conclusion, and committed to seek ratification, where necessary, once such an outcome was reached. Unfortunately, little progress has been made to date on the DDA negotiations.

Leaders also reaffirmed the extension of their "standstill commitments" until the end of 2013 as agreed in Toronto, and they committed to roll back any new protectionist measures that may have been implemented. These outcomes are not only significant but also have strong political implications.

Moreover, agreement by leaders in the energy sector to seek concrete cooperative measures to mitigate oil price volatility has opened up doors to help related industries, jobs, and people to deal more effectively with substantial fluctuations in energy prices.

On climate change, leaders reaffirmed their political support for the successful Cancun meeting and agreed to strengthen cooperation among G-20 members to pursue green growth as a way of sustainable growth. Such agreement will present an opportunity for Korea to take a leadership role on the green growth issue.

Also on the agenda was the anticorruption issue. Leaders committed to make efforts to fight corruption and to ensure transparency and equality in the corporate environment. Further, they approved an action plan that incorporates concrete anticorruption measures, including strengthening global cooperation, in nine different sectors.

### *Financial Regulation*

Last but certainly not least, the Basel III framework and the policy framework for SIFIs were finalized at the G-20 Seoul summit. Moving forward, leaders agreed to address issues that warrant more attention in order to build a more resilient financial system to prevent recurrence of crises.

In close coordination with international financial institutions such as the Financial Stability Board (FSB) and IMF, the G-20 will have to achieve concrete outcomes on these issues at the Cannes summit.

These issues include further working with the FSB to strengthen its capacity, resources, and governance, including representativeness; determining a cohort of global SIFIs; finalizing a multipronged framework with more intensive supervisory oversight; instituting effective resolution capacities and higher loss absorbency capacity; elaborating macroprudential policy frameworks; addressing regulatory reform issues pertaining specifically to emerging-market and developing economies; strengthening the regulation and oversight of the shadow banking system and over-the-counter derivatives markets; converging the International Accounting Standards Board (IASB) and Financial Accounting Standards Board; addressing the IASB governance review process; and developing common principles on consumer protection in financial services.

## Closing

I have attempted to set out the implications of the Seoul summit's outcomes in key areas for the Cannes summit. As the success of the Seoul summit will be measured by achievements at the Cannes summit, Korea is, indeed, keen on ensuring a highly successful French presidency.

I am confident that at the Cannes summit G-20 leaders will again deliver on their commitments and further illustrate to the world the effectiveness of the G-20 as our premier forum for international economic cooperation.

*Choi Heenam is the Alternate Executive Director of the International Monetary Fund.*

## Selected Commentary

**Korea and the World Economy**
*C. Fred Bergsten, Peterson Institute for International Economics*

**Korea's Challenges and Opportunities in 2011**
*Chae Wook, Korea Institute for International Economic Policy*

**A Reflection on the Seoul Summit**
*Paul Volcker, Former Chairman of the Federal Reserve*

**The G-20: Achievements and Challenges**
*SaKong Il, Korea International Trade Association*

**Korean Green Growth in a Global Context**
*Han Seung-soo, Global Green Growth Institute*

**Korea's Green Energy Policies and Prospects**
*Whang Jooho, Korea Institute of Energy Research*

## Additional Commentary and Analysis

Korea: Economic Prospects and Challenges after the Global Recession

Achievements in Seoul and Korea's Role in the G-20

Africa and South Korea's Leadership of the G-20

Korea's Green Growth Strategy: A Washington Perspective

An Ocean in Trouble, An Ocean of Opportunity

System Architecture for Effective Green Finance in Korea

Economic Implications for South Korea of the Current Transformation in the Middle East

Korea-Africa: Emerging Opportunities

U.S.-Korea Economic Relations: A View from Seoul

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**Korea Economic Institute**

1800 K Street, N.W
Suite 1010
Washington D.C., 20006