

**East Asia and the World:
Reflections on Longer-Run Economic Trends**

Hugh Patrick

Discussion Paper No. 52

Hugh Patrick

Co-Director, APEC Study Center
Director, Center on Japanese Economy and Business
R.D. Calkins Professor of International Business Emeritus
Columbia University



**Asia-Pacific
Economic Cooperation**

Discussion Paper Series
APEC Study Center
Columbia University

December 2007

**East Asia and the World:
Reflections on Longer-Run Economic Trends***

Professor Hugh Patrick
APEC Study Center
Columbia University

ABSTRACT

The global economy is in the long-run process of a huge, fundamental transformation founded on development and growth, exemplified by the astounding, rapid, and sustained economic rise of China and India.

East Asia – defined here as the ASEAN 10 nations plus South Korea, Japan, and China – has been the most dynamic, fastest growing region in the world over the past 50 years. That will continue for at least the next 25 years. However, the demographic transition to low birth and death rates, aging, and eventual population decline will have profound economic and social effects. As China's labor force growth drops, its growth rate will slow dramatically, from 5.5% to 3.8% to 1.9%. For essentially demographic reasons, the most rapidly growing Asian countries 30 years from now will be India and ASEAN (and the U.S.), not Korea, China, or Japan.

East Asia has a high degree of economic interdependence in trade and foreign direct investment. I am somewhat positive about the government efforts to promote economic cooperation in this region. Governmental dialogues about economic cooperation – in ASEAN +3, ASEAN +6, central bank forums, APEC – involve a useful learning process. However, I do not think these economic cooperation discussions will result in any regional institutions of deep economic substance, such as an East Asian FTA, in the foreseeable future.

* Lecture to Lotte Inc. corporate executives, May 16, 2007 in Seoul, South Korea

Introduction

You all know a great deal not just about your Lotte companies but about business management, marketing and your industry, and of course a great deal about your home country. In contrast, I know very little about any of these topics.

Today I want to consider the very big picture – the global and East Asian business environment in which you will operate in the future. I do this in the broadest possible economic terms – not just companies or industries, not just Korea, and not just the near future. Rather, I want to focus on some important longer-term trends, both global and regional. What I have to say is obvious, but it is important to remind ourselves of these trends from time to time, especially as they continue to evolve.

First I consider the evolving global economic environment. Next, I consider longer run economic growth prospects, especially for Korea, China and Japan. Finally, the longest part of this presentation is on East Asian regionalism and economic cooperation.

The Evolving Global Environment

First, the global economy is in the long-run process of a huge, fundamental transformation founded on development and growth. This process is exemplified by the astounding, rapid, sustained economic rise of China and India. Economic globalization is driven by the development and spread of technology – not only in manufacturing, but notably in communications technology. The internet and the cell phone are major new means of communication – as you and indeed all Koreans know very well.

This globalization process creates both opportunities and challenges for businesses and government policymakers. Businesses have to adjust to, and take advantage of, a world that has become increasingly dynamic and competitive. Businesses have to move forward, not backward. Governments have to adapt as well, creating a policy environment that

accommodates, even supports, change while helping those harmed by change, but without resorting to protectionism, even though it often is politically so tempting.

The international experience of economic development over the past 50 years, by far the most rapid period of world economic growth, provides important lessons. First, market economies perform significantly better than non-market economies in increasing output, raising living standards, and other measures of success. Second, competitive markets perform significantly better than monopolistic markets in productivity and output growth, and consumer welfare. Third, to be effective, markets require a set of fundamental, strong supportive institutions including the definition and protection of property rights, the rule of law, and active and effective financial and labor markets. Fourth, a country's liberalization of foreign trade in goods and services enhances its economic performance, standards of living, and consumer welfare. Fifth, economic development and growth involve, indeed require, major structural and institutional changes.

This dynamic process of change creates some losers but even more winners. Change is driven more by domestic forces – new technologies, new industries – than by trade liberalization. People and capital have to shift out of inefficient, declining industries, and that is much more difficult and painful in advanced, slow-growing economies than in rapidly growing developing economies. While education and opportunities for changes in occupation are essential for making adjustments from one generation to the next, most economies have not yet succeeded in developing good restructuring programs for those who are the current inefficient producers, such as in agriculture.

The global economic system today faces major economic challenges. How can a rapidly growing, export-oriented China be included and accommodated without generating a protectionist backlash in the United States and European Union? Will market forces be sufficient to deal with intermediate as well as short-run tightness in energy supplies? Can countries agree upon a global system to limit CO₂ and other emissions to reduce global warming? Will the WTO multilateral, global trading system continue to be undermined, rather than supported, by the rapid increase in bilateral FTAs? As you know, these are

incorrectly called free trade agreements, both because they are fundamentally preferential agreements that discriminate against non-members and because they never cover all trade and never eliminate all tariffs.

And how will the rising global imbalances of trade and foreign exchange reserve holdings be resolved, with the U.S. running a huge current account deficit - \$857 billion in 2006, some 6.5% of GDP – while others, notably China and Japan, run huge surpluses and have huge official foreign exchange reserves? Of course Korea also is a part of this pattern, even though the won has appreciated substantially against the dollar, unlike the Chinese yuan, while the yen has actually depreciated due to capital outflows from Japan, reflecting interest rate differentials and the carry trade.

I am optimistic as to how many of these problems will be resolved, though somewhat less so when they require international governmental cooperation and initiatives. Energy and other commodity markets will be subject to volatile price fluctuations, but over the longer run the combination of new technologies and market forces will reduce the current high prices of oil and other natural resources.

The adjustment of the U.S. trade imbalance will require concerted, if autonomous, macroeconomic policy actions in many countries including Korea. The U.S. has to get its own economic house in order – increasing private saving, further reducing the government budget deficit, and thereby slowing the growth of demand for imports while increasing exports. Countries running current account surpluses, such as Korea, China and Japan, will have to shift more to domestic demand, particularly consumption, to sustain demand growth. This should be, and probably will be, a long-run process of rebalancing global demand; a too-rapid reduction of the U.S. trade and current account deficit would be dangerous since it would involve a significant slowdown of U.S. economic growth. This would spill over to other countries, such as Korea and Japan and especially China, which rely so much on exports and current account surpluses as a source of aggregate demand.

Long-Run Economic Growth Prospects

As my second major theme, I want to consider long-run economic prospects for South Korea, China, Japan, Southeast Asia, the U.S. and the world – not just 10 but 20 and 30 years from now. Of course the future is uncertain, and the longer we look into the future the wider the range of possible outcomes, and the greater the likelihood of unanticipated major shocks.

Future economic growth will depend even more than in the past on innovation and technology, and on development of human skills. Capital formation, that is to say, business investment in factories, machinery, buildings, software, and information systems, will of course continue to be important, especially because it embodies new technologies. My approach is from the standard supply-side – focusing on the ability to produce increasing amounts of goods and especially services. This assumes that in the long run aggregate demand will be sufficient, even though we have seen the discouraging experience of Japan for the past 15 years, in which that clearly has not been the case. Thus, I focus more on potential growth rates, what South Korea and the other economies are probably capable of achieving. Before discussing Table 1, let me make some general comments.

These projections ignore many important potential problems and issues, such as global warming and environment degradation. They assume there will be no major wars in East Asia, or indeed the world. They assume that a major, sustained domestic crisis does not occur in China. And, most importantly from a Korea perspective, they assume that the North Korean economy and people will not be fully integrated with South Korea in the foreseeable future.

Earlier Japan and Korea's, and now China's, very rapid growth was achieved through the process of importing, and adapting foreign technologies, and then improving them and developing one's own world-class technologies. Inevitably, this initial phase of rapid industrial development gradually slows down as the economy develops and the technology gap is narrowed. Once countries reach high levels of per capita income, growth depends

fundamentally on the rate of new innovations, hardware and software, both domestically and globally; in such economies the growth rate slows to 1.5 to 2.5 percent.

A very important second reason that growth will slow down in Korea, China and Japan is demographic. With low birth rates and increasing life expectancy, in the longer run the absolute number of available workers will decrease significantly, even in China.

The development and increasingly flexible utilization of human skills – through formal education and on-the-job learning – will be more essential than ever. How to adjust to having fewer workers but using them much better will be a major challenge for Korea and Japan, and in due course China, and indeed all economically advanced countries that do not engage in substantial immigration.

The third productive force, in addition to workers and technology, is of course capital. This includes the efficient allocation of financial capital so as to make real capital formation effective and profitable. We used to think that the world had a shortage of savings globally relative to profitable investment opportunities, particularly in capital-short developing countries. Today we seem to have a global surplus of saving, in part because in too many developing countries the lack of supportive infrastructure and a good business environment, much less political risk, have made risk-adjusted returns too low. Relative to potential growth rates of South Korea, China and Japan I do not expect the future domestic savings rates to be a constraint on business investment and government infrastructure investment, even though high household saving rates will significantly decline in Korea and China, as they already have in Japan. And if the domestic saving rate declines too much because of aging, funds will readily be borrowed from abroad.

To make long-run projections of GDP growth, we have to estimate – or at least guess at – what the labor supply will be, and what that labor's productivity will be. Labor input is fundamentally a demographic variable – how many people of working age there will be. Those estimates have to be adjusted for male and female participation rates and number of working hours. We can predict the labor force some 15 years into the future for any country

World Economic & Population Outlook 2006-2050

Long-term Forecast of Global Economy and Population 2006-2050
Japan Center for Economic Research

Country Name	2000	2005	Forecast				Forecast					
			2020	2030	2040	2050	Average annual growth rate (%)					
							2001-05	2006-20	2021-30	2031-40	2041-50	
GDP (100 billions)	Japan	32.7	34.7	42.4	47.1	49.9	49.9	1.2	1.4	1.0	0.6	0.0
	China	49.6	77.3	173.3	251.6	304.2	333.9	9.3	5.5	3.8	1.9	0.9
	Korea	7.6	9.4	15.6	18.6	20.1	20.3	4.4	3.4	1.7	0.8	0.1
	India	24.5	33.8	70.7	103.0	144.0	191.2	6.6	5.0	3.8	3.4	2.9
	ASEAN	17.7	22.1	38.7	54.6	72.9	92.4	4.5	3.8	3.5	2.9	2.4
	U.S.	95.9	110.9	167.5	214.1	271.7	339.6	2.9	2.8	2.5	2.4	2.3
	EU	102.6	111.6	145.2	163.1	181.1	198.9	1.7	1.8	1.2	1.1	0.9
	GDP per capita (thousand)	Japan	25.8	27.1	34.5	40.9	47.4	53.1	1.0	1.6	1.7	1.5
China		3.9	5.8	12.2	17.8	22.4	26.4	8.4	5.1	3.8	2.3	1.7
Korea		16.3	19.7	32.2	39.5	45.9	52.0	3.9	3.3	2.1	1.5	1.2
India		2.4	3.0	5.2	6.8	8.8	11.0	4.9	3.6	2.8	2.6	2.3
ASEAN		3.9	4.6	6.8	8.9	11.3	14.1	3.0	2.7	2.8	2.5	2.2
U.S.		33.7	37.2	49.5	59.3	71.6	86.0	2.0	1.9	1.8	1.9	1.8
EU		23.2	24.8	31.9	36.3	41.4	47.3	1.4	1.7	1.3	1.3	1.3
Population (10 millions)		Japan	12.7	12.8	12.3	11.5	10.5	9.4	0.1	-0.2	-0.7	-0.9
	China	127.4	132.8	141.7	141.1	135.8	126.2	0.8	0.4	0.0	-0.4	-0.7
	Korea	4.7	4.8	4.9	4.7	4.4	3.9	0.4	0.1	-0.3	-0.7	-1.1
	India	102.1	110.9	135.9	150.9	163.6	173.3	1.7	1.4	1.1	0.8	0.6
	ASEAN	45.2	48.5	57.2	61.6	64.4	65.4	1.4	1.1	0.7	0.4	0.2
	U.S.	28.4	29.8	33.8	36.1	38.0	39.5	1.0	0.8	0.6	0.5	0.4
	EU	44.2	44.9	45.5	44.9	43.8	42.0	0.3	0.1	-0.1	-0.3	-0.4

[Notes] 1. Both GDP and GDP per capita are measured in purchasing power parity (PPP, constant 2000 \$).

2. Population forecast of U.S. is based on United Nations's figure.

3. ASEAN includes Thailand, Indonesia, Malaysia, Singapore, Philippines and Vietnam.

4. EU excludes Bulgaria, Cyprus, Czech, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia.

5. GDP and population at 2005 include estimated figures.

[Sources] Cabinet Office, *Annual Report on National Accounts*

Ministry of Internal Affairs and Communications, *Population Census*

United Nations, *World Population Prospects: The 2004 Revision*, etc.

better than any other economic variable, since future workers are already born. Beyond that it is a matter of estimating future fertility trends. They are low, particularly for Korea but also importantly for China, as well as Japan. Japan is an early indicator of the future; its working age population has been declining for more than a decade, and its population has already peaked. To estimate total labor supply we have to adjust for net immigration or emigration, which I assume will not be significantly different from zero for most of these countries.

So what can be said about probable major long-run economic trends – growth of population, GDP growth per capita, and GDP growth per worker. The Japan Center for Economic Research in Tokyo has recently made a useful, reasonable if cautious set of demographic and GDP projections for countries from now to 2020, 2030, 2040, and 2050, more than 40 years ahead.¹ The study estimates GDP in terms of purchasing power parity, not exchange rates, which makes country comparisons possible. While the specific numbers are only indicators, they make clear the expected major trends, as are shown in Table 1.

One major conclusion is that in East Asia, and indeed in most of the world, the demographic transition to low birth and death rates, aging, and eventual population decline will have profound economic and social effects. A second obvious conclusion is that while total GDP growth will slow, people will become richer. While there are poor people in almost all rich countries, deep, widespread poverty today no longer is a problem in Japan or Korea, and perhaps will not be a problem in China within several decades.

What are the GDP growth projections? In Table 1, South Korea's growth rate is estimated to be 3.4% between now and 2020, and then slow quite substantially, to 1.7% between 2021-2030, and to 0.8% between 2030-2040. Japan's projected growth rate will of course be slower: 1.4%, then 1.0%, then 0.6%. Importantly, as China catches up, its growth rate will slow dramatically, from 5.5% to 3.8% to 1.9%. Some analysts however say this is too low a projection, especially between now and 2020, for China.

¹ Komine, Takeo et al. March 2007. "Demographic Change and the Asian Economy – Long-Term Forecast of Global Economy and Population, 2006-2050" (Tokyo: Japan Center for Economic Research, Long-Term Forecast Team).

The most rapidly growing countries 30 years from now will be India, ASEAN and the U.S., not Korea, China, or Japan. The reason is essentially demographic. The population and the labor force will continue to grow in India and ASEAN because fertility rates will remain above 2.1, and the U.S. will continue to receive many immigrants as well as maintaining a fairly high fertility rate. These trends are provided in the population growth rows in Table 1. The middle set of rows indicate that the growth rates of GDP per capita will be reasonably good, and the range among countries is considerably narrower than total GDP growth because of the population factor.

Why the dramatic slowdown in GDP growth rates? Both labor inputs and labor productivity slow down. Indeed labor force will begin to decline absolutely from the 2020 decade in both South Korea and China, and is already negative in Japan, according to these estimates. The growth of GDP per capita is our best single measure of a country's standard of living. It depends on the demographic effect and especially on improvements in worker productivity.

The JCER study estimates that the growth of labor productivity (GDP growth per worker) will slow down to what might be called an advanced country rate. Korea labor productivity is projected to increase between now and 2020 at a 2.8% rate and then slow down gradually to about 1.8% by 2040. This is the rate projected for Japan from now on (1.7-1.9% to 2040.) Not surprisingly China, at a much lower level and stage of development, will achieve faster labor productivity growth, 5.2% to 2020, but then it will slow gradually to 1.9% by 2040. The projection for the U.S. is between 1.9-2.1% until 2050, while the EU slows from 1.8% to 1.6%. These are somewhat arbitrary but reasonable guesses; and they are quite close to each other as the economies reach the global production frontier.

How do South Korea, China, and Japan perform relative to each other? Of course total GDP size is very different due to population size. But in standard of living terms, South Korea is estimated to reach Japan's present level in another 10 years or so, and by 2030, if not sooner, to have the same level that Japan then has. It will take China another 25 years to reach Korea's 2007 level of income, and even by 2050 will be only half the level of Korea

and Japan. Even more important, in absolute terms Korea's average GDP per capita will double between now and 2030.

East Asian Regionalism and Economic Cooperation

The main focus of my lecture is to share some thoughts about East Asian regionalism and cooperation.

As you know, East Asia has been the most dynamic, fastest growing region in the world over the past 50 years. It was led first by Japan, and then South Korea and the other newly industrializing economies of Taiwan, Hong Kong and Singapore. The resource-rich countries of Southeast Asia followed. And, as you well know, the dramatically rapid growth of China ever since 1978 has made it a major economic and political player regionally and globally.

As is clear from my previous comments, East Asia led by China will continue to be the most rapidly growing region of the world for at least the next 25 years. Indeed, China is becoming the key East Asian country economically and politically.

One basic assumption has to be that the Chinese economy will continue to grow rapidly before gradually slowing down as it catches up, and as its rapid demographic transition proceeds. Nonetheless, I do have some serious concerns about China, mostly domestic in nature. Will China be the first economy whose population grows old before it becomes as economically advanced and well off as, say, Korea is today? Urbanization will be ever stronger, as it is in Korea. The urban-rural disparities may narrow but they will continue, and will be a rising social and political problem. Since China doesn't have much land per farmer either, Chinese agriculture will eventually become inefficient, and food will be imported. How will China deal with that? Korea and Japan are not very good role models of long-term agricultural adjustment.

China's rapid economic growth process today is based on two fundamental imbalances; gradually both will have to change. First, a high fixed investment rate is essential for electric power, transportation and other infrastructure needs, for factories, machinery commercial buildings, and for housing. But when the rate becomes too high, like today, inevitably some of the investment is wasteful. Second, China's current account (trade) surplus, not just with the United States but with the world, is far too large as a share of its GDP. In addition to increasingly intense political pressures from abroad, China is facing inflationary pressures at home. To solve these unsustainable trends China will have to increase its share of consumption in GDP, and allow the exchange rate to appreciate, probably very gradually. Exchange rate reform will require domestic reform.

There are major public goods costs in China's development process – particularly air pollution, environmental destruction, and lack of water in the north. China is both blessed and cursed with huge domestic sources of coal. CO2 emissions not only harm Chinese, but they contribute increasingly to the process of global warming. And of course they pollute Korea too.

I do not expect Chinese economic growth to be steady and smooth. All economies – whether capitalist or socialist – have been subject to serious economic fluctuations over time, business cycles in one form or another. One major challenge for Chinese economic policymakers, and for Korean and other foreigners investing and doing business in China, will be how to cope and deal with these inevitable economic slowdowns, whatever their source.

I do not know how the Communist one-party political system will deal with the inevitable tensions that economic development and growth bring – individual and regional income disparities, urban-rural disparities, a rapidly increasing middle class, the internet and other new communications technologies. Some scholars argue that economic development almost inevitably leads to democratization, with multiple political parties, or at least free speech, civil liberties, rule of law, and other values and institutions of democracies. South Korea is certainly one of the most exciting cases of the peaceful shift from military, authoritarian control to democracy.

There is no certainty that China will become a democratic country. I expect that for the foreseeable future the Communist Party will remain in power, and other political parties will not be tolerated. I have various political concerns about China: how will the increasingly powerful provinces and the central government deal with each other; what will be the political role of the military; how about civil rights and human rights? And corruption?

Let me turn to the broader context of East Asia. What do we mean by East Asia? How do we define it? East Asia, and indeed Asia as a whole, are Western rather than Asian cultural, political and economic concepts. I assume most of you are Koreans. Let me ask two questions.

First, how many think of yourselves as East Asians? Second, how many of you think of yourselves as Asians, defined to include India and Pakistan as well as other South Asian countries?

What is it that makes a group of countries consider themselves a region, in their own view or that of others? By what characteristics and criteria do we define East Asia? Who do we include, and who do we exclude, when we talk about East Asian regionalism? It turns out the definition is not so straightforward, and we use different definitions for different purposes.

While there may be some East Asian racial sense of identity, and geography is certainly important, it is difficult to argue East Asia is homogeneous in terms of language, history, religion or culture.

In East Asia today the main motivations for developing a regional perspective are predominantly economic and, relatedly, political. The fundamental reality underlying East Asian regionalism is the high degree of economic interdependence – in trade and foreign direct investment – which have been driven by markets and private businesses such as yourselves. Economic cooperation is now proposed as a government-initiated, functional way

to create region-wide public goods – region-wide institutions, currency and financial arrangements, and trade agreements that benefit all participants.

However these presumed economic benefits are less important for government policymakers than deep political objectives – to create a peaceful, cooperative, supportive East Asian community, no matter how general and vaguely community is defined.

Economic incentives and opportunities for regional cooperation are one way of defining East Asia as a region. However, the East Asian political players and the economic players are not exactly the same group. Moreover, some economies are in practice excluded from both: North Korea, Mongolia, and East Timor. Nonetheless, Laos, Cambodia, Myanmar and Brunei Darussalam are included in most definitions of East Asia for political reasons even though they have very small economies. In contrast, Taiwan, a major trading partner and direct investor in China and elsewhere in East Asia, is excluded; in that case politics clearly dominate economics. If one were to define East Asia in terms solely of major economic players, in addition to South Korea, Japan and China it would include Taiwan, Hong Kong, Indonesia, Malaysia, Thailand, Singapore, and the Philippines, and none of the smaller countries.

Obviously, an economic definition like this is politically unacceptable. East Asian regionalism is a political concept and the membership is politically defined by governments as they seek means of achieving regional economic cooperation. The political reality is that East Asia today means the ASEAN 10 nations plus South Korea, Japan, and China.

ASEAN +3 is not the only model proposed for East Asian economic cooperation. Japan, despite China's objections, has put forward the ASEAN +6 Summit concept to include India, Australia, and New Zealand. The intentions are far more political than economic. I do not think this East Asian Summit will become an important institution.

One key issue for every East Asian economy is how to deal most effectively with the United States, the sole global hegemonic economic, political, and military power. APEC –

the Asia Pacific Economic Cooperation forum – was the first and indeed continues to be the only governmental organization that has as members not only East Asian economies and Australia and New Zealand, but especially the United States, as well as Canada, Mexico, Chile and Peru. But APEC is basically a government dialogue discussion group, not based on a treaty, with no formal legal powers to implement any agreed-upon policies; it relies on consensus, peer pressure and incremental changes. Its most important function is to bring the heads of state together every year.

At the APEC meeting in Vietnam in November 2006, the United States suddenly proposed that APEC consider a U.S. Asia Pacific Free Trade Agreement. I do not think it represented a serious commitment by the United States government; rather it aimed primarily to show U.S. interest in East Asia and in the ongoing dialogue on a government-led East Asian regional architecture. No one expects this proposal to go anywhere. Indeed Japan's policy is quite explicit: first develop East Asian trade and financial arrangements and then, at some later, undefined stage, invite the U.S. to join in.

I have fundamentally different views regarding East Asia cooperation in currency and finance on the one hand, and on bilateral or regional trade agreements on the other hand. East Asian financial and currency agreements will be based on and supportive of the global financial system and global financial markets; they will be consistent with IMF rules and norms. The ASEAN +3 foreign exchange bilateral swap arrangements, the Chiang Mai Initiative and the Asian bond initiative, are useful, but modest. The recent ASEAN +3 agreement to pool foreign exchange reserve funds earlier committed the swap program to lend out in times of crisis, a sort of small Asian Monetary Fund, is an interesting step forward, but how these funds will be administered and invested, and issues of control are yet to be decided. These are only small, first steps in a very long process. Cooperative coordination of foreign exchange rates, and eventually a single rate fixed for East Asian economies, is a long way off, and may never occur. The idea of a single East Asian currency, analogous to the euro, is even further off.

I have real concerns about the development of bilateral or even regional preferential trade arrangements, which we incorrectly term “free trade agreements,” as I have already mentioned. There are several problems. First, agreements discriminate against non-members, so they have a distortionary trade diversion economic effect. Second, the agreements typically are very detailed, particularly the rules of origin for every product, and have many specific clauses, which make it extraordinarily difficult later to accept other members or to generalize the agreement to more country members. This is called the Bhagwati spaghetti bowl effect, and will be a serious problem. Third, FTAs undermine the WTO system of multilateral, non-discriminatory trade commitments. Clearly economically the first-best by far is the WTO global system. A poor second best are regional agreements. Bilateral FTAs are a third best.

The political reality is that the WTO Doha Round has not yet achieved a successful conclusion. Virtually every country is now vigorously pursuing a number of bilateral trade agreements. The recently negotiated Korea-U.S. agreement is by far the largest economically for the United States since NAFTA. As Professor Merit Janow, member of the WTO Dispute Settlement Appellate Body, Columbia Professor, and Co-Director of the Columbia APEC Study Center has stated, “The FTA train has already left the station, and is moving rapidly down the track.” We will probably need another decade or more to see where it ends up. I think it will either come to a dead end stalemate, or a train crash.

The political and security objectives of the current Korea-U.S. agreement are far more important than the net economic benefits. Since I have to accept the political reality that FTAs will continue to proliferate for some time, I support the Korea-U.S. trade agreement in order to strengthen the Korea-U.S. political and security alliance which, as you know, has been weakening for some years.

On the whole, I am quite positive about the East Asian government efforts to promote economic cooperation for two reasons. First, these governmental dialogues about economic cooperation – in ASEAN +3, ASEAN +6, central bank forums, APEC – involve a useful learning process. Dialogue is both a symbolism of commitment to cooperative modes of

formulating policy, and a process of learning about each other's national perceptions, priorities, problems, values, and modes of behavior. The potential political and security benefits of cooperation are significant; discussion of economic topics provides a rationale, a mechanism, for this much broader-based process of addressing more sensitive issues.

Second, I do not think these economic cooperation discussions will result in any regional institutions of deep substance, such as an East Asian FTA. The disparities among the potential members are too great – level of development, willingness to give up national autonomy, the conflict between agriculturally-inefficient Northeast Asia and more efficient Southeast Asia, and the importance of the WTO system and the U.S. and EU markets.

In other words, the phrase “East Asian economic cooperation” is nice, vague rhetoric but with only modest substance. It hides the underlying China-Japan tensions, the significant internal weaknesses of the ASEAN structure, and what I suspect is considerable Korean policymaker skepticism.

The major problem is the ongoing pursuit of bilateral FTAs. That they open markets on a preferential basis forces others to negotiate offsetting bilateral FTAs as well. Japanese are certainly not happy about the Korea-U.S. FTA. However, in the longer run I fear countries are creating a system full of incompatibilities, which will be a threat to the WTO multilateral system 10 years or so down the road.

In Conclusion

Economists spend a lot of time worrying about what could go wrong in the economy, in order to propose policies to prevent or mitigate those problems. Despite what I have just said about FTAs, nonetheless I, like many economists, am quite optimistic about the long-run future despite the huge problems we all face. This is because I am optimistic that in the long run humans adjust and adapt, and so too do institutions and government policies. Discoveries, innovations, and technological progress are fundamental drivers of improvements in human well being. They have brought remarkable change in the past and will continue to do so in the

future. You face exciting times, with both opportunities and challenges. It is up to you to respond creatively and pro-actively.