

The Korean Problem and  
Northeast Asian Economic Cooperation

The Evolving WTO Regime and Regional Economic  
Cooperation: Implications for Northeast Asia

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## 1. Need for Northeast Asian Economic Cooperation

Since the 1990s, the world has witnessed two major trends in the global economy. One is the global effort to build a multilateral world trade order through the WTO. The other is the strong emergence of regional economic blocs such as NAFTA, the EU, and APEC. The WTO forecasts that the number of regional trade agreements will be 250 by 2005.

There are several reasons for the emergence of multilateral regional economic blocs under the WTO system. First, nations within a certain trade or investment zone are increasingly being inter-dependent. Second, The trend of regional integration has been deepened among advanced nations. Since the end of the World War II, the US, which used to be the sole leader of a multilateral free trade system, has started to profess a strong regionalism. At the same time, the European countries have been integrated to form the EU by the end of the 20<sup>th</sup> Century. Third, developing nations or transitional economies are now more enthusiastic about regional economic blocs, since they recognize that participating in regional economic blocs is essential to boosting foreign support and understanding in the process of trade and investment liberalization and the adoption of the market economy.

It is predicted that such a strong emergence of regionalism is bound to deepen the polarization of the world economy. The super economic power of the US since the close of the WW II is now in decline. Instead of the superpower of the US, the world economic order will turn into a tri-polar system with the equal power of the North American region led by the US, the EU, and the Asian region centered around Japan, China. Recently, North America, Europe, and Asia have emerged as the three major

pillars of the world economy, accounting for 90% of world trade.

At the 3<sup>rd</sup> Summit of American Nations on April 22<sup>nd</sup>, 2001, the American nations agreed to create the FTAA by December 2005, linking the American countries into a single economic bloc. The introduction of a single currency in EU member countries on January 1, 2002 is likely to be a major turning point in the process towards a “single Europe”.

As regional economic integration deepens worldwide, as seen in the emergence of NAFTA or the EU, there is increasing need for East Asian countries to magnify their effort for economic cooperation. In witnessing the new global trends, East Asian countries have recognized that the existing bilateral economic framework is no longer sufficient in dealing with the prevailing changes. In response, East Asian countries have recognized the need to expand economic ties multilaterally with neighbor countries in the Asia-Pacific region. Moreover, taking into account the present and future prospects of East Asian countries, economic ties with neighboring nations are expected to create a synergy effect, maximizing the interest of all nations involved.

As the economic size of the East Asian region grows, the region's share in international trade is expected to increase from 27.2% in 2000 to 35% by 2020. The share of world import is also likely to rise from 24.9% in 2000 to 33.5% by 2020. Therefore in response to the continuous increase of regional trade volume among East Asian countries, it is high time to seek diverse multilateral cooperative frameworks.

Furthermore, recent Asian financial crisis has proven that one nation's crisis is bound to spread to other closely linked countries. This has given rise to ardent discussions on establishing an East Asian economic framework. Moreover the nations share the recognition that making continuous efforts for trade and investment

liberalization and a stable financial structure is crucial in overcoming a crisis.

## 2. Planning a Northeast Asian Economic Cooperative Framework

There are already some signs of economic cooperation in the region. Spontaneous cooperation has turned into central government based effort since 1997. ASEAN + 3 provides the best example for this effort for government-to-government cooperation.

The success of regional economic integration in East Asia is highly dependent on the participation of Korea, Japan, and China. The three Northeast Asian countries contribute as much as 90% of the East Asian economy. Therefore regional economic integration without the three nations would inevitably have a weaker presence or impact.

Japan has high technology and massive capital, and Korea has advanced manufacturing technologies and experience of a rapid economic development. China can provide vast labor force and potential market with 1.35 billion potential consumers. This suggests the potential benefits and feasibility of economic cooperation among the three countries. Furthermore, by establishing an economic cooperative framework among the three countries, all three are most likely to gain benefits.

As China will be the greatest beneficiary of investment, China has been proactive in creating a Northeast Asian economic cooperative framework. Moreover, as has been mentioned above, the restructuring of state-owned companies, the development of the inner land, etc will make foreign capital vital. Therefore China recognizes the urgency and importance of a regional economic framework.

In the case of Japan, amid the prolonged economic recession, Japan is experiencing a severe labor shortage due to the aging population. As faced with

challenges of supporting the elderly citizens, Japan is also likely to have much at stake in forming an economic cooperative body.

When turning to Korea, Korea is likely to gain benefits from regional economic integration in that it would be conducive to creating a favorable environment for stability on the Korean peninsula and for reunification, thereby providing a critical momentum for improving inter-Korean relationship. Moreover, Korea has comparative advantages over Japan and China in that not only is Korea advanced than China in terms of market economic structure and human capital, but also has a less bureaucratic, therefore a more flexible economic structure than Japan. Therefore Korea is most likely to enjoy substantial benefits by regional economic cooperation.

The economic cooperation of Korea, China, and Japan is expected to compose a major cornerstone of the regional economic cooperation in East Asia as a whole. Furthermore, by embracing ASEAN, it is likely to create an institutionalized economic cooperative body covering the entire East Asian region. The increasing flow of trade and investment in the region has made East Asian countries more interdependent than ever before. Moreover the three Northeast Asian countries of Korea, China, and Japan have been increasingly engaged in trade and investment in East Asia. Under such circumstances, a regional economic cooperative body is most likely to satisfy the needs of all nations concerned. Therefore the collaboration between Northeast Asian countries and ASEAN will undoubtedly bring the two regions closer together and ultimately create an East Asian economic framework encompassing both Northeast Asian and Southeast Asian countries. Furthermore, in the long run, this will lay the foundation for the East Asian economy to emerge as one of the three major pillars of the world economy.

### 3. Challenges in Northeast Asian Economic Cooperation

However, economic cooperation triggers political consideration in the region. Especially Northeast Asian cooperation cannot escape from political characteristics. The member countries comprise not only of China, Japan, and Korea, but also of Russia, North Korea, Taiwan, and Mongolia.

There are many obstacles that hinder the process of Northeast Asian economic cooperation. The past history of Japanese colonialism, the conflict of Japan and Russia over Northern Islands, the rivalry between China and Japan, and the conflict between Mainland China and Taiwan remain as obstacles for economic cooperation in the region.

Throughout the world, economic integration generally takes place among countries with similar economic sizes and stages of development. However, in the case of East Asia, the economic disparity among countries is greater than in any other region. It also seems to have adverse effect on the integration process.

The United States' strong opposition to the establishment of a regional economic cooperative body in the region also has had a negative effect. Therefore it is crucial to balance and align the conflicting interests of all parties involved in forming an economic framework.

Above all, North Korea has been a major source of political and military tension in the region, as well as a critical obstacle to regional economic cooperation. North Korea is still a communist regime, while China, Russia, and Mongolia are in the transitional period from a planned economy to a market economy. Therefore the economic disparity among the countries is also another challenge to building a framework for economic cooperation. These are the most daunting challenges that have

to be solved in the future for more active economic cooperation in the region.

Considering the different stages of economic development, and the political, economic, cultural diversity of East Asian countries, economic integration in the region should be a gradual and long-term process, starting from a more moderate level of integration. As a matter of fact, establishing an institutionalized regional economic body such as the EU of Western Europe, the NAFTA of North America, or the MERCOSUR of Latin America could be possible only in the far future.

Therefore, in the short run, Economic Cooperation in Northeast Asia should take the form of “soft regionalism,” in which local governments and private sectors take the initiative for cooperation in terms of specific business projects.

#### 4. Current Situation of Korea and Prerequisites for Economic Integration

Improvement in the relationship between South and North Korea and consequent political stability on the Korean Peninsula are the kernel necessary for progress of economic cooperation in Northeast Asia. There are two aspects in which the North Korean problem works as a hindrance to cooperation in the region. The first one is a political problem that North Korea remains as a sole remnant of cold-war era. As long as the two Koreas keep confrontation against each other, China and Russia have to side with the North, and the US and Japan have to stand by the South escalating up tension in the region. Especially the North-US relationship will work as an independent variable that determines the future prospect of the North-Japan and even the North-South relationship.

Actually, we can say that North Korea is holding the key to the political

stability of Northeast Asia. When North Korea improves its relationship with the neighbors including South Korea with flexible stance, Northeast Asian economic cooperation will be strengthened. On the other hand, it is the role of the neighbors that can make North Korea have flexible posture. One of better ways to drag precarious North Korea out of the hard shell is to give confidence that it can get economic benefit from interchange and contact with the neighbor countries without being threatened of its political stability.

The second aspect is that North Korea is a link in many projects of Northeast Asian economic cooperation. Especially in the projects of reconnecting railroads between North and South Korea and bringing in natural gas from Russian Far East to China, North Korea, South Korea, and Japan, the participation of North Korea is a prerequisite. Those projects also can be very helpful for the recovery of North Korean economy as well as for the political stability of the region. On this regard, the reform measures announced on the 1<sup>st</sup> of July 2002 by North Korea have significant meaning. New measures include increase of price and wage levels, realization of exchange rates. And the central government has transferred responsibility for managing production to local authorities except in industries such as munition that are critical to its national strategy. With the recovery from serious economic difficulties, North Korea now needs to secure economic stability and prepare a basis for sustainable growth. There are still debates whether these series of drastic changes are a symptom of transition to a market economy or only a restrictive and temporary device to rebuild socialist planned economy.

The Japan-North Korea summit meeting scheduled September 17 might have come out of strategic plot to induce more foreign capital which is critical for the



recovery of North Korean economy. Still we have to wait to see more fruitful result from the summit meeting. Nevertheless, it is clear that these changes will contribute to the enhancement of economic cooperation in Northeast Asia.

## 5. Future Prospect of Economic Cooperation and the Role of Outside Powers

Considering its geographical situation, the Korean peninsula is a strategic gateway to Northeast Asia, connecting Northern China, Japan, and far-eastern Russia. Therefore, in order to maximize such geographical advantage, the North and the South Korea have to facilitate economic cooperation with each other. In other words, for example, when the inter-Korean railway is constructed, the Korean peninsula will be directly connected with the Northeast China, Russia, Central Asia, and Europe by land-route. Therefore it will definitely contribute to the political stability of Korean peninsula, which is prerequisite for the economic prosperity of the region, and it is highly likely that Korea will emerge as a logistics hub with easy access to any part of the world.

Of course, to make this possible, it is vital to build political trust between South and North Korea as well as economic cooperation. On the shorter term, it is necessary to develop practical measures to strengthen economic ties with North Korea and help North Korea overcome its economic difficulty. On the longer term, it is important to expand economic cooperation and make the two Koreas' economies more inter-linked in order to facilitate further economic integration in the future. North Korea is expected to gradually expand its trade and investment with South Korea by following a "selective economic cooperation policy", considering its contradictory situation in opening up its market while maintaining its political regime.

At the same time, there remain substantial hindrances to inter-Korean economic cooperation. The greatest obstacle in bilateral trade and investment is the lack of a market in North Korea. As a matter of fact, the largest share of trade with North Korea has been primary products. During the last decade, North Korea has hardly developed any new products, which lessens the likelihood of trade expansion. Moreover, political and military tension between South and North Korea, excessive transaction costs, and North Korea's underdeveloped trade environment are major obstacles. Therefore, in order to overcome the limits to inter-Korean economic cooperation, international cooperation is essential. In this regard, it would be advisable to review diverse measures to support the North, such as helping North Korea join international finance institutions or establishing an international aid organization for North Korean development.<sup>67)</sup>

On the other hand, once tangible results are seen in establishing a logistics transportation route via land, sea, and air, and in launching a land route to the GeumGang Mountains, inter-Korean economic cooperation is likely to expand in size rapidly. As of 2000, North Korea's trade with South Korea took up 21.6% of its total trade ( 425 million dollars). Though it is smaller than the trade volume of 24.8% with China or 23.5% with Japan, the practical volume North Korea's trade with South Korea is estimated to be larger when taking into account non-direct trade between the two Koreas. On the other hand, the bilateral economic cooperation should go beyond expanding merely the size of trade and put greater emphasis on improving the quality of trade.

The most feasible areas of trade and investment between South and North

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<sup>67)</sup> One feasible measure would be to establish a Northeast Asian Development Bank. The creation of a Northeast Asian Development Bank is most likely to promote Northeast Asian economic cooperation and help establish social infrastructure in

Korea are the agricultural sector or the construction of social infrastructure. On the other hand, it is also important to create a stable investment environment in order to prevent any possible conflicts in the inter-Korean process. In particular, it would be advisable to reconstruct and repair the existing roads and railways between South and North Korea, construct new roads and sea lanes. If necessary, South Korea could also provide the facilities and technology in reforming the harbors of North Korea. Such economic cooperation in constructing social infrastructure will lay the framework for developing the Korean peninsula into a logistics hub of Northeast Asia within the next decade. At the same time, in order to create a stable investment environment, there are several crucial matters to consider. First, it is necessary to make official documents of all bilateral agreements, in order to prevent any possible conflict in the future. In the long term, it is well-advised to study the possibility of creating a joint inter-Korean body in charge of investment planning or implementation.

Expanding trade and investment between South and North Korea will be a critical cornerstone in transforming the Korean peninsula into a logistics and business hub of Northeast Asia within the next decade, and will be the driving force of Northeast Asian economic cooperation as well.

In other words, the initial step in reaching this goal is to draw the plans for an economic body linking the three Northeast Asian countries, namely China, Japan, Russia, and South and North Korea on a long-term and step-by-step basis. To this end, the central government, local governments, and the private sector must take the leading role and work together to initialize feasible projects. At the same time, a regional political cooperative framework is necessary to resolve remaining conflicts and promote

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Northeast Asia as well.

friendship among the three countries. This is necessary in order to relieve political tension and seek cooperative measures, which is to lay a firm foundation to facilitate the on-going economic cooperation. This will bring the nations to the ultimate goal of establishing an economic cooperative body.

Once this is achieved, the body should be expanded to embrace other Northeast Asian countries such as Taiwan or Hong Kong in order to create a truly Northeast Asian economic cooperative body. It also requires a strong leadership to align the different interests stemming from the diverse political and economic situations of all countries in the region.