

## Economic Cooperation in Northeast Asia: Feasibility or Illusion?\*

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Despite the differences in economic management and political systems in the Northeast Asia, the region has great potential for economic growth and mutual cooperation by forming "natural economic territories" and or "linear free trade area" and consequently taking advantage of vast differences in factor endowments and development stages. For a multilateral cooperation scheme such as the celebrated project of "Tumen River Development Area" bordering jointly North Korea, China, and Russia to get started, it is crucial for the nonmarket economies in the region to accommodate the general business practices in market economies. In particular, North Korea needs to establish a successful opening similar to China's special economic zones. At this time, it is very unlikely that the region will develop as a meaningful subregional economic bloc. Rather, the countries may participate actively in making APEC a viable multilateral cooperative organization.

### I. Introduction

In recent years, the world economic system has been moving toward globalism as testified to by the Uruguay Round negotiations. Yet, surprisingly enough, economic regionalism also is gaining significant momentum as was made evident by the launching of the Single European Market this year and the enlarged North American Free Trade Agreement (NAFTA), which will be put in force next year. With the global free trade system at the crossroads of newly emerging economic blocs in the post-cold war World economic system, some authors suggest a regional economic block movement even in Northeast Asia. In this regard, such con-

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cepts as "Northeast Asia Economic Circle," along with "Greater East Asia Coprosperity Sphere," "Plan Yellow Sea Economic Circle," and "China Economic Community" have been proposed by some academicians as well as policymakers. The concepts in the context of intra-regional economic cooperation<sup>1</sup> have received some popular support in the region as both the EC and NAFTA are emerging as bipolar regional economic blocs and implicitly discriminating against non-member countries' imports by keeping external tariffs while eliminating internal tariff and trade barriers among member countries.

The Northeast Asian economy in this paper is defined on the basis of purely geographical proximity to include South and North Korea, Japan, Northeastern three provinces of China namely Jilin, Heilongjiang, and Liaoning and the Far Eastern part of Russia.<sup>2</sup> The impressive economic growth in China in recent years, the birth of the Commonwealth of Independent States in 1991, and subsequent political and economic changes in Northeast Asia appear to be of long-lasting global significance. Recognizing the enormity of factor endowment and growth potential and partly as a long-term countermove against EC and NAFTA, some academics have presented ideas of forming a Northeast economic circle at several international conferences in the region.

Of the most significant factor in the regional economic cooperation in Northeast Asia could be the China. China has succeeded in implementing major components of the open door policy which was adopted in 1978. In recent years, China became more aggressive in pursuit of an outward-oriented economic management, outperforming even South Korea in export activities from 1991 onward. Despite some severe economic and political turbulence, the newly born Russia also has undertaken a series of profound economic reforms; and some crucial reforms to adhere to general principles of market economies are still underway.

Japan is also a very important factor in any subregional economic bloc movement because of her sheer economic strength. At present, Japan is ready to intensify her direct foreign investments on a massive scale in China after more or less completing huge overseas production base in ASEAN countries. Japan also is extremely eager to establish a *de facto*

<sup>1</sup> Economic cooperation in this paper could be interpreted as mutually accorded efforts to facilitate freer cross-border flows of goods, services and productive factors than the present pattern in existence.

<sup>2</sup> In the case of EC and NAFTA, geographical proximity along with common cultural heritage and similar level of development was one of the most important binding links to form a single market.

Japan centered economic sphere in Northeast Asia. South Korea, too, increased trade volume with both China and Russia dramatically. Combined with the rapidly increasing international trade in this region, a new regional economic cooperation in Northeast Asia in a formal framework suddenly became a popular subject matter even in multilateral meetings of ranking government officers.

South Korea at present is searching for new frontiers to diversify her export markets in order to expedite her needed structural adjustments in industrial upgrading necessary to compete in the increasingly intense international economic environment of the post-Cold War era.

North Korea, still the staunchest socialist inward-looking planned economy, entered the middle of international controversy by withdrawing her Nuclear Nonproliferation Treaty membership of the International Atomic Energy Agency, but has not given up searching for an economic outlet of international cooperation. This is clearly reflected by the fact that North Korea hosted the United Nation's Program Management Meeting of the Tumen River Area Development Programme (TRADP) in May in Pyongyang.

The purpose of this paper is basically threefold: a) to review interdependent trade and foreign investment structure in the region, b) to analyze the possibility of multilateral economic cooperation scheme within a formal framework in the region, c) to delineate some critical issues, mutual lessons and needed adjustments on the part of non-market economies to promote intra-regional economic cooperation. Because of the sheer complexity as well as multiplicity of the intra-regional relationship, it should be noted that emphasis is given to the multilateral relationship with South Korea at a focal point while some other intra-regional relationship may come into the picture when necessary.

Section II presents some major features of the intra-regional economic relations. Section III discusses some specific schemes of multilateral economic cooperation as illustrated in the Tumen River project in the region. Section IV delineates some mutual lessons and major adjustments needed on the part of non-market economies in the region to promote regional economic cooperation. The paper concludes with some remarks on the future prospects of the intra-regional economic cooperation in a formal framework in Northeast Asia.

## **II. Recent Development of the Intra-Regional Economic Relationship**

Perhaps, the most promising characteristics of Northeast Asia for

economic cooperation turn out to be the tremendous diversity in population as well as geographical size, per capita income, and trade volume across the countries in the region. This is evident in Table 1.

**Table 1**  
MAJOR ECONOMIC INDICATORS OF NORTHEASTERN ASIA (1989)

(Unit: US\$100 million)

	Popul. (million)	GNP	GNP per Capita	Trade	Export	Import
S. Korea	42.4	2,101	4,968	1,239	624	615
N. Korea	21.0	233	1,108	48	20	28
Japan	123.1	28,337	23,016	4,860	2,752	2,108
China <sup>1)</sup>	97.9	495	506	81	62	19
Soviet Union <sup>2)</sup>	7.9	288	3,627	121	55	66
Northeast Asia (A)	292.3	31,454	—	6,348	3,513	2,836
World (B)	5,155.4	236,142	4,580	58,802	28,990	29,812
A/B(%)	5.7	13.3	—	10.8	12.1	9.5

Notes: 1) Heilungjiang, Kirin Province, Liaoning Province.

2) Far Eastern region.

Sources: Economic Planning Board, Korea Development Institute, JETRO & IMF.

The most important variable to indicate the degree of economic cooperation in the region could be multilateral trade statistics. For this reason, an intra-regional trade matrix is presented in Table 2. In 1989, the largest trade cells are for the bilateral trade between South Korea and Japan but by 1992 the cells between Japan and China had become the biggest. Trade between the former Soviet Union and other countries is light and generally falling with the economic deterioration of the CIS. In particular, North Korea's trade volume with other countries in the region is very small perhaps due to North Korea's inward-looking trade regime.

The potential of far greater future intra-regional economic interaction is indicated by diversity and richness of natural resource endowment and development stages. For example, the Far East Russia is blessed with abundant natural resource deposits such as coal, natural gas, non-iron

**Table 2**  
**TRADE MATRIX AMONG NORTHEASTERN ASIAN COUNTRIES**

(Unit: million of \$)

Origin	Destination					Total
	N. Korea	S. Korea	China	Japan	CIS	
N. Korea						
Export	—	11**	167	268	364*	772
Import	—	199**	399	216	86*	1231
S. Korea						
Export	199**	—	585***	12878	NA	60760
Import	11**	—	2263***	14569	NA	64686
China						
Export	359	2263***	—	6026	1766	59826
Import	175	585***	—	8151	1699	53274
Japan						
Export	171	16568	6256	—	2625	277122
Import	302	11832	11138	—	3184	220612
CIS						
Export	NA	NA	1544	2893	—	24904
Import	NA	NA	1942	2887	—	24904

Figures are for 1989: 4th quarter 1990: 3rd quarter, except for N. Korea which are for 1989. \*figures for 1991, \*\*for 1992, \*\*\*for 1990 based on the Economist Intelligence Unit report.

*Note:* Because of accounting problems, country A's exports to country B do not equal to country B's imports from country A.

*Source:* IMF, Direction of Trade.

metals, wood and marine resources yet to be fully tapped. Northeastern China has a wealth of minerals, sufficient agricultural output, and abundant labor. North Korea is endowed with both mineral and human resources. Although South Korea is poorly endowed with natural resources, she has accumulated sufficient experiences in adapting western technologies and in developing a unique government-level, export-oriented strategy, which has one of the highest growth performances in the world during the last 30 years. Indeed, Korea can serve as a prototype model for centrally-planned economies in the region considering adopting outward-looking development strategies. The inherent mutual complementarity

among the Northeast Asian countries has been well documented by the UNDP Mission team to look into the feasibility of the Tumen River Area Development Project as shown in Table 3.

The diverse factor endowment and different level of industrial development and experiences show that economic complementarity among the nations in Northeast Asia is simply obvious (Ywon 1991). Despite the complementary nature of sub-regional economies inherent in the geographical proximity and the differential factor endowment, the Cold War between the East and West has prevented the natural economic partnership between market and non-market economies in the region that would have been taken place otherwise.

In the post-Soviet Union era, Northeast Asia is clearly emerging as a new growth center of the World economy. Much of this change can be attributed to China's successful opening program, as well as its decentralization scheme and more recently, to the political disintegration of the former Soviet Union.

However, the trace of the Cold War that prevented full-scale economic cooperation in the region still remains in Northeast Asia, most notably on the Korean peninsula. Although after a series of inter-Korea prime ministerial meetings South and North Korea agreed on non-aggression accord, major steps are still necessary to nurture sufficient understanding and trust between the two Koreas. This argument is further verified by North Korea's recent controversial withdrawal from the Nuclear Non-proliferation Treaty of the IAEA.

The most visible sign of growing intra-regional economic cooperation is found in the rapidly increasing level of bilateral trade between South Korea and China. The total trade volume between South Korea and China registered US\$4,443 million in 1991, almost quadrupling the trade volume between South Korea and the CIS in the same year (Table 4). South Korea's trade with China continued to surge in 1992. Indeed, China's export to South Korea rose by 165 percent in 1992. Of course, the Sino-Japan bilateral trade has been not only larger in volume than that between Korea and Japan but also historically far longer.

Another significant sign of growing economic cooperation between South Korea and the former Soviet Union can be found in the rapid expansion of the bilateral trade. For the period of 1987-1991, the average annual growth rate of the bilateral trade between two countries registered at 55 percent, soaring from US\$133 million in 1986 to US\$1,202 million in 1991 (Table 5). The impressive growth of the bilateral trade over this period was partially due to the fact that there was initially a very small

**Table 3**  
THE COMPLEMENTARY CONDITIONS OF  
NORTHEAST ASIAN COUNTRIES

	Advantages	Disadvantages
Northeast: China	Favorable agricultural conditions, adequate and various agricultural products (such as corn, soybean, meat, fruit), some textile products, oil, coal, building materials, medicinal herbs, and excess labour.	Lack of capital, advanced equipment, technology and management experience, comparative shortage of some mineral resources, out-dated infrastructure.
DRPK:	Rich mineral resources, metal, ore and simple processed products, aquatic products, some industrial commodities and plentiful labour.	Shortage of capital, insufficiency of farm, sideline and light industrial commodities, backward equipment and technology
Far East: Russia	Plenty of forest, non-ferrous metal ore, aquatic resources, oil, gas, coal and some products of heavy and chemical industries (such as steel, fertilizers, etc.)	Severe shortage of agricultural and light industrial goods, lack of labour and capital, backward industrial equipment and management experience.
ROK:	Capital, advanced technology & equipment ready to move out, vanguard industrial products	Shortage of energy and industrial resources, lack of grains for stock raising, insufficiency of labour
Japan:	Surplus capital, advanced technology, plenty of superior equipment ready to move out, vanguard industrial products, management experiences.	Severe shortage of energy and industrial resources, insufficient grains for animal husbandry and some agricultural products, comparative deficiency of labour.

*Source:* UNDP, Tumen River Area Development Programme Mission Report by Miller M., A. Holm, and T. Kelleher, October 1991.

**Table 4**  
SOUTH KOREA'S EXPORT AND IMPORT WITH CHINA

(Unit: million U.S.\$)

	Total	Export	Import	Trade Account
1985	1,161	683	478	205
1986	1,335 (15.1) <sup>1)</sup>	715 (4.7)	621 (29.9)	94
1987	1,679 (25.7)	813 (13.7)	866 (39.5)	-53
1988	3,087 (83.9)	1,700 (109.1)	1,387 (60.2)	313
1989	3,143 (1.8)	438 (-15.4)	1,705 (22.9)	-1,267
1990	2,853 (9.4)	585 (9.9)	2,268 (33.0)	-1,673
1991	4,443 (55.7)	1,003 (71.5)	3,441 (51.6)	-2,438
1992	6,379 (43.6)	2,654 (164.7)	3,725 (8.3)	-1,071

*Notes:* 1) The export and import figures do not include the indirect trade figures via Hong Kong.

2) The numbers in the parentheses indicate the percentage change from a year earlier.

*Sources:* 1985-1989: EPB, White Paper on Economy.

1990-1992: The Korea Institute of International Economic Policy.

**Table 5**  
SOUTH KOREA'S EXPORT AND IMPORT WITH CIS

(Unit: million U.S.\$)

	Total	Export	Import	Trade Account
1985	113.0	59.7	62.3	-2.7
1986	113.8 (0.7)	49.9 (-16.4)	63.9 (2.6)	-1.4
1987	200.4 (76.1)	67.2 (34.7)	133.1 (108.3)	-65.9
1988	289.9 (44.7)	111.6 (65.9)	178.3 (33.9)	-66.7
1989	559.9 (106.8)	207.7 (85.2)	391.7 (119.7)	-184.0
1990	889.0 (62.9)	519.0 (149.5)	370.0 (-5.6)	149.0
1991	1,202.0 (35.1)	625.0 (20.4)	577.3 (56.1)	47.7
1992	859.1 (-28.5)	364.6 (-41.7)	494.5 (-14.3)	-129.9

*Notes:* The numbers in the parentheses is percentage change from the previous year.

*Sources:* Korea Institute for International Economic Policy.



trade volume between two countries. However, the political and economic uncertainties in Russia last year caused a significant setback in the bilateral trade, dropping the trade volume by 28 percent from the previous year.

South Korea's major export items to the CIS were textiles and heavy and chemical products as shown in Table 6 (Lee 1991). In 1990, thanks to the rapid growth of South Korean exports in electronics, cars and machinery, heavy and chemical industrial products represented 82 percent of Korea's total export the CIS.

While exported mainly finished products, it imported from the CIS mostly raw materials such as coal, timber, fur and raw cotton, pig-iron, scrap iron, nickel-ingot and pulp. In 1990, industrial raw materials and fuels constituted 81 percent of Korea's imports from the Soviet Union (Table 7). However, the Sino-South Korea trade pattern has been characterized by the two-way flow of manufactured goods rather than the exchange of manufactured products for primary goods as observed between South Korea and Russia.

Compared to trade performance, Korea's direct foreign investment to the CIS has been marginal. At the end of 1991, Korea's total investment in the CIS amounted to US\$1.5 million to cover four projects. However,

**Table 6**  
SOUTH KOREA'S MAJOR EXPORT ITEMS TO THE CIS IN 1990

	Value (US\$1,000)	Rate increase from previous year (%)	Share (%)
Food & Direct Consumer Goods	866	106.4	0.17
Raw Materials and Fuel	2,096	33.6	0.40
Light Industrial Products	91,622	31.2	17.65
Heavy & Chemical Products	424,562	212.4	81.78
Total	519,147	149.9	100.0

*Source:* Korea Customs Administration.

**Table 7**  
SOUTH KOREA'S IMPORT FROM THE CIS IN 1990

	Value (US\$1,000)	Rate increase from previous year (%)	Share (%)
Food & Direct			
Consumer Goods	60,000	-11.4	16.34
Industrial Raw			
Material and Fuel	299,186	-2.9	80.94
Capital Goods	8,781	-42.4	2.38
Nondurable & Durable			
Consumer Goods	1,270	960.5	0.34
Total	369,652	-5.6	100.0

*Source:* Korea Customs Administration.

there are a number of joint venture projects now under negotiation.

In contrast, South Korea's direct foreign investment in China registered cumulative US\$514 million in connection with a total of 487 projects as of the end of February this year. Out of the total cumulative direct foreign investment, US\$150 million — accounting for 61 cases — took place during the first two months of this year. The trend is likely to deepen at an alarming rate as Korean entrepreneurs seek to take advantage of low wages and marketing potential in China. Thus, South Korea's direct foreign investment in China will certainly reinforce the mutual economic partnership which has already been established in the region.

It is further well known that Japan enjoys both the highest capital surplus and technological superiority in the region. Thus, Japan has emerged as the largest investor in the region and particularly in China. Japanese direct foreign investment (DFI) in China has undergone three distinctive phases. The first phase during the period of 1980-83 dealt with basically resource development. But Japan's DFI into China during the second phase of 1985-88 involved mainly relocation of plants to overcome the Yen appreciation. Finally, from 1991 onward Japan switched the investment strategy to aim for potential marketing opportunities in China from 1991 onward.

The amount of Japanese DFI in China jumped dramatically in recent years. In 1992, for example, the Japanese DFI in China reached US\$2.17 billion accounting for 1,805 projects, having risen 201 percent and 16.8 percent respectively from the previous year 1991.<sup>3</sup> This performance is far greater than South Korea's DFI in China.

### III. A New Scheme for Multinational Economic Cooperation in Northeast Asia

Economic cooperation among countries in the region with different systems of economic management faces a host of challenges and barriers that would not exist at all between market economies. Often, both legal framework and confidence building for long-term economic cooperation between two systems of economic management in Northeast Asia are still lacking.

Eventually, the leadership for economic partnership must be carried out by multinational firms of the market economies in the region. It is private firms from market economies that will ultimately undertake direct foreign investment and technology transfers to the countries that need foreign capital. This leads us to reaffirm that the sub-regional economic cooperation depends on the extent to which non-market economies are ready to accept the behavioral principles of private firms in market economies.

As a new approach to exert the confidence building necessary to promote the regional economic partnership in Northeast Asia, it is worthwhile to pay attention to the much celebrated on-going Tumen River Area Development Programme (TRADP), which is a part of the United Nations Development Programme's efforts. TRADP appears to be a concrete starting project which will facilitate economic cooperation on a sub-regional basis. The strategic location of the Tumen River Delta area in terms of global trading patterns provides the countries in Northeast Asian countries with enormous potential. Being located at the northernmost tip of North Korea, the Tumen River delta is ideal for establishment of a Special Economic Zone (SEZ) for North Korea in separation of large dwelling communities.

Situated within easy access to major markets in the industrialized Chinese provinces of Jilin, and Heilongjiang and to favorable supply fac-

<sup>3</sup> See Industrial and Trade Newsletter, Number 1448, Korea Institute for Industrial Economies and Trade.

tors such as labor and natural resources from Russia, DPRK and Mongolia, the Tumen River area also has the tremendous advantage of proximity to Japan, South Korea, and further of providing access to Europe.<sup>4</sup> As far as two Koreas are concerned, the United Nations Development Programme (UNDP) project could serve as a unique confidence building process between two Koreas.

The mineral resource deposits and natural resources in Northeastern Asia and their economic complementarity could justify the concept of the Tumen Delta area as a future Hong Kong with the potential for entrepot trader and related industrial development akin to that region. Regional cooperation involving the Tumen River Project among the three bordering countries namely China, North Korea, and Russia appears to be a crucial testing case to demonstrate that the non-market economies involved can work together with market economies in the region to realize even a fraction of the Tumen Delta Potential despite the differences in their respective economic management systems. The three border countries should coordinate in such a way that the project will secure the confidence of international investment community and the necessary financing of about 30 billion dollars for the long term development.

The TRADP may be viewed as a truly multinational scheme, the first of its kind, to facilitate the inter-country trade as well as technology transfer and attract foreign capital investment to the region, if the project is implemented as conceived in the initial United Nation's Project document.

The project could serve as a feasible starting point for the countries concerned to realize the potential benefit of sub-regional multilateral cooperative schemes. In fact, the project could be seen as a concrete example of "linear free trade zone" or "free trade belt."<sup>5</sup> As important, this will enable the bordering countries along the Tumen River to be put on a learning curve of maximizing the gains of international trade, foreign investment and technology transfer especially from the market economies in the region.

In order to promote economic partnership between market economies and centrally planned economies in the region, non-market economies in

<sup>4</sup> For details, see Kim Hak Su (1992) and UNDP (1991).

<sup>5</sup> The concept of "linear free trade zone" or "free trade belt" is differentiated from the traditional concept of free trade areas. The former applies to each bordering state to create its own special economic zone in a network fashion through which free flows of limited commodities is allowed, thus being only partial as well as sub-regional opening of bordering states. For details, see Sohn Byeong Hae (1992).

the region must understand some behavioral principles of multinational firms of the market economies in the region.<sup>6</sup> In this regard, these countries must first understand the factors that are influencing global trade and direct investment in the 1990's. The factors which merit careful scrutiny by Russia, and for that matter by North Korea would include the following:

- o Enhanced global competition
- o Increased sophistication of markets
- o Product globalization
- o Impact of capital flow
- o Growing protectionist sentiment
- o Competition for foreign investment and technology transfer
- o Pending inflation

Any multinational project in the region must consider the above factors one way or another in order to design any meaningful multilateral cooperation scheme. This is especially true on the part of centrally-planned economies in the region to initiate multilateral joint ventures in collaboration with firms from market economies.

Competition in the global marketplace is no longer an exclusive territory of the developed nations of the world. In fact, for the past two decades the net flow of exports has been continually shifting from the developed nations to the newly industrialized countries of the world.

Japan and the newly industrialized economies of South Korea, Taiwan, Hong Kong and Singapore are dominant in this respect. Other developing nations, ranging from Brazil in South America and the Thailand in Southeast Asia to Israel in the Middle East and Hungary in Europe are also enhancing their trade positions.

Most newly industrialized economies have also been primary recipients of foreign investment because, in spite of the increased risks involved, the return on investment for the foreign partner is usually higher; and their markets have also been open to the foreign joint venture firms. Although the growth rates of these countries vary considerably, they offer excellent potential for present and future returns. In fact, none of these countries could have achieved their present rates of growth without the infusion of foreign technology and investment.

However, most lesser developed economies and especially formerly socialist economies also lack the financial resources needed to further their

<sup>6</sup> For the multi-national firms' behavior in the socialist economies, see Grub (1987).

internal investment and to provide for adequate infrastructure development. There is a prime need for capital goods. Construction of roads, ports, and telecommunications facilities are essential for attracting foreign investment. In the global marketplace, there is increased competition for foreign investment and technology transfer. However, foreign firms will not invest in a country that does not have a stable economy in either a political or economic sense.

Today, most multinational corporations tend to meet all of their production needs in existing plants and facilities in their global network. Therefore, the attractive economies in which they seek to invest are those that offer goods market potential at least in the long run. No longer are firms looking for desperately low-cost labor, which is often unskilled. In fact, through the use of robotics, flexible manufacturing systems, and other forms of plant automation, most products can be produced more economically at home.

Even when companies consider investing in a developing country, looking to the time when the domestic market would be accessible for sale of their products, political instability or rapid shifts in policies may scare them away. Finally, inflation is creeping upwards in most countries. If it becomes rampant, it will have a tremendous distorting effect on global trade and investment. These above mentioned points somehow need to be fully understood by the project managers in the centrally planned economies if they wish to integrate their economies with the global market.

As a result, economic reforms of Russia and for that matter North Korea and the other CIS member countries should take these factors into a full consideration to attract foreign direct investment. In this regard, North Korea appears to be long way to go if she is really interested in gaining benefits from opening her economy. Nevertheless, China's success in opening its markets to attract foreign investment could serve as an effective model for North Korea to follow.

#### **IV. Some Critical Issues and Mutual Lessons to Promote Economic Cooperation in Northeast Asia**

At present, several major problem areas hinder the multilateral cooperative potential in Northeast Asia from materializing. First, the lack of a basic framework for economic cooperation between two different economic systems still exists. Second, the two systems lack mutual trust. Third, political and economic uncertainties in North Korea and Russia make economic interactions with these countries risky.

For example, South Korea lacks serious experiences in Russia and vice versa. Most critically, South Korea has not had any experience doing business directly in North Korea. Most importantly, the political and economic environment in "Northern Countries" still is very much uncertain for international economic cooperation to be effective to the truly meaningful extent.

Despite a series of the summit meetings and various official contacts between South Korea and Russia, the legal and institutional frameworks for economic cooperation between two countries is still lacking. For example, the investment guarantee agreement between South Korea and Russia has not gone into effect because of Russian legislative delays. Furthermore, the debt service schedule of South Korean government loan for economic cooperation with formerly the Soviet Union is not only unknown in detail but also uncertain.

Furthermore, the existing centrally-planned economic system in Russia has broken down but a new economic system with price liberalization and unitary exchange rate system has not yet been established to replace it. Russia's historic process of purging the remnants of communism is still far from complete. The Russian economy at the moment is experiencing hyperinflation, a negative growth rate, and massive unemployment and is also unable to service her debt outstanding.

As a result, Korean firms doing business in the CIS face great uncertainty and risk. In particular, the economic decision-making process has been aggravated by the disintegration of the former Union structure, which makes it extremely difficult for South Korean businessmen to find the right Russian business partner. For instance, Korean businessmen are discovering that their Russian counterparts frequently wish to revise contract terms after it has been signed.<sup>7</sup> The problems relating to the inconvertibility of the ruble and the repatriation of profits have not been fully resolved.

Unlike the economic interactions with other former socialist countries, any attempts to promote inter-Korea economic cooperation has been so far dictated by political ideology. Obvious economic complementarity between two Koreas is tremendous but ideological differences have deterred the potential economic partnership. After both Russia and China took their economic-aid hands off North Korea by terminating the supply of "soft" loans at concessional rates, North Korea ran into economic and

<sup>7</sup> For the description of major problems encountered by Korean businessmen in Russia, see Lee Chang Jae (1991).

some political crises that will continue into the foreseeable future.

Regarding North Korea's political and economic situations in recent weeks, the Economist Intelligence Unit observed:

*"From now on Juche is for real and for the first time North Korea really does stand alone. For as long as North Korea goes on pretending that technical and managerial problems can be solved by increasing doses of ideology, its economic crisis will only deepen. Should 1993 fail to bring desperately needed Chinese style economic reforms, plus an aid package from Seoul or Tokyo, then chances of either a popular uprising or an elite coup can only grow."*<sup>8</sup>

This assessment clearly shows the degree of uncertainties and risks of involving North Korea in any attempts to materialize a multilateral economic cooperation in Northeast Asia.

Obviously, different approaches to various modes of economic cooperation between market and non-market economies in the region are needed. In this regard, the opening strategy adopted by China may provide valuable lessons to both Russia and North Korea. Chinese Special Economic Zoning policy demonstrates that ready access to world-class information, marketing and technology center appears to be very crucial at the initial stage of opening. The opening of China's Guangdong Province with direct access to Hong Kong is a clear example of success. Of course, Chinese with firm commitments for international contracts also provided lucrative incentives to foreign investors. The initial success then exerted spread-over effects to coastal areas and finally to inland regions along Yangtze river.<sup>9</sup> Perhaps China itself may eventually become a special economic processing zone. Although Chinese call their system the "Socialist Market Economy," it is in reality a Chinese version of a market economy.<sup>10</sup>

A crucial lesson one can draw from China's experience is that in the absence of a competitive market environment, trade orientation could serve as the best substitute for the capitalist market mechanism in the short and medium term to facilitate competition among producers and consumers in a socialist economy. Historically, Asian NICs and Japan pur-

<sup>8</sup> See the Economist Intelligence Unit, *South Korea, North Korea Country Report* No. 11993, 1993, pp. 34-35.

<sup>9</sup> For Chinese evolutionary process of introducing market economic components in various segment of the economy, see Ahn Choong Yong (1993a).

<sup>10</sup> For Chinese recent economic performance and related structural changes, see Ahn Choong Yong (1993b, 1990).



sued export-oriented economic management with varying degree of emphasis to achieve a rapid economic growth.

Even in the socialist setting, the Chinese skillfully adopted a strategy to exert competition among local governments at provincial and city levels with carefully designed decentralization strategy. Because of the "Competition" element maintained in the Chinese economic reform, China and her neighboring countries were able to become natural trading partners. They indeed demonstrated that country's opportunities for profitable investment expand more rapidly if its neighbors are growing economically fast.

The same logic also could be applied to North Korea and Russia. For the North Korean and Russian side, it is very important to develop a cadre of "business entrepreneurs" who can handle international business practices inside the "business incubator" within the Special Economic Zones, for example, along the Tumen River Delta area and in the Russian Far East as perceived by the "Greater Vladivostok Project."

In the case of the Russian Far East-South Korean economic cooperation, geographical proximity provides tremendous cost advantages for trade, to encourage technological exchange and direct investment. South Korea's repairing and maintenance of Russian ships is an illustration of the point. In order to tackle Russia's shortage of hard currencies to settle the bilateral trade, both South Korea and Russia are desired to work out a barter trade scheme in a formal way for the time being.

Unlike other multilateral relations, inter-Korea trade can exploit a number of unique common denominators possessed. They include the possibility of direct ground shipments, common language and common cultural heritage, to name just a few. These favorable factors are not found in other bilateral relations in the region. A barter trade scheme could, similar to the one between South Korea and Russia well be implemented to circumvent North Korea's hard currency problem — the two Koreas have already conducted the barter trade at a very minimal scale.

Both Russia and North Korea need to produce a viable opening outcome — one that could serve as a model to other regional multilateral projects of their interest. Russia and North Korea could be more aggressive at least on a sub-regional basis in setting up special economic zones to induce foreign investors and tap effectively local resources including human power. In this regard, the establishment of SEZ in a "linear free trade area" at the "Golden Delta" of the Tumen River where Russia, China, and North Korea share a common border should be

able to serve as a catalyst for regional development which will trigger the initial opening process on the part of North Korea and accelerate Russia's on-going opening strategy.

One feasible multilateral cooperative effort in Russia could be the natural resource development in Siberia through direct investment from the U.S., South Korea, Japan, etc. Russian authorities may also give serious consideration to inviting direct foreign investments for telecommunication systems and plants producing petrochemicals, forestry products and electronic and electric goods in the region.

## V. Conclusion

Northeast Asian countries, hitherto bilateral economic relations, must evolve into a complex web of multilateral commitments for substantial economic cooperation to materialize among them. Economic cooperation between market economies are basically dictated by the market signals despite some tariff and nontariff barriers. Economic cooperation between market and non-market economies must also ultimately determined by market signals.

Despite the differences in economic management systems, the Northeast Asian countries should maximize the growth potential by taking the advantage of geographical proximity and vast differences in factor endowments if economic growth is each country's priority. Yet political instability will serve as one of the most detrimental factors to the non-market economies' opening efforts. Therefore, in order to expand intra-regional economic intercourse, North Korea and Russia must convince sure potential investors that their direct foreign investments can be fully guaranteed with firm commitments to the international code of business conduct.

In particular, it is also terribly important for all the countries in the region to recognize the fact that the economic cooperation between North and South Korea is crucial to expedite mutually beneficial economic activities among countries in the region. Undoubtedly, increased economic contacts between South and North Korea will automatically lead to continued expansion of economic cooperation in Northeast Asia. For example, a gas pipeline to develop Siberian energy resources will require tripartite involvement from Russia, North and South Korea. A trans-Asia-Middle East traffic route will involve China and the two Koreas. Thus, the standing conflicts on the Korean Peninsula must be resolved to ensure future peace and prosperity in the region.

Finally, all the countries in the region, especially Japan, South Korea and China should take some initiatives to establish a "Northeast Asian Development Bank"<sup>11</sup> which will assist in financing regional development projects of common interest, however small the initial funds might be. Combined all the positive factors together in the region with successful openings of Russia, China, and North Korea, the present concept of limited economic openness could be transformed in the long run into the idea of unlimited openness (Ivanov 1991). Then, Northeast Asia may be able to emerge as an feasible economic cooperative economic entity perhaps in the form of Professor Scalapino's "Natural Economic Territories" (Scalapino 1991).<sup>12</sup>

The Tumen River Delta project is a good candidate even for the Natural Economic Territories. But then it requires that all the countries involved are determined to make it a joint success story. For this purpose, the North Korean stance is critical to make the concept of a "Northeast Economic Circle" viable to any meaningful extent. If North Korea's intentions and multilateral commitments continue to be blurred by uncertain political development, the concept will be at best a wishful scenario beyond even long time horizon.

In the years to come, it is very likely that Northeast Asian countries with the possible short-run exception of North Korea, will be outward-looking and Pacific-oriented. The trend of the trans-Pacific trade in the past decade clearly suggests that the trans-Pacific orientation of South Korea, Japan and China will be either on the rise or at least unabated. Thus, the option of forming a Northeast Asian economic bloc at this point, in contrast to the EC or NAFTA, may simply not be tenable for the region's future development.

In the meantime, the countries in the region may be better off intensifying the functions of the Asia Pacific Economic Cooperation (APEC) and the Pacific Economic Basin Council (PBEC) as the primary vehicles to promote economic cooperation but eventually to liberate trade on a global scale, as pursued in the Uruguay Round. For this to happen, APEC should continue to pursue "open regionalism" and to accept the entry of

11 For the necessity of creating a multilateral financing scheme for the regional projects, see Kim Cae-One (1992)1

12 Professor Scalapino defined the natural economic territories to be sometimes a product of governmental policies, in some cases the result of private initiatives, in many cases a combination of both. Whatever their stimuli, they cut across political lines. For example, combining the Guangdong, Hong Kong, and Taiwan is one case and South Korea and Jilin or Shandong provinces together could be another in the future. For details, see Scalapino (1991).

both Russia and North Korea. For this purpose, South Korea should work together all APEC members to invite both North Korea and Russia to join the APEC as South Korea did for China.

Indeed, South Korea must play a major role, first, in bringing North Korea in fuller measure into the wider Asia-Pacific economic avenue with an introduction of foreign exchange earning multilateral projects either in the Tumen River delta or elsewhere in North Korea and subsequently in encouraging a process of unification. Needless to say, it would be far better for a unified Korea as well as regional prosperity as a whole if Korean unification is a process rather than a product of catastrophic event. Located at the center of the complex equation of geo-political and economic powers in Northeast Asia, South Korea needs to seek simultaneously bilateralism, sub-regionalism or regionalism, and globalism in the years to come.

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