Korea - Japan Partnership in a Dynamic but Turbulent East Asian Economy

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I. Introduction

It is indeed a great privilege for me to participate in the 54th annual meeting of the Japanese Society of International Economics Association (JSIEA), especially since this is the first time after formally agreeing to participate in regular academic exchanges and joint research collaborations between JSIEA and Korea International Economic Association earlier this year. Based on this mutual agreement between the two associations, Professor Yamazawa Ippei (1995) proposed some important and constructive viewpoints to promote Japan-Korea partnership in the dynamic East Asian economy at the Korea International Economic Association’s Summer Policy Convention in Taegu, Korea last June. This paper was written in response to Professor Yamazawa's to express a personal viewpoint from South Korea (hereafter Korea).

In the contemporary world, East Asia is the fastest growing area, within which Northeast Asia is the fastest growing section. During the period of 1971-1991, the average annual growth rate of the East Asian economies recorded 6.8 percent, which is twice as high as the 3.4 percent of the global average. The combined growth of the eight highest performing East Asian economies (Japan, four of the first tier Asian

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NICs, and three of the second tier Asian NICs) and China's recent economic upsurge were described by the World Bank study (1993) as the East Asian miracle.

The East Asian growth momentum is likely to act as a domino to growth in the South west Asia in the very near future. During the past decade or so, Northeast Asia in particular has been the most rapidly growing region in the world economy, despite its vast heterogeneity in development stage, factor endowment, and economic management system. At the center of the development miracle were Japan's successful catch-up with the western industrial leaders despite her belated crusade for economic modernization at the turn of this century, the rapid industrial take-off of the first tier Asian NICs (South Korea, Taiwan, Singapore, and Hong Kong) in the 1970s, the recent accelerated growth of the second tier Asian NICs (Malaysia, Thailand, Indonesia) in the 1980s, and the continuation of China's spectacular growth especially in the 1990s.

Judging from recent performance, there has been a growing recognition that the Northeast economies could become a catalyst in creating a new growth pole in Asia in addition to North America and the EU. Indeed, this potential further signifies the notion of the 21st century as "Asia-Pacific Era" or the "Asia-Century". A concerted open regional effort towards an intra-regional economic cooperation can serve as a concrete building block toward the current APEC movement.

The purpose of this paper is basically to describe a) both the dynamic nature and the turbulent factors which are emerging in Northeast Asian economies, b) the roles which both Japan and Korea need to play in a bilateral as well as multilateral framework, and c) major adjustments that other countries in the region should make to promote regional prosperity and consumer well-being.

It should be noted that the policy implications of this paper could be extended to all of East Asia, including ASEAN member countries, but the discussion here is focused on Northeast Asia to make arguments on the basis of geographical proximity rather than other criteria. In this context, Northeast Asia here is defined to include Japan, South and North Korea, three Northeastern provinces of China—namely Jilin,
Heilongjian, Liaoning provinces—and the Russian Far East.

Section II discusses some optimistic prospects, as well as turbulent factors expected to occur in Northeast Asian economies. Both aspects of this region’s contributing influences are multilateral in nature, but the bilateral cooperation between Korea and Japan is crucial in determining the future path of development in Northeast Asia. Section III presents the roles which Japan and Korea need to play to promote regional cooperation on a bilateral as well as multilateral basis. It also discusses the major adjustments other countries in the region need to make to ensure regional economic cooperation. Section IV concludes the paper with suggestions for economists in both Japan and Korea.

II. Opportunities and Challenges in Northeast Economies

In very recent years, Northeast Asian economies have been faced with a host of new opportunities as well as serious challenges which necessitate the invigoration of Northeast Asian economic cooperation. In addition to the expected multilateral economic benefit, advancement in intra-regional economic cooperation in Northeast Asia is likely to ease whatever political and military tensions still exist in the region.

To begin optimistically, the countries in the region, despite the differences in economic management systems, are determined to grow economically under some form of an outward-oriented trade and investment regime. China, the most populous nation in the world, especially, has been very successful in transforming herself into a “socialist market economy” (McMillan, 1995). Russia has also been outward-looking during the recent transition period, but with mixed success. More importantly, the Russian Far East offers an entire gamut of natural resource deposits which could be tapped to further regional economic growth. Although only to a very limited extent, North Korea also appears to be joining the regional outward orientation. Overall, this newly emerging trend is a drastic contrast to the isolationist doctrine which prevailed in the Cold-War era. Indeed, it is miraculous that East Asia outperformed both the EC and NAFTA and other subregional economic blocs, even in the absence of a concerted
cooperative institution except a subregional effort by ASEAN.

Second, very recently, the world has witnessed the official emergence of key regional economic blocs such as the EC and NAFTA, and the ambitious plan of the Asia-Pacific Economic Cooperation forum which has pledged itself to internal free trade by the year 2020 in the midst of creating a new global trade regime based on the World Trade Organization. In parallel with the emerging economic blocs, there exists a growing awareness among Northeast Asian countries of the fact that the geographical proximity, the vast differences in the level of development, and untapped natural resource deposits in the region could be tremendous blessings for regional economic dynamism, provided that they are properly combined for common regional benefit.

Third, in the post-Cold War era, it is no longer feasible for Northeast Asian countries to continue growth on the basis of unlimited access to the U.S. market. As a result, there appears to exist widely shared agreement that Northeast Asian economies must be increasingly reliant within Asia itself. Neglected growth potentials in the region are increasingly becoming realized.

The end of a global Cold War has triggered a variety of conceptual frameworks designed for a more concerted economic cooperation in Northeast Asia. As Professor Krugman points out, it is not surprising that neighboring countries tend to trade with each other more than countries farther apart. Northeast Asian economies constitute the most populous region in the world, characterized by profound differences in economic management, resource endowments, and level of development. The inherent complementarity in Northeast Asian economies could be a driving force to ensure a common regional prosperity if intra-regional economic cooperation is more systematically pursued. This potential could be the brightest prospect in regional economic cooperation.

In very recent years, however, Northeast Asian economies are faced with a set of serious challenges, the most serious of which is yet to come. As an aside, military and political issues are of course terribly important, but they are beyond the scope of this paper. Focusing on socio-economic issues, some of the most crucial issues to be faced
are country-specific, but many are multilateral in nature and thus require a collective action agenda. If mismanaged or poorly coordinated among the countries concerned, Northeast Asia is likely to contain a set of extremely turbulent and volatile factors which will destroy regional growth potential. Some common regional volatilities revolve around the following factors:

First, the recent Northeast economic dynamism has been accompanied by 1) the most rapid rate of energy consumption and 2) the most rapid urbanization in the world. Major energy sources have been coal, oil, and atomic power plants. Beginning in 1993, China became a net importer of oil. In fact, three major oil-consuming countries out the global top eight—specifically, Japan, China, and South Korea—are located in the region. With the Russian Far East, there are four.

Environmental deterioration has also been extremely acute in the Yellow Sea area. Ozone depletion has already affected the weather condition in the region. An accelerated urbanization has also generated all kinds of urban problems including waste accumulation, water pollution, and urban crimes. These same problems are true for the East Sea area (The Japan Sea) although to a lesser degree.

The increased environmental deterioration is likely to become a cancer for the 1.5 billion people residing in this part of the world (Kim Jin Hyun 1995) if not properly prevented through regional preventive measures. The unabated industrial growth of the most populous nation in the world—namely, China—must be critically assessed in its environmental implications. The Russian Far East and the two Koreas also have some serious environmental problems.

The Yellow Sea, and for that matter the East Sea (Japan Sea), is also quickly becoming a dead sea. Furthermore, the increasing number of atomic energy power plants also raises some critical safety issues. Most at stake is the sheer survival of 1.5 billion people in China, Japan, the Koreas, and Russia combined.

Third, it has already been pointed out that East Asia’s future economic growth and dynamism must be increasingly reliant with in Asia itself. We need to recognize that the U.S. market during the post-Cold War period served as the greatest and most
lenient absorber of Asian products. Under the IMF-GATT system, both Japan and Asian NICs took advantage of the "unlimited" U.S. market. But now, the question arises as to whether Japan is ready to play a leading role to ensure a freer trade-oriented Northeast Asia. In other words, do we have a country in the region which can play the role the U.S. played in promoting global growth in the post-war era?

Fourth, the Korean peninsula is still divided on the ideological front, and the two Koreas still face the potential danger of severe hostilities, if not military confrontation. North Korea is still an extreme example of a closed, cohesive and inward-looking entity. The inducement of North Korea to an open-door policy appears to be the most viable alternative to ensure regional stability as well as to create a new source of growth in the region. To what extent is North Korea serious about its bid to open the Rajin-Sonbong or another free trade area? In this regard, could China's gradualism in making a transition to a "socialist market economy" be applicable for North Korea as well?

III. The Roles of Japan and Korea, and Bilateral Partnership

In order to protect the sheer survival of the enormous population in Northeast Asia and also to materialize the regional growth potential, some important multilateral efforts appear to be in order. At the moment, environmental cooperation is the only area in which there exists a tangible institutional mechanism in Northeast Asia as a precursor to prospective regional institutional development.

To deal effectively with the major geo-environmental issues raised above, the role of Japan is the most critical to assure that the regional growth potential would be neither damaged nor hampered. In particular, transfer of Japan's "public technology" for common environmental protection in the region is urgently needed to induce environmentally friendly practices in the rest of the region.

Recently, south Korea also has increased its national budget as well as international commitments to preserve the regional environment. It is encouraging that there have been some civic green movements in Korea. Next year, the Korean government will
increase its annual budget by 28.2 percent specifically for the protection and improvement of the environment, as compared to 12 percent increase of the overall budget. The government will also conduct for the first time next year an eco-census to identify both waters and substances polluting the environment.

Perhaps, some form of the cross-country civic movements must be activated stronger than ever to spread an environmentally friendly life style at a household level. Some multilateral efforts are required to introduce environmentally friendly production processes as well at a firm level. Of course, cost is involved in this endeavor. In addition, international political economy is also operating to bring pollution-reducing production methods into the less developed countries in the region. Nevertheless, comprehensive joint studies by multinational academic communities on a regional eco-census could be a good starting point.

Regarding the inducement of North Korea into an open-door policy as a viable alternative for a new regional source of growth and regional stability, the UNDP project entitled the “Tumen River Area Development Programme” which involves North Korea, China, and Russia deserves more serious attention from the countries in Northeast Asia. The Tumen River Area could be implemented as a “natural economic territory” or “linear free trade area” (Ahn Choong Yong, 1993), in accordance with the idea proposed by Professor Scalapino (Scalapino, 19934). It is a concept of an open multilateral subregional entity which takes advantage of natural economic links.

Perhaps, the most important issue lies in how to finance the project. Some multilateral efforts such as creating an “East Asia Development Bank” or expanding the financing capability of the Asia Development Bank are necessary. Japan, the largest creditor in the world, needs to pay ardent attention to a multilateral financial arrangement with other countries in the region. Undoubtedly, North Korea should dismantle some legal and institutional barriers at central and local levels to induce direct foreign investment from neighboring market economies.

In addition, some bilateral issues between Japan and Korea must be addressed. It is important that Korea-Japan partnership be discussed to promote multilateral economic
cooperation in Northeast Asia, because Japan and Korea are the only market economies in the region and must take a leading role in transforming the current former socialist economies of the region. The functioning of market economies requires both price and nonprice information. In particular, institutions must arise to provide nonprice information (McMillan, 1995). Both Japan and Korea should play an active role of providing nonprice information to economies in transition.

Both Japan and Korea are under great transition in their own rights. At the moment, Japan is going to break away from its longest on-going post-war recession. Also, Korea is about to integrate itself more fully in the globalizing world economy.

First, Japan needs to undertake major reforms to get over from its catch-up "syndrome" which is reflected by the current recession. After Japan successfully catching up with western economic powers, Japan needs to become a "normal advanced country". Since the catch-up objective has been achieved, Japanese economy now requires major adjustments to transform herself from a producer-oriented society to a consumer-oriented one. Professor Eisner (1995) suggested that both the housing sector and infrastructure in Japan need to be developed on a massive scale to trigger a domestic consumption-based economy.

Japan’s producer-oriented society has successfully served the purpose of the catching-up with the west. Professor Akamatu (1935) pioneered the truly creative flying geese theory to explain an international pattern of industrial development when Japan pursued the "Co-Prosperity of the Great East Asia." However, Japan has maintained a virtually "full set" economy until ever recently. Its legacies are still very visible.

Syrquin and Chenery’s cross-country development pattern (1989) also clearly indicates that major industrial countries shifted from producer-based to consumer-based societies as the per-capita income reached the highest bracket of the world. As the World Bank indicated, the chronic trade surplus of a major industrial power with a producer-protective orientation will be more likely to become a direct threat to free trade itself in the WTO era.
Japan's transition to a consumer-oriented society will require massive deregulation and substantial financial sector reforms. Many economists in Japan argue in favor of this transition, but I often hear that "the bureaucrats and sometimes the politicians do not listen to this recommendation." This seems to me a mysterious part of the Japanese system.

Perhaps, the greatest contribution of Japan to East Asian development is the country's demonstration of a successful catch-up process to western industrial leader status as a non-western nation within only in a few generations. Indeed, it is a miracle achievement for Japan to rise as the second super economic power in the world despite her belated quest for modernization.

New sources of endogenous demand must come from countries with large populations in the region, in the post-Cold War period: China, India, and Indonesia. In addition, there need to be increased exports into Japan by Asian producers. This is extremely important not only in terms of quantity but also quality.

Second, for the continued regional growth and industrial upgrading, Japan needs to substitute the role the U.S. played in the Cold-War period in absorbing Asia's quality products. Japan's increased imports of that kind will help close the price differential between domestic and international markets for the benefits of Japanese consumers. Furthermore, it will serve as a catalyst to assure an industrial upgrading of neighboring countries in Northeast Asia. In turn, the industrially upgraded neighboring countries will be able to continue to absorb Japan's sophisticated products.

South Korea is also confronted with major economic challenges. Deregulation has been emphasized to allow free competition and to attract foreign investment, although its effectiveness has also been seriously questioned. To clean up the underground economy and to reduce rent-seeking activities, the Kim Young Sam administration has taken an abrupt measures in introducing the real name system in financial as well as real estate transactions.

The recent "globalization" has been part of Korea's catch phrase, in which rules and regulations are required to meet international standards. To tap into new technologies
from advanced countries is crucial in making Korea’s attempts successful. In this regard, the inducement of DFI through removal of all restrictions is a major component in Korea’s catch-up efforts. South Korea’s attempt to join the OECD exemplifies its liberalization and deregulation efforts. Along the line of liberalization, the inducement of Japanese firms into Korea is essential in Korea’s endeavor to learn advanced technologies and management practices.

Perhaps the most serious economic issue in South Korea at the moment is how to deal with the rapid wage hike which has stripped the labor productivity growth. The wage level in Korea’s manufacturing sector has already risen to the wage level in the United Kingdom. As a result, the improvement of labor productivity is a most urgent issue.

With the phasing out of labor-intensive industries, effective future-oriented structural adjustments have been emphasized. For example, numerous strategic alliances with foreign firms have been built up over the years. At the same time, Korea has put itself in the position of being forced to transfer to other countries the location of much of its manufacturing. Korean firms must seek alliances with firms in the region, especially with Japanese firms.

South Korea’s lop-sided trade deficit vis-a-vis Japan since South Korea’s economic modernization drive has been well known. In fact, South Korea’s accumulated bilateral trade deficit against Japan has been greater than South Korea’s global trade deficit. This issue can be resolved by South Korea’s expanded entry into the Japanese market as Japan opens its domestic market much wider than before and as South Korea attempts to localize capital goods imports.

Regarding the bilateral economic cooperation issues between Japan and South Korea, on top of the priority list is technology transfer and technology cooperation. In the past, many South Korean firms have experienced some difficulty in accessing some Japanese technologies at the right time and of the right kind. As a result, South Korean firms were forced to use time-consuming reverse engineering or partnerships with U.S. or European firms (Kim Linsu, 1996 forthcoming).
This situation applies to microwave ovens, VCRs, and semiconductors among other things. Of course, there were some frustrations in dealing with U.S. or European firms in these efforts. Technology transfer involves both giving and receiving. Nothing would happen if the giver is not willing to provide and the receiver is not ready to absorb. If the giver is reluctant but the receiver is ready to absorb, then the receiver tends to acquire the needed technology one way or another. Once a country builds up some degree of absorptive capacity to receive new technologies, the argument of boomerang effects on the giver appears to be invalid. Under this circumstance, a mutually cooperative game between the willingly giving end and absorptive receiving end is likely to contribute more to people’s well-beings in both countries involved.

IV. Conclusion

Today, both globalization and regionalization require global perspectives as well as an understanding of the socio-economic mechanism of the regional community. Each country in Northeast Asia and its corporations in Northeast Asia should follow emerging international norms, attitudes, and values characterized by reciprocity, mutual understanding, and obedience to rules and laws. Although we know that new regional structures in the Northeast are emerging along the globalization trend, as evidenced in APEC movement, even short-run outcomes are still uncertain.

True economic cooperation on a multilateral setting is greatly affected by the fundamental psychologies of the people in the region concerned. In addition to the various turbulent factors which could be detrimental to fostering regional growth potential in Northeast Asia, there is the worrisome symptom of “neo-gunkokushugi” in Japan, although it is represented by a small segment of ultra conservatives. This is also true to a substantial extent in China.

However, there exists a majority of Japanese people who recognize the multilateral historical relations in Northeast Asia as it happened. The spirit of the majority in Japan who accept the historical truth of the recent past in relation to neighboring countries should be translated into Japan’s initiatives to promote multilateral economic
cooperation in Northeast Asia. It applies to Japan’s policy on the official development assistance program, technology transfer, and environmental protection in Northeast Asia. Beyond the global super-economic power status, genuine moral leadership on the part of the Japanese is an essential ingredient to building a harmonious and prosperous subregional community in East Asia.

In recent months, it has been very encouraging to see that some strategic alliances between Japanese and South Korean firms have taken place. Horizontal division of labor between Japan and South Korea finally started to emerge with the current Yen hike and South Korea’s rising eagerness to commit to R & D efforts.

The economists in Japan and South Korea need to find out ways and means of how the two countries can maximize the geographical proximity which has been a driving force in recent subregional economic cooperation elsewhere. The economists of the two countries can also contribute a great deal to expanding mutual understanding of the people of the two countries.

In Korea, the Japanese-speaking generation is gradually fading away. The majority of opinion leaders and active academicians in their fifties or younger in Korea who studied abroad were educated in the U.S. As a result, there is currently a huge communication gap between the generation in their fifties or younger in the two countries. This situation must be rectified. It should be mentioned that Japanese is becoming one of the most popular foreign languages among college students in Korea.

As Professor Yamazawa (1995) asserted in his paper presented in Taegu, a closer partnership between Japan and South Korea will be a key to successful development of the Asia Pacific Economic Cooperation Process. On this proposition, I fully agree. Furthermore, I also agree with his assertion that joint endeavor on the part of Japanese and Korean economists in understanding each other will contribute to resolving the common survival issues between the two countries.

Bibliography
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