

# Strategies for Globalization in Northeast Asia

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## 1. Introduction

In the 21st century, many changes have occurred in the world. The shape of things to appear in the 21 century must be different from that of the last century. In regard to the shape of things in the 21st century, Dr. Lester Thurow, who is a prominent professor in MIT, mentioned some of the possible changes to be seen in the 21st century. In his view, the following three points broadly illustrate the characterization of the 21st century.

First, in the industrial societies of the nineteenth and twentieth centuries, the location of natural resources and the possession of capital determined the development of each country's industries. Generally labor-intensive products were made in poor countries; capital-intensive products were made in rich countries. In contrast, man-made brainpower industries don't have natural predetermined homes. They are geographically free-capable of being located anywhere on the face of the earth. The economically dominant will be able to create, mobilize, and organize the brainpower that determines their location.

Second, technological changes, especially in the transportation, telecommunications and information industries, have drastically reduced physical distance in terms of cost and time. Furthermore, these changes are creating a world where anything can be made anywhere on the face of earth and sold everywhere else on the face of the earth. National economies fade away. A substantial disconnection arises between global business firms with a world-view and national governments that focus on the welfare of their voters. Countries splinter, regional trading blocs grow, and the global economy becomes ever more interconnected.

Finally, the rules of the worlds trading system have always been written and enforced by its dominant economies-Great Britain in the nineteenth century and the United States in the twentieth century. But the twenty-first century will have no dominant power able to design, organize, and enforce the rules of the economic game. The unipolar economic world dominated by the United States is over. A multipolar world has arrived.

The establishment of economic partnerships among the neighboring nations in Northeast Asia have accelerated since early 1990s. Amid this trend, Korea, Japan and China are the only major economic countries which remain nonaligned to any of the regional economic organizations.

This paper discusses a strategic framework in which collaborative regional development in Northeast Asian countries. This paper consists of five sections. Section 2 introduces recent development of trade and investment in a global economy. Section 3 discusses economic cooperation in Northeast Asia. Strategies for collaborative regional development in Northeast Asia is established under a game approach. The conclusion is surmised in the final section.

## **2. Recent Development of Trade and Investment in the global economy**

In the 21st century, national boundaries have become increasingly meaningless and the concept of national sovereignty has decreased gradually. Strategic alliance and network building in business and industry across national borders are essential. The perspective of the global economy in the 21st century is characterized as the development of open multilateralism, regionalism, and rapid growth of foreign direct investment(FDI).

### **Toward the Open Multilateralism**

The U.S. support for the GATT, and for the successive rounds of multilateral tariff negotiations including Uruguay Round, was an important factor in the evolution of the open multilateral trading system, which is one of the great success stories of the past century. The Uruguay Round succeeded in extending multilateralism and successfully gave birth to the WTO. Not only did it succeed in reducing tariff rates on virtually all industrial products but also in extending multilateral disciplines to such areas as trade in services, agriculture, and protection of intellectual property, and to areas including unfair trade restraints in all force of safeguards and antidumping actions. The gains from the open multilateral trading system can hardly be overestimated and the potential for future gains remains great.

### **Regionalism**

Regionalism, which started in Europe in the 1950s, has become a worldwide phenomenon in the 1990s alongside globalization. In particular, the launching of the North American Free Trade Agreement (NAFTA) in the early 1990s and the emergence of the European

Monetary Union in January 1999 symbolize the rise of regionalism. In the first decade of the 21st century, the deepening of regionalism will become more tangible when euro banknotes and coins begin to circulate in all the euro zone countries on January 1, 2002, while the widening of regionalism will be more evident if the Free Trade Area of the Americas (FTAA) is realized in 2005.

The combined trade volumes for each region in Table I have all increased over the period. This implies that regionalism is on the rise.

Table 1: Trade Patterns in Major Regions of the World

	Exports		Imports		Combined	
	1980's	1990's	1980's	1990's	1980's	1990's
EU						
world	100.0	100.0	100.0	100.0	100.0	100.0
EU	53.9	56.5	51.2	54.5	52.5	55.5
North America	10.7	9.0	9.9	9.2	10.3	9.1
East Asia	4.0	7.9	6.6	10.9	5.3	9.4
East Asia						
world	100.0	100.0	100.0	100.0	100.0	100.0
EU	11.2	13.6	9.5	12.9	10.4	13.3
North America	33.6	26.6	21.7	18.4	28.0	22.7
East Asia	34.3	46.2	39.5	51.1	36.7	48.6
North America						
world	100.0	100.0	100.0	100.0	100.0	100.0
EU	18.2	15.5	16.7	15.1	17.4	15.3
North America	42.0	47.6	34.0	36.9	37.5	41.7
East Asia	17.9	21.3	29.0	33.2	24.2	28.0

Source: IMF, Direction of Trade Statistics, Various Issues.

While the pillar of the WTO with respect to trade in goods, service, and intellectual property is nondiscrimination, the cornerstone of regional trading agreement is discrimination. There has been a proliferation of regional trading agreements in recent years. By increasing the membership of the WTO, it is clear that the number of regional agreement is expected to rise drastically.

It is therefore not surprising that there is renewed interest in whether regional agreements compete with, or complement, the multilateral trading system which has developed in the WTO. While there may be no clear answer, it cannot be denied that recent regional development has major implications for the ruled-based multilateral trading system. Many even argue that rising regionalism will eventually lead the world economy into a tripolar system consisting of Europe, North America and East Asia.

## Rapid Growth of Foreign Direct Investment (FDI)

The benefits of FDI and related activities are almost without dispute. Among these

are increased competition within national markets, transfer of technology, and spillovers associated with this transfer. The latter is of special note. The existence of spillovers implies that FDI is associated with increases in productivity of domestic firms. These domestic firms can be suppliers, distributors, and even competitors of multinational firms.

Recognition of these benefits has led to a worldwide shift in the official attitude of these nations towards direct investment and multinational enterprises. Twenty years ago, the developing nations as a group were almost unanimous in their condemnation of multinational firms, which were viewed as agents of imperialism. Today, however, in light of the very favorable economic performance of a number of developing nations that have maintained open policies towards inward direct investment, many nations that were only recently hostile to this investment now welcome it with open arms. The result has been a shift in policy of these countries from restrictive to relatively open regimes.

However, the problem with this is that there exists a competitive situation between some governments and foreign investors. These governments often subsidize domestic companies in direct competition with foreign investors. The answer to these problems lies in the establishment of some international standards for foreign direct investment.

During the past ten years, the rate of growth of FDI and related activity has consistently increased faster than that of world trade, which has grown faster than that of world output. The relationship has been fundamentally altered. Trade and investment were traditionally seen as alternative means of exploiting foreign markets. Today, they are not substitutes for each other, but are complements instead. The complementary relationship between trade and foreign direct investment will become stronger in the future. In addition, the growth of FDI will enhance globalization efforts in the future.

### **New Emerged Issues and Challenges: Ironies**

The evolution of the multilateral trading system since the Second World War has been replete with ironies. The first irony is that the growth and liberalization of the international trading system has been achieved under the auspices of GATT, which did not even have the legal status of an international economic organization. (see Anne O. Krueger, 1996). The second irony is that the very success of the multilateral tariff negotiation under the GATT has generated interdependence across nations at a unprecedented rate. The ramifications of increased interdependence gave rise to great gloominess over the prospects for a successful outcome of the Uruguay Round. So a timetable for phasing out all quantitative restrictions on trade and service including intellectual property rights and trade-related investment measures is now being established under the WTO. The third irony is that the United States provides strong

leadership for an open multilateral system and its very success has resulted in its retreat from open multilateralism. The success in fostering the open multilateral trading system led by the U.S. has led to a reduction in its share of world GDP and world trade. Increased competition from abroad has, in turn, increased protectionist pressures in the U.S. and led Americans to see themselves more as a competitor in, rather than as a protector of, the open multilateral trading system.

With these ironies, major challenges that are currently facing the open multilateral trading system arise out of the increased globalization of economic activity. By definition, challenges are problems which are as yet unsolved. Under the WTO, as mentioned before, increased interdependence has raised complex issues such as the increasing protectionist pressure and bilateralism, and the development of the Preferential Trade Agreement(PTA) including the Foreign Trade Agreement (FTA).

### **Increasing Protectionist Pressures and Bilateralism**

Since the Uruguay Round was launched, many developing countries have realized the importance of trade and have gone far toward liberalizing their investment regimes as part of their market-oriented reforms. The evolution of the multilateral trading system under the WTO has been replete with hope and expectation for the developing countries. Many LDCs and central planned economies which had adopted inward looking strategies have begun to adopt outward oriented policies.

However, there exist many threats to the ideas of globalization and multilateralism under the WTO. Probably the biggest threat is the increased intensity of protectionist pressure and bilateral negotiating practices that have emerged in the large trading nations, especially the United States.

In the days of the Cold War, the US commitment to support the multilateral trading system was unwavering and the US had provided the necessary leadership for the continued growth of the multilateral trading system.

Nowadays, protectionist pressures in the US have increased dangerously. Since the mid-1980s, US trade policy has become increasingly aggressive and bilateral. Moreover, the US has increased its willingness to exert pressure bilaterally on its trading partners and has implemented administered protection including Antidumping(AD) and Countervailing Duty(CVD). As the US resorts increasingly to bilateral measures, their tendency to move away from open multilateralism will necessarily become strong.

Finding ways of reducing the protectionist pressures such as administered protection and bilateralism, as well as channeling trade policy through the WTO multilaterally, is clearly of major importance.

### **Preferential Trade Arrangement(PTA)**

Another issue related to the attempt to weaken the multilateral trading system is the development of the Preferential Trading Arrangements(PTA) over the past decade in member countries of EC and NAFTA. The burgeoning number of preferential trading arrangements presents more potential challenges to the multilateral system.

So the most urgent task facing the WTO is how it should work with existing PTAs. An amendment to GATT Article XXIV currently requires members of PTAs to refrain from increasing their trade barriers against outsiders. This requirement can be changed so as to require that members can phase in a "most favored nation"(MFN) extension by a certain date. This change would greatly reduce the anxiety and uncertainty on the part of outsiders to a particular PTA.

Although it can be argued that PTAs present building rather than stumbling blocks to the strengthening of the multilateral system, there is little question that PTAs present a serious challenge to the WTO. However, under the right conditions, PTAs (or FTAs) can actually complement and enhance multilateralism.

## **3. Economic Cooperation in Northeast Asia**

Recently there exist many threats to the ideas of globalization and multilateralism under the WTO. One way to reduce the protectionist pressures is to establish a strong relationship among Asian countries. APEC espouses "open regionalism." It is very clear that what APEC means by open regionalism is to extend the benefits of liberalization among its members to all outsiders without any discrimination. We expect that APEC will serve as a vehicle for compromise between the PTAs and the multilateral system. In order to achieve this goal, APEC has put forward a credible and ambitious time schedule for achieving free trade throughout the world. Our great responsibility is to move ahead with Asian countries to make ourselves compatible with the concepts of globalism and regionalism.

The establishment of economic partnerships among the neighboring nations in Northeast Asia have accelerated since early 1990s. Amid this trend, Korea, Japan and China are the only major economic countries which remain nonaligned to any of the regional economic organizations.

China, Japan and Korea constitute an important part of the world economy, and their presence is crucial in Northeast Asia. In terms of economic size, the three countries represented 19.8% (20.4% including Hong Kong) of the world's total GDP in 2000. With regard to trade volume, their share of the world's total trade amounted to 11.8% (14.9 % including Hong Kong) in 1999. Compared to ASEAN + 3, the three countries' shares in terms of GDP and trade volume are 91.2% and 67.9%, respectively, in 2000. In

Northeast Asia, since economic sizes and trade volumes of the remaining countries and regions, i.e. North Korea, Mongolia, Taiwan, the Russian Far East, are quite limited, they have a dominant position.

So far Northeast Asian economic cooperation has not been institutionalized and ASEAN + 3 has been led by ASEAN. However, given their prevailing economic strength, if the three countries get together, they can play a key role in shaping the future direction of both Northeast Asian economic cooperation and ASEAN + 3 or East Asia as a whole.

Recently, Korea has put forward a credible and ambitious time schedule for establishing the Free Trade Agreement with Japan as well as China. A recent study on a potential free trade agreement between Korea and Japan pointed out that if the agreement were realized, the trade imbalance between Korea and Japan would deteriorate in the short run at Korea's cost. The Japanese report, however, emphasized that both Korea and Japan will benefit greatly if the dynamic effects are considered. The dynamic effects are said to result from increased competition, for example, between Korean and Japanese firms. Increased competition then will induce strategic alliances between them (which will increase intra-regional investment) as well as foreign corporations' investment in the countries (more likely in Korea than in Japan because of production cost differentials between Japan and Korea). In other words, dynamic effects arise from improved productivity and they are estimated to bring more benefits to Korea than Japan. On the other hand, there exists a negative view of forming a trading bloc covering China, Japan and Korea in the near future given the differences in the political economic system, and the level of economic development and technology among China, Japan and Korea. Moreover, non-economic concerns such as unresolved issues on recent history occasionally surface in Northeast Asia. In brief, despite the necessity and the efforts for a more formal economic cooperation organization in Northeast Asia, a state-to-state level agreement on a trading bloc would be difficult in the near future.

Even though there exists a negative view on the FTA between Korea and Japan, analysts point out that the positive side of FTA is not limited to expanding trade volume. As seen in the case of the European Union (EU), the FTA serves as a catalyst to vitalize competition among member nations, accelerate industrial realignment and expedite economic reformation.

#### **4. Strategies for Collaborative Regional Development in Northeast Asia**

In order to implement the collaborative regional development discussed above, we need to develop a strategic framework in which collaborative regional development

takes place. Conceptually, we can think of the progression of regional development from an independent stage through a collaboration stage to an integration stage through FTA.

The most important element in realizing collaborative regional development is a leadership at national levels. The leadership should be supported by people's recognition for the necessity of the collaborative regional cooperation.

The leadership and peoples' recognition are essential in transforming bilateral relations prevalent in Northeast Asia to more constructive and stable trilateral or multilateral relations. Broadminded leaders and peoples with a vision about the future of Northeast Asia must be nurtured. Without understanding and trust at the individual level, collaboration becomes unsustainable.

The current question in Korea is how to manage the FTA agreements with Japan and China in the near future. To achieve the government's schedule for the FTA smoothly, we first need to establish a strong economic cooperation across related countries. However the economic cooperation across Asian countries during the last three decades has not been successful. Now we should review the characteristics of the previous economic cooperation and then propose a new strategy to strengthen the economic relationship for the near future.

For this, the game approach, a theory of the prisoners' dilemma, is introduced here. This approach provides a more clear interpretation of the economic relationship between two countries. We don't need to explain the whole story of the game here. Instead the payoff matrix of this game is reconstructed as follows.

If both players, Korea and Japan, for example, choose cooperation, then each receives 0. If Korea(Japan) cooperates while Japan(South) does not cooperate, Korea (Japan) and Japan (Korea) receive a payoff of -2 (1) and 1 (-2) respectively. Since a noncooperative player can take advantage of the other's cooperation strategy, the payoff of the cooperative player is assigned to be -2. Finally, if both choose noncooperation, each receives -1. The table shows their utilities associated with each possible pair of actions they can take.

Table 2. A Prisoner's Dilemma

		Korea	
		cooperation	non-cooperation
Japan	cooperation	(0, 0)	(-2, 1)
	non-cooperation	(1, -2)	(-1, -1)

When a game is played once, there is a unique equilibrium point: Both players choose non-cooperation and each receives a payoff of -1. It implies that even though the cooperation strategy will result in a better utility for them, they choose a noncooperative strategy because they don't want to take the risk of cooperating with



each other.

In the case of a infinitely repeated game, the outcome is different from the one shot game. The following four possible cases are to be considered in the repeated game.

### Case I

Suppose each player cooperates continuously. Then each receives 0 at each period. If each player discounts future payoffs using a discount factor of  $\delta$ , the payoff yields as follows.

	period 1	period 2	period 3	.....	discounted sum
Korea	0	0	0	.....	0
Japan	0	0	0	.....	0

### Case II

Suppose both players refuse to cooperate continuously. Then each receive -1 at each period. The discounted future payoffs yield as follows.

	period 1	period 2	period 3	.....	discounted sum
Korea	-1	-1	-1	.....	$-(1-\delta)^{-1}$
Japan	-1	-1	-1	.....	$-(1-\delta)^{-1}$

### Case III

Suppose Korea cooperates at the first iteration and Japan takes advantage of Korea's willingness to cooperate. Then Korea can receive -2 and Japan 1 in the first period. But if Japan even fails to cooperate in the second period, Korea revert to a safe policy of non-cooperation. Then they all receive -1 respectively. In the third period, they realize that cooperation is the dominant strategy for them and then choose cooperation. Then they can get a payoff of 0 afterward. The discounted sum of this case is presented in the following table.

	period 1	period 2	period 3	.....	discounted sum
Korea	-2	-1	0	.....	$-1-\delta$
Japan	1	-1	0	.....	$1-\delta$

### Case IV

Korea chooses cooperation forever while Japan takes opposite strategy. This one sided cooperative strategy could not be continued because the political burden to Korea

Korean government tends to increase as time goes on.

	period 1	period 2	period 3	.....	discounted sum
Korea	-2	-2	-2		$-2(1-\delta)^{-1}$
Japan	1	1	1		$(1-\delta)^{-1}$

In comparison with the outcomes derived from the four cases, it is clear that a cooperative strategy for both players is dominant. Therefore if each presumes that the other will have a good sense in a cooperative way, they will be at a cooperative equilibrium, and they receive a payoff of 0 per each period.

For the game to be taken limitedly, the cooperation is also a dominant strategy as the game is played infinitely. Suppose that the game is over at the end of a specific period, then there is no chance to retaliate each other by taking a noncooperative strategy. Considering this limitation, each player is inclined to take a cooperative strategy from the first period to receive high utilities. This result can also be derived by taking consideration of a recursive backward of the game.

Logically this argument is not wrong, but in reality, the cooperation strategy would take place in this case of the corporation in Northeast Asia as the game is played infinitely in the same way. There are various ways to explain this. First, the games are repeated only a finite number of times, but the number is unknown. Since there is no clear prediction about the completion of FTA, there is always the possibility that the relationship will go on. Then the two countries have some incentive to sustain the cooperation for the sake of such future contingencies: if this incentive is large enough, the cooperation will persist. Secondly, both leaders in the two countries realize that there are real gains to be had by cooperating for a short term, and Korea(or Japan) would plan to reciprocate Korea's(Japan's) cooperation to achieve these gains. Therefore, as long as each side is taking advantage of the other, both are benefiting from this mutual cooperation. Thirdly, they also realize the importance of FTA. The achievement of FTA is important for both economies. This makes cooperation easy to achieve. Therefore, in the process of the FTA of the two countries, the cooperation will be a dominant strategy.

However, due to many political, economic and historical reasons, EU or NAFTA-type formal economic integration has long been alien to Northeast Asian countries. Therefore, the efforts to strengthen economic cooperation in Northeast Asia have mainly been concentrated on enhancing informal economic integration. Apart from worldwide ascendant regionalism, it was the Asian financial crisis that changed the situation in this regard. Korea and Japan have established government-level negotiations with Chile and Singapore, respectively, and researchers have embarked upon the debates over a possible Korea-Japan FTA.

## 5. Concluding Remarks

As countries become increasingly global, there will be more trade agreements needed to overcome inevitable trade disputes. As many of specialists in Northeast Asia agree, there exists a need for a more formalized economic cooperation entity in Northeast Asia. The government should not be passive, but rather proactive in trade talks. It should also investigate the potential impacts to Korea, for instance, if Japan and China engage in a certain trade agreement. Despite worrying voices among economic analysts here, the positive government attitude on the matter is considered appropriate in view of the fast-changing global economic structure. However, the government should be fully prepared for the possible ill-effect the FTA with Japan could have on the national economy despite favorable assessments by the two institutes from a long-term point of view.

The key players that could contribute to both formal and informal economic cooperation are China, Japan and Korea. Their economic strength both in terms of GDP and trade volume is such that their positions are crucial both in strengthening economic ties among Northeast Asian economies and in deepening economic cooperation among the ASEAN + 3. In other words, these three countries are mainly responsible for backwardness of Northeast Asia and East Asia in terms of regional economic cooperation. Consequently, the solutions to this problem of regional backwardness must also be found in the dynamics of the relationship between the three countries.