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## **ROK-US FREE TRADE AGREEMENT: A PRAGMATIC AND STRATEGIC VIEW**

Accompanying Materials:

**“Economic Integration and Reconciliation in Northeast Asia:  
Possibilities and Limitations,”** in *Rethinking Historical Injustice in  
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## **Economic Integration and Reconciliation in Northeast Asia: Possibilities and Limitations<sup>1</sup>**

Wonhyuk Lim

In 2004, Fuji Xerox Chairman Yotaro Kobayashi did something very unusual for a Japanese businessman. He publicly criticized Prime Minister Junichiro Koizumi for making visits to Yasukuni Shrine, where the Japanese war-dead, including Class-A war criminals, are honored. In making his statement, he was careful to base his criticism on economic, rather than moral, grounds. He argued that the Prime Minister's visits to Yasukuni Shrine would be bad for Japanese business, especially in China. Shortly after Kobayashi made his public comment, he was condemned as a traitor and was harassed with death threats from right-wing organizations in Japan. Two Molotov cocktails were found near the entrance to his residence, and a bullet was delivered in an envelope to his address.<sup>2</sup>

In a number of ways, this incident was symbolic of the possibilities and limitations of economic approaches to promoting reconciliation and cooperation in Northeast Asia. Regional economic integration, and opportunities it created, led a businessman like Kobayashi to speak out against the forces of ultra-conservative nationalism. Yet, at least on the surface, his public statement appeared to be motivated mainly by economic calculus, not by a deep conviction to promote mutual understanding between nations with historical animosity toward each other. Regarded as "a business move," a statement like Kobayashi's risked criticism not only from right-wing organizations in Japan, but also from people outside Japan expecting to see more genuine gestures for reconciliation. While the former could accuse Kobayashi of betraying the nation, the latter could criticize him for being insincere. They both could claim he "just did it for money." Although increasing economic integration and deepening interdependence may enhance the prospects for co-existence between formerly hostile nations, there seems to be a limit to how much economic exchanges can promote mutual understanding and harmony. In David Crocker's terminology, economic integration may facilitate "thin" reconciliation, but may have only a limited

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<sup>1</sup> Forthcoming in *Rethinking Historical Injustice in Northeast Asia: The Korean Experience in Regional Perspective*, ed. by Soon-Won Park and Gi-Wook Shin (New York: Routledge).

<sup>2</sup> See "Editorial: Firebomb Threat," *Asahi Shimbun*, January 14, 2005, and Norimitsu Onishi, "The Japan-China Stew: Sweet and Sour," *New York Times*, January 19, 2005. Onishi notes that "China is considered partner by Japanese business interests and rival, if not outright adversary, by political class."

effect on “thick” reconciliation.<sup>3</sup>

This paper looks at the possibilities and limitations of using economic integration to promote reconciliation and cooperation in Northeast Asia, a region that has witnessed a great deal of conflict and tension since the mid-nineteenth century. While the continuing economic growth of the region and expected increase in the relative significance of intra-regional trade may facilitate economic integration, geopolitical considerations interacting with historical animosity may actually increase tension in the region. It would require conscious efforts on the part of political leaders and civil society organizations to come to terms with history and craft a shared vision for the future.

This paper is organized as follows. Section 1 provides a brief theoretical discussion on reconciliation and cooperation, starting with Immanuel Kant’s theory of perpetual peace. It looks at how structural variables such as democratization and globalization may interact with nationalism to affect reconciliation and cooperation. Section 2 looks at “the burden of history,” focusing on factors that have traditionally shaped international relations in Northeast Asia. This section highlights the emergence of Western and Japanese challenges to the traditional Sino-centric order in the nineteenth century, and emphasizes that with the resurgence of China, this triangular interaction is likely to shape the region’s future as well. Section 3 analyzes the evolving pattern of economic relations in East Asia in recent years. Although the problem of reconciliation mainly concerns countries in Northeast Asia, discussions on economic integration schemes usually include Southeast Asia as well, and it would be useful to look at East Asia as a whole. East Asia has become an economic bloc comparable in size to Western Europe or North America, and intra-regional trade is likely to become increasingly significant.

Section 4 then looks at the external economic strategies of major players in East Asia. While China has been engaged in proactive economic diplomacy on all fronts, Japan has been somewhat reactive, responding to ambitious Chinese initiatives on economic integration. Preoccupied with the North Korea problem, South Korea has mainly focused on promoting cooperation in Northeast Asia. ASEAN(Association of Southeast Asian Nations) has sought to achieve tighter regional integration in Southeast Asia as well as with China, Japan, and South Korea, but the progress of its efforts has been hampered by the different levels of economic development among the member countries. Section 5 examines possible trajectories for regional integration in Northeast Asia. Because regional integration schemes have the potential of causing a significant shift in international relations, they may become a new source of tension both within

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<sup>3</sup> See David Crocker(1999), “Reckoning with Past Wrongs: A Normative Framework,” *Ethics and International Affairs* 13: 43-64.

the region—for example, between China and Japan—and with extra-regional players such as the United States. The challenge for Northeast Asia is to find an alternative that is effective in promoting reconciliation and cooperation but is at the same time non-threatening to extra-regional countries.

## 1. Theoretical Background

The idea that voluntary economic exchanges can contribute to peace has been around for a long time.<sup>4</sup> Close interaction between people from different nations allows exchanges of ideas and sentiments, making it easier for them to understand other people's views. When two sides can realize gains by trading with each other, they are likely to try to work out contentious issues between them and develop this mutually beneficial relationship further—unless the military balance is such that one side is tempted to risk war and take over the other side.

Immanuel Kant was one of the first thinkers to argue that economic exchanges among nations tend to contribute to peace as long as these exchanges take place on a fair and voluntary basis. However, trade among nations was only a small part of his theory of “perpetual peace.” In fact, he analyzed structural conditions for peace at three different levels: domestic politics, international relations, and cosmopolitan system. He clearly understood the interrelated nature of the challenges.<sup>5</sup>

At the level of domestic politics, Kant argued that republicanism was a pre-condition for peace. He defined republicanism as being characterized by the separation of powers and by a representative system of government. Kant noted that in a republican system, citizens would have a voice in important national decisions, and compared with an absolutist monarch, they would tend to be much more hesitant to start a war. By contrast, an absolutist monarch would more likely go to war on a whim because he is largely shielded from the consequences of his decisions. At the international level, Kant advocated a federation of free states as a realistic option to secure peace. While the creation of an international state or a world republic might be an ideal way to end international anarchy, Kant believed it was unlikely that nation-states would agree to give up their sovereignty. Finally, looking at the relationship between the individual and the world, Kant argued that for there to be perpetual peace, every individual should be accepted as

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<sup>4</sup> On the intellectual history of peace, see Istvan Kende(1989), “The History of Peace: Concept and Organization from the Late Middle Ages to the 1870s,” *Journal of Peace Research* 26: 233-247.

<sup>5</sup> See Immanuel Kant(1797), *Kant's Political Writings*, edited by Hans Reiss (Cambridge: Cambridge University Press). The author would like to thank Young-Joon Park for his helpful comments on this section.

a citizen of “the universal state of mankind.”

Many of Kant’s ideas on peace appear to be relevant for promoting reconciliation and cooperation as well. A system of governance based on accountability and transparency is likely to allow greater introspection and public discussion. Under such a system, chauvinistic or jingoistic sentiments are likely to be subjected to closer scrutiny before they have a chance to lead the nation astray. Such a political system is also conducive to the development of civil society, which can promote mutual understanding among citizens of different nations. A federation of free states, agreeing to respect each other’s sovereignty and build mutual trust through arms control and expanded interaction, is likely to reduce the possibility of renewed conflict. Such an international arrangement basically institutionalizes reconciliation and cooperation, for which trade is an important contributing factor. Finally, the idea of treating every individual as a citizen of the world allows people to transcend national boundaries and look at the problem of injustice from a universal perspective.

There are some important caveats in applying this framework, however. First, while a system of governance based on accountability and transparency is likely to be conducive to reconciliation, it is probably counterproductive for a nation to demand that another nation adopt such a system as a prerequisite for reconciliation. To the extent that interaction with the outside world facilitates change, making reconciliation conditional on the democratization of the other side is actually likely to impede such a political transition. Moreover, the key to reaching reconciliation is to move the hearts and minds of the peoples, rather than the leaders, of the nations involved. Certainly, West German leaders like Willy Brandt in the 1970s did not wait until Poland was democratized to issue their apologies to the people of Poland. In the Northeast Asian context, the democratization of China and North Korea should not be a pre-condition for reconciliation.<sup>6</sup> Second, to be effective, a federation of free states should come *after* reconciliation rather than before it. Before crafting a shared vision that transcends national boundaries, nations that make up a federation should first come to terms with history. Because nationalism was instrumental to the outbreak of historical hostilities in Northeast Asia as well as other parts of the world, nationalism would have to inform the discussion on reconciliation. Advocacy of a regional or supranational identity would ring rather hollow before national wounds are healed. Finally, while the idea of accepting every individual as a citizen of the world allows

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<sup>6</sup> In recent years, some American academics and policymakers have been floating the idea of forming a “value alliance” with nations that share the core values of democracy and market economy against “the irredeemable forces of darkness” in the post-9/11 world. See, for instance, Victor D. Cha and David C. Kang(2003), *Nuclear North Korea* (New York: Columbia University Press). The risk inherent in such a confrontational and Manichean approach is that it may actually reduce the prospects for reform in countries targeted by the alliance and greatly increase the possibility of conflict.

people to look at the problem of injustice from a universal perspective, there should be consistency in applying this principle across time and national boundaries. It would seem rather disingenuous to criticize another country for its human rights abuses without coming to terms with own human rights abuses perpetuated against citizens of other countries in the past. For the nations in Northeast Asia to move to the future, they must first take a look back at history.<sup>7</sup>

## **2. The Burden of History**

For many centuries, China was a dominant force in East Asia, if not the world. As late as 1820, according to Angus Maddison's estimate, its GDP accounted for over 25 percent of the world's total output, and its place in the world seemed secure.<sup>8</sup> However, in the course of subsequent decades, the Sino-centric "world order" in East Asia unraveled under the attack of intruding Western powers and a rising Japan.

In particular, the emergence of Japan as a revisionist power in East Asia was an important event because it fundamentally changed the dynamics of international relations in the region. Combining the Japanese ethos with Western technology, Japan rapidly modernized itself and adopted an increasingly proactive foreign policy.<sup>9</sup> Although some intellectuals in Korea and China hoped that Japan would lend a helping hand in the modernization of their countries, their hopes were dashed as Japan became an imperialistic power of its own.<sup>10</sup> China's defeat in the Sino-Japanese War of 1894-5 accelerated the demise of the Ching Dynasty, and the destruction of the Russian Fleet by the Japanese Navy in 1905 dealt a devastating blow to the Russian Empire. Japan's brutal colonial rule in Korea also left a bitter legacy.

Japan initially defined its role as a "junior partner" of global powers such as Britain and greatly expanded its influence in East Asia. Starting in the 1930s, however, Japan began to pursue an independent course of military adventurism. Seeking to dominate East Asia and to

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<sup>7</sup> Asking the German people to accept the past and seek reconciliation with other nations, former German President Richard von Weizscker once said: "Seeking to forget makes exile all the longer; the secret of redemption lies in remembrance."

<sup>8</sup> For historical perspectives on China's economic performance, see Angus Maddison(1995), *Monitoring the World Economy, 1820-1992* (Paris: OECD), p.30 and Angus Maddison(1998), *Chinese Economic Performance in the Long Run* (Paris: OECD).

<sup>9</sup> See Michio Morishima(1982), *Why Has Japan Succeeded? Western Technology and the Japanese Ethos* (Cambridge: Cambridge University Press). For a comparative study of China and Japan in the nineteenth century, see George M. Beckman(1962), *The Modernization of China and Japan* (New York: Harper & Row).

<sup>10</sup> See Kazuyoshi Uehara et al.(1994), *A Modern History of East Asia*, translated from Japanese to Korean by Kyu-Soo Lee et al. (Seoul: Yet Oneul).

expel Western powers from the region, Japan called for the establishment of a “Greater East Asia Co-Prosperity Sphere,” under the slogan of “Asia for Asiatics.” Although Japan’s defeat in World War II marked the end of this ambitious project, Japan’s foreign policy before 1945 seems to have significant implications for regional cooperation in East Asia after the end of the Cold War.<sup>11</sup>

In this regard, it may be useful to draw lessons from Europe. A thought experiment by analogy may be particularly useful. In Europe, the initial impetus for regional cooperation came from the historical failure to cope with Germany as a revisionist power. Emerging victorious from World War II yet continued to be concerned with Germany, France took the initiative to promote regional cooperation that included Germany, which, for its part, made efforts to become a trustworthy neighbor. The origin of the European Union can be traced back to the Schuman Declaration of May 9, 1950. In proposing this plan, Robert Schuman and Jean Monnet sought to arrest the relative decline of Europe in the postwar U.S.-Soviet bipolar system and to prevent the outbreak of war in Europe, especially between France and Germany. Acknowledging that a united Europe would *not* be made “all at once, or according to a single, general plan,” Schuman expressed preference for a gradual approach, and, as “a first step in the federation of Europe,” he called for the pooling of coal and steel production and sought to “change the destinies of those regions which [had] long been devoted to the manufacture of munitions of war.” Forty years later, the unification of Germany served as a major driving force for the creation of the European Union, as Germany and its neighbors agreed to make Germany an integral part of Europe rather than an unhinged revisionist power.

Events took a rather different turn in Northeast Asia after World War II. The historical failure to cope with Japan as a revisionist power had been broadly similar to the European experience with Germany, but China did not have a chance to patch things up with Japan after the war, which instead established close relations with the United States as its “junior partner.” No supranational body was created along the lines of the European Steel and Coal Community. Although many hoped that the end of World War II would open a new era of reconciliation and cooperation in Northeast Asia, the ensuing Cold War made it all but impossible for the countries in this region to work together toward a common future. Instead, the intense U.S.-Soviet rivalry during the Cold War resulted in the partition of the region along ideological lines and greatly increased risks of conflict. Nowhere was this more evident than in Korea, as the nation was divided along the 38<sup>th</sup> parallel in 1945 and became a battleground for an internationalized civil war

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<sup>11</sup> On the evolution of Japan’s foreign policy before 1945, see Sang-Jung Kang(2002), *Toward a Northeast Asian Common House*, translated from Japanese to Korean by Kyung-Duk Lee (Puriwa Ipari Publishing Co.).

from 1950 to 1953, pitting South Korea and the United States against North Korea and China.

Although the collapse of the Soviet Union in the early 1990s removed most of the structural constraints that had impeded regional integration, genuine reconciliation and cooperation in Northeast Asia remain an elusive dream. There are basically two reasons for this slow progress. One has to do with Japan's failure to address its past wrongdoings in a credible and consistent manner. Although the Japanese government has issued a number of official apologies, the most significant of which might be Prime Minister Tomohiro Murayama's in 1995, these apologies have been often followed by "misstatements" from influential Japanese politicians who tend to beautify Japan's past colonial rule. These misstatements not only cast doubt on the sincerity of the official apologies, but also tend to overshadow the significant efforts that Japan's civil society has made in order to resolve historical problems through international cooperation. The other reason has to do with the generally negative attitude of the United States toward regional cooperation in Northeast Asia, for fear of being excluded from the region.<sup>12</sup>

These two elements are closely linked. As long as Japan subscribes to the logic of *datsua* ("escape from Asia") and regards the Japan-U.S. alliance as one of overriding importance, Japan's willingness to work for reconciliation and cooperation in Northeast Asia would be greatly diminished. In this case, Japan would likely reinforce U.S. concerns about regional cooperation in Northeast Asia and take advantage of the bilateral alliance in its quest to become a "normal" nation, volunteering to assume a larger share of burden in international affairs. An unrepentant Japan intent on expanding its military role under the U.S.-Japan alliance would not be trusted by its neighbors, even if economic interaction in the region continues to increase. Such an outcome would not be conducive to the stability of the region.

To promote reconciliation and cooperation in Northeast Asia, political breakthroughs should be supplemented by increased economic and cultural exchanges. Consistent and credible actions should be taken to build trust. Also, potentially enormous benefits from the integration of Northeast Asia should be spelled out, for countries both inside and outside the region. The construction of energy, information, and transportation networks and the integration of national markets in Northeast Asia should offer tremendous business opportunities. In this regard, it is worth noting that unlike the Soviet Union during the Cold War, China has actively sought foreign direct investment (FDI), and heavy economic interaction on a firm level may serve as a check against geopolitical strategists who tend to take the nation-state as a unit of analysis. For Northeast Asia to secure peace and prosperity, it is essential that the region be open to the world's

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<sup>12</sup> See Sunhyuk Kim and Yong Wook Lee(2004), "New Asian Regionalism and the United States: Constructing Regional Identity and Interest in the Politics of Inclusion and Exclusion," *Pacific Focus*, October.

major corporations; in turn, to become an inviting place for these corporations, Northeast Asia should be a peaceful and prosperous region. Regional cooperation in Northeast Asia should be used as a building bloc for global economic integration. The creation of a “Fortress Northeast Asia” should not be the objective.

### 3. Evolving Pattern of Economic Relations in East Asia

Geographically, Northeast Asia is a region that includes China, Japan, and South Korea as well as Mongolia and North Korea.<sup>13</sup> Together with ASEAN 10 (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam), they constitute East Asia. The ten member-nations of ASEAN and the three large economies in Northeast Asia comprise what is commonly known as ASEAN plus 3. Although there is a continuing debate on whether East Asia constitutes a “natural” grouping, economic interaction within this fast-growing region has intensified over the past few decades, particularly among the ASEAN plus 3 countries. The region is now a large and growing market in its own right, and intra-regional trade and investment flows have become more important over time. The transformation of East Asia from an export production base for the rest of the world to an increasingly integrated market has significantly enhanced prospects for regional cooperation.<sup>14</sup>

In 1960, the combined GDP of ASEAN plus 3 was only two-fifths of U.S. GDP, with Japan contributing 81 percent of the total, followed by China with 8 percent.<sup>15</sup> As Table 1 shows, by 2003, the combined GDP of ASEAN plus 3 had become approximately 70 percent of the GDP of the U.S. or EU 15 (Euro Zone).

**Table 1. Regional Comparison of GDP and Population (2003)**

Region	GDP (US\$ bil.)	Population (mil.)
ASEAN plus 3	7,028	2,001

<sup>13</sup> The Russian Far East is sometimes included in this grouping.

<sup>14</sup> See Francis Ng and Alexander Yeats(2003), “Major Trade Trends in East Asia: What are their Implications for Regional Cooperation and Growth?”, World Bank Policy Research Working Paper 3084.

<sup>15</sup> See Lawrence Lau(2004), “Asian Regional Economy in a Multilateral Setting,” paper presented at the Symposium on *Asian Network of Economic Policy Research(ANEPR) 2003-2004: Asia in Search of a New Order*, organized by the Research Institute of Economy, Trade, and Industry(RIETI), Tokyo, January 16-17, 2004.

ASEAN 10	686	537
China	1,410	1,288
Japan	4,326	127
South Korea	605	48
NAFTA	12,342	425
U.S.	10,882	291
EU 15	10,750	392

Source: *World Development Indicators* and *ASEAN Statistical Yearbook 2004*.

As Table 2 shows, the total GDP of Asia as a whole is expected to surpass that of the U.S. in 2025, while the combined GDP of ASEAN plus 3 is forecast to be slightly less than the U.S. GDP. Within East Asia, there will be an important change as well. China's GDP, which was only about one-third of Japan's GDP in 2003, is expected to surpass Japan's in 2025.

**Table 2. Long-Term Forecast for GDP in Major Regions**

	Nominal GDP Growth (Annual)					Nominal GDP (US\$ tril.) [World Share, %]		
	2001 -2005	2006 -2010	2011 -2015	2016 -2020	2021 -2025	2003	2015	2025
World	7.7	6.3	5.6	5.5	5.3	36.44 [100]	81.49 [100]	137.72[100]
U.S.	4.8	5.3	5.8	5.7	5.7	11.00 [30.2]	21.32 [26.2]	37.19 [27.0]
EU	12.3	4.7	3.5	3.6	3.5	10.52 [28.9]	21.17 [26.0]	30.04 [21.8]
Japan	1.5	6.1	4.5	2.9	2.1	4.29 [11.8]	8.57 [10.5]	10.94 [7.9]
BRICs	-	-	-	-	-	2.87 [7.9]	11.47 [14.1]	25.89 [18.8]
China	11.9	15.0	10.6	9.4	8.6	1.41 [3.9]	6.30 [7.7]	14.93 [10.8]
India	9.6	9.8	9.1	9.2	9.0	0.54 [1.5]	1.81 [2.2]	4.33 [3.1]
Brazil	2.9	6.5	7.0	6.7	6.4	0.49 [1.4]	1.33 [1.6]	2.51 [1.8]
Russia	23.4	11.2	10.1	9.5	5.1	0.43 [1.2]	2.04 [2.5]	4.12 [3.0]
Asia	4.8	8.8	7.1	6.3	6.1	8.17 [22.4]	21.72 [26.7]	39.60 [28.8]

Source: Global Insight, *World Economic Outlook*, January 2005.

These prospects have far-reaching implications for international relations in East Asia. Will China begin to throw its weight around and challenge the U.S. supremacy in the region, much like Japan did before 1945? Will it act like the U.S. when it was beginning to emerge as a global power and establish a Monroe Doctrine of its own in East Asia and seek "open door" policy in other continents? Will Japan idly stand by when China is almost certain to overtake Japan as an economic powerhouse? Will it choose to cooperate with China or try to form a united front with

the U.S. against China? As these questions suggest, changes in the relative size of the economies are likely to have a significant effect on the external strategies of these countries.

Another factor that will have a significant effect is changes in the relative importance of intra-regional trade. The relative importance of intra-regional economic interaction in East Asia has undergone a dramatic change over the past century. If dependence on intra-regional trade is used as a measure of regional cooperation, East Asia had a much higher level of regional cooperation in the pre-war period. The gravity coefficient for the East Asian trading bloc showed a secular decline between the mid-1930s and the mid-1980s, when it began to rise again. The gravity coefficient in the mid-1930s was more than twice the level in the mid-1980s.<sup>16</sup> There is little evidence that the relative decline in intra-regional trade adversely affected the economic performance of East Asian countries, which took advantage of increased opportunities for inter-regional trade in the postwar period. In fact, the relative decline in intra-regional trade coincided with the remarkable growth of outward-oriented industrializing economies in East Asia, which exported the bulk of their final goods to high-income countries in North America and Europe. The heavy dependence on extra-regional demand, however, seemed to rule out tighter regional integration in East Asia, because much of intra-regional trade was derived from the outside. After analysing trade patterns based on 1999 data, a Japanese researcher even warned against making too much out of economic inter-dependence in East Asia.<sup>17</sup>

Demand from North America and Europe is likely to remain important for the foreseeable future, but there are signs that intra-regional demand is becoming more important in recent years. In particular, if China's impressive economic growth is sustained, its role as a market for final demand will become increasingly important.<sup>18</sup> Currently, China is serving as "the world's

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<sup>16</sup> For a historical analysis of changes in the gravity coefficient in East Asia, see Peter Petri(1994), "The East Asian Trading Bloc: An Analytical History," in *Regionalism and Rivalry: Japan and the U.S. in Pacific Asia*, edited by Jeffrey A. Frankel and Miles Kahler (Chicago: University of Chicago Press), pp21-52. See also Eisuke Sakakibara and Sharon Yamakawa(2003), *Regional Integration in East Asia: Challenges and Opportunities, World Bank East Asia Project* (Tokyo: Global Security Research Center, Keio University).

<sup>17</sup> See K. Sugiura(2000), "The Fantasy of Asia's Inter-Dependence," FRI Research Report No. 79 (Tokyo: Fujitsu Economic Research Institute). In 1999, Japan's exports to the United States amounted to \$130.0 billion while its imports from the U.S. were only \$57.5 billion. AXJ9 (Asia Excluding Japan: China, Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, and Thailand) exported \$234.6 billion to the U.S. but imported only \$107.3 billion. By contrast, AXJ 9's exports to Japan were 118.4 billion while its imports from Japan amounted to \$151.9 billion.

<sup>18</sup> On the impact of China's economic growth, see Fred Hu et al.(2002), "The Five Great Myths About China and the World," Goldman Sachs. The five great myths are: (1) China is going to take over the world; (2) "New Industrial China" is hollowing out manufacturing and stifling growth in the rest of the world; (3) Low wages, high productivity growth and a grossly undervalued currency are relentlessly raising China's competitiveness; (4) Structural imbalances are driving deflation at home and abroad; (5) Japan, ASEAN and the rest of Asia are fighting for their lives against the rising mainland economy.

factory,” but rising affluence in its coastal areas and ambitious investment projects in underdeveloped regions in the west and northeast are creating a great deal of final demand. China’s rapid economic growth offers great opportunities for East Asia to increase intra-regional trade. According to an estimate based on a computable general equilibrium (CGE) model, China is projected to become the largest Asian importer by 2005. Contrary to the view that China’s exports will stifle growth among its neighbors, China’s expansion, particularly when accelerated by its WTO initiative, is projected to open unprecedented market opportunities for Asian exporters.<sup>19</sup> Spearheaded by China’s rapid growth, continuing economic expansion and increasing intra-regional interaction in East Asia is enhancing the prospects for tighter integration.

#### **4. External Strategies of Major Players in East Asia**

Faced with significant political and economic changes in East Asia, major players in the region are formulating external strategies to advance their national interests. Building on the strength of its rapid economic growth, China is engaging in proactive economic diplomacy on all fronts. At the same time, China is trying to keep a low profile and avoid creating the impression that it is out to challenge the status quo in international relations.<sup>20</sup> China’s regional initiatives have put Japan on the defensive. Although Japan initially wanted to be quite selective in signing preferential trade agreements, dealing first with advanced industrial economies such as Singapore and South Korea, it increasingly finds itself having to respond to China’s regional agenda, especially in Southeast Asia. South Korea, for its part, is mainly concerned with promoting cooperation in Northeast Asia as a way of addressing the North Korea problem. ASEAN is actively engaged in trade negotiations with countries in East Asia as well as from the outside, but the lack of a unified internal market has weakened its bargaining position.

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<sup>19</sup> See David Roland-Holst(2002), “An Overview of PRC’s Emergence and East Asian Trade Patterns to 2020,” ADB Institute Research Paper 44 (Tokyo: ADB Institute).

<sup>20</sup> Given China’s efforts to present itself as a benign and non-hegemonic power, the way it handled the Koguryo controversy was something of a surprise. With its territory extending from the northern half of the Korean peninsula to Manchuria, the ancient kingdom of Koguryo had the potential to develop into a contentious issue between Korea and China for some time. A major controversy erupted in 2004 when the Chinese Foreign Ministry decided to remove Koguryo from the ancient history of Korea in the country profile section on its website. When South Korea protested, China responded by deleting the entire pre-1948 history of Korea. The only consolation to Koreans was that China was at least fair enough to do the same to Japan. With North Korea being as dependent as it is on China, some Koreans interpreted the Chinese action as an attempt to do the historical groundwork to expand its influence into the Korean peninsula. The Chinese could have said that Koguryo was a multi-ethnic ancient kingdom whose rulers were Korean but whose cultural heritage was shared by China and Korea, but, for some unknown reason, the Chinese Foreign Ministry decided to go well beyond that. The Koguryo controversy led many Koreans to take a second look at China.

The slogan of “peaceful rise” sums up China’s current external strategy. China is trying to maintain its rapid economic growth and establish strong economic relations on all fronts while presenting itself as a benign, non-hegemonic power. Through such a strategy, China is in effect minimizing the possibility of containment by Japan and the United States. China is forging close economic relations with other countries by offering access to its huge market, especially in the wake of its accession to WTO in 2001. Although foreign businesses are aware of the risks of “boomerang effects” when they transfer technology to their Chinese counterparts, the competitive nature of the market entry game places serious limitations on their choices. China is also reaching out to resource-abundant countries around the globe in order to secure raw materials to sustain its economic growth. A good example is the establishment of the Shanghai Cooperation Organization in 2001 linking China with Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, and Russia. This organization helps China to improve its energy security and increase its influence in the oil- and gas-rich countries in Central Asia.<sup>21</sup>

The rapid expansion of its domestic market is leading China to play an increasingly prominent role in regional cooperation in East Asia. For political as well as economic reasons, China has been making serious efforts to sign a free trade agreement with ASEAN countries, which, in turn, see preferential access to the Chinese market as a possible solution to their present difficulties. In particular, ASEAN countries hope that a free trade agreement with China would enable them to reap an “early harvest” of China’s WTO accession commitments, although they are also concerned about the possibility of Chinese goods flooding their markets. In 2002, China committed itself to creating a free trade area with ASEAN by 2010. In 2004, as a gesture of goodwill, China reduced tariffs on goods imported from ASEAN 6 (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) and unilaterally eliminated tariffs on goods imported from the four late-comers in ASEAN (Cambodia, Laos, Myanmar, and Vietnam). China has been active in Northeast Asia as well. In 2002, it proposed an FTA with Japan and South Korea, and a year later, the three parties agreed on 14 priority areas for trilateral cooperation. Although the quality of institutions in China is not up to par with advanced industrial countries, China has used its sheer size and potential to advance major initiatives in regional cooperation. China enjoys a very strong bargaining position because it can offer its external partners huge benefits from market liberalization in the wake of its WTO accession if they in turn agree to provide China with needed capital, technology, or geopolitical gains.

Although Japan’s departure from multilateral principles predated China’s regional

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<sup>21</sup> See Howard W. French, “China Moves Toward Another West: Central Asia,” *New York Times*, March 28, 2004.

initiatives,<sup>22</sup> Japan has yet to formulate a comprehensive external economic strategy. At a fundamental level, Japan is still struggling with the same problem of identity it has faced since the second half of the nineteenth century: Is Japan inside or outside Asia? Japan's "escape from Asia" and domination of Asia defined the two phases of Japanese foreign policy before World War II. The question is whether Japan can now craft a new role as a benevolent neighbor and respected leader in East Asia instead of becoming a "junior partner" of a global power or a military adventurist on its own.

So far, Japan's approach has been piecemeal and reactive. In response to the weakening of multilateralism since the late 1980s, Japan has taken a more positive view toward preferential trade agreements, but its inefficient agricultural sector has limited its options. Japan signed an economic partnership agreement with Singapore in 2002 and with Mexico in 2004, but these agreements were defensive and exploratory in nature. Far more significant would be an economic partnership agreement between Japan and South Korea. As the only two OECD members in East Asia, Japan and Korea are in the position to advocate deep regional integration based on a high level of institutional quality, going beyond WTO consistency.<sup>23</sup> The strategic significance of this economic partnership would go beyond trade and investment areas, however. It would mark a new era for the two traditional rivals and give China something to think about. Unless Japan and South Korea make it clear to China that their economic partnership agreement is open to further membership, there is even a chance that China might interpret this agreement as a potential building block of containment against China as both Japan and South Korea have a military alliance with the United States. Just as China's initiative toward ASEAN has led to a competitive response from Japan, the proposed economic partnership agreement between Japan and South Korea has prompted China to push for a trilateral agreement involving all three countries right from the start.

As a divided land-bridge in Northeast Asia, South Korea's external strategy in recent years has focused on addressing the North Korea problem. Korea is not a small country, with the combined population of the North and South exceeding that of Britain, France, or Italy, but the presence of China and Japan is likely to limit South Korea's role in East Asia—especially when North Korea's economic problems and military threats demand attention.<sup>24</sup> In particular, North

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<sup>22</sup> See Naoko Munakata(2001), "Evolution of Japan's Policy toward Economic Integration," mimeo, Center for Northeast Asian Policy Studies (CNAPS), Brookings Institution.

<sup>23</sup> On the precedent-setting effect of the economic partnership agreement between Japan and South Korea, see Fukagawa(2003), "Japan's View on Northeast Asian Community: Institutional Approach from Economic Partnership Agreement(EPA)," mimeo, University of Tokyo.

<sup>24</sup> For a discussion on South Korea's role in promoting regional cooperation, see Chang-Jae Lee(2002),

Korea's nuclear challenge is a source of tension that should be addressed as soon as possible.

The outline of a solution to the nuclear problem is reasonably clear.<sup>25</sup> The U.S. should end what North Korea regards as "hostile policy" toward it, and North Korea should freeze and then dismantle its nuclear program under inspection. Through various programs to assist North Korea's economic development, the international community should convince North Korea that a non-nuclear future for North Korea would be better than a nuclear one. To resolve North Korea's nuclear problem and to promote peace and security in Northeast Asia, South Korea is pushing for the construction of energy and transportation networks in the region, facilitating economic development not only in North Korea but also in China's northeastern provinces and the Russian Far East. Such investment projects will also create business opportunities for firms from this region as well as from the outside, and allow them to share in the benefits of increased regional integration.

As for preferential trade agreements, South Korea's approach has been largely defensive and exploratory much like Japan's. In 2004, South Korea signed a free trade agreement with Chile and Singapore, both of which present few problems for South Korea's protected agricultural sector. Beyond the two agreements, however, it is not clear what steps South Korea will take even as it continues to participate actively in regional dialogue such as the ASEAN plus 3 meetings. Negotiations for a free trade agreement with Japan have been going on in the past few years, but progress has been slow due to resistance from some manufacturing sectors as well as concern with China's negative reaction to the bilateral agreement. Also, although some have recently advocated a bilateral free trade agreement with the United States for the sake of high politics more than economics, they have yet to make it clear what they plan to do with agricultural liberalization under GATT/WTO Article 24. Those who champion a bilateral free trade agreement with China face the same problem.

Although ASEAN has been a promoter of regional cooperation since its establishment in 1967, its success has been rather uneven. Initially formed as an anti-communist bloc against the expansion of China and the Soviet Union, ASEAN was slow to integrate economically. In fact, it was not until 1992 that ASEAN established the ASEAN Free Trade Area(AFTA) with a plan to eliminate tariffs among the member countries. It was hoped that AFTA would serve as an

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"East Asian Economic Regionalism and the Role of South Korea," paper presented at the conference on *Korea as a 21<sup>st</sup> Century Power*, held at the University of Cambridge, April 3-6, 2002.

<sup>25</sup> On the contours of a solution to North Korea's nuclear problem, see Wonhyuk Lim(2004), "North Korea's Economic Futures: Internal and External Dimensions," paper presented at the conference on *Korea: The East Asian Pivot*, held at the Naval War College, Newport, Rhode Island, August 26-27, 2004, accessible at [http://www.brookings.edu/fp/cnaps/events/lim\\_20051102.pdf](http://www.brookings.edu/fp/cnaps/events/lim_20051102.pdf).

economic glue holding ASEAN together after the end of the Cold War. However, ASEAN has made only slow progress in economic integration, primarily due to the 1997 economic crisis and the expansion of ASEAN to incorporate Cambodia, Laos, Myanmar, and Vietnam. Although the enlargement achieved the political objective of uniting all of Southeast Asia, it widened the differences in the level of development among member countries, making ASEAN less cohesive. ASEAN leaders reaffirmed the ASEAN Vision 2020 at the 2003 Summit and agreed to establish the ASEAN Community by 2020, but they decided to adopt a pragmatic “2+X formula” reflecting that not all the 10 member states are willing and able to move at the same pace. This “variable geometry” allows Singapore and Thailand to take the lead and other countries to join later in regional integration efforts. When extended to negotiations with non-ASEAN countries, however, such a non-unified approach may generate “spaghetti bowl” effects.

As far as negotiations between non-ASEAN countries and ASEAN as a group are concerned, ASEAN has taken a rather eclectic approach. ASEAN is conducting free trade negotiations with major economies such as China, India, Japan, South Korea, and the United States, among others. At the same time, ASEAN is also making efforts to integrate more tightly with China, Japan, and South Korea as a group in the ASEAN plus 3 framework. As these bilateral or plurilateral negotiations are being conducted ahead of the realization of the single ASEAN market, however, a unified ASEAN negotiating position is not easy to achieve.

## **5. Possible Trajectories for the Future**

During the Cold War, most countries in East Asia belonged to one of the two competing hub-and-spoke alliances headed by the United States and the Soviet Union. Primarily due to historical reasons, including military conflicts in the twentieth century, there was very little multinational cooperation in East Asia at the governmental level. Yet, economic linkages were extensive, at least in the non-socialist part of the region. Japan provided the lion’s share of intermediate goods to outward-oriented industrializing economies, which exported final goods to the American and European markets. The 1985 Plaza Accord accentuated this trend, as the appreciating yen led Japan to increase its investment in Southeast Asia. Although there was no preferential trade agreement in East Asia, extensive international production networks were established in the region to reap the benefits of global trade.<sup>26</sup> At least until the end of the 1980s,

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<sup>26</sup> On Japanese investment in Southeast Asia, see Seiichi Masuyama (2000), “The Role of Japan’s Direct Investment in Restoring East Asia’s Dynamism: Focus on ASEAN,” in *Restoring East Asia’s Dynamism*, edited by Seiichi Masuyama, Donna Vandebriek, and Chia Siow Yue (Tokyo: Nomura Research Institute), pp.213-296.

East Asia took advantage of globalization without giving preference to regional integration. For the most part, export-oriented countries in this region adhered to multilateral principles.

A number of developments since then, however, have led East Asia to take a more favorable view of regional integration. The end of the Cold War and economic reform in transition countries such as China and Vietnam greatly enhanced the prospects for tighter integration in East Asia. Also, the signing of the North American Free Trade Agreement and the formation of the European Union spurred exploratory discussions on “defensive” responses from East Asia. The 1997 economic crisis highlighted the need to create transnational institutions such as an Asian Monetary Fund to protect the collective interests of the countries in the region.<sup>27</sup> Finally, the rapid rise, or more accurately, resurgence of China prompted a search for an international arrangement designed to minimize the risks associated with a shifting balance of power. Sea changes in international relations triggered by the end of the Cold War and the rise of China are increasingly forcing countries in East Asia to look at preferential trade agreements with geopolitical and economic significance.

For instance, China and Japan are competing to strengthen ties with Southeast Asia by signing a free trade agreement with ASEAN. Japan and South Korea are negotiating an FTA, raising concern on the part of China. The United States is also keeping an eye on developments in East Asia, for fear of being excluded from any significant regional agreement. Combined with the very real possibility of major shifts in international relations, historical rivalry among major players is making any ambitious regional initiative by one country a potential source of tension in East Asia. At the same time, the region already has in ASEAN plus 3 a forum where various concerns can be addressed in a constructive manner, affected in part by the Asian economic crisis of 1997-98.

Against this background, it may be useful to consider possible trajectories for regional integration in East Asia. The region basically has four major players—namely, ASEAN, China, Japan, and South Korea. The pattern of regional integration in East Asia will largely be determined by their interaction. By offering an asymmetrical liberalization schedule, China has made much more progress in its negotiations with ASEAN than has Japan or South Korea. Unlike Japan or South Korea, China is not hampered by an inefficient agricultural sector. While there is some concern about the possibility of Chinese imports flooding the market, ASEAN countries can expect an “early harvest” if they sign a bilateral agreement with China ahead of other

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<sup>27</sup> On evolving views toward regional integration in East Asia, see C. Fred Bergsten(1990), “The World Economy after the Cold War,” *Foreign Affairs* 69(3) and T. J. Pempel(1999), “Regional Ups, Regional Downs,” in *The Politics of the Asian Economic Crisis*, edited by T. J. Pempel (Ithaca: Cornell University Press), pp.62-78.

countries. The competitiveness gap between ASEAN and China is likely to widen in China's favor as China increasingly attracts more FDI than does ASEAN.<sup>28</sup> Delaying a free trade agreement with China will only reduce net benefits to ASEAN.<sup>29</sup> Consequently, the best strategy for ASEAN countries is to push for an early agreement with China while securing concessions from China to reduce adjustment costs in their domestic markets.

Japan and South Korea can move toward a free trade agreement of their own to facilitate industrial restructuring and promote investment. Although some Chinese scholars have expressed reservations about this agreement, a trilateral free trade agreement is not realistic at this point, not the least because of GATT/WTO Article 24 and vulnerability of the agricultural sector in Japan and South Korea. It will be more realistic to seek first at least partial solutions to agricultural problems during the course of multilateral trade negotiations, which offer greater room for compensatory mechanism. As in the case of NAFTA, which was expanded from a bilateral agreement between Canada and the U.S. to incorporate Mexico, a bilateral agreement can develop into a trilateral agreement when the shock from liberalized trade can be contained at a manageable level. However, the enthusiasm or urgency for a bilateral agreement between Japan and South Korea may not be as high as the one between ASEAN and China. In particular, the competitiveness gap between Japan and South Korea may not widen even if the signing of the agreement is delayed. While the bilateral agreement may create dynamic benefits by facilitating industrial restructuring in both countries and promoting investment flows from Japan to South Korea, short-run gains from trade liberalization are likely to be unevenly distributed in Japan's favor because Japan's current average tariff rate is lower than South Korea's. These issues must be addressed before the bilateral agreement can be successfully concluded.

The two sets of bilateral agreements can then serve as the building blocks for more extensive regional cooperation in East Asia and beyond. If and when Japan and South Korea are ready to address agricultural liberalization issues, China and ASEAN on the one side and Japan and South Korea on the other can join forces, either individually or as a duo. It is also at this juncture that a free trade agreement with the United States can be discussed in a substantive manner. The risks associated with a shifting balance of power in East Asia should be minimized through such

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<sup>28</sup> In 1990, a year after the Tienanmen demonstrations, the net FDI inflow for China was \$3.5 billion; whereas, the net FDI inflow for ASEAN 10 was \$12.8 billion. By 1993, however, China had overtaken ASEAN 10, and the gap continued to widen in subsequent years. In 2003, the net FDI inflow for China was \$53.3 billion; whereas, the comparable figure for ASEAN 10 was \$19.1 billion. For Indonesia, Malaysia, the Philippines, and Thailand, the net FDI inflow in 2003 was actually less than what these countries had attracted in 1990, respectively.

<sup>29</sup> On this point, see Mohd Haflah Piei(2002), "The East Asia Free Trade Agreement: An ASEAN Perspective," paper presented at the conference on *Prospects for an East Asian Free Trade Agreement*, organized by the Korea Institute for International Economic Policy (KIEP), Seoul, Sept. 27, 2002.

cooperation. For the foreseeable future, the ASEAN plus 3 framework is likely to provide a forum for constructive discussions on promoting reconciliation and cooperation.

## **6. Conclusion**

Although economic integration seems to offer tantalizing possibilities for formerly hostile nations in Northeast Asia, it would require more than trade and investment ties for these nations to come to terms with history and craft a common vision for the region. Not only are there inherent limitations in using economic exchanges to promote mutual understanding, but also geopolitical considerations interacting with historical animosity may trump commercial interests favoring regional cooperation. As Yotaro Kobayashi's case shows, entrepreneurs doing business in foreign countries have a good incentive to guard against the forces of ultra-conservative nationalism because, after all, they have to be attentive to local sentiments if their business is to prosper; however, business leaders are vulnerable to criticism because, no matter what they do, they are seen to put money before anything else. A strictly commercial rationale for reconciliation and cooperation is not likely to be very effective in promoting genuine understanding between formerly hostile nations. Also, geopolitical considerations may override commercial interests and influence the pattern of economic exchanges in a way that is likely to raise, rather than reduce, tension between historical rivals. Although China has managed to attract a great deal of FDI from former foes as well as friends, there is no guarantee that economic interaction will continue to expand as Japan and the U.S. increasingly speculate about China's ultimate objective.<sup>30</sup>

It would require conscious efforts on the part of civil society and political leaders to overcome the limitations of purely economic approaches. A political breakthrough in an effort to come to terms with history should be supplemented by increased economic and cultural exchanges to broaden mutual interests and understanding. Consistent and credible actions on the part of political leaders are important so that there would be neither "apology fatigue" nor "misstatement fatigue." Once significant progress has been made in regard to historical problems, civil society and political leaders should make efforts to construct and institutionalize a shared identity and a future vision that transcend national borders. To minimize the risk of conflict, proponents of these regional integration schemes should make it clear that they are to be the building blocks of larger integration. With ASEAN and South Korea effectively playing the role of mediators between China and Japan, coordination and consultation within the ASEAN plus 3 framework would be desirable. Also, potentially enormous benefits from economic integration should be

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<sup>30</sup> See, for instance, Zbigniew Brzezinski and John J. Mearsheimer, "Clash of the Titans," *Foreign Policy*, January/February 2005.

spelled out, for countries both inside and outside the region. The construction of energy, information, and transportation networks and the integration of national markets should offer tremendous business opportunities. It is essential that Northeast Asia be open to the world's major corporations so that they would have a stake in engaging, rather than containing, nations in the region and argue effectively against geopolitical strategists who tend to see more potential for conflict than cooperation.