

## **Preparing the Age of Northeast Asia: The New Economic Policy and Inter-Korean Cooperation**

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### **INTRODUCTION**

**T**he new government owes much to ordinary people for their volunteerism, fund-raising and campaigning. Acknowledging the power of the people, on February 25, President Roh Moo-hyun designated his administration a “Participatory Government.” At the same time, he defined the current 21st century as the “Age of Northeast Asia,” emphasizing that Korea must play a pivotal role.

This plan incorporates two major initiatives: First, seeking new momentum for further economic growth and second, establishing peace on the Korean peninsula. In his inaugural speech, President Roh stated, “The Korean peninsula is located at the heart of the region. It is an extensive bridge linking China to Japan, and the continent to the ocean. That very geopolitical characteristic often caused pain for Korea in the past. Today, however, this same feature is offering us an opportunity.” He went on to say, “Korea is endowed with highly creative and well-educated people as well as a state-of-the-art information infrastructure. Logistics bases are being perfected on land and sea and in the air as seen in the up-to-date facilities at

Incheon International Airport, Busan and Gwangyang Ports, and the projected high-speed railway systems. Clearly, the nation is being equipped with all the basic requirements necessary to lead the Age of Northeast Asia in the 21st century. And it will emerge as an international logistics and financial hub in Northeast Asia.”

Korea overcame its economic difficulties after the Asian financial crisis in 1997 with exceptional speed, and got back on the track toward stable growth. But in light of the slump in domestic demand, as well as in the world economy, especially the United States, it is hard to see a rosy future ahead. It seems particularly bleak as we face issues of imminent war against Iraq and North Korea’s nuclear capability. On the other hand, a new economic order is forming in Northeast Asia, hastened by China’s accession to the World Trade Organization (WTO) as well as changes in North Korea. In this transition period, it is inevitable that Korea should set a new economic course in order to further growth. In response to those circumstances, the new government’s blueprint, although it is still somewhat abstract, is estimated to be a timely and proper action.

Prior to implementing a plan for developing the nation as the economic hub of Northeast Asia, the government should first work on improving inter-Korean relations, especially, determining the role the North will play. Despite various efforts to enhance economic cooperation between the two Koreas, the stability of inter-Korean relations has been hampered by political and security issues. Still worse, North Korea seems more interested in what benefits it will receive for granting permission to South Korea to do business than in the positive effects of economic cooperation. Under these circumstances, it will take considerable time and changes by the two Koreas to develop profitable businesses that are based on rational business practices and guaranteed by authorized institutions.

While it is true that stable improvement of inter-Korean relations is a prerequisite for the drive to develop Korea as the hub of Northeast Asia, it is also a fact that economic cooperation in Northeast Asia can facilitate stable inter-Korean economic relations.

In this respect, each goal is a necessary condition for the other. This report aims to present ways to maximize the two Korea's mutually complementary functions: firstly, it will review the comparative advantages of the South Korean economy, and secondly, it will deal *a priori* conditions of inter-Korean relations.

### INITIATIVES FOR THE ECONOMIC HUB OF NORTHEAST ASIA

#### *Manufacturing Sector*

The advancement of the tertiary industries, namely the logistics and financial industries, is the key to developing Korea as an economic center. The manufacturing sector, however, should not be ignored. In fact, the complementary link between the secondary and tertiary industries must be reinforced, considering the scale of the Korean economy and the existing industrial infrastructure. Specifically, the logistics and financial industries should be developed in a way that raises the secondary industries one level higher through complementary functions, rather than replacing them. The scale of the Chinese economy and its price competitiveness invited some skepticism about the future of the Korean manufacturing sector. However, China is also faced with obstacles, such as regional protectionism and market division, as well as economic disparities among regions. In that light, the Korean manufacturing sector seems to have the growth potential to be a leading partner of China. The recent hospitality of China toward the Korean auto industry attests to that.

Given the ongoing changes in the Northeast Asian economy, including those in China, the gap in development among nations in the region, and the economic conditions in North Korea, three requirements should be promoted in order to achieve an advanced industrial structure: the principle of selection and concentration;

**Table 1. Economic Indicators in East Asia**

Nation (Year)	Area (1000 km <sup>2</sup> )	Population (million)	GDP* (US\$bn)	GDP** (US\$)	Exports fob*** (US\$bn)	Imports cif**** (US\$bn)
China(1991)	9,561	1,275.1	1,080	919	267	244
Hong Kong(1991)	1	6.9	162	24,080	177	205
Indonesia(1989)	1,904	212.1	152	676	66	37
Japan(1989)	378	127.1	4,765	37,299	403	349
Korea(1989)	99	46.7	462	8,918	150	141
Malaysia(1989)	333	22.2	90	3,891	90	76
The Philippines((1989)	300	75.7	75	926	35	36
Russia(1998)	17,075	145.5	260	2,147	95	44
Singapore(1989)	1	4.0	93	20,738	122	116
Taiwan(1991)	36	22.2	309	12,599	122	107
Thailand(1989)	513	62.8	122	1,825	65	62
Viet Nam(1998)	331	78.1	31	418	14	17

\* Current Price GDP

\*\* GDP per capita

\*\*\* fob: free on board

\*\*\*\* cif: cost, insurance and freight

Source: Asia-Pacific Economic Cooperation [<http://www.apecsec.org.sg>].

development of applied technology to link economies in the region; and development of an inter-Korean linked comparative advantage.

#### A. Selection and Concentration

While China will continue to hold the advantage over its competitors in labor-intensive industries and low value-added industries, there is also a significant potential domestic demand for manufactured goods in areas such as automobiles, information technology, steel, ship-building and the construction industries. The size of the Chinese manufacturing industry is not yet large enough to meet the domestic demand, and its level of technology is still in the development stage. China thus regards its economic cooperation

with the outside world as a major policy strategy for industrial growth. Since China joined the WTO, however, there are growing concerns that its market opening might cause Western nations to tighten their monopolies. Accordingly, the Chinese government has tried to open its market in a way that increases its economic leverage, while diminishing the power of Western companies.

On the other hand, Japan has advantages over Korea in high value-added industries. Yet it will be difficult for Japan to aggressively advance into the Chinese market or to pursue an economic cooperation strategy for the time being, due to de-industrialization in its manufacturing sector, concerns about diminishing corporate profits, and macroeconomic instability. Since Japan cannot afford to make aggressive moves for now, Korea can raise its share in the Chinese market and secure competitiveness in the global market by selecting core industries with competitive advantages, and then concentrate investment and research and development capability on them. Considering the higher wages in the Korean labor market and the possibility of conflicts between labor and management, a more advanced industrial structure achieved through industry selection and investment concentration could contribute to improved added value, and thus lead to more stable labor-management relations. From this perspective, it is necessary to aggressively pursue “selection and concentration” strategies: first, by boldly investing in R&D in industries already proven to have comparative advantages in the global market such as the IT industry, and second, by fostering a highly skilled workforce.

#### B. Developing and Linking Applied Technology

Northeast Asian countries vary dramatically in levels of economic development and in terms of system, historical background and natural environment. Accordingly, in order to apply advanced industrial technology to different economies, processing and applied technology must be developed to reduce investment and management costs, as well as to secure time to acquire technology.

Korea can improve its ability to create added value and contribute to unifying industry standards in the region by developing practical technology that can link regional economies. It not only has a geo-economic advantage, but also an applied and processing technology advantage and inter-Korea economic cooperation. It should be remembered that the Korean economy gained a competitive advantage in advanced technology and standardization, and at the same time experienced rapid growth through an export-oriented strategy. The lessons Korea learned will play a positive role when obstacles arise in the process of economic cooperation.

#### C. Developing an Inter-Korean Linked Comparative Advantage

The economic conditions in North Korea are so deplorable that a comparative advantage between the two Koreas cannot even be contemplated. In fact, developing a comparative advantage based on existing conditions and economic capability could cause resentment among North Korean citizens. The two Koreas must be linked as a single economic unit, however, taking their geo-economic conditions and resources, and their long-term land development plan into account. Then an advantage over surrounding nations must be developed for the Korean peninsula economy. The first step to this end is to set a long-term industrialization plan that takes into account the geo-economic locations and the scant resources of North Korea. Next, comes a search for ways to rebuild industries in the North and to promote cooperation between industries of the two Koreas. The goal will be to improve the North Korean economy on a long-term basis, at the same time it is enhancing the competitiveness of the South.

#### *Logistics and Financial Sectors*

The global economy is melding into a single unit with the rapid growth of the telecommunication and IT industries, and as more and more financial assets moving across borders. On the other hand, the

**Table 2. National Information Index(NII) and Its Ranking**

Nation	National Information Index						NII Ranking					
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
Hong Kong	73	77	81	79	85	82	12	12	11	11	10	11
Japan	68	78	81	79	80	77	14	11	10	10	11	16
Singapore	71	76	80	77	79	85	13	13	12	12	12	10
Taiwan	51	50	58	69	77	80	22	22	20	19	13	12
Korea	53	54	58	62	70	75	21	21	21	21	19	17
Russia	23	22	21	20	19	15	37	37	36	36	37	42
China	16	15	14	14	13	12	46	46	46	46	45	45
Tailand	18	17	16	14	12	11	45	45	45	45	46	47
Philippines	14	13	11	10	9	11	48	48	48	48	48	48
Indonesia	13	12	11	9	8	9	49	49	49	49	49	49

Source: The Ministry of Information and Communication [<http://www.mic.go.kr>].

EU is expanding, China and the ASEAN member countries are concluding free trade agreements (FTA) and other nations are pursuing exclusive regional economic cooperation. The coexistence of these trends is perceived as a new opportunity as well as a challenge for each nation's industry and external policies. Within the current trend of globalization, the logistics and financial sectors in particular, are regarded as areas critical to the success of regional economies.

A war is being waged in Asia to decide what area will be the next financial, commercial, production and knowledge hub. As a matter of fact, in order to attract foreign companies, many Asian countries have successfully incorporated the special economic zone (SEZ) concept, which has enhanced the competition of their national economies and thus contributed to regional economic development: Singapore's free trade zone, Hong Kong's Free Harbor, Taiwan's export processing zones (EPZs) and scientific industrial belts, to name a few.

The concept of an SEZ in each region varies, depending on the

**Table 3. Top Six Asian Ports: 2002 Container Throughput**

	Ranking	TEUs (million)	Growth Rate
Hong Kong	1	19.14	+ 7
Singapore	21	6.94	+ 9
Busan	3	9.33	+ 16
Shanghai	4	8.61	+ 36
Kaohsiung	5	8.49	+ 11
Shenzhen	6	7.61	+ 50

purpose, environment and historical background of the country. Moreover, their objectives and functions also differ depending on the characteristics of each regional economy.

In the case of China, at the early stage of its reform efforts, it set a comprehensive goal for building a special economic zone: not only to build a channel for foreign capital and advanced technology, but also to create an environment serving a multitude of uses: as a testing ground for economic reform measures, a buffer between mainland China and Hong Kong and Taiwan, an intermediary base to develop trade, and a site to promote comprehensive development of regional economies. SEZs of other countries or regions, however, were designed to play smaller roles and functions. Nevertheless, one thing they have in common with China is that they all focus on inducing foreign capital by further developing their logistics and financial sectors. Moreover, a key success factor has been the creation of an environment to achieve that goal. For regional economies to function as logistics and financial centers, they need to secure geographical locations and conditions such as special economic zones or industry clusters. Even more important are human resources, legal and institutional systems and efficient management networks based on the practical application of information technology.

#### A. Enhancing the Business Environment

In the current race towards becoming the Asian hub, Korea

seems to be far behind its competitors. Compared to its main competitors, Singapore, and Hong Kong, together with China, Korea's business environment is less favorable, especially in areas of shareholder rights, corporate leaders' integrity, labor relations, tertiary education, safeguards for foreign investments and other elements directly related to foreign investment.

As it is necessary to secure a workforce with international business and foreign language skills, Korea's first step should be to develop experts in trade, financial, and service areas, who are fluent in such languages as Chinese, Japanese and English. This requires the reorganization of educational system and curricula of foreign language institutions. Also, in order to develop expertise in international trade, financial, international bodies, investment related laws, more MBA courses and specialized graduate schools must be established. An internship system based on industry-academic cooperation would also lead to greater expertise in the workforce. Meanwhile, investment-related laws must be improved, global laws and procedures simplified, transparency of regulations secured, and administrative regulations reduced. Also important is to build a system for cooperation of central and local governments as well as for the division of jobs so as to introduce a comprehensive one-stop service. In order to actively respond to the advent of a new economic order in Northeast Asia, it is urgent to establish a system of cooperation between the two Koreas for human resources and legal and institutional infrastructure.

#### B. Building a Logistics Base and Network

The new government plans to develop the Seoul metropolitan area, Kwangyang and Busan as logistics bases in line with its goal to create an economic hub on the Korean peninsula. This plan should not only meet international standards in transportation, telecommunication, residence, laws and environment, but should also include a high-end distribution service network. To build on this competitiveness in the logistics and financial sectors of the Korean

economy, Korea's comparative advantages against Singapore, Hong Kong and Shanghai must be identified and developed. In the process of building a logistics network, Korea will be able to create an integrated system, based on apply its competitive advantage in IT, in particular, using an ultra-high speed telecommunications network between logistics bases and financial institutions. Also, taking advantage of its strategic location on the West Sea, Korea can act as an intermediary, to compensate for deficiencies in the Chinese economy such as regional divisions and lack of infrastructure. In doing so, it will improve its own capability to create added value.

In the long term, Korea must lead the way in improving and linking transportation networks in neighboring countries, including sea and air transport, railways, roads and underwater tunnels, in order to build a logistics network between the Korean peninsula and the Eurasian continent. In particular, it is necessary to form a committee consisting of the two Koreas, China, Russia and European border countries to discuss how to link transcontinental railways, the Trans-Siberian Railway (TSR) and the Trans-China Railway (TCR), with railways of South and North Korea, and to determine how to utilize them. The committee would implement the project, plan funding, and mediate related institutions. Also, the two Koreas should establish a permanent body to link, manage and operate their transportation networks. At the same time, an international cooperation system must be established to improve the region's infrastructure. Given that the United States is against the idea of creating a separate comprehensive financial body in Northeast Asia, it will be more realistic to form project-oriented consortiums as the need arises. Another alternative is to reinforce Korea's funding capability by globalizing its capital market. This will secure an environment where the market provides the capital required for economic cooperation projects in the region. To this end, Korea needs to rapidly upgrade the competitiveness of its financial institutions and open the market to foreign financial firms in order to pave the way to its goal. And in the long term, it is necessary to enhance the

convertibility of the Korean won as an international settlement currency.

### *Building an IT Network in Northeast Asia*

#### A. A Telecommunications Community and Industry Standards in Northeast Asia

If Korea is to become an economic hub in Northeast Asia, it must go beyond building IT clusters of conventional types to developing a pivotal network. The priority should be on an integrated telecommunication system founded on sound industry standards; that is, building a Code Division Multiple Access (CDMA) belt in which Korea has a geographical and technological advantage. Following this step, Korea will more one step closer to being a window to the world for Northeast Asia.

As part of efforts to build an integrated telecommunication system for Northeast Asia, South and North Korea should cooperate in two major areas: securing inter-Korean telecommunication channels and building wireless a telecommunication network of North Korea. This will not only facilitate North Korea's entry into the global economy, but will also spur infrastructure improvements required for its opening to the outside.

#### B. Expanding On-line Cultural Exchanges and Cooperation for Software Development in the Region

As for IT application areas, various projects including an integrated internet site for tours of Northeast Asia and an e-commerce network must be developed utilizing Korea's competitive advantage, so as to facilitate trade and investment between countries in the region and to lay the foundation for a free trade zone. Also, with regard to inter-Korean economic cooperation, the focus should be on resolving the difficulties that hamper economic cooperation: These would include complaint handling and technical guidance, through satellite and Internet for the time being, considering the

limitations of the North Korean regime. Meanwhile, in order to develop on-line cultural information and to expand exchanges, the two Koreas, China and Japan can cooperate in standardizing the computer processing of Chinese characters and in developing and applying translation programs. Centering on inter-Korean cooperation, countries in the region need to discuss and implement code standardization and develop translation software for applications to Internet exchanges. This will contribute to forming a cultural community of Northeast Asia. North Korea has a competitive advantage in software development such as voice processing and translation programs, which can be used as a means to induce North Korea's active participation. With regard to software, countries including the two Koreas, China and Japan can work together to protect intellectual property rights as well. Such projects will accelerate cultural exchanges and establishment of an informational and cultural community in Northeast Asia. To this end, nations must form an organization to manage intellectual property rights in the region, including in North Korea.

#### **DEVELOPING AND UTILIZING THE NATURAL RESOURCES OF NORTHEAST ASIA**

One of the reasons for the economic difficulties facing North Korea is the lack of natural resources, including energy sources. China, despite its size, is also poor in terms of the amount of usable resources compared to the population. The same goes for Korea and Japan, who are entirely dependent on imports for oil and other energy sources. This makes it doubly important to establish a cooperative relationship with Russia, the only neighboring country rich in resources, so as to secure economic growth in the region. As Russia is increasingly interested in the issues of the Korean peninsula, it will be possible to implement joint projects between the two Koreas and Russia, which will improve inter-Korean relations

and secure natural resources.

In order to resolve energy shortages of South and North Korea, the two need to jointly participate in crude oil and gas development projects in Siberia for the early completion of pipelines linking Irkutsk, China, North and South Korea and Japan. Assuming that North Korea carries out economic reforms, it would be wise to combine Russia's technology and South Korea's capital to modernize and maintain North Korea's heavy chemical, steel, petro-chemical and energy facilities for commercial use. Potential candidates for this effort would be Kimchaek Steel Plant, Seungri Chemical Factory, Heungnam Fertilizer Factory and Hoecheon Engineering Machinery Factory. South Korean capital and North Korean labor would benefit joint construction projects in Siberia and construction, forestry, agriculture, fishery industries in the Russian Far East. This would help normalize the North Korean economy and secure a stable source of natural resources for the South. To give a specific example, the two Koreas could implement such projects as the Korea-Russia industrial complex construction in Nahotka, logging and timber processing in Siberia, a South-North Korea joint farm development in the Russian Far East coastal area and a cooperative fishing industry in the Russian Far East Sea.

#### *Reinforcing and Utilizing the Network of Overseas Koreans*

Considering the number of overseas Koreans, it is important to establish their identity as Korean people, and hence, to utilize their talents in developing the nation as an economic hub. In particular, their assets such as capital, technology and distribution networks are sorely needed by Korea, in order to accelerate the development of a South-North Korean economic community.

Such organizations as the Overseas Korean Foundation, World Federation of Overseas Korean Traders Associations, and World Federation of Korean Association of Commerce are becoming more active, as Korea's international status rises and as economic

conditions of overseas Koreans grow. These efforts by the private sector only are not enough, however, to concentrate their commercial and industrial capabilities. The Korean government, therefore, as part of its plan to develop Korea as an economic center, needs to 1) enhance the competitiveness of the nation by increasing exchanges and economic cooperation between businesses at home and abroad in preparation for the global economic order of 21st century, 2) build a Korean economic community by forming a network consisting of businesses in the two Koreas and Korean overseas, and 3) vitalize the national economy and reinforce competitiveness by attracting investments from overseas Koreans. North Korea's opening and its adaptation in the world economy can become a reality with the combined help of the national economy and the overseas business community.

#### IMPLICATIONS FOR INTER-KOREAN ECONOMIC COOPERATION

##### *The Opening of the North Korean Economy and the Economic Hub*

Recently, North Korea has demonstrated its intentions to open and pursue economic reform. It designated Shinuiju Special Administrative Region, Kaesong Special Economic Zone, and Mt. Kumgang Tourist Zone, and it announced a series of new laws relating to those zones. That came on the heels of the price-wage and incentive system reforms of last July. Back in the 1990s, North Korea had attempted to normalize its economy by revamping its planned economic system but those efforts failed to live up to expectations. Yet, that failure did lead to a more flexible, realistic policy, at least in the economic area. But the move caused side effects such as worsening inflation due to the short supply of goods and the renewed proliferation of the black market. Furthermore, despite the devaluation of the North Korean won, the foreign exchange rate on

the black market soared, dashing hopes for economic stability. And although the recent nationwide pay raises fueled hopes for improvement, North Koreans continue to cope with shortages and delayed wage payments, and they are increasingly unhappy about the widening economic gap between regions and classes.

Clearly, economic factors led to the failure of North Korea's economic policy change: The inability to supply products, the price liberalization and insufficient follow-up reform measures. More importantly, however, non-economic factors such as the ideological limitations of the leadership, the conservative establishment and the negative diplomatic environment were major constraints. This unsuccessful economic reform turned the conservatives, in particular, all the more conservative, and the regime had to hold to a tougher line on nuclear issues, among others. The view from another angle is that recent U.S.-North Korea confrontation was exaggerated by North Korean leadership in order to blame the U.S. for Kim Jong-il's failed economic reform measures.

Under these circumstances, North Korea, for now at least, is showing a relatively positive attitude toward inter-Korean economic cooperation since the South dispatched its special envoy to the North in April, 2002. The inter-Korean ministerial talks were resumed, and the Inter-Korean Committee for the Promotion of Economic Cooperation held its 4th meeting in Seoul from February 11 to 14. In addition, the two nations started a long-awaited overland tour of Mt. Kumgang along a temporary cross-border road. Previously agreed-upon economic cooperation projects like Kaesong Industrial Complex Project are expected to proceed.

However, the nuclear issue has yet to be solved, and the scandal surrounding the secret remittance to the North during the previous administration is creating skepticism among South Koreans over economic cooperation projects. Expansion of cooperation projects in the short term appear unlikely. It will be also considerably difficult for the North to take specific steps to actively respond to cooperation projects when there is growing resistance to the United States.

Trade volume between the two Koreas in 2002 set a new record-high of 640 million dollars, including non-transactional trade, and process-on-commission trade, which are driven by economic factors, exceeded 170 million dollars. This year, however, the South Korean economy is expected to slow down, and non-transactional trade is also expected to diminish drastically due to the nuclear issue, which, in turn, will reduce inter-Korean trade volume. Further progress in inter-Korean economic cooperation is not expected, given the characteristics of the inter-Korean relationship, and the worsening international politics surrounding North Korea. Furthermore, confusion exists over roles and functions of the South Korean government and businesses vis-à-vis inter-Korean economic cooperation projects, (a case in point: the previous administration's remittance to the North). As long as public skepticism remains, the outlook for economic cooperation is dim.

It is hoped however, that the plans for a Northeast Asia hub will improve inter-Korean relations and spark more cooperation. To this end, the government needs to establish a new framework for inter-Korean cooperation by public consensus. Roles and functions of the government and business should be clearly divided so that businesses focus on financial feasibility, whereas the government focuses on providing humanitarian support to North Koreans, establishing peace on the peninsula and creating an environment for the development of inter-Korean relations. Specifically, it must be able to convince the public that building an economic hub is a realistic step toward building the Korean economy. Inter-Korean economic cooperation is a prerequisite for that goal, so that they can accept the realistic functions of cooperation projects.

If the two Koreas were to work together on construction of an economic center, it would create synergy by strengthening the capabilities of both nations. For the South, implementing initiatives for building the economic hub of Northeast Asia provides a legitimate foundation for the direction and the economic feasibility of inter-Korean economic cooperation. For the North, on the other

hand, participation in inter-Korean economic cooperation projects in the bigger frame of regional economic cooperation will reduce the North Korean regime's anxiety over their dependence on inter-Korean cooperation funded by the South.

Until now, there has been skepticism regarding large projects, for example, linking infrastructure between the two Koreas. Due to the weak cost-benefit ratio, such projects would not attract international investment. When a Northeast Asian network is formed within the context of building the economic hub of Northeast Asia, many huge projects will secure not only the economic feasibility, but also a legitimate basis for implementation. This would also reduce uncertainty arising from other inter-Korean economic cooperation projects.

North Korea is neither experienced in setting policies for smooth economic reform, nor prepared in terms of the environment. The biggest obstacle, however, is that it does not have external economic channels similar to those of mainland China, namely Hong Kong, and Taiwan. Nor do North Koreans live abroad as the Chinese do. Therefore, a network that allowed the successful reform of China. Incorporation of the North as a pivotal part of the regional economic network will be the most powerful tool for streamlining reform and opening of North Korea. In sum, the basic scheme provides an important mechanism that can deepen and expand reforms and opening of North Korea.

#### *Implications of Policy Direction*

The synergy between building the economic hub of Northeast Asia and inter-Korean economic cooperation will itself drive the development of inter-Korean relations. This can be understood by looking at the structure of the Greater Chinese Economic Area now being formulated among mainland China, Hong Kong and Taiwan. These three, despite the differences in their political and economic systems, are utilizing Hong Kong as a base for economic cooperation

in the region, and hence, are facilitating economic, social and cultural exchanges and cooperation. These nations will be able to combine production, and ultimately develop into a single economic entity. Mainland China and Taiwan have been able to expand functional economic and social exchanges, despite conflicting positions regarding the legal status of Taiwan. They have no institutional mechanism to do that. On the other hand, the two Koreas have already resolved conflicts over state recognition, but have yet to solve ideological and military conflicts. Therefore, fundamental improvement of inter-Korean relations should start with South Korea's efforts to become an economic pillar of the region and to include North Korea.

The engagement policy toward North Korea aimed at ending the Cold War and establishing peace on the peninsula, pursued a functional economic community in the sense that it aimed to achieve common prosperity through combining production elements under two different systems. However, Korea has not gone as far as to function as an open economic hub in the region. Since the financial crisis in Asia, however, South Korea has improved to some extent. In terms of the flexibility of its system and the soundness of its financial structure, however, it still needs to secure the tangible and intangible assets required to be an economic pillar of the region.

Expanded inter-Korean economic cooperation will combine production of both economies, building on a foundation of peace and coexistence and leading to the recovery of the North Korean economy and to further growth of the South Korean economy. This will, in turn, greatly strengthen role of the Korean peninsula economy in building a new economic order in Northeast Asia. As China's entry into the WTO and improved relations of North Korea with Russia and Japan are expected to enhance the cohesiveness of regional economies and the mobility of production elements, the economic relations between the two Koreas will be in harmony with the changes in the economic order of the region. This will minimize the burden on the South Korean economy, and at the same time

accelerate the recovery of the North Korean economy.

Plans for developing an economic hub in line with inter-Korean economic cooperation should be implemented in a way that (A) guarantees the profitability of inter-Korean economic cooperation projects by advancing into neighboring markets, (B) reduces the burden on the South Korean economy by attracting investments from surrounding countries, (C) establishes a regional cooperation system by balancing the growth of the South and North Korean economies and national interests of surrounding countries, and (D) utilizes production elements of the region to improve the international competitiveness of the Korean peninsula economy.