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# Northeast Asian Economic Cooperation and Japan

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## Introduction

In Japan, the subject of economic cooperation in Northeast Asia brings to mind the “Sea of Japan Economic Bloc” initiative. The “Sea of Japan Economic Bloc” refers to the countries that surround the Sea of Japan, that is, Japan, Korea, North Korea, Far East Russia, and three Northeast Chinese provinces (Heilongjiang, Jilin, and Liaoning). It is sometimes broadly construed to include the Yellow Sea and East China Sea. Furthermore, the Sea of Japan is called the “East Sea” in South Korea, and the area is called the “northeastern Asian economic area” in China. As some words have special historical and political meanings, it is difficult to arrive at common definitions. This report examines economic cooperation in the “Sea of Japan Economic Bloc” and Japan’s role in light of present economic conditions.

## The Large Potential for Development

The end of the Cold War turned expectations and the possibility of forming an economic bloc in this area into reality. Russian reform began with the Perestroika of the Gorbachev administration in 1986 and expanded to market reform after the collapse of Soviet Union in the end of 1991. China initiated reform and an open door policy in 1979, reaching a completely open stage and establishing a socialist market economic system in 1992. Though North Korea

has remained closed, the two former socialist powers, i.e., the Soviet Union and China, established a market economy, which means that an economic age replaced an orientation around politics and security, and free markets in the area became a distinct possibility.

Next, from the latter half of the 1980s to the 1990s, a surge in trade and foreign direct investment (FDI) has been effected by Japan and South Korea. Korea, in particular, expanded trade with and investment in China after the restoration of diplomatic relations in 1992. Japan also rapidly implemented FDI in China in response to the strong yen. Expectations of a complementary economic area were heightening in Japan. Furthermore, the WTO was established in 1995, and regional and bilateral agreements (e.g., EU, NAFTA, and APEC) complementing the WTO became very active in the 1990s.

The Sea of Japan Economic Bloc Plan in Japan was announced at the Sea of Japan Symposium, an international conference held in Niigata in 1988. At that time, Japan was in the midst of a bubble economy. This economic bloc was an abstract plan, an idea much too idealistic to promote development and not grounded in sufficient economic exchange or mutual dependence.

Each country in this area was thought to have the following advantages: Japan has capital and high technology. South Korea has standardized technology and capital. Although North Korea has been a closed socialist economy, it is blessed with cheap, good-quality manpower and mineral resources, as well. Far Eastern Russia is rich in petroleum, natural gas, non-ferrous metal such as gold and diamond, lumber, and marine products. Northeast China has good-quality labor, agricultural products, and natural resources such as coal.

The above advantages of each country make possible the vertical international division of labor. The formation of an economic bloc by a mutually complementary international division of labor made the potentialities for the development big. The area is expected to achieve the most remarkable economic

growth in Asia after Southeast Asia.

### **Concerns Regarding the Plan**

The key is the area's complementary production elements such as capital, technology, manpower, and the required mineral and energy resources. Some advanced countries, not having enough natural resources, have only capital and technology. On the other hand, other countries lack funding, technology, and sufficient infrastructure because of underdevelopment but are blessed with natural resources and cheap, high-quality labor. As these countries exist near each other and can help each other, there is great potential for development in this area.

Although expectations and possibilities are considerable regarding this plan, many difficulties about how to realize it occur to us. There are major factors in the area that could be politically divisive. International politics and security influence economic cooperation closely. First, ideological structures differ. Mixed together in the area are capitalist economies such as Japan and South Korea, emerging market economies like Russia, a socialist market economy (China), and a socialist planned economy (North Korea).

Economic exchange between South Korea and China has expanded rapidly since the restoration of diplomatic relations in 1992. In addition, mutual exchange among South Korea, Russia, and North Korea has increased gradually. South Korea has adopted a "sunshine policy" towards North Korea, but the situation is still very unstable. Peace on the Korean Peninsula is a particular problem. There are many unstable factors affecting politics and security, including the missile problem. We have to pay attention to North Korea, as peace on the Korean Peninsula is a fundamental requirement for the economic bloc. In addition, Russian exploitation of energy resources could easily become the seed of international conflict, because energy resources are strategic goods.

Next is the historical issue of the Japanese invasions. Many areas in Northeast Asia were invaded and colonized by Japan, and some unsettled problems remain. The inconsiderate remarks and behavior of certain Japanese politicians impede mutual understanding and mutual trust. Moreover, an economic bloc plan seeking the vertical international division of labor may stir memories of past imperialism and colonialism.

Third, there is the northern territory issue between Japan and Russia, which also involves fisheries in the area, too. This territorial problem could become a diplomatic impediment to economic cooperation between Japan and Russia.

There are also economic factors that could be divisive. First, the stages of economic development differ among the countries. Different development stages mean a mixture of developed and underdeveloped countries with respect to economies and production systems. This makes coordination and mutual profit fairly difficult.

Although the task is easier when an economy develops well, the driving force of the plan weakens under worsening economic conditions. For example, APEC, which previously was considered a shining example of spontaneous cooperation that overcame differences in development, has not worked well recently because of economic sluggishness.

When an actual economy develops well, wishful thinking gets stronger in a planned economic bloc. But the driving force becomes weak, and it often depends on the economic conditions when an actual economy becomes worse in the collapse of the bubble and the financial crisis. Each country tends to pursue its own egoistic profits. In actuality, economic concern has been concentrated on domestic affairs and not on international affairs since the Asian financial crisis in July 1997.

A second economic factor is that the market economy is not understood fully and has not taken root sufficiently, especially in China and Russia. Many prob-

lems rooted in past economic systems remain ; system reforms, as well as awareness of the need for reform, are insufficient to achieve the transition to a market economy from a socialist one. The need for a market economy is recognized, but the systems that support it are weak. Market function sometimes do not work well with a mixture of capitalism and socialism. And some distortions are also caused by political dictatorship, because a market economy can only be based on the civil society of a democracy.

Third, the regions outside of South Korea and North Korea, which have promoted the plan, are rather minor and have not been treated with much importance by their own central government. Cities on the Sea of Japan side, such as Niigata and Akita (called the “reverse side” of Japan), and Hokkaido are somewhat lagging in development.<sup>i</sup> Northeast China is also lagging in reform. Far Eastern Russia is far from Moscow and has not been treated well. Development has been delayed because of lack of sufficient social infrastructures.<sup>ii</sup>

As mentioned above, there are many political and economic fears in this area. The principle of openness is needed in this area to avoid such fears. We have to promote trade, introduce capital from other countries, and form a free economic area. The promotion of close economical interdependence will form the foundation of peace.

### **Japan's Role and the Present Economy**

Japanese expectations of the economic bloc are, first and foremost, to secure energy and natural resources. Next is to use the international division of labor to secure cheap labor and land. Another is regional development in the other Sea of Japan countries.

The other countries expect Japan (and, most likely, South Korea) to supply the financial support, foreign direct investment (FDI), and technical coopera-

tion, in addition to the opening of Japan's high-income market.

One question that arises is whether both sets of expectations are mutually compatible. For example, Japan's requirements are criticized as being based on self-serving views of the vertical international division of labor. The other countries demand a horizontal international division of labor as well as more financial support and technology transfer. The question is whether Japan can accede to those requests. The post-bubble Japanese economy, unable to settle its financial sector's bad debt, has plunged into recession and financial disorder and has therefore become domestically oriented.

A big role for Japan is economic and financial cooperation. ODA from Japan is currently needed to build infrastructures, but Japan, facing deflation and a gigantic government budget deficit, is now considering a reduction in its ODA budget. Thus, Japanese funding will begin to decrease. FDI in Northeast Asia has not been very active.<sup>iii</sup>

Asian developing countries are catching up with Japan even in high technology. Improvement and applied technology is comparatively easy to transfer. South Korea is ahead in the diffusion of high-speed telecommunications. In China, many students who studied in America are returning home and starting business ventures. The technology levels of these countries are becoming more similar. Russia holds advanced technology in such fields as aviation, aerospace, and nuclear reactors.

Japan also suffers from the hollowing out of its economy. Because of FDI and the shifting of production to neighboring developing countries, many products are being reverse imported into Japan. Although this provides Japanese consumers with cheap, good-quality imports, the hollowing out of the Japanese economy continues as even production in efficient industries is being transferred to China, which is becoming the world's production base. Temporary restrictions on imports of onions, mushrooms, and rush grass have been



invoked as protectionism rears its head. Although Japan does profit from the international division of labor with Asia, the transformation of Japan's economic and industrial structure will not be a smooth process. Japan should display leadership in this area but falters instead. Japan's inward-looking tendency is growing stronger, and economic leeway is decreasing.

### **Expectations toward South Korea and China**

South Korea has tried reform actively in the economic crisis and proactively adopted U.S. management style and information technology. As an advanced country in the OECD, South Korea is better able to display effective leadership.

Many ethnic Koreans live in this economic area. As there are 1.9 million Korean people in Northeast China and many in Japan and Far East Russia, the network of ethnic Koreans extends across national borders. In fact, Korean FDI into China's three northern provinces has proceeded rapidly since the restoration of diplomatic relations in 1992. This economic community is sure to expand organically. The South Korean government has a strong motive to pursue the formation of a Northeast Asian economic area and unite its people and the countries in which they live.

Geographically, South Korea is located in the middle of Northeast Asia. The infrastructure for international distribution is improving, with Incheon International Airport and Pusan Port serving hub functions whose facilities are managed with inexpensive fees, advanced technology, and efficient, 24-hour-a-day operations.

Expectations toward China are also considerable. Chinese economic development has been remarkable. China is very likely to some day become the world's production base. China can supply the world with not only low-tech products such as clothes and toys, but also household electric appliances and high-tech products. Although the abundance of counterfeit products in China

should be criticized, it means that the country has a sufficient material production system. In recent years, such counterfeit products have not been mere inferior copies, but rather copies so similar to the originals as to drive the latter from market. China is now moving to the production of cars and high-tech products and is thought to have gone quite far in securing the knowledge, talented people, and physical systems for production.

At present, reforming state-owned enterprises and other aspects of effecting the transition to a market economy are of top priority in China. In the Northeast provinces, heavy industry was given priority in the era of a planned economy, and the proportion of state-owned enterprises was larger. Therefore, a key factor is whether they can achieve efficient production for a market economy. Balance between supply and demand is determined by price in a market economy, in which competition is the rule and is needed to produce low-priced, good-quality products and to strengthen competitive power.

Succeeding in a market economy requires reform of state-owned enterprises, introduction of FDI, and promotion of trade. At the same time, entry into the WTO and the hosting of the 2008 Olympics are certain to help further open the Chinese market and expand domestic demand. These developments will also significantly influence northern China. However, FDI from abroad must increase for the provinces to develop.

## Conclusion

The wave of Asian economic development and market reform has been moving steadily northward from the south. Thus, the economic development of Northeast Asia is certain to occur in the 21<sup>st</sup> century.

This economic area is politically and economically very complex. As I indicated, economic development must be accomplished through free trade and FDI. Development is only possible when each country forms relationships of



close economic exchange and mutual complementation. Because we will be forming a vertical international division of labor for the first time, we need a dynamic perspective on how vertical international division of labor develops into a horizontal one in the long run.<sup>iv</sup>

First, Japan and South Korea must cooperate together and take a leadership role because technological and financial cooperation are important in the formation and development of the economic area. Second, South Korea must become a center politically because peace on the Korean Peninsula is a prerequisite. The network of ethnic Koreans is very important. Third, rapidly developing China has an important role as the world's production base, which influences development in Northeast Asia.

Lastly I would like to talk about Russia briefly. Far East Russia is exploiting the energy resources such as petroleum and natural gas in earnest. In the future, Russia will become an important country with strategic goods. Furthermore, as Russia possesses advanced military technology, such as missiles and atomic energy, a key factor is how to make use of them as civil technologies.

In an age of global business operations and global competition, the economic development of Northeast Asia must be based on an open door policy and the free market. Furthermore, foreign capital must be actively attracted so as to acquire capital and technology. Open economic cooperation with the United States and Europe must be pursued, as well.

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i The Sea of Japan side of Japan is also called the "reverse side" of Japan, lagging behind in economic development. We must prove how economic development of the Sea of Japan side will be connected with the Pacific side organically. For example, the mutual complementation between the Sea of Japan side and the Pacific side depends on the route over which cargo discharged in Niigata port is carried to Tokyo

on the Kanetsu Highway. But there are many problems, such as how to overcome severe natural conditions (i.e., heavy snowfall) and high domestic distribution costs.

- ii Respondents to a questionnaire survey of the Sea of Japan economic bloc plan administered by the Niigata Economic Research Center cited the most difficult items in promoting economic exchange as “political factors” in Far East Russia and North Korea, “differences in economic systems” in Northeast China, and “culture and difference in national character” in South Korea. (Source : *Nihon Keizai Shinbun*, Japanese economic newspaper, January 15, 1992, the local financial page. )
- iii *Nihon Economic Newspaper*, February 23, 2001.
- iv Kaneda (1997).

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