

New Political Economy of East Asia: Korean Perspective

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Abstract

This paper first examines the effects of the rise of Chinese economy on Korean economic development and Korea's policy to deal with them. The paper then investigates the Korean perception of the problem of emerging economic integration and political conflict in East Asia and Korea's strategy to cope with the problem. Emphasis is given to comparative historical perspective.

I. Introduction

With the rise of the China, Korea faces two major (inter-related) challenges:

- Finding new development strategy
- Finding Korea's Place in the international political economy

II. China Shock and Korea's Development Strategy

Rise of China a mixed blessing for Korea economically.

- China now the largest export market (21.8% in 2005, 27.2% if Hong Kong is added), far surpassing the US (14.5%). China the source of the largest trade surplus.
- On the other hand, Chinese exports increasingly competing with Korean goods, and Chinese imports pushing up the price of raw materials in the global market.

As a result, Korea's terms of trade deteriorates, and that reduces the growth rate of national income, by as much as 1.4% points on average from 1996 to 2005 (GDP growth rate 4.5%, GNI growth rate 3.1%).

- Korea also has to compete ever more intensively with China to induce investment (even by domestic firms), which is no longer confined to investment by smaller firms in labor intensive manufacturing industries. China by far the largest destination of Korean FDI overseas.

Korea's strategies: finding new sources of dynamism.

- Moving into new technologies and industries.
- Becoming 'business hub' for Northeast Asia: logistics, R&D, and financial centers.
- Promoting service industries.

Some success in IT in the last decade or so, but has not been able to stop the deterioration of terms of trade.

Directly related to the emergence of China and also controversial is 'business hub' for (North-) East Asia.

Transforming Korea into a country like Ireland, Netherlands or Singapore in Northeast Asia: will this work?

- Logistics center not plausible: mostly substitutive rather than complementary with China.
- R&D center somewhat effective, but not so many jobs created.
- Financial center: can Korea, which is tainted with the record of financial repression and crisis, do this?

On the other hand, service has a large potential for growth. Labor productivity: Korea 100, USA 228, Japan 200 (2001).

- Korea now aiming at developing service industries as a new major source of dynamics.

Korean government is now pursuing FTA with the US, mainly to promote service industries, by inducing FDI from the US.

* The short run effect of the FTA with the US on BOP(current account) is expected to be negative.

However, it is not clear how FTA with the US will lead to the inflow of FTA large enough to become new source of dynamism.

- Inflow of FTA, like domestic investment, is mainly the function of domestic reform efforts.
- Meanwhile, opening will increase the need for further reform, which Korean government has been poor in implementing (e.g. financial supervision ability with financial market opening).

Utilize FTA to induce domestic reforms? Korea's own experience shows that domestic reform does not entail external opening. Rather, external opening without domestic reform may precipitate crisis.

Cost of Conflict resolution formidable.

- Politicized compensation system: waste may outweigh the benefit of opening (e.g. the compensation of agricultural sector through Uruguay Round).
 - FTA with US likely to have a thoroughgoing impact on the Korean economy, so that introducing labor market flexibility and social safety net a necessity. But that is a difficult task which takes time.
- * Korean government intends to complete the negotiation by the end of March 2007 to meet the deadline of the US Trade Promotion Act.
- If labor market flexibility and social safety net is not duly provided, FTA will further increase Korean people's sense of uncertainty and insecurity that has already reached a dangerous level after the 'IMF crisis' in 1997. Sense of uncertainty and insecurity may undermine growth potential by reducing birth rate, e.g. Korea's birth rate: 1975: 3.47; 1985: 1.67; 1995: 1.65, 2005: 1.08. Now the lowest in the world.

III. International Political Economy in East Asia and Korea

A more fundamental question with the rise of China is: what will happen to the future system of international political economy in East Asia?

Korean economic development owes much to the postwar arrangement of international political economy in East Asia.

Emergence of China may fundamentally disrupt that condition.

East Asia currently characterized by economic integration and political conflict.

Will economic integration solve the problem of political conflict?

- History of Europe in the 19C tells that nationalism cannot necessarily be contained by economic integration.
- In Europe two great wars in the 20C apparently abolished the threat of nationalism (as the Thirty Years War did to religion in the 17C).

In East Asia the problem has not been solved.

Japan:

- post-war settlement failed to eliminate the prewar legacy.
- Ever since 1952, consistent move to the right (that is, the revival of nationalism).
- * Koizumi's visit to Yaskuni Shrine not an isolated event but a part of that consistent move.

China:

- a country that feels humiliated in the past but becoming strong now. Not a democracy either. In this respect, somewhat resembles Germany in the late 19C.
- Also, seemingly not completely out of the memory of the tributary system of the Middle Empire.

Korea:

- nationalist sentiment strong, but no way to be an aggressive one against its neighbors.
- The possibility cannot be excluded that Korea may find itself in a position like Poland's in the prewar period sooner or later.
- Problem is complicated by the North-South division.

Korea's strategy: managing alliance. Alliance critical for Korea, and while Korea may not count much to the great powers, it may be something as an ally.

Korea's place in the emerging system of alliance in East Asia: US-Japan alliance countering China (?).

- Koreans know the importance of the alliance with the US (as Poles saw their

alliance with Britain in the prewar period).

- Also, Korea shares more values and systems with US and Japan than with China.

FTA to consolidate alliance with the US?

Many Koreans believe that the real purpose of FTA is political.

Most of the US FTA with countries outside the Western Hemisphere also seem to be motivated by political considerations.

FTA will surely contribute to consolidating the alliance with the US.

However, since the current uneasiness of Korea with the US stems from political issues, political measures may have to get priority in terms of effectiveness and cost.

- Seeking agreement with the US on the North Korean problem: especially on whether North Korea's current regime has the ability (and will) to exchange nuclear weapons for security and economic aid.
- Dealing with the perception in the US that Korea may join the Chinese side in the emerging structure of alliance in East Asia.
- Developing a mechanism to live with US government whose ideology differs from that of Korea's incumbent government .

However, in historical perspective, there is a serious problem with being on the side of US-Japan alliance: US-Japan allied against China is similar to Britain-Japan allied against Russia a century ago.

- Japan utilized that leverage to colonize Korea. Will history repeat itself?
- Can Japan become a "country trusted by her neighbors"?
- What is the role of the US in this context? If Japan by herself cannot do the job of getting trusted by her neighbors, should or will the US make Japan do so?
- Should Korea try to be "more loved" than Japan by the US?