PART THREE
THE KOREAN ECONOMY
IN REGIONAL AND
GLOBAL CONTEXTS
Asia has become far more interconnected in the last two decades than it was in the first quarter century after World War II. A host of indicators point in this direction. Intra-Asian trade and investment patterns have become more intricately interwoven. A series of military and security arrangements have eroded earlier “go it alone” or “bipolar” security arrangements among the region’s nation-states. From cartoons to karaoke and from pop music to internet sites, popular culture now bleeds across national borders in ways unimaginable two decades ago. Similarly, just as a host of environmental problems refuse to be constrained by political boundaries, neither have the environmental protection programs that have been put in place to counteract their impacts. Similarly, labor markets, both legal and illegal, have become less constrained by national boundaries; so have organized crime and infectious disease (Shinn, 1998). At times in response to these trends, and at times independent of them, a host of trans-national organizations, institutions and networks have sprung up across Asia. Some of these are governmentally supported, others are privately run, and some involve track-two operations that mix public and private.

Until recently, it was widely assumed that this more interlinked Asia would be part of a new global balance of power. The stark bifurcations of
the Cold War, it was argued, would give way to more complex triangular interactions based on three distinct regions. Each region would orbit around one of the world’s three strongest economies: Europe around Germany; North America around the US; and Asia around Japan. Although cohering primarily because of economics, these three regions would also take on non-economic roles in the shaping of international activities. As a result of its increased connectedness, Asia, it was presumed, would gain both cohesiveness and strength in the international arena.

The crisis that swept across Asia in 1997-98 forced a serious reassessment of these assumptions. Was Asia in fact an effectively integrated region? And if it was, what was it integrated to do? More specifically why did such integration fail to provide a more effective region-wide buffer against the crisis? Hindsight underscored the fact that whatever ties might have been developing across Asia provided neither a region-wide economic elixir nor a region-wide moat capable of protecting Asia from external onslaughts.

This situation in economics was mirrored in other areas. Asia confronts a host of problem areas that spill across national borders or protrude into the region from outside. Security, environment, crime, drugs, illegal migration, and pandemics are only some of the most obvious. And yet, though the scope of such problems may transcend national borders, the willingness and ability of actors within the region to join around a collective approach to them remains uneven at best.

At least two dimensions of this problem are important. First, almost every specific regional problem has a differentiated impact across the region as a whole. Individual “regional” problems often define quite different regions. And second, regional arrangements designed to deal with one set of problems are often inappropriate for problems in other areas. Even more problematic, institutions aimed at one set of problems may in fact conflict quite explicitly with, and may work in ways that undo, institutions and solutions targeted toward different problems.

This results in a high level of ambiguity about “regional” solutions to “regional problems.” It raises questions concerning the extent to which the
integrative activities across Asia are mutually reinforcing, constituting the underpinnings of a collectively stronger region? Are the growing numbers of trans-border activities—like so many seemingly independent beams, pillars, and joists that serve as the supportive underpinnings of a final coherent building—being erected above them? Or are they more akin to the rush of newly-fallen trees hurtling randomly down a churning river, ever in danger of crashing into one another and forming impenetrable logjams downstream? Answering these questions one way or the other may simply be a function of which problem areas one examines. This paper, and the larger project of which it is a part, attempts to sort out the various elements of Asian regional connectedness as a basis for dealing with questions such as these. In the process it will also seek to shed light on the economic and political achievements and limitations inherent in Asian conjunctions to date and the consequent implications for the future.

This paper focuses the tensions that have arisen within the Asian region between the often conflicting regional activities of markets and governments. The first section provides a quick overview of postwar Asian regional cohesion and division. This is followed by an examination of the relationship between regionalization and regionalism in Asia, a relationship that centers on the interplay between markets and politics. A third section of the paper examines how the analyses in the previous sections have played out in two specific instances: the debates over the East Asian Economic Caucus (EAEC) versus the Asia Pacific Economic Cooperation (APEC) Forum and in developments leading up to and following Asia's economic problems of 1997-98.

Such problems are of more than semantic interest. They are in fact critical to the ongoing development and structuring of trans-national relations in the Asia-Pacific. They develop a basis for understanding a number of recent conflicts that have arisen in Asia. Beyond their relevance for Asia per se, however, they also provide additional, non-European based, grist for theorizing more broadly about regionalism as a worldwide phenomenon.
The Asian "Region:"

An Overview

In its scope and meaning, the term "region" is geographic (or perhaps geo-psychological). "Regions" are contiguous territorial areas that are presumed to have external boundaries that distinguish one region from other equally distinguishable regions of the world. Easy examples include Sub-Saharan Africa, the Middle East, Western Europe, and Central America. People regularly utilize such regional categories, and they are largely the result of the collective decisions of actors, both within and without the region, to treat it as a meaningful unit. In almost all instances, the units that make up any such region are nation-states.

Regions are typically thought of in essentialist geographic terms. The particular boundaries of different regions are taken as largely unproblematic givens, as "natural regions," even though almost all regions of actual political and economic significance involve far more than simple geographic lines on a map. In reality, regions are far more fluid and complex mixtures of physical, psychological, and behavioral traits (Mansfield and Milner, 1997; Katzenstein and Ohkawara, 2000). Although regional terms spring quickly to use, there is no natural or self-evident definition of any actual region. As Richard Higgott (1997: 238) has put it: "the yardsticks of 'regionness' will vary by the number of policy issues or questions present and above all by what the dominant political actors in a given group of countries at a given time see as their political priorities."

As a consequence, within the broad geographical area typically thought of as Asia, different problems and different institutional responses to them delimit several quite distinct "Asian regions." No single map of Asia is so inherently self-evident and logical as to preclude the consideration of alternatives. Rather, as with geographical borders throughout history, Asia's regional boundaries have been subject to high levels of contestation. Different visions of Asian regionalism remain hotly contested. Certain possible maps complement one another, but still others contend sharply with
The complexity of delimiting the outer boundaries of contemporary Asia has deep historical roots. John Montgomery (2000) suggests that unlike many other geographical areas that are easier to observe and that enjoy greater proximity to Europe, Asia and particularly the more generic term, Far East, are “idiosyncratic products of Western narcissism.” The terms were defined during an imperialist period in terms of their geographical remoteness “from the atlases of Europe.”

Asia is even more difficult to encapsulate since, until very recently, there had never been any indigenous regional grouping that even claimed to be “Asian.” Some qualification had always been added to the name. Today, several sub-regional groupings bear the name “Asia” and they enjoy different levels of clarity and institutionalization: South Asia (the 7 countries of SAARC), South-East Asia (the 10 members of ASEAN), East Asia (the countries lying east of the Irrawaddy, including Burma), Northeast Asia (the countries having a coast on the Sea of Japan), and Central Asia (the 5 former Soviet Republics, to which Afghanistan is commonly added as a matter of convenience). Although they are not institutionalized, “East Asia,” “Northeast Asia,” and “Central Asia” have been commonly acknowledged as entities. Yet few of these potentially nominal regions necessarily coincide with internal or external actors’ own perceptions of their reality (Shiraishi, 1999: 2). Moreover, to add to the general fuzziness, the now widely used term Southeast Asia did not even come into existence until the 1943 Quebec Conference established a Southeast Asian military command under Lord Mountbatten.

If one considers economic problems confronting different countries of Asia, certain regional configurations become “logical.” Most notably, as will be examined in detail below, integration of technology- and capital-rich Northeast Asia with labor-rich and capital-poor Southeast Asia makes a certain amount of region-defining economic sense. But excluded from this particular Asia are such contiguous nation-states as Russia, North Korea, and South Asia. And if one considers economic matters such as trade and investment capital, an even broader region is encompassed.
When one turns to security and defense, however, still a different picture emerges of the region. US alliances with Japan, South Korea, and Australia, plus its guarantees of Taiwanese autonomy, along with its extensive military presence in the region, make it the single key player in security developments across Asia. Furthermore, problems of security and defense define a much wider “regional security order” (Lake and Morgan, 1997). From a security perspective, there are a host of nation-states whose interactions must automatically be included, when thinking of region-wide Asian security problems: Japan, China, Russia, the US and most likely India and Pakistan, along with the smaller countries of Southeast and Northeast Asia (Alagappa, 1998).

These different “maps” are but examples of the broader problem: no self-evident and essentialist Asia forms a single logical regional unit for dealing with all of the region’s problems. Rather the particular problems that emerge frequently determine which of many possible “Asias” will be the most relevant unit from which to anticipate a response.

Nevertheless, despite the problem of defining specific Asian boundaries, there can be little debate about the increasing ties across the region in the last three to four decades. As I have examined more extensively in another context (Pempel, 1997), the countries of Asia were, for the early postwar period, far more insulated from one another than integrated. Post-colonial legacies, Cold War politics, and traditional historical animosities were but a few of the centrifugal forces repelling Asian countries from one another. US security arrangements with Japan, Taiwan, and South Korea, along with those toward other Asian countries, drove additional wedges into any Asian collectivism. These security arrangements were based on conspicuously bilateral linkages between the US, on the one hand, and each of its Asian allies, on the other. This bilateral pattern in Asia contrasted sharply with the region-wide security arrangements, such as NATO, that the US put in place within Europe (Krasner, 2001). Efforts by post-colonial governments to bolster usually shaky levels of national cohesion proved equally divisive. Unlike more recent claims concerning the alleged transcendence of certain timeless “Asian values,” the first two decades af-
ter World War II saw local political leaders emphasizing the purported distinctiveness of Malaysian, South Korean, Chinese, or Indonesian cultures. Most of these leaders denied that Asia as a whole had relevant trans-border culture whatsoever. Indeed, many countries explicitly banned songs, radio programs or movies produced within neighboring Asian countries. As a consequence, Asia in the early postwar years experienced little of the integrative, trans-border amalgamations that began to stitch the European countries together as early as the 1940s—most especially through NATO, the European Coal and Steel Community, and the embrace of presumptively pan-European values.

By the 1960s and 1970s however, developments in several separate arenas had spurred greater trans-border cohesiveness across Asia. Infrastructural connections have deepened in areas such as shipping, aviation, telecommunications, and fishing. Various trans-national non-governmental organizations are addressing a host of problems, from environment to human rights to sex tourism, from a regional rather than from a national perspective. Cross border investments, production, trade, and technology transfers have deepened tremendously, particularly since the mid-1980s. More importantly, such economic deepening has been associated at both the mass and elite levels with the high growth rates and improved productivity in both Northeast and Southeast Asia. The result has been a perception that the economic well-being throughout the region is more closely and intimately linked and has become more of a collective, than an individual or a national, venture.

The region has also been more closely connected through new institutions. The two best known are ASEAN (created in 1967) and APEC (begun in 1989). But these two are complemented by a host of other formal regional institutions including ARF (ASEAN Regional Forum), the PBEC (the Pacific Basin Economic Council), Pacific Economic Cooperation Council (PECC), the Asian Development Bank, and AFTA (the ASEAN Free Trade Agreement), among others. A recent addition of note is the APT (ASEAN Plus Three, meaning the ASEAN member states plus Japan, South Korea, and China).
A growing network of multilateral institutions also developed on security matters (Mack and Kerr, 1995). The more notable of these include: the ASEAN Regional Forum (ARF), started in 1993 and a body which includes the related Senior Officials Meetings (SOMs), the Council for Security Cooperation in the Asia Pacific (CSCAP), and various think tanks that bring together private and public officials. Formal institutions (or at least regularized governmental cooperation) have also developed in a diversity of other areas: environmental protection, labor markets, crime, administrative cooperation, scholarly exchanges, and the like. Far more numerous are the so-called Track Two activities that bring together private individuals and organizations along with governmental officials meeting in their private capacity.

Formal institutions however have been but a minor voice in the broader chorus of an increasingly integrated Asia. Without question the region remains fragmented by a diversity of cultures, economies, ethnicities, and politics. Security considerations remain high throughout the region, making many of its members reluctant to think peacefully about the neighborhood as a whole. Moreover, none of the region's formal organizations have been central to the organization or functioning of the region's economy, which has been driven far more by private corporate actions (Gilpin, 2000: 266). Indeed, as will become clearer in the next section, bottom-up economic integration has been far more important in Asia's growing cohesiveness than have formal organizations. To appreciate this fact it is necessary to distinguish between regionalism and regionalization.

**Regionalism and Regionalization in Asia**

It is important to distinguish between the two terms *regionalism and regionalization* (Breslin, 2000: 207; Hurrell, 1995; Gamble and Payne, 1996). The first, regionalism, involves a process of institution creation. It occurs most conspicuously when nation-states come together through "top-down" activities by creating conscious and deliberate projects of gov-
ernment-to-government cooperation. New mechanisms are typically designed to deal with one or more transnational problems that confront several nations in common. In response to common negative externalities beyond their individual capacities to resolve, several presumably rational governments act collectively to reduce transaction costs and individual vulnerabilities while simultaneously furthering their own self-interests (Keohane, 1984). Regionalism in short, has at least three key elements: it is top-down; it requires formal (usually governmental) agreements; and it involves semi-permanent structures in which governments or their representatives are the main participants.

Regionalization, in contrast, develops from the bottom-up through social processes. Economics is typically one of the most powerful of these processes. In one common view, “the most important driving forces [in regionalization]...come from markets, from private trade and investment flows, and from the policies and decision of companies” (Gamble and Payne, 1996: 334, cited in Breslin, 2000: 207). Social processes are by no means completely independent of governmental actions and institutional underpinnings. Yet, the core engines of regionalization are the multiple actions taken by hundreds, if not thousands, of individual social and economic actors. Thus in contrast to regionalism, regionalization is a process that is bottom-up, socially constructed, and results in no governmentally representative bodies.

Without a doubt, as was noted in the previous section, explicit top-down government institution-building contributed to enhancing Asian cohesiveness. These new institutions brought several of the once distant and disparate nation-states of Asia into formal union with one another. The first of these was ASEAN. Created in 1967, ASEAN is a regional body that sought initially to reduce the tensions involved in longstanding intra-regional security conflicts among its first Southeast Asian members with cooperative (though not collective) defense. Over time, ASEAN's defense and security focus became less acute and the organization took on the additional role of facilitating trade for its members. More recently, it has expanded its own membership to ten countries while simultaneously
encouraging closer ties between ASEAN and Northeast Asia as well as across the Pacific.

Until the late 1980s, the principal impetus toward closer integration in Asia, however, came not from explicit and formal organizations such as ASEAN, but rather from the much more bottom-up process of economic regionalization. Economists make a strong case for broadening markets though regional economic integration. Such regionalization expands market size and enhances the independence of individual corporations within the larger region. When bolstered by monetary coordination, regionalization can facilitate trade while also reducing balance of payments problems. Overall, the argument is, region-wide economic rationalization ultimately redounds to greater economic efficiencies, growth, and collective welfare for the region as a whole. It is precisely such economic ties that were long the most visible and interlaced fibers crisis-crossing Asia. New trans-border production networks, cross national investment, and intra-regional trade have contributed greatly in making Asia more cohesive as a region.

At least three analytically separate components were vital in weaving Asia's more complex regional economic webs: investment, production networks, and trade. All trace fundamentally to the development and increased utilization of what have come to be known as post-Fordist production processes. These processes are driven by innovation within the production process, by small batch production and quick changeover of product lines, by the development of long-term supply and subcontracting networks, and by the simultaneous integration of a large number of small and medium-size manufacturers. Such production arrangements, particularly in manufacturing, fostered the development of complex forward and backward linkages among contractors and component producers in different countries across Asia and the use of sub-contractors and partners across national lines (Bernard, 1994).

Pioneered by Japanese manufacturers such as Toyota, these processes also spurred substantial investment by Japanese corporations into other parts of Asia, starting in the early 1970s and accelerating dramatically in the latter half of the 1980s. The earliest Japanese investments were made in
Northeast Asia, most notably Taiwan and South Korea; later they expanded into Southeast Asia. As a result, various trans-border production networks were created in products such as textiles, light manufacturing, and raw materials.

An even stronger wave of intra-Asian investment and trade was unleashed as a result of the currency realignments that followed the Plaza Accord of 1985. Once again Japanese-owned corporations led the way, setting up far more extensive and sophisticated production facilities throughout Southeast Asia (Doner, 1991; Hatch and Yamamura, 1997; Hatch, 2000; Pempel, 1997). This period marked a key decision point in Japanese politics as business and political elites rejected the potential alternative option of deregulating Japan's domestic economy and moving toward growth based on increased domestic demand. Instead, Japanese production methods were "regionalized," with cheap labor in Asia infused by technological and manufacturing sophistication from Japan. Japanese investment monies developed a trans-nationalized expansion of the production facilities and networks of the country's major manufacturers, including complex production networks in automobiles and electronics. In these, the non-Japan-based firms typically provided components for the much more complicated production processes integral to the Japanese-owned companies' worldwide strategies (Hatch, 2000).

Investment by Japanese-owned corporations was soon followed by money from companies based in Hong Kong and Taiwan. Much of this investment went into China, creating rather distinctive and cross-national Chinese production networks. Typically based on family and ethnic connections these took on a fundamentally more flexible and fast-moving character from the facilities developed in Asia by Japanese-owned companies (Hamilton, 1999). Additional outflows of money from companies based in South Korea, Singapore, and Malaysia further enhanced and complicated the webs of bottom-up connectedness among the Asian economies. By the turn of the century, a dense web of diverse production networks in different sectors crisis-crossed Asia. These involved diverse corporations with quite different types of trans-border organization and
varying degrees of manufacturing flexibility.

Heavily as a result of these investment flows, intra-Asian trade jumped substantially, becoming far more multi-dimensional and complex than it had been previously and adding still additional layers to intra-Asian linkages. Roughly 30 percent of Asia’s total exports were intra-Asian in 1970; by 1994 this figure was up to 47 percent. Intra-Asian imports increased from 30 percent to 52 percent (Guerrieri, 1998: 68-69). A considerable portion of this was, of course, not the trade of finished products sold between merchants in different countries, but rather intra-firm trade that grew out of particular companies’ movement of components throughout their trans-border production networks. Overall, economically driven regionalization created numerous business ties that leaped across Asia’s political boundaries, vastly enhancing the integration of the region.

Importantly however, this deepening of intra-Asian economic linkages was counterbalanced by the steady and continuous reliance of most of the expanding Asian markets on the United States. US markets remained the ultimate destination for a substantial portion of what was produced through intra-Asian production processes. With various fluctuations over time, the US consistently absorbed between 25 and 33 percent of Asia’s exports. More importantly, on a bilateral basis, the US remained the largest or second largest market for the exports of nearly a dozen Asian countries. In most instances, the US absorbed anywhere from twice to six times as much of the exports of these Asian counties as did their second largest markets (Pempel, 1997). Additionally, nearly 30 percent of US exports went to the ASEAN 5, the 3 Asian NIEs, China, and Japan.

The economic importance of the US to Asia was also evident in the vast amounts of US capital that flowed into Asia in the form of both short-term loans and portfolio investment, particularly during the early to mid-1990s. Before 1990, flows of portfolio capital were trivial, but by 1996 they exceeded $30 billion per year. About half of this went to South Korea alone. A considerable amount of this short-term “hot money” found its way into both the stock and property markets in the rapidly expanding economies of Asia. Thus, as supplier of both market and capital, the United States
has remained a paramount contributor to Asia’s economic development.

In contrast to the rather extensive network of cross-border connections that have been built up through corporate and economic actions, the networks of formal institutions created by governments remain far fewer in number and less fully institutionalized than those linking Europe (Aggarwal, 1998; Grieco, 1997). The governments of Asia have entered into far fewer comprehensive institutional arrangements than have their counterparts in the European Union. Even in the economic sphere, where Asian ties are strongest, there is no institution seeking to provide intra-regional trade preferences. As John Ravenhill (2000: 329) has observed, “East Asia is the only major region that lacks its own economic organization committed to trade liberalization on a discriminatory basis.” The same institutional “lag” is almost certainly as true in comparisons of Asia to MERCOSUR and NAFTA as it is to Europe.

Obviously, any complex process of regional integration is unlikely to be linear. Nor is there any logical reason to assume that Europe’s present is Asia’s future. The political impediments to deepened regionalism in Asia remain incredibly strong, as will be clear in the subsequent sections. While economics may foster closer ties among Asians, political considerations may present quite understandable barriers to comprehensive regional integration. Still, the chronological trend lines in almost all of the areas noted above point toward a more, rather than a less, cohesive and integrated, Asia. Yet if top-down regionalism and bottom-up regionalization have both been increasing links across Asia, the informal process of regionalization has been advancing far more speedily than has the more formal process of regionalism.

Perhaps even more importantly, the bottom-up patchworks created by the many threads of economic regionalization do not always define overlapping geographical spaces. Indeed they do not always blend easily with one another. Nor do the various membership lists created in the many institutions of Asian regionalism overlap. Instead, there remain strongly contested arguments about which parts of which Asia constitute integral parts of any emerging Asian region.

11. Remapping Asia: Competing Patterns of Regionalization and Regionalism 375
Two Battles about Boundaries

The competition between the respective integrative pulls of regionalism and regionalization can best be underscored by examining two concrete situations in which the logic of one has contended with the logic of the other. These situations were: (1) the debates about the EAEC and APEC and (2) the debates over institutions and the boundaries of regional institutions in the aftermath of the economic crisis of 1997-98. In both cases, although economic logic pressed for one particular "regional" pattern, political logic often pressed for quite a different "regional" pattern.

This is so for at least three reasons. First, neither regionalization nor regionalism is purely endogenous. Important as the actions of intra-regional actors may be, these are frequently shaped in powerful ways by, or in response to, actions and powers of extra-regional actors. Regional developments are inextricably anchored in a larger global context. Actions by the United States, for example, as well as by Europe, and non-governmental economic developments in markets far outside of Asia, have all been critical at different times to Asian regional activities.

A second obvious impediment to enhanced regionalism rests on the tremendous domestic political and economic diversity of those countries potentially included in any Asian regional arrangements. Just as any specific region is politically and economically embedded in a larger global context, so is it shaped by the domestically generated agendas of the various intra-regional governments whose cooperation is needed to create regional institutions. While many studies of Asian integration have justifiably emphasized the economic pulls that favor closer linkages (e.g. Ohmae, 1995), few of the integrative moves in Asia have been automatic, natural or the simple outgrowth of economic forces being guided by an "invisible hand." In some cases, politics has been a driver not only of closer political, but also of closer economic, ties. In other instances, political considerations have worked against deepening regional ties. Not surprisingly, govern-
ments within Asia (as elsewhere) differ in their respective views toward closer regional ties. This is particularly true when formal commitments require some surrender of national authority to a new supra-national institution. Always at issue in matters involving regional institution building are the questions of power, sovereignty, and choice.

An extensive literature establishes the many ways in which domestic politics can drive multilateral agendas: e.g., Hall (1987), Katzenstein (1977), and Steinmo, Thelen, and Longstreth (1992), inter alia. The distinctive economic policies pursued by individual nations are hardly determined exclusively by prevailing economic conditions. Instead, contingent and historically rooted political and organizational dynamics carry great weight in such policies and the institutions which formulate them (Hall: 19-21). Political relations and economic structures are not infinitely malleable and capable or easily responding rationally to the shifting patterns of incentives, but path-dependent structures reflective of existent and historically entrenched social relations (Beeson, 9).

Third, different actors bring diverse resources to the regional table, providing them with widely varying bargaining capabilities. Different political goals and imbalanced political resources make it natural that different actors will often support or oppose very different demarcations of any regional bodies into which they choose to place themselves.

**EAEC versus APEC**

One of the more important battles over Asia's regional institutional boundaries surrounded proposals for the creation of an East Asian Economic Caucus (EAEC). The EAEC was first proposed by Malaysian Prime Minister Mahathir Mohamad during a visit by Chinese Premier Li Peng in December 1990. Fears of growing integration in Europe had led many Asian business and government leaders to consider ways in which they could cooperate more closely with one another. Adoption of the Single European Act in 1987 and speedy progress toward "Europe 1992"
deepened fears of a "fortress Europe" that might seek to wall off Asian imports. Concerns worsened with the enlargement of the EU and the ratification of the Maastricht Treat on European Monetary and Political Union. And it became more worrisome still with the passage of the North America Free Trade Agreement that linked the US, Canada, and Mexico in a regional trade agreement (Mattli, 166.). Mahathir’s proposal for an EAEC (alternatively an East Asian Economic Group, EAEG) was a deliberate effort to create an East Asian regional economic organization to counter these other two bodies.

In Mahathir’s formulation, the membership of the EAEC would be composed of the ASEAN countries, Japan, China, and South Korea. It would explicitly not include Australia or New Zealand, two countries geographically in Asia and both with commitments to developing a credible “Asian identity,” as well as the United States and Canada, both important trading partners for many Asian exporters. As such, the proposal was epi-grammatized by pundits as a “caucus without Caucasians.” Although the proposal was specifically for an East Asian regional body, its suggestion was also driven by domestic Malaysian politics. Mahathir sought through the EAEC to provide a basis by which his country could move beyond the divisive ethnic politics of bumiputra preferences at home by providing a profitable outlet for Malaysian Chinese business interests across Asia. It also grew out of Mahathir’s “Look East” policies and his “Vision 2010.” The first aimed to attract Japanese aid, technology and investment to spur Malaysian industrialization while the second sought to make Malaysia a developed country by the year 2010 (Kimura, 2000).

Still, Mahathir’s proposal resonated with many other leaders in ASEAN who were concerned about the possible division of the world into competing trade blocs. Not surprisingly, the United States was adamantly opposed to what appeared to be a regional arrangement that would be explicitly antagonistic to the open trade and investment agenda being pushed by the US. The US had extensive strategic and economic interests throughout Asia. These had been developed as far back as the years immediately following World War II when the US helped to structure the domestic politi-
cal regimes of Japan, South Korea, and Taiwan. As "developmental states," (Johnson, 1982; Woo-Cumings, 1999), these three had forged political economies that were intimately connected to, and dependent on, the strategic policies of the United States. US defense guarantees and alliances were particularly critical to the three countries, enabling them to follow their unusual pattern of economic development (Cumings, 1984). Equally critical was the willingness of the US to encourage, for strategic and Cold War calculations, the rapid export-oriented economic development of the three as alternatives to the economic models being pursued by China and the Soviet Union. Opening US markets to imports from these three allies, while allowing them to maintain essentially closed mercantilist economies at home, shaped their development, and ultimately the roles they all played in subsequent economic developments within the Asian region (Pempel, 1999b).

By the end of the 1980s, the US had lost much of its enamorization with the domestic mercantilism of its Northeast Asian allies, and it initiated aggressive bilateral negotiations to break down some of the barriers to US merchandise sales and investments in these countries. It was not anxious therefore to see the closed mercantilism of Northeast Asia regionalized by expanding it to Southeast Asia as well. Hence in March 1991, Secretary of State James Baker made it clear that the US would not tolerate an EAEC.

Baker also asked Japan to oppose the notion. Japan had been building closer economic ties to Southeast Asia for two decades. Forging a regionalization of Japan's own domestic economic model was an important part of Japanese national strategy. The explosion of Japanese investment into other parts of Asia, starting in the 1970s and then accelerating in the period following the Plaza Accord, was closely tied to the geo-political aims of Japanese governmental leaders. A host of new Japanese legislation and MITI directives had underwritten and encouraged Japanese-owned corporations to invest outside Japan's four main islands and to expand production particularly into Asia. In this sense, Japanese aims for Asia were closely congruent with those of Mahathir and the EAEC.
At the same time, however, Japan was quite conscious of its security and economic dependence on the US. Although strong, Japanese links to Asia were hardly of sufficient weight to long-term national economic well-being as to offset its ties to the US and the rest of the developed economies of the world. Nor was China uniformly anxious to embrace Mahathir’s notion. Seeking economic acceptance beyond Asia, and particularly in the US (which was the ultimate destination of so many of its exports), the Chinese government was, like Japan, skeptical of a closed regional bloc. Chinese fears concerned antagonizing governments in the developed economies of North America and, to a lesser extent, Western Europe.

And meanwhile even within ASEAN there was ambiguity. Both Indonesia and Singapore were particularly dubious about the EAEC. As a sub-region, the countries that make up ASEAN have national economies that are vastly more economically competitive than complementary. ASEAN’s member states export raw materials to the same markets just as they compete for manufactured exports in the same markets. Liberalizing their respective tariffs toward one another would have only a minor economic effect on their collective economic well-being. Any politically driven and formal linkages would bring the members together on grounds other than natural economic complementarity.

Economic complementarities delimit a much broader “Asia.” For purposes of investment and production, the mix of Northeast and Southeast Asia certainly provides far more realistic complementarity than can be found within the institutionalized ASEAN region. Capital- and technology-rich Japan, and to a lesser extent, South Korea, and Taiwan, complement labor-rich and capital-poor Southeast Asia. This generic East Asia thus provides the core of an economically feasible region, at least as a production unit. And it was largely on such an economic basis that the EAEC gained its momentum. Yet, such a definition of an Asian region is economically incomplete as such. Though viable as a production unit, when one considers markets as well as simple production, then only the much larger Asia-Pacific region, a region that includes the US market, makes
economic sense.

It was the struggle between whether to define "Asia" in terms of its role as a productive unit or as a more complete market that lay at the heart of the debate about the EAEC versus APEC. Institutionalizing an East Asia of production lay behind Prime Minister Mahathir's proposed formulation of the EAEC. As a production unit, and for certain domestic political purposes, such an organizational principle might have made sense. But it lacked fundamental sensitivity to the ultimate markets by many of its potential East Asian participants (not to mention being strongly opposed by the US, Canada, and Australia). As a result it was essentially rejected in favor of APEC, and in October 1993 the EAEC was accepted as a mere caucus within APEC. It was APEC that took on the major role, thereby institutionalizing a regional definition that was trans-Pacific rather than simply East Asian in membership and one that, on trade and economics, represented an "open regionalism" rather than a "fortress Asia."

APEC was the joint brainchild of Australia and Japan. Following twenty-five years of proposals or some institutional form to encourage Asia-Pacific cooperation, APEC was created only in 1989. It was organized around three allegedly complementary goals, all of them economic in character: (1) liberalizing trade and investment, (2) facilitating trade, and (3) increasing economic and technical cooperation. Like the EAEC, APEC was at least partly driven by external events, most notably the growing ties within Europe and more particularly by the slowness in developments within the Uruguay Round of GATT. As the *Financial Times* noted at the time (de Jonquieres, 1994, cited in Mattli, 1999: 168):

Last year's [APEC]...summit was prompted by a common desire to kickstart the Uruguay Round negotiations, which were then stalled. Many APEC members believe that by presenting a united front...and hinting that the grouping could become an alternative to the GATT if the round failed, they prodded the EU into making the concessions needed to conclude the world trade talks.

APEC gained political momentum following its active embrace by
President Clinton in its Seattle meeting of November 1993. For Clinton, APEC represented an opportunity to deflate protectionist sentiments domestically while consolidating the US position as an integral part of the emerging trans-Pacific economic regionalization. APEC thus gained form as a regional organization that crossed the Pacific, and that included the US and Canada from its origins, and subsequently took in Chile and Mexico as members.

Political and institutional goals of the APEC members differed strongly, however. The US, along with Canada, Australia, and New Zealand, for example, long advocated that regional organizations such as APEC commit to formalistic and legalistic approaches aimed at liberalizing trade and investments. This was most clear in President Clinton’s speech at the Seattle meeting of APEC in 1993. Many Asian members, in turn, feared that the US would seek to turn APEC from a forum for discussion with an orientation toward trade facilitation and economic cooperation into a “results oriented” body pressing trade targets and number-specific economic openings. The fear was that if the US got its way, only one of APEC’s three nominal goals would be pursued. Trade liberalization would take priority over trade facilitation and economic cooperation. Some even asked if APEC was “a tool for US regional domination” (Nasudurai, 1996).

Thus, in contrast to the enthusiasm shown for a formalized APEC by the US, Canada, and Australia, APEC’s ASEAN members were skeptical of any such institutionization. ASEAN had provided its members with a long and positive experience of institutional informality and mutual respect of national sovereignty. Extensive institutionalization represented a direct challenge to that experience. Moreover, it was also clear to the ASEAN countries that a body with the US, Japan, and China as members would hardly be particularly responsive to the demands of its smaller members. Thus when APEC was established, members were careful to ensure that it lacked a serious secretariat—despite APEC’s use of the heavily bureaucratized OECD as a model. Rather, APEC was set up in a way that would avoid the high cost of a Paris-like secretariat. But, more importantly, most member states did not want their own sovereignty infringed by any mas-
sive bureaucracy with extensive rules and regulations as had occurred with the EU. Thus the APEC secretariat was established in 1993 with only 23 officials, all of them seconded from own governments.

The adoption of APEC institutionalized, albeit weakly, a more “open regionalism” explicitly based on the undeniable economic linkages already undergirding the extensive trans-Pacific economic regionalization. As Acharya (1997) put it, for many in Southeast Asia, APEC meant a move from “the ASEAN way” to the “Asia-Pacific way.” The regionalism of APEC was the logical institutional manifestation of the pre-existing trans-Pacific regionalization that had been developed by corporations over the previous decades.

Even following the institutionalization of APEC and throughout the mid-to late-1990s, different national agendas continued to divide its members. On the question of how open the members would be to foreign direct investment, for example, there was a sharp split between the members from Southeast Asia on the one hand and the US, Japan, and South Korea on the other. When first formed, ASEAN sought cooperative security measures as its prime goal. Efforts to give an economic role to the organization failed, including preferential trading arrangements (PTAs), the ASEAN Industrial Project (AIP) ASEAN Industrial Complementation (AIC), and the ASEAN Industrial Joint Venture (AIJV) (Stubbs, 2000: 300). Then during the mid- to late-1980s there was a shift domestically in all four of the main ASEAN countries. Domestically based economic liberalizers gained sway as they saw the benefits that stemmed from the inflows of Japanese foreign direct investment. The result was a shift in all four countries from official domestic opposition to overt support for more liberalized inflows of foreign capital. The total inward flow of Japanese FDI to ASEAN rose to $16 billion during 1987-91. When money coming from the US, Europe, Taiwan and South Korea is added, the total inflow to ASEAN rises to $42 billion. This inflow allowed exports of manufactured goods from the ASEAN region to grow dramatically (Stubbs, 2000: 308).

Japanese and other Asian companies weighed in on the issue of ASEAN's economic liberalization. By the late 1970s, Japan had clearly
staked its own economic welfare on Asian regional dynamism and open investment. As noted earlier, the Japanese government took a host of explicit actions to encourage Japanese-owned companies to move parts of their production facilities to the rest of Asia. And in a speech in Singapore in January 1997, Japan’s Prime Minister Hashimoto stated that Asian economic dynamism had ushered in a new era in which a “broader and deeper” partnership between Japan and ASEAN was called for. This was, he said, because “stability and development in Asia are prerequisites for Japan’s stability and development, and it is self-evident that the two are inseparable” (Shiraishi, 1999: 2). For Japanese officials, Asian regionalization extended, rather than diminished, Japanese political options and authority.

Operating networks of production within Southeast Asia, Japanese companies sought to move their products from plant to plant across borders without incurring excessive costs in the form of tariffs or non-tariff barriers. They added their corporate weight to pre-existing pressures for greater liberalization of capital and trade. In addition, the Japanese government actively used its official leverage, leverage acquired not only because of cumulative Japanese FDI but also because of government directed ODA, to push officially for foreign economic policies throughout the region that would be more favorable to foreign-owned investors (Hatch and Yamamura, 1996).

 Corporations from Japan and elsewhere have certainly seen this potential and actively pursued freer movement not only of goods but also people, services, and capital across the Pacific and throughout East Asia. They also pressed for common product standards, harmonized customs procedures, an APEC business visa, a Pacific investment code, common rules on the protection of intellectual property rights, and an effective monitoring mechanism to ensure that the promises of the integration are kept (Mattli, 1999: 172 and Lawrence, 1996: 91-92). Not all of these goals were achieved of course, but the pressure was strong for an internally liberalized and region-wide economic regime.

Japan and South Korea, on the other hand, resisted opening their own
domestic markets to foreign direct investment. The approaches of these two countries grew out of their longstanding mercantilist policies aimed at protecting domestic industries from outside competition. For them Asian regionalization permitted their capital, plants, and technology to be invested elsewhere in the region, but it did not entail the reverse movement of those items into their own countries. Southeast Asian countries, on the other hand, mostly short of domestic capital, had long encouraged foreign direct investment as a quick and necessary way to catalyze rapid industrialization at home.

A final complication to the question of Asian regional ties within APEC lay in the importance of sub-national governmental actions. While national governments or individual corporations were typically the key protagonists in integration, by the mid-1990s sub-national governments had become the key engineers in fostering trans-border connections within much of Asia. Nowhere was this more conspicuous than in the diverse ways in which Chinese provinces (and in some instances sub-provincial governments) have pursued developmental activities quite at odds with one another. Decentralization of power in the post-Mao era has been a key determinant of China’s re-engagement with the global economy and its Asian neighbors, and under decentralization, provinces have gained enhanced capability to act with high degrees of autonomy from Beijing. Thus, Guangdong Province has forged a virtually microregional economy with neighboring Hong Kong to the virtual exclusion of the rest of China. Fujian has done much the same with Taiwan (Breslin, 2000; Naughton, 1999).

Across Southeast Asia a number of exports processing zones (EPZs) have also been formed. Zones in Malaysia are typically far more closely integrated with Singapore’s free-trade sector than with the local Malaysian economy (e.g., Breslin, 2000; Pempel, 2000; Thimbipillai, 1998). The UNDP’s Tumen River Area Development Programme for the Tumen delta represents another example in which sub-national governmental actors from Japan, northeast China, North and South Korea, and parts of the Russian Far East have been the prime movers, well beyond the institu-
tional boundaries of APEC. Despite the grandness of its proposed scope, however, the project may well have foundered on the complexity and competing agendas of the many national and sub-national governmental actors (Bernard, 1996). In all such cases, the particular delineations of "region" are not congruent with the administrative boundaries of national states. Instead, as with various trade and investment networks, such Asian integration is often microregional. It links subnational territories across national borders, and thereby defines complicated microregions that have little relationship to national political boundaries. In these different ways, regionalization often advances in ways orthogonal to national administrative boundaries. More generally regionalization and regionalism in Asia are almost always complicated by the simultaneous processes of decentralization and localization.

Several key traits stand out in the overall picture for Asia by the mid-1990s. First, there was a high degree of productive integration across many parts of the region. Although Japanese money drove much of this integration, additional networks were created by Taiwanese, Hong Kong, Singaporean, and Korean firms as well. In many instances, these production networks were contained within East Asia, but in others they spilled across these boundaries. But the most important element that set boundaries on Asian regionalization was the recognition that North American markets were critical to East Asian export success. The creation of APEC was the clearest manifestation of this realization. APEC enjoyed, however, only a low level of institutionalization, largely around issues of trade and investment, and its Southeast Asian members in particular were reluctant to cede to APEC any strong formal role on economic issues. As a result, its powers were sharply constrained.

The debates over Asian regionalization and regionalism that crystallized in arguments over the EAEC versus APEC centered largely on matters of trade and investment. An issue that subsequently proved critical, but that was not particularly strongly addressed, concerned monetary policy and currency movements. Only with the economic crisis of 1997-98 did questions of how to deal regionally with currency flows take on major
Post-Crisis Debates over Asian Institutions

No event in political economy was more devastating to Asian regionalism and to collective regional well-being than the economic crisis that struck in 1997-98. In the context of this region-wide economic crisis many countries in Asia began to reexamine the specific character of their ties to one another and to the particular brand of regionalism they deemed most appropriate. The crisis showed to many that existing regional organizations with deep internal divisions about goals and agendas simply lacked the political tools needed to cope with collective or intra-regional economic problems. This was made clear in APEC’s (and ASEAN’s) unquestioned inability to ward off, or to provide help to countries hurt by, the economic crisis of 1997. That very inability to act gave rise to a subsequent rethinking on the part of many Northeast and Southeast Asian governments about the desirability of establishing geographically narrower institutions that might be more effective in meeting their particular needs in the event of any future economic crisis. Moreover, their objectives shifted from matters of trade and investment to matters of currency flows and monetary policy. There is already considerable literature on the events of 1997-98 (Pempel, 1999b inter alia). The events themselves are largely agreed upon, as indeed, are many of their specific economic causes. But the larger meaning of the crisis remains under heavy dispute.

Thailand, along with many of the other economies to fall into difficulties in 1997-98, had large pools of outstanding short-term loans, usually denominated in US dollars. Thailand, along with many other Asian exporters, had pegged their currencies to the US dollar. This strategy worked well for these countries as the dollar depreciated vis-à-vis the Japanese yen, for much of the early 1990s. Japanese investment monies and project development loans continued moving into much of the rest of Asia, while Asian exports of countries with pegged currencies, became nominally
cheaper within the US market. When the dollar began to gain in value, however, repayment of the loans became more expensive in local currencies and the export earnings that had previously funded these loans dwindled as Asian exports became more expensive. Contributing to the problems of these exporters, the Chinese government had devalued the renminbi in 1994, and Chinese exporters were thus competing vigorously against other exporters in Asia. Speculators, banking on the eventual need for currency realignment, correctly bet heavily against the ability of the Thai government to maintain the peg of the baht to the dollar. When the Thai baht eventually collapsed in June 1997, it confronted the Thai government with a massive problem of debt repayment.

In this situation, the Japanese government quickly emerged as something of a savior while the United States emerged as a villain. The US, constrained partly by Congressional opposition to “foreign bailouts,” took almost no steps to ease what many agreed was largely a short-term currency problem. The Japanese government in contrast, put together a group to provide an emergency bailout fund of $10 billion, of which $4 billion was committed by Japan itself. The Japanese government also pressured twenty-one Japanese banks to roll over their existing Thai loans, which constituted roughly one-third of the total amount of outstanding loans (Winters, 1999). The amount loaned by Japan to Thailand eventually proved to be greater than the total amount that the US devoted to the IMF packages of Thailand, Indonesia, and South Korea combined.

The currency problems in Thailand were quickly followed by similar problems in Indonesia, Malaysia, and South Korea, and to a lesser extent in the Philippines and other parts of Asia. From the Japanese perspective, the problems in all of these cases were largely short-term liquidity problems, rather than long-term structural problems. Unlike earlier crises in much of Latin America, for example, these governments typically had positive balances in fiscal policy and excellent rates of GNP growth. Their problems did not result from their governments having excessively liberal spending policies. Rather, the argument went, the problems grew primarily, out of the lack of capital controls which had allowed currency speculators
and American hedge funds and mutual funds to invest, and then withdraw, all too quickly, vast amounts of short-term "hot money." What the countries in crisis needed, the Japanese argued, were loans to tide them over the short-term liquidity problems, and then perhaps longer term controls over fast moving capital.

Hence, at the World Bank-IMF annual meeting in September 1997 in Hong Kong, Japan put forward a proposal for a somewhat loosely specified Asian Monetary Fund. The fund would have a total capital of about $100 billion with Japan contributing as much as one-third. Most critically from the perspective of the US and the IMF, the fund would be independent of IMF structures; it would be an Asian fund in the narrowest sense of "Asia." The US was strongly opposed. So too was China, a country not anxious to see Japanese influence within the East Asian region enhanced in any way.

The US had usually favored global institutions over regional ones, and well-institutionalized, rule-based institutions over informal bodies. The IMF was also an institution heavily subject to US influence. So opposition to an Asian Monetary Fund was not completely surprising. But beyond institutional biases, the US also recognized the potential for collective Asian action against the US, and its control over its own economy. The US had been running massive current account deficits and had to rely heavily on purchases of US Treasury notes by such large reserve countries as Japan and China. These two were the two largest holders of US Treasury certificates. Indeed, in 1995, the combined foreign exchange reserves of Japan, Taiwan, China, Singapore, Thailand, Malaysia, South Korea, and Indonesia amounted to $566.5 billion. Thus, the proposal for an Asian Monetary Fund presented the specter of Asian financial coordination against the US. In short, the monetary dimensions of regionalization were becoming increasingly clear to players on both sides of the Pacific.

US fears were not completely hollow. On April 8, 1996, Ministry of Finance official Eisuke Sakakibara had called together an informal meeting of Asian central bankers in Tokyo, under the direction of Toyoo Ghoten, former head of the Bank of Japan. Most of those invited were hostile to...
US proposals for financial services liberalization in the World Trade Organization. The agenda of the bankers was to consider ways to act collectively to counter US influence. Naturally enough, the US was not invited.

The US analyzed the overall problems in Asia quite differently from Japan. There was widespread US governmental commitment to the ideology of "free markets." Moreover frustrations were deep throughout the US government over its decades-long inability to open the markets of Japan and South Korea for trade and investment by US-based firms. Thus, not surprisingly, the US government, together with the IMF, insisted on extensive conditionality as the basis for the IMF loans. Essentially, the domestic governments in the three countries receiving IMF loan packages were required to commit themselves to extensive restructuring of their domestic economies, in some cases such as in South Korea, at the micro-level of corporate organization. These worked quite well in the eyes of the Americans. As then Assistant Treasury Secretary Larry Summers put it with regard to Korea, "The United States achieved more changes in the Korean economy as a result of the IMF packages than we did in twenty years of bilateral negotiations."

The meaning of events in 1997-98 exacerbated a longstanding division between the World Bank and the IMF, with the World Bank arguing that the IMF lacked the expertise, and therefore should not engage in micro-economic management. Joseph Stiglitz, the number-two man at the World Bank, and a long time critic of IMF policies, joined forces with Sakakibara to form a joint project aimed at exploring Asian economic growth and IMF reform.

Furthermore, the very labeling of the crisis became subject to intra-regional disagreements. Within policy circles in North America and Europe, what occurred was "an Asian contagion," "Asian cronyism," or "an Asian economic crisis." For the West, the source of the problems lay largely within the affected countries themselves and typically their failure to adopt US style market economies.

In contrast, within many circles in Asia, the same events were treated
as the result of insensitive and draconian policies pursued by the United States, the IMF, and the World Bank, with their collective commitment to a "Washington consensus." This Washington consensus, it was argued, collectively challenged, rather than supported, goals defined by the bulk of those within a narrower Asia. Within East Asia, the crisis was not an "Asian crisis," but an "IMF crisis" (Higgott and Breslin, 2000). Indeed, as The Economist (2000: 109-110) put it, "The International Monetary Fund is so unpopular in East Asia that it now has an entire economic crisis named after it." As a consequence of such perceptions, widespread support developed within that narrower Asia to begin exploring institutional mechanisms by which closer ties among them, particularly in finance, might serve as an effective counterweight to the power of those "extra-Asian" actors. Still other actors moved in a different direction, namely toward the development of bilateral trade pacts.

By September 1998, even the US had become more encouraging of Japan's efforts to develop a modified version of the AMF in the form of a $30 billion "New Miyazawa Initiative," named after Japan's Finance Minister. Under this plan Japan offered loans at below market rates with few conditions attached.

A second stage of the Miyazawa Initiative was designed to encourage even greater use of the yen as a reserve currency. A fund of some $20 billion was created to guarantee yen denominated bonds issued by governments in the Asia-Pacific. This fund was to be managed by a new Japan Bank for International Cooperation. The bank was established in October 1999 through the merger of the Japan Export-Import Bank and the Overseas Economic Cooperation Fund. Further, an emergency support agency, called the Asian Currency Crisis Support Facility was created at the Asian Development Bank with a capitalization of some $3.7 billion. Cumulatively, these measures enhanced the intra-Asian prestige of the Japanese government on monetary matters. They seemed to be providing some of the kinds of help that beleaguered governments in Southeast Asia had long been seeking unsuccessfully from the IMF.

At the same time, that the plan was driven by more than neighborly
generosity was evident in the fact that some of the major beneficiaries of the Japanese largesse were thousands of Japanese multinational firms heavily invested in Asia. Indeed with the new monies the government abandoned its policy of several years of decoupling its aid to Asia from purchases from Japanese companies. In fact, a 600 billion special yen facility was created with exceptionally soft conditions to sponsor public works projects in Asia, “in principle on a tied basis to Japanese export” (Terry, 1999).

From an institutional perspective, two different developments can be noted as having arisen in the wake of the crisis. First, APEC by the year 2000 had been reduced largely to a shell. It no longer had the institutional capacity to drive forward any serious trans-Pacific economic agenda. And this hollowing out was in turn the result of a collective loss of confidence by its members in the organization’s abilities. As a result, trans-Pacific regionalism suffered a strong blow.

A second interesting development however was the launching in November 1999 in Manila of what has come to be known as ASEAN Plus Three (the ASEAN countries, plus China, Japan, and South Korea). In many respects APT, as it has come to be known, represented a reconfigured EAEC. And unlike earlier formulations, APT appears initially to have gained the enthusiastic support of both China and Japan. Moreover, although it remains largely informal, the APT countries reached an agreement on currency swaps in May 2000 at Chiang Mai. The agreement would solidify an East Asian regional capacity to engage in monetary intervention in the event of any future financial crises—and to do so largely independently of the US or the IMF. In short, following the crisis, the countries of East Asia moved largely toward institutions that would be specifically narrower in membership than APEC and that would focus on currency flows rather than on trade and investment. Institutional remapping continued.
Conclusion

This paper has examined Asian regionalism and regionalization. It pointed out the ways in which Asia has become a more cohesively integrated region over the past thirty to forty years. But it also stressed how production processes, foreign direct investment, trade and other economic forces exerted a far greater push toward such cohesion than did formal institutions.

Asia, meanwhile, was shown to have different boundaries depending on whether one focused on economic or on political integration. These battles were played out in the debates over the narrow Asia of production envisioned by the EAEC and the larger trans-Pacific region delimited by production plus markets that was institutionalized in APEC.

The crisis of 1997-98 made it clear that collective Asian growth remained highly vulnerable to monetary forces and institutional powers beyond East Asia. Short-term capital flows from portfolio managers and loans from many non-Asian banks left the economies of several Asian countries highly vulnerable to rapid pullbacks. Such vulnerability to instantly fluid capital, in contrast to longer-term foreign direct investments, catalyzed among many players in Asia a move toward newer and different institutions that might buffer their economies from such vulnerabilities in the future. Such vulnerabilities also revealed the ineffectiveness of existing institutions such as ASEAN or APEC to cope with short-term monetary instabilities.

The paper also suggests that the evolution of Asian regionalism and regionalization has been deeply shaped by a host of complex political forces. Despite the weakness of regional institutions in 1997-98, for example, and despite the most sweeping claims of much of the globalist literature, markets by no means gained complete autonomy from any state in Asia. Most Asian governments typically retained the ability to regulate a host of economic activities within their borders and they were not without continued...
authority and power, even as they entered into formal regional arrange­ments, or found themselves enmeshed in complex economic webs of regionalization. This was made clear during the crisis, and equally clearly in its wake. Throughout the period, Asian governments quite explicitly sought to, and did, structure economic forces rather to be rolled over as they swept by.

At the same time, both regionalization, and regionalism may well have taken certain governmental options "off the table." The powers retained by governments may remain formally vital, but the practical options they have in particular circumstances may shrink considerably. Certainly, governmental options in the face of the massive withdrawal of dollar denomi­nated funds from Asia in 1997-98 were few in number.

Throughout the paper, however, the stress has also been on the ways in which regionalism, regionalization and national governmental agendas have continually interacted to redraw the boundaries of alternative Asian regions to meet their differing national goals. Such remapping remains subject to great political contestation in the region and from outside. Which particular map of Asia predominates at a particular point in time is clearly the outgrowth of economic and political struggle. To date, the homogenizing forces of globalization have by no means swept these aside. And if this has been true in the battles between economics and politics, there is reason to suspect that it is true in other problem areas such as security, labor, and the environment as well. And if these patterns are in evidence within Asia, there is reason to assume that they are characteristic in other geographical regions as well.

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International Peace.

It has often been observed that the level of "institutional density," and thus also the capacity to undertake collective action, is quite low in the Asia-Pacific region relative to that prevailing in Europe and North America. The Asia Pacific Economic Cooperation (APEC) forum, founded in 1989, quickly emerged as one possible means to redress these disparities. The 1993 meeting in Seattle elevated APEC from a ministerial level forum to a leaders' summit attended by the member countries' heads of government. Within weeks, the prospect that an emerging APEC in the rapidly growing Asia-Pacific region might seek its own liberalization agenda in lieu of the global multilateral trade regime was alleged to have prodded the European Union into completing the stalled Uruguay Round of GATT negotiations. A year later in Indonesia, APEC leaders agreed to the Bogor Declaration, a broad commitment to achieve "free and open trade and investment" in the region by 2010 for developed countries and 2020 for developing countries. A mere five years after its inception, APEC appeared to be off to a robust start—both institutionally and substantively—toward becoming an organization of global, as well as regional, consequence.

Only a few years later, however, there were instead widespread concerns
that APEC, in Flamm and Lincoln’s (1997: 2) words, was “in grave danger of sinking into irrelevance as a serious forum.” Little progress had been made toward setting in motion the Bogor Declaration, subsequent trade liberalization efforts failed to produce meaningful results and, after the Osaka meeting in 1995, more general doubts had been raised about whether APEC’s voluntary and consensual decision rules would ever enable the organization to serve as a vehicle of liberalization. In Gilpin’s (1997: 29-30) view, “Unless it makes fundamental changes, APEC will be a minor player. Lack of purpose, inefficient organization, and inadequate power will condemn APEC to a subordinate position to both the North American and the European regional trade organizations in the evolution and operation of the international economy.” The 1997 Vancouver and 1998 Kuala Lumpur meetings yielded no progress toward implementing APEC’s “Early Voluntary Sectoral Liberalization” initiative, in large part because of Japan’s unwillingness to liberalize its politically sensitive fishery and forestry markets. After APEC gave up on the initiative and instead referred it to the WTO, observers began to question: “Should everyone acknowledge that this whole idea of creating a ‘Pacific Community’ to rival the European Community has been a failure and put APEC out of its misery?” (Sanger, 1999).

Confidence in the forum’s potential usefulness was diminished further when APEC failed to generate any sort of constructive response to the financial crisis that struck East Asia in 1997-98. Many analysts and policymakers both within and outside of the region complained that the International Monetary Fund (IMF) was slow to respond to the crisis, and that the remedies it imposed were not only inappropriate to the particular circumstances of the afflicted countries but actually exacerbated their problems. These criticisms first arose in connection with the IMF’s bailout of Thailand, the first country struck by the crisis; the United States did not contribute to the ad hoc financial assistance package coordinated by Japan and assembled under IMF auspices. Moreover, the crisis seemed to be spreading and thus threatened to put more pressure on the IMF’s limited resources. In this context of regional dissatisfaction with both global
multilateral solutions and with the US reaction, and with APEC appearing ill-suited to cope with currency and financial destabilization, Japan proposed the creation of an Asian Monetary Fund (AMF), a regional facility that would be prepared to disburse pre-committed emergency funds more promptly than the resource-strapped IMF. In the face of vigorous opposition from the IMF and the US, which feared that it would undermine the authority of the US-dominated IMF, the AMF proposal was thwarted, though the idea has persisted and has resurfaced periodically in different forms.

What accounts for these failures to build trans-Pacific or regional institutions? Why the sudden declination of APEC’s trajectory? Why, in a region with ample international reserves available and no small measure of support, was the AMF proposal dismissed out of hand? There is no shortage of tenable answers to these questions, most of which point to the difficulty of reaching consensus regarding APEC’s ends and means in view of the high degree of diversity characterizing its members. From this standpoint, APEC’s liberalization agenda was premature and overly ambitious for a nascent organization embodying East-West, North-South, and/or big power-small power cleavages. And, there were legitimate doubts about the potential impact of the AMF on the effectiveness of the IMF.

These impediments to institution building in the Asia Pacific, while quite real, were far from insurmountable. Rather, this paper argues that the APEC and AMF cases reveal a failure of leadership on the part of the United States and Japan. It is not simply that the two countries failed individually to exercise regional leadership. Nor is it just a failure of joint leadership, that is, to coordinate their initiatives for regional collective action and their efforts to build coalitions to support them. A stronger form of leadership failure has also been manifest: both the US and Japan have used their considerable structural power negatively to block the other’s proposals for regional collective action, rather than positively to exercise leadership. Because the prospects for meaningful trans-Pacific collective action diminish sharply without the constructive participation of both the US and Japan, each therefore is capable of blocking the other’s or third

12. The United States, Japan, and the Power to Block: The APEC and AMF Cases
party initiatives. If, in a post-hegemonic world the US no longer has the willingness and/or the ability to undertake collective action single-handedly, and if in a post-Cold-War world neither the US nor Japan has sufficient incentives to bridge their differences and sacrifice some domestic interests to achieve a unified stance, then we can expect continued stalemate and undersupply of regional collective goods. The following section reviews the concept of leadership and its application in the last decade to institution building in the Asia-Pacific region, and develops the idea of blocking power as a negative exercise of structural power. The subsequent two sections then examine in greater detail the failures of leadership in the APEC and AMF cases, respectively.

**Leadership: A Conceptional Overview**

One central connotation of the world leadership concept addresses the purposes or objectives leaders seek to accomplish. In the broadest and most diffuse usage, leadership aims to provide world order, which typically includes the properties of peace, stability, prosperity and, in some versions, justice. More specificity is needed, however, to apply the concept in an empirically useful manner. Accordingly, it has been most often employed to account for functionally and/or geographically defined components of a broader world order, i.e., the formation and operation of international regimes, such as those regulating world trade, finance, health, or the environment. Leadership is hypothesized to facilitate the international cooperation necessary to establish and maintain rule-based regimes, a process which involves the building and subsequent deepening of international institutions. Cooperation and institution building depend on solution of collective action (CA) problems among self-interested states in order to produce global (or regional) public goods (GPG or RPG). Although it cannot be demonstrated that leadership is either necessary or sufficient in all situations for the solution of CA problems and the provision of GPG, there is general agreement that constructive leadership increases their
likelihood.\footnote{2}

A second connotational emphasis is on the kinds of capabilities necessary for the exercise of leadership. The original literature on leadership was concerned exclusively with hegemonic leadership, i.e., a situation in which a single state holds a preponderant share of a diverse array of productive, financial, commercial, military and diplomatic capabilities (though the precise kinds and concentrations needed vary by issue area and by historical context). Capabilities on this scale provide the hegemon with structural power that enables the exercise of leadership insofar as CA problems are solved if the hegemon has enough of a stake or interest in the anticipated orderly outcome to undertake unilateral production of the GPG and sufficient resources to bear a disproportionate share of the costs. Structural power also enables the hegemonic leader both to build coalitions in support of particular CA/GPG solutions and then to obtain continued compliance by using both positive (inducements, side payments) and negative (coercion) sanctions.\footnote{3}

A third, ideational connotation of world leadership taps the legitimacy that followers (a necessary corollary of leadership) accord to the leader, and focuses on the means by which their consent and compliance is gained. Legitimacy stems from several sources. One is the appeal of the domestic models (e.g., democracy, human rights) and systemic ordering principles espoused by the would-be leader. A related source of legitimacy is the degree to which domestic political institutions reinforce the credibility of commitments to international institutions.\footnote{4} Another entails followers’ estimates of the distributional outcomes of the CA promoted by the leader. The wider the distribution of benefits from the GPG, the more legitimate its leadership will be regarded. Conversely, a leader’s use of its position to pursue narrow national interests or to capture an inordinate share of the benefits of CA will result in diminished legitimacy; indeed, the supposed GPG will lose its “public” qualities. Finally, legitimacy varies inversely with the extent to which the leader employs bullying, negative sanctions, or other coercive means to achieve its objectives. These last two considerations combine to distinguish between leadership that is
benevolent (or benign), on the one hand, or exploitative and coercive, on the other. Early versions of the theory of hegemonic leadership, derived primarily from the experiences of Britain in the late nineteenth century and the United States since the 1930s, were largely limited to the exercise of structural leadership by a single hegemonic leader. Later refinements to the theory pointed to other types of activities involved in the exercise of leadership. In addition to structural leadership, Young (1991) introduced the concepts of entrepreneurial and intellectual leadership. Entrepreneurial leadership includes a range of skills, such as coalition building, negotiating, brokering, and deal-making, that help to bring about agreements on CA that otherwise might not be reached. Intellectual leadership consists of the ability to generate innovative ideas, institutional options, and ordering principles that lead to enduring CA solutions and provision of GPG.\(^5\)

**Shared Leadership**

One important implication of Young's formulation is that it allows for the pluralization of leadership, that is, for different countries to contribute to the overall exercise of leadership. Even those completely lacking structural power could contribute intellectual or entrepreneurial leadership.\(^6\) Moreover, the eventual pluralization of leadership is desirable normatively, as well as a practical necessity. Notwithstanding the revival of American power, growth, and competitiveness since the end of the Cold War, US hegemony of the sort enjoyed earlier in the post-World-War-II period will not be recaptured, either globally or in the Asia-Pacific region. Nor is there any prospect that single-nation leadership will be supplied in the foreseeable future by Japan or any other country. If leadership is to be exercised, therefore, it will have to be some form of shared, or joint, leadership. Narrowing our focus to problems of CA in the Asia-Pacific region, the set of countries sharing leadership minimally must include the US and Japan. To be sure, pluralization of leadership would require accommodation of additional countries' participation, especially in light of Asian countries' preferences for consensual decision rules. But any arrangements for trans-Pacific CA would have to revolve around an axis of
US-Japan leadership sharing.

The requirements for the exercise of shared leadership include those necessary for the single-nation case. While the United States no longer holds a concentration of capabilities sufficient for single-nation hegemony, the combined capabilities of the United States and Japan, the world’s two largest economies, are surely enough to enable structural leadership. Confidence in this assessment should be strengthened by consideration of the complementarity of the two countries’ power resources, and by the regional, rather than global, domain across which shared leadership would operate. We can only speculate about the potential legitimacy of US-Japan leadership sharing in the absence of a concrete track record. On the one hand, there are certainly doubts about the legitimacy accorded to each, taken singly. And these doubts would no doubt be compounded if the CA initiatives emerging from deliberate efforts to share leadership were perceived as autocratic, bullying, unfair in a distributive sense, or aimed at advancing the leaders’ interests at the expense of others. On the other hand, were the United States and Japan to formulate designs for CA in the Asia-Pacific region that were not perceived to be narrowly self-interested, that resulted in widely-enjoyed gains, and that respected the need for consensual decision processes, legitimacy for their shared leadership could be built.

But pluralized leadership, even in the simplest, two-country case, poses additional, somewhat more problematic requirements: shared, or at least compatible, interests and a willingness to share. It is not necessary that their interests completely converge for two or more states to engage in joint leadership activities. So long as most interests relevant to the CA problems at issue are compatible, and assuming some modicum of flexibility and willingness to compromise, shared leadership should be feasible. But divergent interests and how they are manifest in divergent preferences over definition of CA problems, institutional design, and the nature of the GPG to be provided virtually preclude shared leadership. And if there is not sufficient convergence of interests and preferences to permit shared leadership, then the willingness to share does not arise as another
requirement. Even if there are enough common interests to allow in principle shared leadership, concerns with national prestige and status may stand in the way. The usual pattern over the last twelve years or so has been for the United States to exhort Japan to share more international responsibilities and burdens, but without corresponding inclusion in agenda-setting, policy formulation, and other activities that would require sharing power and responsibility.

In sum, the conditions necessary for leadership sharing, especially convergent interests, are rather demanding. As will be argued subsequently in reference to CA in the APEC and AMF cases, these conditions have not been met. The next section considers what has been a stronger impediment to CA in the Asia-Pacific region—the use by the United States and Japan of their considerable structural power to block each other’s CA initiatives.

Blocking Power

The expectation of leadership theory, as spelled out in the above discussion, is that states with sufficient structural power will use it positively to exercise leadership by applying it to purposes that others view as legitimate, viz., solution of CA problems and production of GPG. Little attention, however, has been given to the possibility that the same kinds of structural power necessary for positive leadership activities can also be deployed negatively to block CA.

Following Schelling (1978: Chapter 7), a k-group is defined as the minimum set of members (of a larger social universe) that can benefit from production of a public good, even if no other members contribute to its provision. In Schelling’s original graphic presentation, the larger social universe and the k-group subset are comprised of more-or-less symmetric units, that is, they are alike in terms of capabilities and hence also in their ability to contribute to provision of the public good. The identity of members is therefore irrelevant to the question of k-group formation since individual members are essentially interchangeable; should one defect from the k-group, another member could readily substitute. Snidal’s (1985) refinement of Schelling’s framework to allow for differently sized units,
such as states, enables him to model more accurately the CA problem in light of different international distributions of power, including both hegemonic \((k = 1)\) and non-hegemonic \((k > 1)\) situations. In the former one state benefits from producing the public good itself, but in the latter two or more states have to cooperate to solve the CA problem and produce the good (thus opening the possibility of shared leadership).

But suppose that power resources are distributed in such a way, and that the requirements of producing the good are such that at least the two largest states’ participation is required. If either defects, the capabilities of the remaining large state combined with those of all other members would not be adequate to produce the good. The two largest members would therefore have the \textit{power to block} CA. This paper is based on the argument that this abstract logic describes accurately many CA problems in the Asia-Pacific. The earlier statement that the set of countries sharing leadership minimally must include the US and Japan flows from this line of reasoning. Neither Japan nor the United States can act as a regional hegemon, capable of single-handedly engineering and implementing CA, say, to liberalize trade or to stabilize financial markets. Refusal of either to participate is highly likely to thwart such CA endeavors.

The actual exercise of blocking power can take several forms, depending on the issue-specific nature and the institutional context of the CA problem at hand. In the most straightforward case, one or more countries exercises formal veto power, such as in the IMF and World Bank. Both of these organizations utilize decision rules based on weighted voting and special majorities.\textsuperscript{10} For certain categories of important decisions (e.g., to change quotas and voting weights, as well as constitutional changes), an 85 percent majority is required. The United States, with approximately 17 percent of the votes in both organizations, is the only member to hold a single-country veto. Even if the veto is rarely used, it conveys enormous power to the US beyond the ability to reject CA it opposes. As Cameron (2000: 9) argues with reference to the veto power of the US President, "Congress will anticipate vetoes and modify the content of legislation to head them off. The veto power will have shaped the content of legislation

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without actually being used. Veto threats play an important role in this process. So too in the Bretton Woods institutions does the US veto shape outcomes without being actively used. And in other weighted voting situations where the US or Japan lack de jure veto power, such as the regional development banks (Asian Development Bank, Inter-American Development Bank), they clearly hold a de facto veto.

Short of formal vetoes, another form of blocking power consists of active diplomacy to assemble blocking coalitions among states that are also opposed to the proposed CA or are susceptible to the kinds of persuasion (coercion) practiced only by those countries with substantial structural power. Drifte's (1996: 166) description captures well how exercise of this kind of power fits well with Japan's proclivities. Lacking the qualities and will for leadership, on an individual as well as organizational level, but being well endowed with economic power and a cultural propensity to work in groups, Japan's leaders feel more at ease forming coalitions of other states, transnational institutions, and private sector groups rather than replacing the weakening American hegemon. This is also politically the least onerous way (the means ranging from quid pro quo proposals to blackmail) to establish linkages between issues in order to achieve economic as well as political objectives.

As will be shown below in the discussion of APEC and the proposed AMF, neither Japan nor the United States are averse to wielding this kind of power to block CA they do not want to see come to pass. Another method by which structurally powerful states can block CA is by withholding functionally necessary support or participation. Their support can be necessary because of their sheer magnitude or importance in the particular issue area. For example, without US ratification and participation the Comprehensive Test Ban Treaty is sharply diminished in value. So too would be any climate change agreement that did not include the US, the country with the largest emissions. Or the blocking country's support might be necessary because of specialized capabilities that it alone possesses. Consider in this regard the criticality of US force projection capabilities to certain types of multilateral interventions (e.g., Kosovo) or attempts to
reverse aggression (e.g., the 1991 Gulf War). Finally, the blocking country can simply withhold the financial resources necessary for certain kinds of CA. For example, US tardiness in paying its UN dues has severely impaired that organization's ability to conduct peacekeeping operations.

As indicated by the examples in the discussion above, the exercise of blocking power is not simply an abstract possibility. In fact, there is no shortage of recent examples, most involving the United States, of the exercise of blocking power in multilateral fora. Japan also has sufficient structural power to block CA, usually initiatives pertaining to liberalization and market access that would impose adjustment costs on inefficient, but politically sensitive, domestic constituencies. As Drifte's (1996: 164) survey of Japanese foreign policy concludes, “Nothing can be undertaken in international organizations if Japan does not financially support a given action, helps to garner a majority for a vote, or at least is seen in agreement with it.” It will be argued below that both the US and Japan have come to exercise blocking power to an extent that undermines leadership theory's association of structural power with positive leadership, as well as expectations of shared leadership. We now turn to the manifestation of these tendencies in the Asia-Pacific region.

Japan's Exercise of Blocking Power in APEC

Various analysts have anticipated, with Drysdale (1991: 6), that, “APEC...provides a convenient regional framework within which Japan can move toward a position of shared policy leadership with the United States.” The fact that shared leadership has not occurred is attributable to divergent national interests, or at least to a mutual unwillingness to consult and compromise in order to reconcile interests and forge common preferences vis-à-vis APEC. In what ways then have the two countries' interests diverged?
Divergent Interests

Baker (1998: 165) grounds US interests in APEC in three long-standing, fundamental objectives of American policy in the Asia-Pacific region: "to secure economic access to the region; to spread value systems preferred by Americans; and to prevent domination of the region by other powers." None of these is necessarily shared by Japan. With reference to the access objective, APEC appeared to offer the US the opportunity to participate more fully—beyond its security role and as consumer of Asian-produced goods—in the integration of what has been the world economy's most dynamic region. As a vehicle for trade and investment liberalization, APEC would hopefully result in expanded opportunities for US multinational firms and in greater market access in countries, including Japan, that have persistently run large trade surpluses with the US. But some students of the region view these expectations with considerable skepticism:

[O]ne would have to be a fool to think APEC is America’s ticket to the ball. The economies of Asia are indeed becoming increasingly intertwined. But the thread that is tying them together is not APEC, nor any other formal body or treaty. It is, to a large extent, Japanese developmentalism. Japan is regionalizing a dense web of mutually reinforcing ties-between government and business, between independent firms, and between management and labor. (Hatch and Yamamura, 1996: 192)

We can infer from this account that Japan has little interest in formal multilateral negotiations to "organize the Pacific" along liberal lines because it is already organized informally by Japanese firms. In Bello’s (1996: 19) terms, "the main reason Japan does not want an APEC free trade area to form is that it is well on its way to creating a de facto trade and investment bloc."

Also contributing to Japan’s (and other Asian countries’) reluctance to use APEC as a forum for negotiating binding trade and investment rules is the perception that the "United States has often interpreted a rule-based order to mean the extension of American rules and procedures to the rest of the
First, informal diplomacy favors Japan over the rest of the world. Backed by the largest stock of foreign investment, the largest foreign aid flows, major trade flows, and the proximity of being the closest economic superpower, Japan does better than its rivals in the triad by playing by informal rules. Second there is no set of formal rules that could be written to advance Japanese interests that would neither significantly assist US and European interests more (e.g., stronger defenses of intellectual property) nor articulate a standard of conduct that might seem an overt challenge to Atlantic sentiments. Third, Japanese politics and economics make informal bilateral policies feasible and desirable. They have created the traditions of informal government intervention without extensive formal rules at home and industrial groups that are experienced in building their businesses on developing long-standing relationships, not contracts and rules.

In short, multilateral liberalization of the sort advocated by the US in APEC would not work to Japan's advantage. It might produce absolute gains all around, but the US and Western Europe would reap relative gains vis-à-vis Japan in the region were market access to be rule driven rather than determined by existing informal, and often exclusionary, networks centered around Japanese firms. And, we have not yet considered what is widely regarded as the principal obstacle to market opening in Japan: the unwillingness or inability of Japanese governments to agree to international CA that would result in adjustment costs for the various inefficient but politically well connected sectors of Japan's economy, e.g., agriculture (Japan's "Achilles heel"), transportation, construction, distribution.

The second US objective identified by Baker (1998: 165)—"to spread value systems preferred by Americans"—is shared by Japan at a very general level. Both prefer the development of capitalism and democracy in the region, though they often differ on the instrumentalities that should be used to attain these ends (e.g., diplomatic pressure on China to change its human rights practices). But interests diverge significantly when the ques-
tion focuses on the more specific values manifest in the two countries’ respective forms of capitalism—in a nutshell, individualistic, market-oriented, laissez faire American capitalism as contrasted with Japan’s more mercantilist, developmental state version. If divergence on liberalization and market access are key to understanding the recent course of APEC, divergence of the values represented by the two forms of capitalism are more relevant to the fate of the AMF proposal, so we will develop this more fully below.

Prevention of “domination of the region by other powers,” the third objective in Baker’s formulation, is shared by Japan if it is Chinese domination that is to be prevented (though both the US and Japan refrain from articulating this objective). Obviously, however, there is a sharp divergence if the American objective (again publicly unstated) is to contain Japan’s role in the region, whether domination is construed in terms of the informal production networks discussed earlier, the spread of Japan’s developmental state model across the region, or Japanese influence in institutions such as APEC or a prospective AMF.

Turning to the objectives Japan seeks in APEC, as summarized in Funahashi (1995: Chapter 10) and Watanabe and Kikuchi (1997: 141-143), it is evident that some diverge, virtually by definition, from US objectives. First, Japan’s goal of using APEC to curb the US’s unilateralist and bilateralist tendencies is, needless to say, not consistent with the US government’s definition of its interests. Second, nor is Japan’s expectation that APEC will help to keep in check potential regional protectionism in NAFTA (and the EU). Third, there is more compatibility with regard to Japan’s interest in maintaining the US security presence in the Asia-Pacific region: to the extent that this requires sustaining American satisfaction with its economic position, however, there are definite limits, as implied by the market access discussion. Fourth, engaging China via APEC in a web of regional interdependencies while promoting its transition to capitalism is certainly a shared objective, albeit a tricky one inasmuch it intersects with a tangle of security issues, including China’s concerns about the US-Japan alliance, the US military role in the region, and policies toward
Taiwan and its status in relation to mainland China. Finally, Japan certainly places greater importance than the US on the objective of strengthening ties with ASEAN and developing modes of North-South cooperation, especially with regard to development issues. But this is a difference of emphasis rather than a conflict of interests, though the US has complained that Japan’s emphasis on development cooperation is at expense of the relative weight assigned to APEC’s trade and investment liberalization processes.

This discussion has overlooked or underestimated some of the common interests that undergird “the most important relationship in the world” between two countries that are, after all, partners in a bilateral security alliance and highly interdependent economically. Yet, this brief accounting reveals rather significant divergences in their preferences about the shape and purpose of APEC. These preferences have clashed to a degree sufficient not only to dash expectations of shared leadership in APEC, but also to precipitate the blocking of CA in the area of trade and investment liberalization.

The 1995 Osaka Summit: Blocking Trade and Investment Liberalization

The impetus for APEC becoming a vehicle for trade liberalization came from the recommendation of its Eminent Persons Group prior to the November 1993 APEC meeting, held in Seattle under US auspices (and the first APEC meeting to feature a summit of the leaders of APEC’s member countries). This recommendation was endorsed in the communique, or “Vision Statement,” which summarized the ambitious, if vague, agenda which the leaders had agreed to at the summit: “We welcome the challenge...to achieve free trade in the Asia-Pacific region, advance global trade liberalization, and launch concrete proposals to move us toward these long-term goals.”

This broad initial statement of objectives was given more concrete, though still nascent, form at the next APEC summit, held in Bogor, Indonesia, in November 1994. The Bogor Declaration that emerged from this meeting laid out a comprehensive commitment to achieve “free and
open trade and investment” in the region by 2010 for developed countries and 2020 for developing countries. The fact that consensus on the liberalization agenda had been reached under the leadership of Indonesia, a developing country, appeared to lend additional credence to APEC’s liberalization role, signaling that it was not just an American project, but one endorsed more widely by the organization’s membership. Moreover, the staggered timetable for attaining free trade in the region indicated that at least minimal accommodation had been made for APEC members’ diverse levels of development. The Declaration also affirmed the principle of “open regionalism,” meaning that countries outside the grouping would be allowed to benefit (without having to reciprocate) from the liberalization measures of APEC members (thus also ruling out the possibility of APEC becoming a NAFTA-style exclusive free trade area, or FTA).

Malaysia, however, expressed its reservations about the liberalization agenda in a proposed “annex” to the declaration (which was not approved for inclusion by the other members). Malaysia, among other reservations, made clear that it would undertake liberalization only on a unilateral basis, and that it regarded the 2010 and 2020 dates as merely indicative and non-binding. These issues would prove controversial in the ensuing year as the November 1995 meeting was to be held in Osaka, and Japan therefore would be leading the year-long process of imparting greater operational specificity to the expansive Bogor Declaration. Would Japan use its position as chair to steer this process toward the Malaysian and Chinese preferences for unilateral, non-binding, and hence voluntary arrangements, thereby weakening, or at least slowing, the kinds of CA that APEC would need to reach the liberalization goals spelled out in the Bogor Declaration? Or would Japan follow the Indonesian example and provide another strong Asian push to the APEC liberalization process. The choice, according to Doi (1995), came down to “whether to help America spread the western-style free market ideal in the region or be the spokesman for wary Asians who would rather open their markets at their own pace.”

Besides the divergent preferences discussed earlier, there were additional reasons to anticipate that Japan would join the “go slow club” (with
Malaysia and China) and retreat from the Bogor Declaration’s free trade objectives. Japan had foregone leadership of trade liberalization in the recently concluded Uruguay Round, while trying to avoid opening its rice market (Rapkin and George, 1993), so there was little basis to expect a U-turn in the APEC context; it was now encumbered by an awkward and politically tenuous coalition government that would be hard-pressed to make concessions on agriculture or other vulnerable sectors. And there remained significant bureaucratic differences, mainly between the Ministry of International Trade and Industry and the Ministry of Foreign Affairs, as well as within the latter, over APEC and its role as a liberalization mechanism (Funabashi, 1995: 211-215).

At issue after Bogor was the form and content of the Action Agenda that would be agreed upon at Osaka and that would begin to translate the Bogor Declaration into concrete actions. The first skirmish over the Action Agenda came in February 1995, when Japan reintroduced (it had first surfaced in vague form in Bogor) its proposal for a Partners for Progress (PFP) program aimed at mobilizing foreign aid under APEC auspices to be dispensed to the organization’s developing members.21 The ostensible purpose of PFP, as construed by Japanese officials, was to narrow the developmental disparities among APEC members and thereby prepare the less developed members for, and make them more amenable to, liberalization.

Developed countries, especially the United States, were skeptical of the PFP proposal on several counts: First, there were questions about the need to turn APEC into another, perhaps redundant, aid forum. Second, was Japan trying to draw attention away from APEC’s liberalization agenda by emphasizing development cooperation? And third, was Japan attempting to “purchase” the support of APEC’s developing country members for backing away from liberalization—in which Japan too would have to make difficult concessions—by diverting part of its sizeable aid budget to APEC, a much less painful option? Japanese officials defended the PFP as reflecting more accurately the preferences of APEC’s developing members, and as restoring balance to the overall APEC agenda, which they claimed had

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become too heavily skewed toward liberalization. Though the PFP idea remained somewhat vague in the final version of the Osaka Action Agenda, more importantly, Japan succeeded in gaining formal support for the establishment of development cooperation as a third pillar of APEC, along with liberalization and trade and investment facilitation.

More controversial in the lead-up to and at the Osaka meeting were several interrelated disputes over the modalities by which the liberalization process would take place. Japan proposed that the process advance by means of “concerted unilateral action” (CUA) that would leave the extent, pace, timing, and specific method of trade and investment liberalization to the discretion of each member. These details were to be spelled out in the Individual Action Plans (IAP) which would be submitted at the 1996 APEC summit in Manila. In short, liberalization would proceed on a voluntary basis, without the formal commitments, binding agreements, or fixed timetables characteristic of GATT/WTO-type trade negotiations. The IAPs would be “concerted” through a “consultation process” of a “confidence-building nature” that would itself proceed in a consensual, voluntary manner. The United States strongly preferred a more structured approach, involving reciprocal concessions that would more closely resemble negotiations, and in which developed and developing members would implement liberalization along the 2010 and 2020 tracks, respectively, more-or-less simultaneously.

The final draft of the Osaka Action Agenda calls for CUA toward trade and investment liberalization and “collective actions” toward trade and investment facilitation.

A liberalization process that is unilateral, voluntary, and consensual raises the question of comparability: how to ensure that the costs, as well as the benefits, of liberalization are shared equally or proportionally? Although the third “General Principle” in the Osaka Action Agenda called for “overall comparability,” there was considerable skepticism that this could be attained via the loose process of consultation (but not negotiation) sketched out therein. Members would review each other’s unilaterally formulated IAPs, informally exchange information, and then revise their liberalization blueprints in response. The discipline necessary to sustain
movement in the direction of greater openness would be provided by peer pressure and enlightened self-interest.\textsuperscript{25} Not surprisingly, the United States pushed for a more detailed and structured approach, fearful that the less disciplined process prescribed by the Osaka Action Agenda would yield minimal, lowest-common-denominator results, and that the lack of clear and demonstrable comparability would make it politically difficult to gain approval from a skeptical Congress.

The most controversial issue between the Bogor and Osaka summits revolved around whether the liberalization process should be governed by a strict reading of the principle of comprehensiveness or whether it should be relaxed according to the principle of flexibility. From the beginning, successive drafts of the Action Agenda stated that the liberalization process should be comprehensive in the sense of "addressing all impediments" to free and open trade and investment across all economic sectors. After Bogor, however, Japan (with the support of China, South Korea, and Taiwan) pressed for inclusion of additional language permitting "flexibility...in allowing differential treatment" of politically sensitive sectors. The US, Australia, and other members saw this as an attempt to exempt Japan's agricultural sector from the liberalization process, and protested that all countries had sectors they would like to exempt as well. Once the principle of flexibility was legitimated in the Action Agenda, it was argued, the whole process would begin to unravel.

Despite the seeming incompatibility of the comprehensiveness and flexibility principles, both were included in the final version (the latter in weaker terms than Japan would have preferred). It was not at all clear, however, how the two taken together were to be interpreted. In the words of Katzuhisa Uchida, a senior Japanese delegate to APEC: "We all agreed flexibility is necessary, but we can't define it clearly right now" (cited in Inose, 1995: 19). Does the flexibility principle permit exclusion altogether of sensitive sectors, or does it merely enable delay of liberalization until the 2010 or 2020 targets are approaching? Rafidah Aziz, Malaysia's trade minister, consistent with Malaysia's reservations at Bogor, declared at the concluding Osaka press conference that the target dates were not binding.
Asked to clarify Aziz’s interpretation, Japan’s Prime Minister, Tomiichi Murayama, said they were “movable targets,” and other officials, including trade minister and soon-to-be Prime Minister, Ryutaro Hashimoto, failed to clear up the ambiguity.

Yet another controversy involved the “down payments”—packages of specific market opening measures—that members had agreed to bring to Osaka in order to jump-start the liberalization process launched at Bogor. As the two largest and most advanced of the APEC economies, and as the most vocal proponent of liberalization and chair and host of the summit, respectively, the United States and Japan, were expected to offer exemplary down payments for others to emulate. Such leadership was not forthcoming. The US Congress had not renewed the Clinton administration’s “fast-track” negotiating authority, without which the US was unable to put forth much of a down payment. It consisted of trade facilitation measures such as customs streamlining, revision of government procurement procedures, and loosening of restrictions on defense exports. This package not only was a weak model for others to follow, but it also engendered doubts that the US was able and/or willing to make and implement market opening commitments within APEC’s unilateral liberalization process (Funabashi, 1995: 96-97). “The US delegation justified these meager offerings by asserting that, because the American economy already is among the most open in APEC, Washington is obligated to make fewer commitments now than other forum members” (Johnstone, 1995a: 5). While there is a sizeable kernel of validity in this position, the weak US down payment and the lack of fast track authority, along with the last minute decision by President Clinton not to attend the summit, significantly constrained the US role as a credible advocate of the sort of liberalization process it preferred.

Japan’s down payment was more substantial, featuring an offer to accelerate implementation of Uruguay Round commitments to reduce tariffs on hundreds of products, albeit products for which Japan’s tariffs were already very low. Its failure, however, to reveal its down payment until late in the process of preparing for the Osaka meeting, and thus to provide an
model for others to follow, "was seen in certain quarters as a further example of Japan's questionable leadership qualities" (Johnstone, 1995: 9). Without the example of strong US and Japanese packages, it was not surprising that the other members' down payments tended to be modest and to consist largely of repackaged commitments made elsewhere or already underway. A notable exception was China, which offered tariff cuts averaging 30 percent on thousands of products, though it was widely understood that these were cuts that China was soon going to make anyway in connection with its bid for WTO membership.

It is difficult to disagree with Orttudad's (1996: 3) conclusion that while "Osaka offered a major opportunity for the two countries to exhibit the true meaning of shared leadership in a region where they are the only economic superpowers...the Osaka meeting actually highlighted the key differences in US and Japanese priorities for APEC." Indeed, the above survey of disputed issues that arose in the course of forging the Osaka Action Agenda suggests a stronger conclusion is warranted: Japan, with support from some Asian countries, succeeded in eviscerating virtually all traces of the type of liberalization program sought by the United States. The liberalization process that emerged from the Osaka summit was instead voluntary, unilateral, consensus-based, non-binding, lacking common timetables, and uncertain as to comprehensiveness and comparability of members' efforts. These methods and concepts, all deriving from what has been termed the "Asia-Pacific way," engendered understandable doubts about APEC's capacity to serve as a motor force of trade and investment liberalization in the region and in the larger world economy; after all, CA on this front had been effectively ruled out.

But it would be premature to dismiss outright the possibility that the Action Agenda that emerged from Osaka provides an alternative route to liberalization. As Acharya (1997: 343) puts it, the significance of the concepts associated with the Asia-Pacific way "may lie in their value as ways of reconciling conflicting state preferences and finding common ground out of differing economic, political and strategic priorities among members." Not enough time has elapsed since Osaka to provide a fair test,
but suffice it to say that APEC has neither reconciled many conflicting state preferences nor found much common ground. As will be demonstrated, these failures and the resulting loss of liberalization momentum are partly attributable to the lack of positive leadership by either the United States or Japan.

After Osaka

The Osaka Action Agenda instructed members to begin development immediately of Individual Action Plans (IAP), which were to include details and timetables for their liberalization efforts. Draft plans were submitted at four preparatory meetings, with consultations and revisions after each juncture, in preparation for the next APEC Ministerial (and summit) meeting at Manila in November 1996; implementation was to commence on January 1, 1997. The overall process lagged, however, so that serious consultations and peer review to assess the comparability of IAPs was postponed until the following year.

The IAPs submitted at the Manila meeting, covering of course only voluntarily offered products and sectors, were, "on balance an unimpressive collection of vague pledges with few details" (Johnstone, 1996: 9). The exceptions were tariff reductions beyond Uruguay Round commitments made by fully half of the members, notably by China, Chile, Indonesia, Australia, and the Philippines. But the most significant category of trade restrictions in Asia, nontariff barriers, was barely addressed in the IAPs.28

The most disappointing IAPs were those submitted by the United States and Japan. With the Clinton administration facing an election just before the Manila meeting, and still lacking fast-track authority, the US IAP offered little beyond the declaration that the US had already achieved a degree of openness sufficient to satisfy APEC requirements. Proposals to eliminate tariffs on information technology (see below) and to negotiate "open skies" agreements, both areas in which American firms hold strong competitive advantages, were clearly self-interested. Japan's IAP recycled the same tariff reductions pledged a year earlier at Osaka, but contained nothing new of substance. On this and other issues, "Japanese stances
within the forum...appear largely to represent calculations of national interests narrowly defined” (Johnstone, 1996a: 13). Neither the US nor Japan offered any liberalization commitments related to economic sectors or policy measures that might be considered sensitive in terms of domestic politics.

Dissatisfied with the loss of momentum on APEC’s broad liberalization agenda, and unable or unwilling to provide the kind of leadership needed to give it a push, the Clinton administration chose to seek instead a dramatic breakthrough on a more limited sectoral basis. The US, with support from Japan, put forth a proposal for an Information Technology Agreement (ITA) that would eliminate tariffs on a range of computer, software, semiconductor, and telecommunications products by the year 2000, hoping then to use the APEC endorsement to gain wider approval for the ITA the following month at the WTO’s ministerial meeting in Singapore. US officials emphasized that since a number of APEC members are large-scale producers and consumers of IT products, the ITA would result in widely shared benefits. But those developing countries attempting to establish a manufacturing presence in ITA industries, especially Malaysia and China, contended that the US’s ITA proposal would disproportionately benefit APEC’s developed members, whose tariffs tended to be much lower.29 China’s foreign minister suggested that APEC needed to develop sectoral initiatives that would more directly benefit developing countries, specifically mentioning textiles, a sector in which the US maintains high levels of protection.

In the face of this opposition, the US was able to muster only a diluted APEC endorsement for the ITA, and this was obtained only with President Clinton’s personal intervention at the leaders’ summit. The declaration resulting from the Manila meeting supported an ITA “that would substantially eliminate tariffs by the year 2000” while “recognizing the need for flexibility.” Acknowledging that the agreement was helpful, Singapore’s Prime Minister Goh Chok Tong pointed out what had become the hallmark of APEC agreements: “Its wording was ambiguous. It can be interpreted by the members as anything they want it to be” (cited in the
Despite APEC’s lukewarm support, the ITA was approved at the Singapore WTO meeting, thus encouraging the US and other like-minded members to try to use sectoral agreements to restore some momentum to the flagging APEC liberalization process. There were additional motivations for shifting APEC’s emphasis to early voluntary sectoral liberalization (EVSL). Such “[n]arrow initiatives have the distinct advantage of allowing APEC to demonstrate tangible results to business—so called deliverables—throughout a process that will extend for decades” (Johnstone, 1997).\(^\text{31}\) Moreover, as Aggarwal and Morrison (1997: 23) point out, senior APEC officials hoped that “agreements in easier sectors might have a demonstration impact and learning effect in the more difficult areas.” And, in the words of US Trade Representative (USTR) Charlene Barshefsky, APEC sectoral agreements could play a “catalytic” role, providing a “critical mass” for subsequent passage at the WTO (cited in Bullard, 1997).

In the meantime, in the preparatory meetings leading up to Vancouver, the IAP process—reviews, consultations, feedback, and peer pressure—was not producing much by way of the “revisions and improvements” that were originally anticipated in the Osaka Action Agenda, not least because neither the US nor the Japanese IAPs had yet offered much beyond their Uruguay Round commitments. Indeed, the IAP approach to APEC trade and investment liberalization had largely faded from view. In this context, the EVSL initiative was viewed by some as a “face-saving device”\(^\text{32}\) designed to cover the failure to make much progress on this agenda via the IAP mechanism since Osaka. Additionally, after the financial crisis that first struck Thailand in summer had spread to Indonesia and other countries in Southeast Asia, and then to South Korea, resistance to APEC’s trade and investment liberalization agenda stiffened. US officials feared that APEC’s developing members might react to the crisis with protectionist measures, that such a reaction could contribute to perceptions that APEC’s liberalization drive had stalled, which, in turn, could trigger further panic in financial markets.
The Manila Action Plan instructed members to submit proposals for EVSL, and selection of EVSL sectors would be finalized at the November 1997 APEC ministerial meeting in Vancouver. Sectors which had been identified by multiple members would then provide a basis for sector-specific liberalization initiatives. APEC's 18 members initially proposed as many as 61 sectors for EVSL consideration, with members naturally nominating those sectors in which their firms are highly competitive and tariffs are already low or nonexistent. By the time of the November meeting, the list had been reduced to 41. The United States was still constrained by the lack of fast-track authority (Congress had just denied it again in early November), so its proposals were limited to those sectors in which President Clinton could exercise residual tariff authority left over from the Uruguay Round (e.g., wood and paper products, nonferrous metals, chemicals, oilseed products) and in which American firms expected to gain from market opening. Japan too proposed sectors in which it was competitive and/or already had low tariffs, such as environmental equipment and services, precision tools, and scientific instruments.

Inability to narrow to the target of four to six sectors led to agreement on fifteen EVSL sectors at Vancouver. Work would begin on nine of these during 1998, with implementation to start in 1999: environmental goods and services, energy-related products and services, chemicals, toys, gemstones and jewelry, medical equipment, telecommunications, fish and fish products, and forest products. Another tier of six sectors were identified for subsequent EVSL: aircraft, automotive standards, fertilizer, food, oilseeds, and rubber. Overall, the slate of sectors included some for which liberalization would benefit developed countries, others that were of greater interest to developing members, and some for which both developed and developing countries stood to gain (e.g., forest products for the US, Canada, and Indonesia; fish and fish products for Southeast Asian countries and Canada). The Clinton administration claimed residual fast-track authority for some, but not all, of these sectors, thus leading to doubts that the US would be able to negotiate agreements in all of them.

No sooner had agreement on EVSL been reached at Vancouver than
Japan declared its unwillingness to liberalize its markets for fish and forestry products, two industries in which its producers were weak, but politically well-connected. Thereafter, the ensuing meetings preparing a concrete EVSL agreement for the November 1998 ministerial and summit meetings in Kuala Lumpur were dominated by US-Japan disputes over how the agreement would be implemented. US officials maintained that the nine EVSL sectors should be treated as a package, so that members would not be free to pick and choose those in which they would participate or not. The US was willing to tolerate less developed members bailing out of the EVSL program (e.g., Mexico and Chile, both of which claimed to prefer a comprehensive, rather than sectoral, liberalization process), but was unwilling to stand by when Japan, as a developed member, refused to participate fully. As stated by John S. Wolf, US ambassador to APEC, “If that package is to be meaningful, Japan, as the second-largest economy in the world, is going to need to be part of that” (cited in Yeoh, 1998). US officials feared that the whole EVSL process would fall apart if a prominent member such as Japan was able to avoid participation in sectors where costs would likely be incurred. Developing countries would insist on the same terms, rescind or at least weaken their offers, and the EVSL would soon reduce to the same kind of sketchy, ambiguous, and unmeasurable undertaking as the IAPs.

Japan repeatedly insisted that EVSL proceed on a voluntary basis, as implied by inclusion of the term “voluntary” in the name of the initiative, as well as “flexible” in terms of implementation. As if to underscore the point, Japan expressed its reluctance to liberalize other markets besides those for fish and forestry products. Of the nine sectors selected for priority EVSL, and the next group of six candidate sectors, Japan expressed “total reservations” about liberalizing three and “partial reservations” about five others. Japan’s eight reservations exceeded those of any other APEC member, including developing countries. No other developed member of APEC expressed any reservations whatsoever (Masaki, 1998: 21). Moreover, Japan seemed isolated as Southeast Asian countries initially joined US pressure on Japan to liberalize its fish and forestry products.
markets. Following a June meeting, though, Japan claimed that its position had support among APEC’s developing members, who were “forced to be quiet” because, with their economies stricken by financial crisis, they were unwilling to cross the United States. By September, agreement had not yet been reached, and APEC’s developing members’ support for EVSL was weakening, as expressed by China’s ambassador to APEC, Wang Yusheng: “We are ready to participate in all nine sectors, but partially and conditionally, on the basis of voluntarism” (cited in Altbach, 1998a).

As the Kuala Lumpur meetings approached, the recriminatory rhetoric between the US and Japan intensified. Deputy USTR Richard Fisher told reporters that if Japan did not participate in all nine sectors, the Kuala Lumpur ministerial and leaders’ meetings “would be viewed as a failure and Japan would be responsible for that failure,” adding that it “is inexcusable for the second largest economy in the world and the largest economy in Asia not to fulfill its responsibilities” (cited in Altbach, 1998b). US officials also warned of a protectionist backlash in the United States against the flood of low-price Asian imports (including from Japan) and resulting increased trade deficits that had been triggered by the depreciation of Asian currencies and by the attempts by Asian countries to export their way out of financial crisis. To avert such a backlash Asian countries needed to open their markets further to US exports.

Then Japan announced US$204 million in aid to APEC’s developing countries to develop their fishing and forestry industries, a choice evidently intended to rankle the US and to emphasize the importance of development cooperation rather than trade liberalization as an APEC objective. USTR Charlene Barshefsky charged that “Japan is going around the region promising overseas development assistance to countries that don’t participate,” and asked “whether Japan will become a constructive force in APEC or...will continue on the destructive path that it has thus far set for itself” (cited in the New York Times, November 11, 1998). Japanese officials angrily denied that the promised aid was linked to support for Japan’s EVSL position. The spokeswoman for Japan’s Foreign Ministry, Miki Kiyoi, responded that, “if the biggest economy in the world
magnifies forestry and fishing, this is truly counterproductive” (cited in Khanna, 1998).

By the time of the ministerial meeting in Kuala Lumpur, Japan had gained the support of China, Malaysia, Indonesia, and Thailand for its refusal to participate in EVSL for forestry and fish products. Unable to muster a consensus agreement on EVSL, APEC instead referred it to the WTO for further negotiation. US officials attempted to put a positive spin on what was an unequivocal setback, expressing confidence that a WTO accord on the nine EVSL sectors could be negotiated in 1999. Japanese officials indicated, however, that the nine sectors would not be negotiated until the next multi-year round of the WTO, scheduled to start in 2000, was under way (see Richardson, 1998). As Bello (1998) observed, “Apec is effectively stalemated, and all the players know it.” However one might evaluate the thrust of the CA that the United States had promoted within APEC, there can be little doubt that Japan had succeeded in blocking it.

US Exercise of Blocking Power: The AMF Proposal

In summer 1997, much of East Asia was struck by an unanticipated financial crisis of greater scope and depth than any since the 1930s. It was first manifest as a currency crisis in which the Thai baht was besieged by speculative attacks premised on expectations that the baht, which was pegged to the US dollar, would be unable to hold its value. After expending its stock of reserves trying to defend the baht, the Thai government had no choice but to let the currency float, after which the baht lost half of its value in the next six months. As foreign investors fled the country, growth ground to a halt, and the value of Thai assets shrunk. The crisis soon spread to Indonesia and South Korea, as well as to Malaysia and the Philippines, and to lesser degrees elsewhere in the region. These countries too suffered from large, rapid capital outflows, sharp currency depreciation, and collapsing stock market valuations. Accompanying these disasters was financial instability: with exchange rates suddenly much lower, firms
were unable to repay short-term debts to foreign creditors, and many banks and other domestic financial institutions failed. The resulting slowdowns in economic activity forced bankruptcies and layoffs which, in turn, shredded weak social safety nets and, particularly in Indonesia, triggered political unrest.

First Thailand, then Indonesia, followed by South Korea, were forced to turn to the IMF for financial assistance of unprecedented proportions. In such circumstances, the IMF imposes stiff "conditions" that the recipient must meet to receive the loans. Typically, IMF conditionality requires an assortment of austerity measures that aim to stabilize the currency, reduce current account deficits, curb domestic demand, and restrain inflation. But in the case of the Asian bailout packages, the IMF, under strong influence from the US Treasury Department, went much further in prescribing radical institutional reforms intended to make the financial systems of the borrowing countries more closely resemble western types, but which many in Asia and elsewhere regarded as unnecessary for resolution of the crisis at hand. The IMF's new-found reach—well beyond its usual mandate and deep into what heretofore had been considered members' sovereign prerogatives—was justified in terms of a diagnosis of the crisis that placed heavy causal emphasis on features that were internal to the affected countries and characteristic of the developmental state model first pioneered and since promoted by Japan: tendencies toward corruption, crony capitalism, and lax oversight that are thought to accompany close ties among the state, industry, and the financial sector.

Critics acknowledge that this line of explanation of how the crisis occurred is partly true, but that it conveniently overlooks the role of vast increases in short-term capital flows that resulted from the too-rapid capital market liberalization pushed upon East Asian countries (and much of the rest of the world) by what has come to be called the "Wall Street-Treasury-IMF complex." From this perspective, the extreme degree of capital mobility makes for an unstable international financial regime vulnerable to precisely the kind of crisis that occurred in East Asia. Besides the charge that the IMF had exceeded its mandate in insisting on reforms
aimed at emasculating the developmental state, another widely voiced criticism of the IMF was that it applied "one size fits all" conditionality packages that had originally been designed for insolvency crises in Latin America. The East Asian cases, however, were essentially liquidity crises. The inappropriate remedies served to exacerbate the liquidity crisis, expanding it into a broader economic crisis. Higher interest rates, for example, were prescribed to restore the confidence of investors. But this step also squeezed domestic firms, especially those with high levels of debt (as is characteristic of the affected countries). The bankruptcies and layoffs that followed from the credit crunch raised the human and social costs of the crisis. Moreover, the combination of depreciated currencies, reduced equity values, and failing firms enabled foreign firms to acquire undervalued assets at bargain basement prices, thus fueling conspiracy theories, charges of neocolonialism, and fear of western domination. Resentment of the IMF (and of the US) over these developments joined those stemming from the "sovereignty costs" incurred in bowing to IMF demands.

Other perceived shortcomings in the IMF's solution to the regional crises included its slow response times (due to the IMF's cumbersome procedures), an important factor in light of the rapidity with which capital moves and speculative attacks can be mounted. Another was the insufficiency of IMF resources given the growing scale of the problem, and the quota-based limits on how much each member can borrow. The first bailout package, for Thailand in August 1997, amounted to $17.2 billion. The IMF committed $4 billion, as did Japan, and the World Bank, Asian Development Bank, and various Asian countries contributed the balance of the package. The United States did not contribute. In November, the IMF put together a $40 billion package for Indonesia, including $10 billion of its own resources and $4.5 and $3.5 billion from the World Bank and Asian Development Bank, respectively; Japan and Singapore pitched in with $5 billion each, and the US this time contributed $3 billion. The December 1997 bailout for South Korea totaled $57 billion, the largest such package in IMF history. The IMF put up $21 billion, Japan's $10 billion was again the largest from contributing countries, and the US
pledged $5 billion. By this time, IMF resources were largely depleted, raising concerns about how it would deal with subsequent crises that seemed likely to emerge in Asia or elsewhere. Yet the US Congress, where the IMF faced considerable opposition (for very different reasons than in Asia) would not appropriate (until October 1998) the funds to replenish IMF resources ($17.9 billion in new funds, a 45 percent increase in the US quota at the IMF).

It was in these circumstances that Japan, at a September 1997 meeting of G7 finance ministers in Hong Kong, took an uncharacteristically ambitious and bold leadership initiative. The Japanese Finance Minister, Hiroshi Mitsuzuka, proposed creation of an Asian Monetary Fund, a standing institution with $100 billion capitalization to provide emergency financial assistance to Asian countries faced with instability like that which had hit Thailand, Indonesia, and South Korea. The idea had been vetted over several months in the region, where it apparently had received an enthusiastic reception. But the actual proposal in Hong Kong apparently caught US, European, and IMF officials off guard. It had not yet been thoroughly worked out, and not much detail was provided. Japanese officials emphasized that the AMF would have sufficient resources insofar as it could be funded by the ample international reserves of Japan and other surplus countries in the region, and, with resources already in hand, the AMF would be able to respond more promptly than the IMF. These features would serve to deter speculative attacks on currencies and, failing that, would be sufficient to repel them.

Japanese officials also stressed that the AMF was intended to complement the IMF rather than supplant it, that AMF funds would be additional to those provided by the IMF, and that AMF disbursements would be contingent on IMF approval. Therein lay a critical ambiguity: how would AMF funds be disbursed without delay if the IMF had not yet had time to formulate and negotiate the terms of conditionality with the recipient? And, other reports seem to indicate that the AMF was either not intended to require conditionality at all or to impose a much softer version.  

At Hong Kong and in the several months that followed, US officials,
especially from the Treasury Department, along with European and IMF officials, argued against creation of an AMF on several grounds. First, they contended that the 45 percent increase in quotas would provide the IMF with sufficient resources, so the AMF was unnecessary. Second, steps were taken in November to create a new financing "window" that would permit a more expeditious IMF response to crises. Third, and most vehemently, it was argued that an AMF would undermine the authority of the IMF, particularly by reducing its leverage to compel reforms by means of conditionality. Access to AMF funds with no or weak conditionality that enabled recipients to bypass IMF conditionality would of course be seen as a plus from the standpoint of recipients and by those Japanese officials who thought it important to defend the developmental state model. But western opponents viewed the AMF as enabling potential recipients to avoid undertaking the reforms necessary to restore financial stability.41 Furthermore, the IMF itself had been heavily criticized (in the US Congress and in other quarters) for creating "moral hazard," that is, encouraging risky, irresponsible financial behavior by leading countries, as well as banks and investors, to believe they would be bailed out. Steps taken to minimize this problem would not be effective if there was a choice of conditionality programs available to recipients. Lax or no conditionality would only worsen the moral hazard problem.

Finally, it was widely inferred that US opposition to the AMF stemmed from its unwillingness to see the IMF, in which its influence borders on dominance, diminished by creation of a new institution that would be dominated by Japan. By some accounts, this motivation was intensified by the way the Clinton administration's problematic relations with the Republican-controlled Congress, as in the case of fast track authority, undercut US leadership and increased reliance on the IMF as an instrument of US policy: "With the White House increasingly constrained by Congress from committing significant financial resources to international initiatives, Washington has been forced to use the IMF as a primary mechanism for exercising US influence on world monetary affairs" (Altbach, 1997a: 9).

In the face of stiff opposition from the US and the IMF, other Asian
countries and Japan itself began to back away from the AMF proposal and to reaffirm the centrality of the IMF. At a November 1997 meeting in Manila of finance ministers and central bankers from 15 Asia-Pacific countries the AMF proposal was dropped and agreement was reached on what was termed the Manila Framework. The Framework, which was "strongly endorsed" shortly thereafter by APEC at its Vancouver meeting, called for establishing a mechanism for regional financial surveillance to be conducted from the IMF's Tokyo office; cooperative measures to strengthen domestic financial systems and regulatory mechanisms; steps to enhance the IMF's ability to respond quickly to crises; and a cooperative financing mechanism to supplement IMF resources. The latter was scaled down considerably from the AMF ($20 rather than $100 billion) and would take the form of a stand-by arrangement rather than a standing institution, i.e., members would pre-commit resources that could then later be drawn on an as needed basis. These resources could only be disbursed after an IMF program with conditionality had been negotiated, and would be additional to those provided by the IMF package. In short, the new facility sketched at Manila was to be entirely subordinated to the IMF.

Japan's readiness to forsake the AMF proposal was partly attributable to the magnitude of its own financial and banking problems. First, the scale of the resources that would be required to launch and operate a Japan-led AMF likely loomed large, perhaps a serious over-commitment in light of the huge amounts of resources that would be needed to right its domestic financial system. Second, the depth and persistence of its domestic financial problems undermined the intellectual credentials and status as model or exemplar that would be needed were Japan to wage a successful diplomatic battle to establish an AMF along the lines originally proposed. And, once Japanese advocacy of its proposal weakened, Asian developing countries that had strongly supported the AMF were not willing to risk offending the US and the IMF at a time when their economies were either in or teetering on the brink of economic crisis.

Altbach (1997a: 12) concludes that an "important lesson that can be drawn from the outcome of the debate over the Asian Monetary Fund is
that the decline of US power and influence in Asia has been greatly exaggerated." This conclusion, however, is in need of qualification: US power was effective in blocking CA proposed by Japan but, as evidenced in the APEC case, it no longer seems able to deploy its power positively to design and put into effect widely beneficial CA.

Conclusion

If a post-hegemonic US could no longer muster sufficient structural power to push through its liberalization agenda in APEC, it retained enough to block Japan's proposal for a new regional institution, the AMF. Likewise, Japan was unable to overcome US and IMF resistance to its AMF initiative, but it was able to bring to bear sufficient structural power to block US efforts to transform APEC into a forum for negotiating trade and investment liberalization. How can we account for the resort to blocking power by Japan and the United States, and what inferences can be drawn from these prominent cases about the likely future of international leadership in a post-hegemonic, post-Cold-War era?

The exercise of blocking power stemmed in both instances from divergent national interests with respect to the shape and purpose of CA in the Asia-Pacific region. Or, it is probably more accurate to say that in the post-Cold-War era mutual adjustment of interests in order to reach coordinated solutions to CA problems was no longer perceived as an imperative by either country. US and Japanese interests were never entirely harmonious (except perhaps early in the post-World-War-II period, and then only episodically), but the security exigencies of the Cold War placed a premium on subordinating parochial interests to ensure cooperative solutions. Absent such motivation to suppress conflicts of interest, the cooperative basis of the relationship—and thus also the political foundations for any sort of shared leadership—has deteriorated.

The United States operates on narrow margins in its efforts to play a leadership role in promoting liberalization in the Asia-Pacific region. As
US officials repeatedly emphasized in the context of the APEC liberalization process. American markets are, with a few glaring exceptions, already among the most open in the world. Several implications follow. First, the US has little to offer as inducements for others to expand access to their less open markets, so any sort of multilateral liberalization negotiations will of necessity be asymmetrical, with the US demanding more by way of concessions than it is able to reciprocate. Second, this lack of bargaining leverage in multilateral settings has resulted in frequent US resort to unilateral means to pry open others’ markets, not least in Asia. Herein lies a difficult dilemma, since it is the US’s unilateral tendencies that have made others loathe to enter binding liberalization commitments for fear that they will face unilateral enforcement if the US—as self-appointed judge, prosecutor, and jury—determines their trade policies are “unfair.” Indeed, as Kahler (2000: 568) argues: “For APEC to pursue a more legalized future, the United States would need to credibly commit to ending ‘aggressive unilateralism.’” In sum, its huge, affluent market provides the US with a significant source of structural power. But given the relatively open status of its markets, the main way for the US to exercise that structural power—by unilaterally restricting access—undermines the legitimacy of its leadership.

Also undermining the legitimacy of US leadership has been the transparently self-interested character of the proposals it has pushed, notably the Information Technology Agreement and parts of the EVSL; those sectors (e.g., textiles) and practices (use of anti-dumping laws) that the US has kept off the agenda at APEC (and WTO); and the meager contents of the IAPs submitted by the US. Indeed, the reaction of Asian developing countries to the ITA proposal at Manila, and at other junctures in APEC’s ill-fated liberalization process, suggests that they did not expect that the CA the US was proposing would yield a distributive outcome that could properly be termed a regional or global public good.

Japan likewise offered scant little to APEC’s liberalization process: mostly recycled tariff cuts that had already been pledged in other fora and for products in which tariffs were already low. It should hardly be surpris-
ing then, as Johnstone (1997) observed, that “If the United States and Japan are unwilling to take the lead in bringing down their remaining tariff and nontariff impediments, APEC’s other member countries—which in many cases are far more protected—will have little incentive to go forward themselves.” This indeed was the outcome, one which, as argued earlier, reflected Japan’s preferences. How then should Japan’s role in blocking APEC trade and investment liberalization be evaluated from a leadership standpoint?

From one perspective, if some (or perhaps many) other Asian countries preferred a loose, non-binding, consensual APEC focused on development cooperation, and thus were reluctant to commit to formal liberalization under APEC auspices, should not Japan’s deployment of structural power to block this result be considered a form of leadership? As Yoshihiro Sakamoto (1995), MITI Vice Minister of International Affairs, put it prior to the Osaka meeting, “Japan should keep step with the rest of Asia by agreeing only to those US proposals that are acceptable to the whole of Asia.” But this approach reduces leadership to simply seeking the lowest common denominator, and virtually ensures that meaningful CA will not be forthcoming. Leadership instead involves inducing others to undertake CA that stands to serve their long-term interests but that, usually for shorter-term political reasons, they otherwise would decline.\(^{43}\)

From another perspective, the expressed preference for loose, non-binding arrangements, while certainly deriving in part from Asian culture and identity, can also be interpreted as a strategic choice. As Acharya (1997: 342-343) warns:

the risk that the ‘Asia-Pacific way’ could legitimize the inability of the regional actors to push collective goals ahead of individual self-interest should be recognized and avoided. It could become counter-productive if it legitimizes the failure of states to rise above their national interests, and encourages them to adopt a minimalist and conservative approach to cooperation. A great deal of what passes for the ‘ASEAN way’ or the ‘Asia-Pacific way’ is simply a pragmatic and practical response to situations in which multilateralism is being constrained by individual state interests.
And, multilateralism can be more decisively constrained, let us say blocked, by the interests of a state, such as Japan, that wields substantial structural power and is determined to use it to defend narrow national interests.

The AMF proposal represented an attempt by Japan to apply its structural power in a more positive fashion, although it fell short in terms of providing the entrepreneurial leadership needed to gain adequate support. First, the fact that the proposal's announcement in September 1997 surprised the United States, the IMF, and its European supporters contributed to their negative reaction. Second, in its original, poorly articulated form it was certain to provoke opposition on grounds that it would undermine the IMF by providing Asian countries with an alternative requiring weak or no conditionality. Nonetheless, the basic idea of an Asian facility that mobilizes the ample reserves of the region's economic powers for purposes of crisis prevention and financial stabilization continues to be regarded as sound by many within and outside the region. Calls for some form of AMF that is compatible with the IMF continue to resurface, and many regard eventual formation of such an institution as highly likely (Dieter and Higgott, 2000; Bergsten, 2000); some weaker forms of regional CA (currency swap arrangements) that can be considered as elements of a future AMF are already under way (Castellano, 2000). In sum, Japan should be credited for putting forth an ambitious leadership initiative which, while not immediately successful, launched a regional dialogue on feasible forms of CA in the financial and monetary areas that will likely bear fruit sooner or later.

For its part, the United States contributed little to resolution of the Asian financial crisis, with the significant exception of providing a market of last resort for the region's distressed exports. The US used the occasion of the crisis to insist on further liberalization, the importance of capital mobility, and the primacy of the IMF, none of which seemed compelling to the region's afflicted countries. As Zakaria (1998: 80) points out: "Washington has insisted on keeping tight control of the international response to the global economic crisis-while offering very little by way of
Neither the APEC nor the AMF case need have been so dominated by acrimonious efforts by Japan and the US to thwart each other’s leadership initiatives. The point is not that any and all CA proposals are worthy of implementation. Indeed, both the United States’s and Japan’s initiatives were flawed in ways described earlier. But could not these flaws have been ironed out, the proposals improved and made more widely acceptable, and US-Japan differences over them reduced through a process of prior consultation and coordination? Such a process, which would be the stuff of shared leadership, does not seem too much to expect. Instead, as an unnamed US official lamented in the wake of the 1998 Kuala Lumpur APEC meeting, “We behave like two people busy punching holes in the bottom of a boat we are both in” (cited in Hoagland, 1998). If Gilpin (2000: 3) is correct in his assertion that the “international capitalist system could not possibly survive without strong and wise leadership,” the recent state of leadership in the Asia-Pacific region portends rough times ahead.

Notes

1. For a sampling of skeptical views, see also Richardson (1998), Bello (1998), and Castellano (1999).

2. Cf. Gilpin’s (2000: 3) assertion that leadership is a necessary condition: “The international capitalist system could not possibly survive without strong and wise leadership.” Keohane’s (1984) findings are relevant to both the APEC and AMF cases: strong leadership is important for the formation of new regimes, but is less so for the maintenance of already functioning ones.

3. In addition to this static emphasis on the distribution of capabilities, another meaning of leadership derives from consideration of the kind of changes in this distribution that we associate with arms races, technological development, or economic competitiveness. This meaning reduces to being “in the lead” or “winning” some form of race or competition, e.g., “Prime Minister Yohiro Mori and his cabinet have set an ambitious goal for Japan: to surpass the United States within five years as the world leader in information technology and use of the Internet” (Choy, 2000). But this meaning is not related to the exercise of leader-
ship in the sense of solving CA problems or providing GPG. Another, somewhat similar meaning is "Stackelberg leadership," which refers to the advantages accruing to the actor who puts forth her initiative first, thus "beating others to the punch," so to speak. This connotation is similar to what is meant by first mover advantages, i.e., those advantages accruing to the firm which is the first to market with a new product or product standard.

4. For this argument and a US-Japan comparison, see Cowhey (1993).

5. See also Ikenberry's (1996) specification of structural, institutional, and situational leadership. The latter is quite similar to what Young means by entrepreneurial leadership, while institutional leadership, "refers to the rules and practices that states agree to that set in place principles and procedures that guide their relations" (1996: 391). Rix (1993) has developed the notion of "leadership from behind" to describe what he sees as Japan's distinctive style of leadership—low-key, behind the scenes, consensus building rather than bold initiatives and overt exercises of structural power—and which he likens to Young's concept of entrepreneurial leadership. Drifte's (1996) "stealth leadership" is quite similar.

6. Young argues that at least two forms of leadership are necessary (though not necessarily sufficient) and that any two will do, but it seems reasonable to specify further that one of these two be structural leadership. Minimally, we would expect the probability of successful leadership to be higher when structural leadership is in the mix. For a fuller discussion, see Rapkin (1995: 106-109).

7. For a survey of suspicions in Southeast Asia about the legitimacy of US leadership efforts in APEC, see Nesadurai (1996); for discussions of the various obstacles to the legitimacy of Japan's leadership, see Rapkin (1990), Cowhey (1992) and Hellmann (1997).

8. For a fuller conceptual discussion of shared leadership and what would be required for its exercise, see Rapkin and Strand (1997).

9. This common-sense observation of the importance of convergent preferences is often overlooked in accounts of CA failures, which have often focused on the size of the group considering CA, arguing that problems of enforcement and distribution increase as the number of member increases. Haggard (1997) instead emphasizes the group's preference structure, arguing that size is important insofar as the larger the number of participants, the higher the probability that their preferences will diverge. Cowhey's (1995: 206) similar emphasis in an Asia-Pacific context anticipated the course of APEC trade negotiations in the last half of the 1990s: "Japan and the United States have different preferences about dealing with trade issues in the Pacific. These result from different strategic bargaining positions and different domestic political institutions." For analysis of convergent and divergent US-Japan preferences in the Bretton Woods institutions, see Rapkin and Strand (1997).

10. For discussions of decision rules in the Bretton Woods institutions, see Rapkin and

12. The United States, Japan, and the Power to Block: The APEC and AMF Cases
11. Cf. Drifte (1996: 162): “The mere anticipation of any Japanese action can prevent other players from pursuing their national interests if they are seen as conflicting with Japan. ... Japan now matters so much that it does not actually have to do something in order to effect an outcome which is beneficial to its national interest.”

12. In the area of human rights, the US has opposed the creation of an International Criminal Court, as well as the Convention on the Rights of the Child (the efficacy of the former, but probably not the latter, is significantly reduced by the lack of US participation). A similar pattern is found on various arms control issues: the US Senate has voted to not ratify the Comprehensive Test Ban Treaty, and the US opposed the treaty banning the production and use of land mines. Nor has the US approved the Chemical Weapons Convention, thereby weakening inspection safeguards; and it is lagging in commitments to tighten controls on biological weapons. There is also a wide range of environmental issues on which the United States has either tried to block or weaken proposed CA, including, in addition to the climate change example mentioned earlier, biodiversity, desertification, and regulation of trade in genetically modified food products.


14. See also Kahler’s (2000: 562) point about how this reluctance is reinforced by US unilateralism: “Governments may reject binding and precise obligations in a setting that requires bargaining with a government (the United States) that not only has greater economic and legal capabilities but also has demonstrated an attachment to unilateral enforcement.”

15. For a similar line of argument, see Doner (1997: 201-202), who contends that Japan’s private and public networks across East Asia have substituted for formalized regional trading arrangements by solving one type of CA dilemma, “coordination” problems.

16. The value dimension of course also arises in the context of trade and investment liberalization. Consider, for example, the US Government’s 1997 “Trade Policy Agenda,” which asserts that “trade is the tool by which we can project America’s core values globally” (cited in Bullard, 1997).

17. Concern with potential Japanese dominance of the region has most often arisen in connection with the “cap-in-the-bottle” function attributed of the US-Japan security alliance, i.e., the role of the alliance in preventing the possible remilitarization of Japan.

18. For instance, in addition to the three fundamental objectives discussed above, Baker (1998: 169-171) presents more APEC-specific objectives, several of which are or have been shared by the US and Japan: building a stable regional order, spurring the completion of the Uruguay Round of GATT negotiations, and developing mechanisms to resolve...
US-Japan economic disputes.

19. There was no apparent support, however, for a vague US proposal for an eventual Pacific Free Trade Area.

20. For discussions of Malaysia’s, as well as China’s, reservations, and an account of other members’ reactions, see Funabashi (1995: 92) and McBeth and Kulkarni (1994).


22. The discussion below of these disputes draws on the accounts of Johnstone (1995, 1995a) and Funabashi (1995).

23. In a comment that resonates with the earlier conceptual discussion of leadership and CA, US Ambassador to APEC Sandra Kristoff complained that “...the ‘C’ and the ‘A’ of CUA are not convincing, leaving only the ‘U.’ The US doesn’t see much value in the ‘U’ alone” (cited in Funabashi, 1995: 96).

24. As used in an APEC context, “collective actions” on trade and investment facilitation (for example, harmonization of customs procedures) approximates a specific kind of CA problem: coordination. Collective actions (again as used in the APEC lexicon) on trade and investment liberalization (what was rejected in the course of the year leading up to the Osaka summit) represent a different type of CA problem: collaboration. The latter, because it requires mutual policy adjustment, stronger forms of institutionalization, and enforcement mechanisms, is generally thought to be more demanding and harder to solve than the former.

25. For an excellent treatment of these and other aspects of what is termed the “ASEAN way” or “Asia Pacific way”—including voluntarism, consensual decision-making, and aversion to formal, legalistic processes and institutions—see Acharya (1997). Kahler (2000) argues that the aversion to “legalization” in APEC represents a strategic choice rather than shared cultural proclivities.

26. Fast track negotiating authority enables the executive branch to negotiate trade liberalization agreements and then have them voted up or down as a package (rather than item-by-item) by Congress. Absent fast track authority, the US government is not able to offer much by way of concessions and foreign governments are understandably reluctant to concede to US demands.

27. Other contentious issues were finessed at Osaka, notably the definition of “open regionalism” and the associated question of whether APEC trade liberalization should be extended to non-members without requiring reciprocal concessions, as advocated by Japan. The US opposed such an arrangement on grounds that European and other countries would be able to “free ride” on the often politically costly liberalization efforts of APEC members.
The Osaka Action Agenda did not attempt to settle this issue, instead leaving it for future resolution.

28. In fact, there were concerns that some countries' (e.g., Indonesia) tariff cuts had been offset by nontariff barriers instituted since Osaka. The importance, especially from an American standpoint, of tackling the problem of nontariff barriers is well expressed by Flamm and Lincoln (1997: 3): “In some Asian countries, protectionist government policies have historically been opaque, informal, and often officially deniable. Such policies were an effective means of abiding by the formality of binding tariff, quota, and subsidy concessions while protecting or promoting domestic industries and firms. APEC has been able to move beyond the traditional focus of the WTO on tariffs, quotas, and subsidies, and put some of the new issues on its agenda. But little serious discussion or negotiation has occurred yet in these areas. As long as Japan, South Korea, China, and others believe that the government should play a broad and active role in favoring the home team at the micro-economic level, these countries will continue to resort to problematic informal or invisible barriers. Political support for a unilateral dismantling of remaining trade barriers in the United States will not be forthcoming unless these issues are addressed.”

29. For example, US tariffs on semiconductors (0%), computers (1.9%), and telecommunications products (5%) were typically a small fraction of the double-digit rates among APEC's Asian developing countries (see Lachica, 1996).

30. Concerns about nontariff barriers also arose in the ITA context, specifically that the tariff cuts agreed to would be offset by newly instituted nontariff barriers in countries keen on protecting infant IT industries.

31. The “early” in EVSL is in relation to the Bogor target dates of 2010 and 2020.


33. By some accounts, Japan’s adamant refusal to liberalize was not so much in response to immediate domestic political pressures as it was part of a longer-term, rearguard strategy to avoid rice market liberalization. According to an un-named Japanese government source: “The ministry [of Agriculture, Forestry and Fisheries] is firmly resolved to protect the rice market at any cost. Therefore, it wants to delay any concessions on the fish, forest, and some other non-rice agricultural products until the new round of WTO negotiations begins, in hopes of heading off pressure over the rice issue in exchange for those concessions” (cited in Masaki, 1998).

34. Shigeo Matsutomi, Director of the APEC Division, Ministry of Foreign Affairs, cited in Yeoh (1998).

35. Reflecting other dimensions of the crisis, it has also been termed a “debt” or a
"currency" crisis. Once under way, it widened into what others termed a "development" crisis or a full-fledged "economic" crisis.

36. Wade and Veneroso's (1998: 10) summary of the IMF's conditionality for Korea is highly instructive: "It requires major financial restructuring to make the financial system operate like a western one, though without actually saying so, including closing down or recapitalizing troubled financial institutions; letting foreign financial institutions freely buy up domestic ones; requiring banks to follow western ('Basle') prudential standards; requiring 'international' (read 'western') accounting standards to be followed and international accounting firms to be used for the auditing of financial institutions. It requires the government to undertake not to intervene in the lending decisions of commercial banks, and to eliminate all government-directed lending; and to give up measures to assist individual corporations avoid bankruptcy, including subsidized credit and tax privileges... The Fund also requires wider opening of Korea's capital account, to enable even freer inflow and outflow of capital, both portfolio capital and direct investment. All restrictions on foreign borrowing by corporations are to be eliminated. The trade regime, too, will be further liberalized, to remove trade-related subsidies and restrictive import licensing. Labor market institutions and legislation will be reformed 'to facilitate redeployment of labor.'"

37. Bhagwati (1998) introduced the phrase "Wall Street-Treasury complex" to refer to the interests represented by a kind of "power elite" network that presses incessantly for capital market mobility so as to open other countries to highly competitive American firms in the financial sector. Wade and Veneroso (1998) extend the phrase to "Wall Street-Treasury-IMF complex" to encompass also the international institutional component of this network. Note that US efforts to promote capital market liberalization are analogous to its efforts (by means of APEC and the WTO) to promote liberalization of IT, another sector in which American firms have a strong competitive position. Bhagwati, an economist known for his strong support for free trade) makes a strong argument that the salutary effects that follow from trade liberalization do not necessarily accompany capital market liberalization.

38. The US decision not to contribute to the Thai bailout package contrasted with its expeditious and decisive steps to put together a $50 billion bailout of Mexico in 1995. It also created the impression that the US was indifferent to Asia's problems. The Clinton administration was constrained by the fact that the Republican-controlled Congress had passed a law restricting the President's use of the Exchange Stabilization Fund that had been accessed for the Mexican bailout. Nonetheless, US leadership was off to a poor start in coping with the emerging Asian crisis. For an informative survey of how the United States's non-participation in the Thai bailout, as well as its general response in the early stages of the crisis, was perceived in Thailand and elsewhere in Southeast Asia, see Vatikiotis (1997).
Vatikiotis quotes an unnamed senior Thai diplomat as saying that the “American attitude is driving us closer to Japan and China,” an assertion that is certainly consistent with the fate of the EVSL initiative in APEC over the course of the next year.

39. Restrictions on use of the Exchange Stabilization Fund expired in the time between the Thai and Indonesian bailouts.

40. The idea of an AMF is attributed to Eisuke Sakakibara, who was then Vice Minister of Finance for International Affairs and who had presented the concept in various Asian capitals. Sakakibara is noted for his staunch opposition to the kind of neoliberal economic orthodoxy associated with the IMF and US Treasury, and for his strident defense of directed credit, capital controls, resistance to deregulation, and other aspects of Japan’s developmental state model. It was precisely these aspects of Asian political economies that were targeted by IMF conditionality, and that led to perceptions that the IMF and the US were using the East Asian economic crisis to try to “roll back” the Japanese model. For this interpretation, see Altbach (1997a: 5-6), Cumings (1999), and Hughes (2000). In Higgott’s terms, “the Asian crisis is a contest of ideology between Asian and Anglo-American ways of organizing capitalist production.”

41. A cautionary case in point involved Indonesia, which received a pledge of $10 billion in aid from Singapore and another $1 billion from Malaysia, while it was negotiating the terms of conditionality with the IMF. The Indonesian leader Suharto declared that he needed only expertise, but not money, from the IMF (Vatikiotis, 1997).

42. The Clinton administration’s lack of fast-track negotiating authority clearly exacerbated this problem.

43. Consider, for example, how many of the original members of GATT would have undertaken trade liberalization if left entirely to their own devices and without the stimulus provided by US leadership.

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The recent proliferation of proposals for preferential trade agreements (PTAs) involving one or more countries from the Western Pacific Rim marks a dramatic departure in these countries' commercial diplomacy. Throughout the postwar period, they had previously been strong adherents to multilateralism in trade negotiations. Beyond the negotiated commitments they undertook in the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), they had preferred to reduce their trade barriers on a unilateral and non-discriminatory basis. Even those countries that were parties to regional preferential agreements—ASEAN countries through their commitment to complete an ASEAN Free Trade Area, and Australia and New Zealand through their Closer Economic Relations Trade Agreement—continued to place primary emphasis on global forums in their commercial diplomacy.

Since 1998, more than 30 preferential arrangements involving Western Pacific economies have been proposed or are under negotiation, or have been agreed and are being implemented. For the first time, the world's second- and third-largest economies, Japan and China, have either signed or are negotiating PTAs. The agreements will have significance, therefore, not just for the participants and for regional non-participants alike, but also for the multilateral trading system as a whole.
In this paper, I explore three major questions: what is the likely impact of the new PTAs on the economies of participants and on those of non-participants; what is the likely effect of the PTAs on the domestic political economies of the participants; and what is the likely impact of the PTAs on trade liberalization efforts in regional and global forums?

The Impact of the New Bilateralism on Participants' Economics

A striking characteristic of the new preferential arrangements is that they frequently involve countries that are relatively insignificant trading partners for one another. (Table 15 lists the share of proposed partners in the total exports of various Western Pacific Rim countries.) It is axiomatic that, in normal circumstances in a globalized economy, only large economies will provide major export markets: of the three largest economies in the Asia-Pacific region, Japan has to date signed only one PTA (with Singapore), China has signed none, while the efforts of the US government to negotiate preferential agreements were stymied until the Bush administration was granted fast track authority (which it terms "Trade Promotion Authority") by Congress at the beginning of August 2002.

Many of the proposed PTAs involve countries that account for less than 5 percent of one another's exports: close to one-third of the proposals involve parties that constitute markets for less than 1 percent of each other's total exports. Given that the overall context in which the agreements have been negotiated is one of generally low tariffs, the preferential margins they create, the aggregate benefits they confer, and their impact on both levels of trade and the welfare of participants would be expected to be slight as an eyeballing of Table 15 suggests.

A more sophisticated study of the economic effects of trade agreements requires the application of sophisticated economic modeling. In attempting to estimate the effects of PTAs, a computable general equilibrium (CGE) approach is generally utilized. Models are only as good as the conjectures on which they rest. In attempting to estimate the effects of PTAs, these
Table 15. Percentage Share of PTA Partners in Total Exports of Select Countries, 2000

<table>
<thead>
<tr>
<th>Country</th>
<th>Partner</th>
<th>Percentage of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Korea</td>
<td>7.9</td>
</tr>
<tr>
<td></td>
<td>Singapore</td>
<td>5.6</td>
</tr>
<tr>
<td></td>
<td>Thailand</td>
<td>1.9</td>
</tr>
<tr>
<td></td>
<td>USA</td>
<td>10.3</td>
</tr>
<tr>
<td>Japan</td>
<td>Canada</td>
<td>1.7</td>
</tr>
<tr>
<td></td>
<td>Chile</td>
<td>0.2</td>
</tr>
<tr>
<td></td>
<td>Korea</td>
<td>6.9</td>
</tr>
<tr>
<td></td>
<td>Mexico</td>
<td>1.2</td>
</tr>
<tr>
<td></td>
<td>Singapore</td>
<td>4.7</td>
</tr>
<tr>
<td></td>
<td>Thailand</td>
<td>1.2</td>
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<td>Korea</td>
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<tr>
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<td>Chile</td>
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<td></td>
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<td></td>
<td>Mexico</td>
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<td></td>
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<td></td>
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<tr>
<td></td>
<td>Korea</td>
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<td></td>
<td>Singapore</td>
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<tr>
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<td>Thailand</td>
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<td></td>
<td>USA</td>
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<tr>
<td>Singapore</td>
<td>Australia</td>
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<td></td>
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<td>USA</td>
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<tr>
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<td>Japan</td>
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<td></td>
<td>Korea</td>
<td>1.9</td>
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<tr>
<td></td>
<td>New Zealand</td>
<td>0.3</td>
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</tbody>
</table>

Source: Calculated from IMF, *Direction of Trade* data.
Note: Figures in *italics* for agreements already signed.
are often controversial, for instance, the assumptions made about the competitive structure of economic sectors, and about how consumers will respond to changes in the relative prices of goods after trade liberalization. Models usually rely on the idea that liberalization will be "clean," that is, that governments will not replace tariffs with other barriers. Furthermore, CGE models often fail to capture the dynamic effects that regional collaboration may set in train, for example, through stimulating inflows of foreign direct investment.

Alternative models, for instance of the effects of a free trade agreement between Japan and Korea, have produced substantially different estimates. Some studies have suggested that a free trade agreement will have a negative impact on Korean welfare. The variance in results, depending upon the parameters used, means that results from CGE modeling must be interpreted with caution. Nonetheless, on one matter there is a clear-cut consensus in the econometric work: the new PTAs will not deliver substantial economic benefits. Such conclusions are obvious in the instance of countries with few trading links (e.g., between Korea and Chile). They are also straightforward for trade partnerships that are of greater magnitude but are not currently characterized by significant tariff or other border barriers. For instance, even though Singapore accounts for more than 5 percent of Australia's total exports, the recently signed free trade agreement between the two countries is expected to generate an increase in Australian exports of a mere US$37 million, equivalent to less than 0.06% of current total exports. And Singaporean exporters will benefit from reductions in customs duties totaling a mere $1 million per year as a result of the free trade agreement between the island state and the European Free Trade Association (EFTA).

Perhaps more surprising is the modest magnitude of the benefits anticipated from preferential agreements concluded with the world's largest economy, the United States. A study by the US International Trade Commission of the proposed Korea-US FTA concluded that it would provide a one-off increase of Korean GDP of 0.7 percent, still a relatively small figure in the context of the annual average growth rates the Korean
economy has achieved in the last four decades.\(^5\)

Many economists have long contended that CGE models do not capture the full benefits of trade liberalization whereas skeptics of the mainstream pre-occupation with trade liberalization believe that the problem lies not so much with the models but with the profession’s faith in liberalization.\(^6\) Although it will be sensible to maintain an open mind on the potential effects of the new preferential agreements on the economies of participants, it is difficult currently to see them as much more than banal.

**The Impact of the New Bilateralism on Nonparticipants**

The comforting counterpart for non-participants from projections that the proposed PTAs will generate few significant gains for signatories is that they themselves will suffer at worse only small losses from these agreements. The various econometric studies suggest that the aggregate welfare losses the proposed PTAs involving Western Asia-Pacific countries would impose on the rest of the world will be minimal.\(^7\)

Such complacent conclusions, however, may hide more significant losses for individual countries and/or industrial sectors. In multilateral trade negotiations (MTNs), less developed economies have been able to some extent to free ride on the agreements between the big players, the “principal suppliers” in GATT/WTO terminology. Their exports have benefited from these agreements courtesy of the most-favored-nation provision. To be sure, LDCs have consistently complained that many exports of most interest to them have not featured in MTNs to the extent of those produced primarily by industrialized economies, simply because of the latter’s lack of interest in promoting liberalization of trade in these products.

In the rush to bilateralism, however, the weaker economies may miss out altogether, for the reasons discussed above. The current distribution of proposed agreements and those under negotiation among Western Pacific countries is markedly uneven. The poorest countries in the region—

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Indonesia, Cambodia, Laos, and Myanmar—do not figure in any of the proposals for bilateral agreements. To be a participant requires at least three attributes: (1) you must have something to offer potential partners; (2) you must have the bureaucratic capacity to pursue often complicated negotiations (especially on rules of origin); (3) you must have a political system that convinces others of the credibility of any commitments you make. Few of the poorest countries meet these criteria and, in any event, are generally disinclined to offer the concessions that advanced industrialized countries currently seek (including, in some instances, clauses relating to labor conditions). Although less developed countries frequently benefit from other preferential arrangements, such as generalized systems of preferences, the coverage provided by such schemes is often even more selective than that of the new PTAs.

While tariffs worldwide have come down in the last fifteen years, islands of significant protection remain. And some East Asian countries maintain relatively high levels of tariffs: the Japanese government estimates the unweighted tariff rates for China to be 10%, for Malaysia 14.5%, for South Korea 16.1%, for the Philippines 25.6%, and for Indonesia 37.5%.

A study undertaken by the economist William James for the US Agency for International Development notes, for instance, that if Korea signs preferential trade agreements with partners such as Mexico, Japan, or Thailand, textile exporters in Indonesia would be placed at a competitive disadvantage because they will face tariffs of 15 to 18 percent.

Many of the new preferential agreements go beyond tariffs to include measures relating to “deeper integration” in, for example, fields such as investment and competition policy. Such measures may again discriminate against the interests of non-participants. And instances have occurred where countries have given exemptions to their PTA partners when they implement trade-restricting measures, for instance, Mexico’s exemption of goods from Canada and the US when it raised tariffs following the peso crisis of 1994, and a similar exemption by the US of its NAFTA partners from its recent restrictions on steel imports.
For weaker countries, the great advantage of rules-based multilateralism is that it reduces the significance of power in international economic relations. And the most-favored-nation principle largely removes political considerations from the granting of tariff concessions among WTO members. Bilateralism, however, potentially brings power asymmetries back to center stage. Weaker parties may perceive themselves obliged to accept an unequal agreement, as appears to have happened to Singapore in its economic partnership agreement with Japan.

Political factors can also enter the equation in the choice of partners. Some countries face the risk of exclusion from the new arrangements because of such considerations. In the Western Pacific, Taiwan is the most obvious example. Not only has Taiwan been excluded from the ASEAN Plus Three dialogue but also Beijing has warned other governments against negotiating bilateral trade agreements with Taipei. Japan, for one, appears to have taken heed. In discussing potential partners with which PTAs might be concluded, the Ministry of Foreign Affairs identifies Taiwan as one of the few countries/regions (the EU and the US are others) with which a free trade area should not be pursued.

Taiwan is a separate customs territory under the WTO Agreement, and while the possibility of concluding an FTA with a WTO member is theoretically and technically a potential subject for consideration, Taiwan’s tariff rates are already low, so tariff reductions achieved through an FTA would not produce major benefits for both sides. It would be more appropriate to consider strengthening economic relations in specific areas.

Of course, the argument that few benefits from an FTA will be realized when tariffs are low, applied *a fortiori* for Japan’s exports to Singapore, the country with which it chose to conclude its first preferential trade agreement. Save for those countries likely to be completely excluded from the move to preferential trade and for those individual sectors where non-preferred exporters continue to face high barriers, for both of whom the new PTAs are undoubtedly “bad”, the verdict on the overall welfare effects of the new PTAs is once again “banal.”

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13. The Political Economy of the New Asia-Pacific Bilateralism: Benign, Banal, or Simply Bad?
The Effects of the PTAs on the Political Economies of Participants

The failure of the global economy to fragment into three warring blocs, as predicted by some of the more apocalyptic studies of the new regionality in the early 1990s, has led many commentators to take a relaxed view about the move to preferential trade that has occurred since the end of the Cold War, and about the likely impact it will have on the prospects for further liberalization at the global level. Recent modeling by economists, however, suggests a number of reasons why the new wave of preferential trade agreements may have a negative impact on the balance of pro- and anti-liberalization forces in parties to the agreements, and more broadly on the prospects for global trade liberalization.

Freund argues that the welfare gain from joining a PTA is greater than the gain from a move to global free trade when tariffs are low. Market share gains from preferential agreements can dominate the loss in competition to such a degree that states prefer them to global free trade. The redistributive effects of the agreements make preferential reductions more beneficial to participants than are multilateral initiatives at low tariff levels. Grossman and Helpman demonstrate that the prospects for reaching a preferential trade agreement improve when governments have the option to exclude politically sensitive industries. Governments therefore may choose agreements that provide for partial liberalization because these face fewer domestic political obstacles than treaties (such as plurilateral or global agreements) that generate more trade creation. Levy shows that if bilateral agreements provide disproportionately large gains to key agents then they will undermine political support for further multilateral trade liberalization. And McClaren suggests that the sunk investments made by private agents in anticipation of the formation of regional agreements may reduce their support for multilateral liberalization.

The propositions of these studies stand in marked contrast to those of two of the most influential arguments on the new wave of PTAs. Baldwin,
in proposing a "domino" theory of regionalism, suggests that the effects of the new agreements on the domestic political economy will be benign because they will strengthen the position of exporters (by increasing their incomes) and will thereby also boost their incentives to lobby for further trade liberalization at both the regional and the multilateral levels. Meanwhile, import-competing interests will be weakened, both financially and politically.\(^\text{17}\) Similarly, Ethier has argued that the new agreements will promote liberalization because they provide a means, in an overall low tariff context, through which governments can make "credible commitments" to trade liberalization, thereby locking in domestic reforms, and increasing economies' prospects for attracting foreign investment.\(^\text{18}\)

These alternative propositions derived from economic models suggest several conclusions. The first is that much still remains to be resolved regarding the economic and political impacts of the new preferential trade agreements. Very important research questions remain unanswered. There is an urgent need to investigate whether what works in theory also works in practice. Second, the recent economic modeling points to the significance of the political in understanding the origins, evolution, and effects of the new preferential arrangements (an argument made persuasively by Mansfield and Milner in a major recent review article on regionalism).\(^\text{19}\)

**A Preliminary Assessment**

The conclusions of some of the new economic modeling that point to the potentially deleterious effects of preferential trade agreements on the domestic political economy equation are given additional weight by the current lack of specificity of the global trade regime regarding the conditions under which preferential trade agreements are deemed to be legitimate. These conditions are laid out in Article XXIV.8 of the GATT, which allows for closer integration of economies that choose to implement free trade areas or customs unions provided that the customs duties under the new agreement must not be higher or more restrictive than the individual countries had previously imposed, and the preferential agreement

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must eliminate duties and other restrictions on "substantially all the trade" between the participants.

These provisions have generated enormous controversy over the years. In particular, members have failed to reach agreement on defining and operationalizing the clause that refers to "substantially all trade." The WTO notes "there exists neither an agreed definition of the percentage of trade to be covered by a WTO-consistent agreement nor common criteria against which the exclusion of a particular sector from the agreement could be assessed."²⁰ The EU, a pioneer in negotiating PTAs, has argued that the Article XXIV.8 requirement has both a quantitative and a qualitative element, with at least 90 percent of the trade between parties being covered, and no major sector excluded.²¹ But other members have contested this interpretation, which in any event raises its own problems of definition: how is the 90 percent of trade to be measured (does it refer just to existing trade or that which might take place should restrictions be removed?), and how does one define a "major" sector?²²

The lack of agreement on Article XXIV.8 has stymied the work of the WTO's Committee on Regional Trade Agreements, created in February 1996 to examine preferential trade agreements and their implications for the multilateral trading system. Members have simply failed to determine whether or not the large number of PTAs notified to the Committee in the past seven years is fully compatible with the relevant rules. An agreed understanding of the interpretation of Article XXIV.8 is one of the items on the agenda for the current Doha Round of multilateral negotiations.

Meanwhile, member states have exploited the lack of specificity of Article XXIV.8 to reduce the domestic political costs of entering free trade agreements. Here the European Union has again led from the front. It set a precedent for excluding sensitive sectors from bilateral agreements by excluding most agricultural products from its PTAs with Mexico and South Africa. These precedents were seized upon by Keidanren, the Japan Federation of Economic Organizations, in its lobbying in favor of Japanese negotiation of PTAs. Whereas, the Federation argued, it was desirable "to liberalize as much trade as possible" in the agreements, the WTO require-
ment that they should cover “substantially all trade” among the participants provided an opening to omit “sensitive” items from the liberalization schedule, thereby minimizing the domestic political costs of the new regionalism: “as is evident looking at other FTAs, some items of the industry in question which simply cannot be liberalized because of the serious impact by the free trade agreement may result in being removed from the list.” The paper then cites the example of products exempted from tariff liberalization in the EU-Mexico FTA, noting “such examples should prove a useful reference in Japan’s considering FTAs.” And this is precisely what the Japanese government did in its negotiation of the JSEPA: the few products in the ultra-sensitive agricultural sector that Singapore exported to Japan, principally cut flowers and goldfish, were excluded from the liberalization provisions. Zero tariffs apply to less than 10 percent of the volume of exports of agricultural products from Singapore to Japan: the JSEPA created no new preferences in the agricultural sector.

Other Western Pacific Rim countries have quickly signaled that they intend to follow Japan’s precedent. The Korean government has subsequently indicated that it will not expose its agricultural sector to additional competition from Mexico and Chile by lowering barriers as part of preferential agreements. And the Taiwanese government is reported to have sought to exclude 800 products, mainly textiles and clothing, from its proposed free trade agreement with Singapore to protect its domestic textiles industry.

The ambiguities of Article XXIV.8 provide a means by which the circle can be squared: a pro-liberalization agreement that avoids imposing adjustment costs on the least efficient domestic sectors; liberalization without political pain. Such an approach essentially returns to the logic underlying APEC’s original *modus operandi*: that governments voluntarily and unilaterally should choose which sectors they wished to expose to international competition and not be forced by their partners to undertake liberalization that imposes domestic political costs.

While the immediate domestic political benefits to governments are obvious, the potential disadvantages are less transparent. These include direct
economic costs and potentially damaging consequences for the domestic political economy balance, especially in a deleterious effect on the pro-liberalization coalition. The direct economic costs include welfare losses for consumers, the creation of rents for producers in sectors that continue to receive protection, and the establishment of an incentive structure that will encourage the diversion of resources to the uncompetitive sector.

Because preferential trade agreements have a differential impact on domestic economic actors, providing economic rents for some and imposing higher costs on others, they have an impact on which actors will be willing to invest resources in lobbying in support of such agreements. They also affect the propensity of domestic actors to lobby for and against PTAs as opposed to other forms of trade liberalization. By strengthening the position of sectors excluded from liberalization, leaving them as isolated islands of protection in the overall trade landscape, the PTAs risk making the political task of tackling sensitive domestic sectors even more difficult: the producers have more resources to invest in lobbying that would otherwise have been the case, and have more confidence that an investment in such lobbying will bring the outcome they desire.

Moreover, bilateral negotiations reduce the external pressure, gaiatsu, that is brought to bear on governments to encourage them to deal with islands of protectionism. Whereas multilateral negotiations within the WTO maximize the coalition of external forces that line up against a government seeking to continue protection, in a bilateral agreement the opposition comes from just one government, which, especially in the case of the smaller partner, may have little leverage that it can utilize.

But what of the arguments of Baldwin that PTAs will benefit exporting interests and thereby provide them with both the means and the incentive to lobby for further liberalization? While this argument is intuitively plausible, so too is an alternative: that by providing exporters the access to foreign markets that they seek, PTAs may remove the incentive for exporting industries to push for further trade liberalization. The logic is similar to that which Aggarwal and Ravenhill identified for sectoral agreements. Given the relatively small markets that are involved in many of the PTAs...
currently under study or negotiation, such a scenario might seem unrealistic. But any significant extension of the bilateral arrangements will make it substantially less so. Consider Mexico, for example, which provides the current extreme outlier in terms of engaging in preferential trade. A pioneer in negotiating PTAs, Mexico is now party to 34 such agreements with partners that collectively account for more than 60 percent of global GDP. The incentive for Mexican exporters to expend resources in lobbying for global liberalization has been substantially reduced.

Are there forces that would counter these undesirable (or “bad”) trends? One is the realization by pro-liberalization ministries within governments that the negotiation of partial PTAs can have a damaging effect on their broader economic agendas. There is some evidence, for instance, that Japan's Ministry for Economy, Trade, and Industry has had increasing reservations about the desirability of PTAs if in each negotiation it is going to be routed by the Ministry of Agriculture, Forestry, and Fisheries (MAFF) on the domestic dimension of the two-level game.  

Foreign governments are a second source of counteraction. They can act to deter undesirable PTAs in two ways. One is to put pressure on countries that are contemplating entering into partial agreements—as the United States and Australia did in attempting to persuade Singapore not to agree to Japan’s demands to exclude agricultural products from the JSEPA. Their lack of success in this instance casts doubt on the effectiveness of such efforts, unless the governments attempting to apply pressure have significant carrots to offer to induce compliance.

A second way is the most direct: by refusing themselves to enter into partial agreements. This appeared to be the initial posture of the Australian and New Zealand governments in their assertions that negotiation of a preferential trade agreement with Japan would be premature, given the unwillingness of Tokyo to offer concessions on agricultural products. More recently, however, the Australian government has warmed to the idea of negotiating a form of economic partnership agreement with Japan, in which the governments would reach agreement on non-controversial issues while items of political sensitivity would be left to later (for which read

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"shelved"). Such an approach would be likely to split the exporting com-
unity in Australia and take manufacturers and services out of the lobby-
ing equation. The potential danger once again is of pursuing a strategy that
will substantially reduce pressure on Japan for the liberalization of domes-
tically sensitive sectors.\textsuperscript{27}

**PTAs and Liberalization at the Regional and Global Levels**

The issue that has dominated the extensive literature produced by econ-
omists on regionalism in the last decade is whether the new preferential
arrangements will be stepping stones or stumbling blocks in the path of
global trade liberalization.\textsuperscript{28} Some of the arguments raised by skeptics have
already been discussed: the idea that PTAs will have a negative economic
impact on non-participants (possibly prompting retaliation and economic
closure), and the possibility that they will adversely affect the balance be-
tween domestic pro- and anti-liberalization forces. In addition, a point dis-
cussed in more detail below, skeptics have argued that the negotiation of
preferential arrangements diverts the attention and resources of bureauc-
racies and governments away from liberalization at the broader regional or
the global level, sites where trade liberalization will bring larger welfare
gains.

Against these negative sentiments are arraigned a series of more positive
arguments about the new bilateralism. These point to:

\begin{itemize}
\item the likelihood that such agreements will be negotiated more easily and more speedily
than global trade agreements, especially now that the membership of the WTO is ap-
proaching 150 economies (and industrialized economies are heavily outnumbered).
\item the possibility for including provisions in bilateral agreements that go beyond the com-
mitments governments have previously made in the WTO. Bilateral agreements can
produce deeper economic integration and serve as testing grounds for collaboration that
can later be extended through global agreements.
\item the possibility that exporting interests will be strengthened by the new agreements.
Their incomes rise because of the new market access they enjoy; this, in turn, will pro-
vide them with both the means and the incentive to lobby governments for further
liberalization.
\end{itemize}
As Aggarwal has argued, parties to preferential agreements can choose between three alternatives in fashioning a relationship between the PTA and the global trade regime: they can either be nested within the global regime, created as a parallel arrangement, which establishes an institutional division of labor, or set up as an overlapping institution, that is, one whose functions compete in whole or part with those of other institutions. How do the new PTAs involving Western Pacific Rim states relate to the existing regional institutions and to the WTO?

Preferential trade agreements were considered at the start of the APEC process as a possible strategy for realizing its goals of trade liberalization. Fred Bergsten, the former chair of the APEC Eminent Persons Group (EPG) recounts how the use of preferential agreements was advocated by various leaders including the former Singaporean President, Lee Kwan Yew. Originally, the idea was for the arrangements that crystallized into NAFTA to be extended to other APEC members so that it would become an Asia-Pacific-wide preferential arrangement. These proposals failed to become reality both because of the unwillingness of the US Congress to extend preferential arrangements and because Western Pacific countries feared that a hub and spokes arrangement would be created to their disadvantage.

Concern on the part of APEC leaders—at how its ambitious targets for free trade in the region announced at its Bogor meeting in 1994 could be made compatible with preferential trade agreements—prompted a request to the EPG that it study the matter. The EPG gave detailed attention in its third report to this issue. It suggested that the following principles should be adopted: countries should undertake unilateral liberalization to the maximum possible extent (thereby minimizing any discrimination against APEC non-participants in the PTA); furthermore, countries should make a firm commitment to reducing barriers to APEC economies that are non-members of the SRTA as well as reducing such barriers within the SRTA itself; each SRTA should offer to extend the benefits of its SRTA liberalization to all other APEC members on a reciprocal basis; and there should be agreement that any individual SRTA member can unilaterally
extend its SRTA liberalization on an unconditional basis to all other APEC economies (and, under the rules of the WTO, to all other members of the WTO as well), or on a conditional basis to one or several other APEC economies.\footnote{In essence, the Eminent Persons Group called for the acceptance of a norm of what it termed “open sub-regionalism,” that is, a requirement that any preferential trade agreement should be made available to all other APEC members. Such a requirement was always a non-starter, for political if not for economic reasons. Governments enter into preferential arrangements for a variety of reasons, not all of which are economic, and would be unwilling to give up the discretion they enjoy to define “their” region by acceding to APEC principles of “open sub-regionalism.” Automatic entitlement to membership in the sub-regional arrangements was unrealistic: but what is notable about the recent rash of PTA agreements and proposals involving Western Pacific countries is that no mention is made of the possible extension of the agreements to other parties. Rather, when governments have announced their intention to negotiate with other countries from within the APEC region, they have indicated that the plan is to negotiate a separate bilateral agreement. The danger here is of a proliferation of agreements, each with its own special clauses and restrictions, especially rules of origin, that will increase the transactions costs for business and possibly serve as a barrier to closer integration.

To what extent do the new PTAs conflict with other APEC principles? The lack of consensus among APEC members on some of its key principles complicates such judgments.\footnote{For instance, member states disagreed over whether trade liberalization should occur on a non-discriminatory basis (as favored by APEC’s purists) or through negotiating reciprocal arrangements with non-member states. Certainly, there was no expectation, however, that countries would extend free trade measures to some APEC members but not to others.}

On another matter, APEC’s commitment was also explicit: the target for free trade to be implemented by its member states by the year 2010 for its industrialized economies and 2020 for its less developed members.
Curiously, these targets have disappeared from sight in the negotiation of the new preferential agreements. There is no mention of the 2010 deadline in the JSEPA; the proposed timetables for the completion of negotiations and implementation of agreements between China and ASEAN on the one hand, and Japan and ASEAN on the other, also appear to be unconstrained by APEC’s deadlines.

The compatibility of PTAs with GATT/WTO requirements that “substantially all trade” between the parties be included has been discussed in the previous section. Many of the new PTAs, including those involving Western Pacific countries, appear to be compatible only with the letter of the WTO and not with the spirit of its provisions on regional arrangements (and such compatibility derives from the lack of specificity of the relevant GATT article). Indeed, a purist would argue that only one agreement—the CEP between New Zealand and Singapore—is truly compliant with the aim of freeing all trade in goods and services, although the Closer Economic Relations Trade Agreement between Australia and New Zealand comes close (excluding only a few sectors from full liberalization).

Bergsten asserts that the APEC test on trade liberalization is more stringent than that of the WTO. Discussion among APEC members at their Bogor summit, and especially at the following economic leaders' meeting in Osaka, when the Japanese government sought unsuccessfully to exclude agriculture from APEC’s liberalization obligations, led to agreement that trade liberalization within APEC must be comprehensive, with no sector excluded. The terms of the JSEPA appear to be in direct contravention of this commitment.

For the other major regional institution, ASEAN, the consequences of the new bilateralism are less unambiguously bad. On the negative side, some ASEAN leaders, of whom Malaysia’s Dr Mahathir has been the most outspoken, have criticized other ASEAN members for their willingness to enter into bilateral agreements with non-ASEAN states, arguing that these arrangements inevitably detract from ASEAN cooperation and complicate the establishment and enforcement of its own free trade area. Singapore’s activism in proposing and negotiating bilateral agreements
with non-ASEAN states has been seen both inside and outside ASEAN as a clear signal at its frustration with ASEAN's own efforts at forging deeper integration and lack of commitment to its Southeast Asian neighbors.

On the other hand, the recent competition between China and Japan to secure some form of economic partnership agreement with ASEAN has given the grouping an unanticipated boost at a time when its standing, following its ineffective response to the financial crises of 1997-98, was particularly low. The task of negotiating with two giant Northeast Asian economic partners may encourage ASEAN members into deeper collaboration in forging common positions.

**Diversion of Resources**

One of the strongest arguments regarding the potentially negative impact that the new bilateralism has on both APEC and the WTO points to the commitment of resources to the negotiation of the PTAs and how this detracts from trade liberalization efforts at the other levels. Some governments have contested such arguments, stating that they have made the commitments necessary for sustaining negotiations on multiple chessboards.

The argument, at least for APEC, is far from persuasive. Trade liberalization has largely disappeared from APEC's agenda since the breakdown in 1998 of its efforts to promote a package of sectoral liberalization measures (the so-called Early Voluntary Sectoral Liberalization program). There is more than a little irony in the fact that the principal trade liberalization activity at APEC meetings in recent years has been the negotiation between various member countries of bilateral preferential agreements. To be sure, elements of a chicken and egg situation are present here: one reason for the turn to PTAs was the breakdown of EVSL and perceptions of APEC's ineffectiveness in moving the trade liberalization agenda forward; subsequently, countries have devoted their energies to PTAs rather than to reviving the APEC trade agenda which, consequently, has languished.

It is not just a matter of governments having limited resources to pursue
negotiations (which in the case of PTAs are resource-intensive and time-consuming given the requirement to agree on often complex rules of origin). It is also a matter of provision of leadership and of signaling where priorities lie. As APEC's history illustrates, leadership can come from multiple sources. Governments and individual political leaders have been important; so have non-official actors. Over the years, the group of economists associated with PAFTAD and PECC has provided intellectual leadership to the APEC process. The agenda of many of these participants today has changed: their pre-occupation now is not with APEC but with the new bilateral agreements (and in some cases are actively promoting these arrangements). Meanwhile, as APEC's agenda has become dominated by security issues, most recently terrorism, one finds senior government economists writing papers not on the benefits of trade liberalization but on the benefits of cooperating to fight terrorism.

Whether the new PTAs will also cause a problem for the new WTO round of multilateral trade negotiations through diverting attention and resources remains to be seen. The more serious negative impact of the new bilateralism for the WTO is likely to come from the manner in which the partial liberalization, the liberalization without political pain, which the new PTAs afford, has an impact on the domestic political economy balance. In particular, the exemption of politically sensitive sectors from the PTA liberalization will only encourage them to invest more resources in lobbying to prevent erosion of their position through multilateral liberalization.

**Conclusion: Benign, Banal and Bad?**

The new bilateralism in the Asia-Pacific region contains mixed messages for those interested in promoting trade liberalization. On the one hand, many of the agreements are WTO Plus in promoting deeper cooperation than currently prevails on issues such as investment, competition policy, and mutual recognition of standards. In this matter, they may properly
be regarded as benign. Most of the agreements will produce some trade creation, although in many instances the welfare gains are banal in comparison with those that liberalization on a broader geographical scale might achieve, whether this be APEC-wide or through the WTO.

On the other hand, very few of the arrangements are genuinely compatible with the spirit of the GATT provision under which free trade agreements are exempted from having to comply with the most-favored-nation principle. By providing a means to achieve liberalization without political pain, they encourage protectionist interests and have the potential to weaken the pro-liberalization coalition and especially its demand for multilateral liberalization. From this perspective of comprehensive global trade liberalization, such effects are unambiguously bad. Such negative effects could be reduced if the WTO were to reach agreement on a strict definition of Article XXIV.8, and to enforce it through its Committee on Regional Trade Agreements. It would be surprising, however, if the same anti-liberalization interests that constrain governments in their negotiation of PTAs are not also successful in preventing agreement on a stricter interpretation of the WTO provisions.

Notes

1. I use “Western Pacific Rim” as shorthand for Northeast Asia, Southeast Asia, and Oceania.

2. Scollay and Gilbert (2001) and the “official” joint study of Sohn and Yoon (2001), conducted by the Korea Institute of International Economic Policy and Japan’s Institute of Developing Economies both project such negative effects. Studies reported by Castellano (1999) suggest that the overall growth in trade resulting from a Japan-Korea Free Trade Area would be less than 2 percent. See also Korea Herald, 28 February 2002. For a review of various studies on the proposed Japan-Korea FTA and a more positive assessment of likely outcomes, see Cheong (2002).

3. Access Economics (2001); some studies suggest that Australia will suffer a (minor) net welfare loss from the implementation of the agreement.

4. “Singapore signs trade pact with EFTA,” Business Times Online, 27 June 2002,


6. For a comprehensive statement of the skeptical approach, see Rodrik and Rodriguez (2001)

7. Soloaga and Winters (1999) in a comprehensive study of existing regional arrangements reach similar conclusions about their effects on non-participants.


22. In a recent paper on Japan’s strategy on the negotiation of free trade areas, the Japanese Ministry of Foreign Affairs suggested that the “substantially all trade” criterion “implies that countries must achieve a standard of liberalization that compares favorably to international standards in terms of trade volume” and notes that the NAFTA average is 99% while the average for the FTA between the European Union and Mexico is 97%. The paper makes no reference to covering all sectors. Ministry of Foreign Affairs (2002).


26. The MAFF has asserted that since Japan’s average tariff on agricultural products—12 percent—is already lower than those of both the EU (20 percent) and Argentina (33 percent), there is no necessity, given domestic opposition and the likely adverse impact this will have on negotiation of an FTA, for agricultural issues to be included in FTA discussions. “Japan’s Food Security and Agricultural Trade Policy” (December 2002) cited
27. Japan’s Ministry of Foreign Affairs describes the proposed strategy as follows: “One useful approach would be to proceed in two stages as jointly proposed by business circles of both countries, i.e., pursuing economic partnership in areas of mutual interest over the short term while attending to the longer-term task of concluding a comprehensive FTA” Ministry of Foreign Affairs (2002).

28. See *inter alia* Krugman (1991); Lawrence (1991); de Melo and Panagariya (1993); Bhagwati (1992); Bhagwati and Panagariya (1996); Anderson and Blackhurst (1993); Lawrence (1996); Winters (1996); and Pomfret (1997).


34. For further discussion see Ravenhill (2001).

35. See, for instance, some of the papers contributed to the special PECC conference in November 2002 on preferential trade agreements, available on the PECC website.

36. For an Australian example from the now Deputy Secretary of the Department of Foreign Affairs and Trade, former Australian Ambassador to APEC, and former Head of the Department’s Northeast Asian Analytical Unit, see Raby (2003).

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Safeguarding Economic Cooperation, Reform, and Development on the Korean Peninsula

Joachim Ahrens

Introduction

In the aftermath of the collapse of the Soviet Union and other socialist regimes in Central and Eastern Europe (CEE), many analysts expected that the Democratic Peoples' Republic of Korea (DPRK, or North Korea) would soon suffer the same destiny. However, despite a decade of economic decline, international isolation, and widespread famine, the North Korean regime managed to muddle through in the 1990s. By the end of the last decade, when Kim Jong-il had consolidated his power and gained acceptance by the political elite as well as the citizenry, the assessment of North Korean politics and the prospects for change on the Korean peninsula became more differentiated. Particularly since the historical summit of June 2000, optimists among students of Korean affairs, international observers, and South Korean policy makers tend to believe that the DPRK leadership has started a process of serious economic and possibly political transition. Optimists argue that the North Korean regime may be prepared to disarm its military threat potential and to overcome military tensions in Northeast Asia if the United States abrogates economic sanctions (Kim, 2000). Moreover, mainly driven
by Kim Dae-jung’s “sunshine policy,” a consultative and cooperative process between the Koreas aimed at national reconciliation, appeared to have begun. The South Korean government not only held out the prospect of aid and bilateral economic cooperation and called for a peaceful coexistence of the two nations, but also offered a long-term unification proposal. At the same time, North Korea seemed to be willing to consider a model of “one country, two systems” (similar to the model of China and Hong Kong) as a feasible long-term development option (Noland, 2000a). These (presumed) changes in political articulation and action raised substantial hopes for achieving a stable peace, economic prosperity, and a unified Korea in the long run. This optimistic viewpoint was reinforced in July 2002 when North Korean authorities introduced an unexpected price reform that might be regarded as a first small step toward market-oriented reforms.

Pessimists, on the contrary, interpret the recent change in North Korean rhetoric and the regime’s conciliatory gestures as just another tactical move in the overall game of brinkmanship that the North Korean leadership has been playing for a long time. They point out that genuine reform and opening up is not on the North Korean agenda and that the new rhetoric and gestures are just applied in order to secure international aid flows, which are needed to preserve the regime. Moreover, skeptics interpret the recent price and salary increases merely as a means to pass the burden of economic decay more fully onto North Korea’s suffering citizens (Kim, 2000; Eckert, 2002).

All analysts agree, however, that future political and economic developments on the Korean peninsula will be characterized by substantial change that bears considerable uncertainties, risks, and costs. The expected fundamental shift in North Korean economic and political development as well as in inter-Korean relations has been discussed in numerous studies that are based on different scenarios. Owing to the lack of (reliable) data on the North Korean economy, some studies on the DPRK and North-South economic relations have been more descriptive than analytic. Other studies seek to draw lessons from transition economies in CEE and East Asia or

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from the experiences of German unification. Therein, scholars frequently assume that economic transition and integration strategies that worked well elsewhere can be similarly applied to the Korean peninsula without accounting for different context- and time-specificity. Finally, some studies discussing the prospects for economic reform in North Korea and North-South economic cooperation tend to disregard the fact that policy reform has not only an economic, but also a social, political, and even a geopolitical dimension. Although neglecting the political, economic, and social interdependencies of policy reform and institutional change may lead to theoretically efficient solutions, these may not be politically feasible propositions.

At present, there is a lack of studies that analyze inter-Korean economic cooperation and possible economic reforms in North Korea from a theoretical-conceptual perspective. In order to avoid ad-hoc policy action and to develop a comprehensive development strategy for North Korea and inter-Korean economic relations, more studies are needed that explicitly consider the dialectic relationships between economics and politics and focus on incentives which make reform and integration a viable policy choice. This paper seeks to contribute to this discussion. In particular, it addresses the question of how an inter-Korean economic integration process and economic reforms in North Korea (that will necessarily accompany integration) can be institutionally safeguarded.

The analysis builds upon recent research on emerging economic cooperation between North and South Korea. By applying an institutional and politico-economic perspective, we provide a normative, though theoretically underpinned, analysis of how inter-Korean economic integration could be enhanced and institutionally governed. In this context, a recently developed concept of governance can be fruitfully applied in order to identify appropriate institutions, which can safeguard a reconciliation process on the Korean peninsula.

In the next section, different scenarios of future economic and political developments on the Korean peninsula are briefly discussed. The third section provides the conceptual basis for the subsequent analysis by high-
lighting the importance of institutions for successful economic reform and integration. Section four elaborates institutional safeguards for a gradual reform-cum-integration scenario and is followed by the conclusions.

The Final Countdown or toward a New North Korea?

The precise course, the scope as well as the pace of the expected fundamental shift in inter-Korean dynamics are far from clear. Actual future developments will ultimately depend on how the fundamental dilemma faced by the North Korean regime will be overcome. As Pollack and Lee (1999: xv) observe that if

the North Korean regime launched major market-oriented economic reforms, the country would very likely face massive socioeconomic disruption and a growing challenge to its political legitimacy. But if the leadership resists major change, the country's economic base will decline further, ultimately threatening the regime's viability.

Owing to the lack of information about North Korea, the complex dynamics of the involved reform and policy issues, and the enormously politicized nature of inter-Korean relations, any predictions about the actual direction of future economic integration are necessarily highly speculative. Contingent on how the North Korean leadership will seek to solve its dilemma, there are at least five different scenarios for peninsula development, which have already been discussed in the relevant literature (see Figure 18). While, in the end, all scenarios will (most likely) lead to a reunification of the two Koreas, they substantially differ with respect to the political and economic costs incurred by the political elite in North Korea and the societies of both countries.

The first scenario, big-bang economic reform, is more of a theoretical scenario. Given the North Korean leadership's primary concern with regime survival, it cannot be realistically expected that bold market-oriented economic reforms will be conducted in a shock-therapy like manner. This
would literally turn the economy upside down, deprive the government of any effective control of economic processes, and directly undermine the regime’s legitimacy. The second scenario, economic/political collapse cannot be entirely ruled out. In fact, if the North Korean leadership does not conduct any meaningful economic reforms or if it initiates reforms but fails, the collapse scenario is conceivable—especially if foreign aid flows tend to decrease and mass mobilization, e.g., responding to worsening economic conditions, emerges (Noland, 2002). In that case, the absorption of the North Korean economy into South Korea’s through a German-style transformation-cum-integration program may be inevitable. Similarly, the third scenario, conflict-collapse-absorption, appears to be unlikely at present. Although North Korea has repeatedly used its nuclear and military threat potential as a trump card, its leadership does not appear to be prepared for a military conflict. Although the country’s military power belongs among the strongest in the world, there are hardly any chances to
survive a conflict with South Korea victoriously, given the current geopolitical situation in Northeast Asia.  

Given a number of positive signals over the past few years, optimists may claim that the North Korean leadership has in fact already begun to make a genuine policy shift, to initiate gradual market-oriented economic reforms and hence to put the fourth scenario into action. Subsequent to the historical summit in 2000, North Korea undertook a striking shift in foreign policy. It improved its bilateral relations with China as well as Russia and established diplomatic relations with a number of Western governments, including most member countries of the European Union. Furthermore, North Korea entered into four treaties with South Korea relating to investment guarantees, payment mechanisms, trade dispute arbitration, a legal framework for foreign direct investment, and preventing double taxation. Several *chaebol* have started to further economic cooperation with the North, which may imply a new dimension of hard-currency infusions into economic projects in North Korea. More specifically, economic cooperation between the North and the South has been fostered through the Mt. Kumgang tourism project, a contract for an industrial park that allows Hyundai to invest in the area of Kaesong close to the so-called Demilitarized Zone, and the reported possibility of another special economic zone (SEZ, also to be developed by Hyundai).  

In addition, farmers markets and private enterprises in the retail sector have become increasingly tolerated, more business delegations have been going abroad, and several hundred economists and civil servants have been sent abroad for training and to study market economics and management. A training institute for market-economic practices and a research institute focusing on capitalism were opened in 1998 and 2000, respectively, and DPRK officials raised the hope in public that the country may join the International Monetary Fund (IMF) and the World Bank. Moreover, North Korea became a member of the ASEAN Regional Forum in 2000, which is the very first such dialogue on multilateral security that the DPRK has ever participated in. This course of “positive developments” climaxed in July 2002 when the Kim Jong-il regime introduced a price reform that was...
labeled by one foreign observer as the "most dramatic liberalization measures since the start of Communist rule." All these measures, which appeared unthinkable a few years ago, are seen by optimists as a willingness to break with old habits and to create a "new North Korea" that is ready to enter the modern world of the twenty-first century.

Most observers, however, view the fifth scenario, i.e. the muddling-through strategy, as the most likely variant. They argue that the international diplomacy campaign and the partial economic reform measures, which have been implemented (if not only announced) so far, simply served the purpose of securing foreign aid and enhancing the regime's legitimacy externally and internally (Hassig and Oh, 2002; Kim, 2000). However, even if Pyongyang opts for the muddling-through strategy for the present and is able to receive external assistance without being forced to undertake major reforms, this strategy will not be viable indefinitely. Regime-preserving reforms inevitably imply further economic decline. This will force the North Korean leadership at some point in time to choose whether to allow the economy to collapse and consequently to risk its political survival or to seek to maintain its power through genuine, though gradual economic reforms. The realization of this latter option, however, presupposes the willingness and ability of the leadership to adequately change, adjust or re-interpret the predominant Juche ideology. Although most recent developments document weak signals that an ideological shift may become possible (Babson, 2001a), the realization of the necessary policy steps for such a change does not appear to be feasible at present.

Nevertheless, recent events on the Korean peninsula (especially the historical summit in 2000 and the resumption of inter-Korean talks at a ministerial level, after a nine months standstill, in August 2002) raise some hopes for productive and fruitful progress in inter-Korean consultation and cooperation. Even if it seems to be illusionary to seriously talk about an eventual peaceful unification today, policy research should take different scenarios into consideration and seek to elaborate strategies that help North and South Korean policy makers as well as external actors to adequately deal with different development trajectories. In this context, the gradual-re-
form option is not too unrealistic a scenario at least as far as external economic cooperation is concerned. Although this scenario may not be the preferred one from the perspective of pure economic theory (Wolf, 1998), it seems to be more feasible for the following political reasons:

- Strengthening economic cooperation between the two Koreas may be one of the least politically sensitive areas of reform (at least at the lower stages of cooperation).
- Gradual opening could help the North Korean leadership to maintain control over economic development.
- Gradual reforms may allow the North Korean leadership to slowly adjust its ideology to the reform process. In this context, a gradual shift in political articulation and action toward a “socialist market-based economy, North-Korean style” is conceivable.
- A gradual engagement approach would reduce the chance of a North Korean collapse and help preserve peace on the Korean peninsula.  
- Gradualism may also be favored by the South Korean government and citizenry.

Even if the cumulative economic costs are higher than under a big bang-cum-rapid-unification scenario, these costs could be distributed over a much longer period of time, making integration more affordable for a South Korean economy that currently is struggling to recover from its recent crisis.

Given the recent “reform measures and diplomatic opening,” it could be assumed that North Korea is in the middle of Scenario 5, facing the alternatives either of further economic decline and eventual collapse or of starting market-oriented reforms. Pessimists may argue that the recent price reform is a half-baked policy measure that will merely fuel inflation, further destabilize the economy and that it represents the first step in a final countdown for the North Korean economy. However, if this reform is complemented by further policy and institutional reform measures that are suitable to strengthen the supply side of the economy, then the optimistic view may be strengthened, lending support to the proposition that the Kim Jong-il regime is on its way to creating a “new North Korea.” At present, it is too early to tell. Therefore, neither the gradual reform-cum-integration scenario nor the collapse-cum-absorption scenario should be ruled out, the
more so as collapse could also occur as the result of failed gradual reforms (Noland, 2002).

The following analysis is based on the following assumptions:  

- Kim Jong-il and his advisers do not (any longer) regard the North Korean state as a model for Korean unification. They are primarily concerned with regime survival.
- The economy of North Korea is in dire straights and can no longer rely on open-ended subsidies from other (former) socialist countries. Given the centrally planned character of policy making, an economic recovery cannot be expected.
- Economic reform (especially big-bang style) is regarded as potentially destabilizing. However, recent shifts in political rhetoric, progress in diplomatic opening, and some signs of increased flexibility in economic policy making may reflect a greater amenability to change by the North Korean regime. But a firm commitment to genuine reform does not exist.
- Growing economic vulnerabilities imply an increasing likelihood of significant change in North Korea: without reform, an economic and subsequent political collapse is inevitable.
- Maintaining peace and political stability on the Korean peninsula is the overall objective, that is shared by all states.

This paper focuses on a gradual reform-cum-integration scenario, in which North Korea would be willing to improve relations and to gradually promote economic integration with the South. This scenario also assumes the maintenance of two sovereign states and a sufficient degree of convergence of economic and political practices to make reforms plausible and feasible. In particular, this means sufficiently reforming the North Korean economic system to make some degree of integration with the South sustainable and also revitalizing and reforming South Korea’s economy after the recent crisis. Last but not least, such a soft-landing-cum-integration scenario requires substantial, and diplomatic, external framing, i.e. especially that third countries, which are key players in Northeast Asian politics, provide adequate assurances as well as suitable incentives to the North Korean regime.
The Institutional Foundations of Integration and Transition

The reform-cum-integration scenario is based on the notion of a peaceful coexistence of the two Koreas as two sovereign countries as well as mutually beneficial economic cooperation and integration. Both economic integration between North and South as well as reforms in the North Korean economy will be gradual in this scenario, allowing North Korea to basically separate political and economic reforms. This would imply that the political regime might survive for a considerable period of time and be able to conduct domestic economic reforms at its will.

Since the outcome of different policy measures strongly depend on the existing economic and political institutions, it is of utmost importance to make institution building a top priority in policy making. In the gradual reform-cum-integration scenario, institutions need to be created that enhance the incentive compatibility for the North Korean policy makers so that economic reform and integration become a viable policy choice for them. Moreover, geopolitical and security aspects need to be taken into account in order to reduce political tensions on the Korean peninsula and to create mutual trust between the involved countries. This chapter elaborates a theoretical concept that may be appropriate to guide and safeguard policy reform through adaptively efficient institution building.

The recent literature on the political economy of policy reform and economic transition explicitly focuses on the interaction of political institutions, economic rules and regulations, and economic performance. One of the key propositions of this strand of the literature is that a country's politico-institutional matrix determines the incentives of government officials and hence whether or not policymaking will be characterized by good or by bad governance. In the course of the 1990s, the establishment of suitably crafted economic and political institutions constituting good governance has been increasingly recognized as an unalterable precondition to formulate and implement market-oriented reforms, to enforce
private contracts and property rights, to foster regional integration, and to achieve sustained economic growth. Following North (1994: 360), institutions are the

humanly devised constraints that structure human interaction. They are made up of formal constraints (e.g., rules, laws, constitutions), informal constraints (e.g., norms of behavior, conventions, self-imposed codes of conduct), and their enforcement characteristics. Together they define the incentive structure of societies and specifically economies.

While institutions constrain economic behaviour, organizations, such as government agencies, the legislature, political parties, courts, the military, business firms, trade unions as well as civic organizations, are the players. Organizations themselves are built upon institutional arrangements. Hence, they act according to their preferences on the one hand and the institutional constraints in which they are embedded, on the other hand.

Institutions serve collective purposes and structure interaction in markets, firms, networks as well as political exchange and the implementation of public policies. They may facilitate economic exchange (domestically and internationally), induce human capital development, encourage technological change, and reduce transaction costs. But they may also support political and economic monopolies, thwart capital formation, and increase the costs of transacting. Generally, institutions provide the incentive structure of individual behaviour, which determines individual choices and dictates the skills and knowledge that are expected to have the highest payoff. Finally, institutions influence a country’s economic performance, because they have a significant impact on the efficacy of micro- and macro-economic policies. In the absence of an institutional foundation of policy reform, even the “right” policy choices will not materialize as expected.18

A great variety of institutions and organizations perform critical roles in market economies and during the processes of economic transition and regional economic integration: contract and company law, bankruptcy and liability regulations, foreign trade laws, the security of (intellectual) property rights, informal institutions such as entrepreneurial spirit, reciprocity and

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mutual trust in sharing information and resources and transferring knowledge as well as organizations such as independent central banks, anti-trust offices, anti-corruption agencies, universities, research organizations, intermediary agencies acting as information brokers, business associations or financial organizations supplying long-term investment and venture capital as well as civic organizations such as watchdog committees and ombudsmen and a great variety of non-governmental organizations. However, the emergence of these and other institutions and organizations and their proper functioning cannot be taken for granted. Collective-action and institutional failures often result from the inability of private actors to organize themselves, to coordinate investment, innovation activities, and production decisions, and to enforce private contracts. Even if collective action succeeds, the outcome may be socially inefficient due to an unequal distribution of power in the private sector. In these cases, private ordering alone will not yield socially desired results. Under such circumstances, it is the role of the state to help overcome these types of institutional failure and to facilitate the supply, that is the implementation and enforcement, and at times also the creation of socially beneficial institutions.19

But the supply of institutions by the government is not contingent only on the reform-mindedness of the political leadership; it also depends on the administrative capacity and bureaucratic capabilities of the state apparatus. Moreover, the capacities of a public administration to implement economic reforms depend on the existence of a skilled, meritocratic, and professional civil service, that is shielded from vested interests, and a transparent, non-discriminating, government-business interface as well as on the institutions that guide political processes in a given country or between countries.20

These considerations underline the argument that policy reform, economic transition, and integration will be successful only if they are based on a secure and stable politico-institutional foundation.21 Such a foundation, which enhances the incentive compatibility of policy reform and economic performance for political decision makers, is of particular importance if a firm and irreversible commitment to reform is absent or can-
not be easily made credible, as is the case in today’s North Korea. In this case, it is also a necessary mechanism to institutionally safeguard inter-Korean integration and a more general economic opening of the North Korean economy vis-à-vis the rest of the world. The institutional arrangements that underlie the DPRK’s external economic relations must be designed to benefit not only the North Korean economy in general but also the current political elite, so that it is in the interest of North Korea’s authorities to achieve progress also in domestic economic reforms as a precondition to fully reap the benefits from foreign trade, foreign direct investment, and the access to international capital markets.\textsuperscript{22}

Thus, elaborating a set of economically effective and politically feasible reform measures is one side of a coin, the obverse side being the need to craft institutional arrangements that enhance policy makers’ credible commitment to policy reform and enable them to implement reform measures successfully. This insight has led scholars of economic development and transition as well as policy makers and international organizations to give governance-related reforms a prominent role on the agenda of policy and institutional reform.\textsuperscript{23} Given the notion that institutions primarily shape economic and political exchange and determine the formation of policies, we define governance as the capacity of a country’s formal and informal institutional matrix (in which individual actors, social groups, civic organizations and policy makers interact with each other) to implement and enforce public policies and to improve market coordination.

Each country’s governance structure is based on innumerable formal as well as informal institutional arrangements, which affect policy formulation and enforcement. Since the number of relevant institutions is very large and various institutions are of different significance in different countries, conceptual and empirical analyses must rely on proxy variables to assess the efficacy and the deficits of a country’s governance structure. To identify suitable proxies in a systematical way, Ahrens and Meurers (2002) condense the complexity inherent to country-specific governance structures:
they identify separate governance dimensions, which mirror the quality of a country's institutions. It is argued that institutions, that help enhance the quality of policy making, need to show distinct characteristics: (1) They must be clearly defined, and political as well as economic actors must be confident that they are properly enforced. (2) All actors must know and understand the rules and be able to recognize whether or not they are observed. (3) The set of rules must be sufficiently flexible to allow for institutional change if preferences, specific societal needs, or international conditions change over time. This also presupposes the existence of various channels through which individual actors or organizations can initiate and contribute to institutional reform processes. (4) Institutional safeguards must be in place, which hinder powerful political and economic actors from arbitrarily circumventing or changing existing rules at the expense of other actors or society as a whole.

These characteristics constitute four fundamental governance dimensions: predictability, transparency, participation, and accountability. All of these elementary principles are required for the sound management of public resources, an enabling environment for (international) market transactions, and a productive partnership between the public and private sector, that does not degrade into closed circles of influence and privilege. Beyond the realm of national policy reform, they are also required to conduct the activities of international organizations and to frame and to guide regional integration processes such as the envisaged inter-Korean economic rapprochement.

Governance provides the overall perspective from which these interrelated and mutually reinforcing principles are derived. Institutional arrangements that further these principles are expected to provide those incentives, which are conducive to effective policymaking and developmental outcomes. A governance structure is effective if it ensures that public policies and projects are properly implemented and that market processes can thrive within a given legal and regulatory framework, which is not subject to arbitrary political interference.

From this perspective, effective governance is independent of the basic
character of a political system, i.e. the regime type. Even if the full realiza-
tion of these principles cannot be expected to occur in totalitarian or oth-
er non-democratic settings, key elements of effective governance may not be absent. Recall in this context that East Asia's high-performing de-
velopmental states, most of which had rather authoritarian regimes when they successfully managed to catch up with more advanced economies, showed numerous elements of effective governance (Campos and Root, 1996; Evans, 1995). Under such circumstances, key elements of good gov-
erance may first come into existence at sectoral or sub-national levels or in specific parts or functions of the state apparatus such as particular gov-
ernment agencies and ministries and their relations with an existing or emer-
ging private sector or with their counterparts abroad. In these sub-
ordinated realms, actual conditions may reflect the overall principles to vary-
ing degrees. Hence, we follow Wohlmuth (1998: 9) in presuming that “(w)hatever the quality and extent of macro-governance, the degree of meso-
and micro-governance can vary by quality and extent.” Even in coun-
tries with unfavorable structures of macro-level governance, functioning institutional structures at the meso and micro level can exist.

With respect to a potential economic reform process in North Korea and a possible inter-Korean economic integration process, one can argue that the more that policy reform and integration are reflected by the qualities that are associated with effective governance the more they induce political legitimacy, and the more private agents and the negotiating governments will comply with the given rules and regulations and accept policy changes.

A governance structure that scores relatively high on the fulfillment of these principles and yields comparatively high and sustained economic growth rates has been called a market-enhancing governance structure (MEGS). In Ahrens (2002b), I argued that it takes a number of inter-
dependent and mutually reinforcing reform measures at four levels of in-
stitution building to institute a MEGS. These comprise (1) the need to craft institutional mechanisms that allow governments to credibly commit to economic reforms and the need to enhance state capability and hence
to create a state that is able to protect property rights, enforce contracts, and implement policy reforms; (2) the need to limit state authority in order to avoid predatory government behavior; (3) the need for capacity building as a precondition for technically, administratively, and politically implementing and enforcing reform policies; and (4) the need to create key economic institutions for enhancing and sustaining markets.

Creating the different components of a MEGS based on the four fundamental principles of governance is of utmost importance. With respect to the highly complex gradual reform-cum-integration scenario, we pointed out earlier that economic integration between the two Koreas presupposes a sufficient degree of convergence between the two countries regarding economic and political practices. Although this does not necessarily presuppose a radical transformation of the North Korean economy, it requires the introduction of at least some basic elements of a market system. This, however, will be possible only if the North Korean governance structure is considerably reformed with respect to economic policy making. Moreover, the envisaged economic integration process itself needs to be institutionally guided and safeguarded. This requires the creation of another MEGS that must be compatible with the national governance structures of the two integration parties. This "integration MEGS" involves the creation of institutional arrangements that (1) make commitments to promises and policies of the two governments credible; (2) limit the authority of the two governments and reduce the propensity of any party to behave opportunistically; (3) create in both countries the capacities needed to implement integration-related policies and enforce the agreed upon rules of integration; and (4) guide economic integration proper. Finally and of pivotal importance, the "integration MEGS" requires the creation of institutions that are appropriate to create confidence and trust between the two Korean governments on the one hand and between the Kim Jong-il regime and the political leaderships of other countries that have a stake in Northeast Asian development, particularly China, Japan, Russia, and the United States, on the other hand. Therefore, the measures to craft an "integration MEGS" should be guided not only by the four fundamental principles of gover-
nance (accountability, participation, predictability, and transparency), but also by a fifth principle: reciprocity. Keohane (1986: 8; emphasis in original) defined reciprocity as a concept that refers to exchanges of roughly equivalent values in which the actions of each party are contingent on the prior actions of the others in such a way that good is returned for good, and bad for bad. These exchanges are often, but not necessarily, mutually beneficial; they may be based on self-interest as well as on shared concepts of rights and obligations; and the value of what is exchanged may or may not be comparable.

Institutional arrangements that foster reciprocity have proved to facilitate international cooperation and to deter defection. In the context of the envisaged economic integration on the Korean peninsula, institution building guided by that principle could greatly help to make negotiations between the two Koreas and possibly third countries more transparent and predictable and to build confidence and trust between the negotiating parties.27

In general, MEGS are subject not only to political design, but also to evolutionary change, because they are embedded into the wider institutional matrix of society. This implies, on the one hand, that the formal institutional and organizational pillars of a MEGS are basically malleable through political intervention. On the other hand, this entails that policy makers would be badly advised if they try to craft new MEGS “overnight” or in a top-down manner. Owing to their bounded rationality, policy makers can neither know nor compare the consequences of all politically feasible actions nor can they anticipate all future changes in international relations, market conditions, and societal preferences. Like every economic decision, the design of formal institutions is subject to uncertainty. This also implies that it is not advisable simply to copy distinct components of governance structures that function effectively elsewhere in a different institutional environment. Thus, it needs to be emphasized that no blueprint for creating good governance exists, but that the emergence of a MEGS is highly context- and time-specific.

After all, crafting a MEGS is a dynamic process. Policy makers need
to ensure that policies match institutional arrangements and vice versa. Good governance requires a continual adjustment and fine-tuning of institutions and policies to changing political, economic, social, and international constraints. Thus, although the structural foundations of a MEGS must be relatively durable to allow for stabilizing expectations of both public officials and private economic actors, they need also to be sufficiently flexible in order to allow for institutional innovations, for adjusting institutions if new forms of conflict resolution are needed, and for feedback mechanisms that help to correct organizational errors and facilitate policy revisions in cases of failures. A MEGS is (sufficiently) flexible and hence adaptively efficient in a Northian sense if it is based on institutions that encourage learning processes, foster innovative activities, and ensure a relatively high degree of policy adaptability to a changing political, economic, and international environment.

Toward Gradual Reform and Integration on the Korean Peninsula

Based on the preceding conceptual considerations this section explicitly discusses how economic cooperation and integration between the two Koreas and economic transition toward a more market-oriented system in North Korea might be institutionally safeguarded in a gradual reform-cum-integration scenario. It is assumed that the overall objectives of the gradual approach are to create peace and security on the Korean peninsula and to foster economic growth and development in North Korea. Taking the nascent cooperation between North and South Korea as a starting point, the following considerations address three key questions: What may be the adequate sequencing of opening and integrating the North Korean economy with South Korea’s? Which domestic economic reforms would be needed to make the integration process successful, and has the North Korean regime the capability and capacity to undertake these reforms?
Sequencing and Safeguarding Economic Integration

Owing to its Juche ideology and the centrally planned character of economic policymaking, North Korea’s economy has been almost entirely closed vis-à-vis the outside world. In the aftermath of the collapse of the former Eastern bloc and hence the loss of its traditional trading partners, foreign trade turnover has even further declined, making the domestic economy increasingly aid-dependent. North Korean foreign trade has shown a persistent deficit, foreign trade turnover fell substantially in the 1990s, and a substantial portion of the country’s imports are in fact aid in the form of food and oil. The low openness of the North Korean economy is reflected by a very low foreign trade turnover that accounted for 12.6% in GDP in 2000. China is the main trading partner for North Korean imports (which are dominated by industrial intermediates and petroleum), whereas Japan and South Korea are the main destinations of the country’s exports, which are dominated by natural resources and related products as well as light manufactures. Moreover, although the country’s foreign debt is relatively low in absolute terms, North Korea is cut off from international capital markets, because it essentially defaulted on debt repayment. Inter-Korean trade has grown considerably over the last decade from roughly US$1 million in 1988 to US$425 million in 2000. However, bilateral trade has been usually conducted in an indirect way and it is still politically controlled.

More recent developments indicate that the Kim Jong-il regime may be increasingly willing to cautiously and gradually open up the economy and accept external aid, advice, and technical support. After a decade of substantial negative growth rates, which reduced domestic output by some 50 percent, and owing to the ongoing energy crisis, widespread famine, and seriously underdeveloped physical and institutional infrastructures, the North Korean authority seems to realize the binding constraints of its autarkic development strategy and hence may seek to improve its external economic relations (Lee, 2001b).
Stages of Economic Integration

Basically, opening up the North Korean economy will imply a significantly increasing exposure to international competition, considerable changes in domestic output composition causing major structural adjustment processes, and a large-scale redeployment of millions of workers. Ultimately, these risks may seriously threaten the survival of the Kim Jong-il regime. Therefore, in order to make integration a viable policy choice, only a gradual and staggered integration strategy—one that accounts for binding political side conditions and seeks to minimize the economic costs of opening up—appears to be feasible on the Korean peninsula, in order not to make excessive (and unrealistic) demands on the political capabilities, the economic capacity, and the ideological receptivity of the North Korean system as well as the financial capacity of South Korea that is needed to support and manage the integration process.

In principle, integration steps beyond project-style cooperation range from a free trade area to ever deeper forms of integration to eventually a full economic union, in which economic policies of the integrating countries would be harmonized (standardized). While market integration (i.e., deregulation) dominates the first stages of the process, policy integration becomes increasingly important at later stages, when new institutions and organizations have to be created for governing the integration area. This shift in emphasis also implies a shift in potential political costs, because increasing policy and institutional integration entails a growing loss of sovereignty in economic policy making. This, in turn, will not only make it more difficult to cope with asymmetric shocks affecting the Korean economies, but also to conduct tailor-made reform measures that fit different development needs in the Northern and Southern economies.

Figure 19 portrays an idealized gradual integration model that is based on three broad components: (1) confidence and trust building measures (CTBM); (2) the staggered economic integration process; and (3) the external framing of economic integration. The unalterable foundation of any progress in integration would be the continuation and intensification of
confidence and trust building
staggered economic integration:
- projects
- special economic zones
- free trade area
- customs union
- restricted common market
- common market
- economic union
- full economic union
- unification

external framing

Figure 19. An Idealized Model of Economic Integration
Source: Ahrens (2002a)

government-led CTBM, which could greatly enhance transparency and predictability in inter-Korean relations. These measures would have to be complemented by creating an institutional and legal framework for inter-Korean economic exchange and gradually increasing CTBM through cultural and educational exchanges (e.g., family reunions, study trips, external training programs for North Korean bureaucrats, economists, engineers, etc., and partnerships between towns, clubs, and associations).

A staggered integration strategy would be the core of the process. Even if one-off projects (such as the Mt. Kumgang tourism project) do not yield spillover effects on the North Korean economy, they can well serve the purpose of strengthening mutual trust: In that sense, such projects show a pilot character and induce learning processes for the North Korean government and bureaucracy as well as foreign investors enabling all parties to find more effective ways for collaboration. Gradually, such pilot projects
could be complemented by projects that offer prospects for (limited) spillovers into the broader economy, e.g., SEZs, industrial parks and preferential investment zones in urban areas.

In the Korean case, an economic integration process would be highly politicized from the very beginning, and the degree of politicization would further increase the more policy integration will become necessary in order to accomplish deeper steps of integration. Since, at present, the North Korean leadership is neither willing nor able to credibly commit to domestic economic reforms and has no access to international capital markets, the creation of a free trade area appears to be impossible. However, the establishment of SEZs may prove to be an economically useful and politically feasible strategy that could be promoted before the two Koreas may enter deeper stages of integration.

From North Korea's perspective, SEZs have the advantages that they can absorb foreign investment without affecting the domestic economy, can support learning processes, and would allow the buildup of strategic economic relations with South Korea, China, or Russia without the need to immediately engage in a major economic reform program. A critical point is that the North Korean government would in principle be able to increase its political credibility if it undertakes major public infrastructure and logistical investment in SEZs. This would credibly signal its commitment, owing to the irreversible nature (i.e. the sunk costs) of such investment. If SEZs perform well over time, they may gradually yield increasing tax revenues, which the government could use for financing social needs in the domestic economy. In sum, even if the overall commitment to economic reform is extremely low in North Korea, the establishment of SEZs may represent a feasible opportunity for the political regime to accept lower degrees of freedom in policy making in exchange for attracting foreign investment and technology.

If domestic economic reforms become a viable policy choice for the North Korean leadership, the creation of a free trade area and subsequently a customs union with the South would be conceivable. Such integration steps would yield considerable efficiency gains in economic exchange, but
require some policy coordination mainly relating to (foreign) trade and competition policies. While the integration of product markets would hardly affect the South Korean economy, Noland et al. (2000) estimate that it would have substantial positive effects on the economy in the North. Led by huge increases in the exports of light manufactures, the foreign trade share in North Korean national income is estimated to increase by more than 300 percent. At the same time, the Northern economy would be subject to massive changes in output patterns with output figures increasing, especially in the manufacturing and construction sectors, and with decreases in the production of capital goods. While food availability would considerably improve, employment in agriculture would decrease releasing labor into the growing industrial sectors. If military demobilization would be feasible and could complement the establishment of a customs union, an enormous peace dividend would be achieved, possibly amounting to a two-digit percentage point increase in GDP.

Factor market integration would have a significant impact on both North and South Korea. It is to be expected that labor would tend to massively migrate from North to South and capital vice versa. This would not only imply enormous shifts in production patterns but also entail higher wealth and income inequality in both economies. With respect to real convergence, Noland et al. (2000) find that the amount of capital investment necessary to raise Northern per capita incomes to 60 percent those of the South would actually drive the rate of return on capital in the North below that in the South. However, it would be possible to attain the 60 percent target without such equalization of the rate of return in the two parts of Korea under high-end estimates of the speed of technological convergence. This suggests that either the rate of technological convergence would have to be very rapid (say, 12 percent annually), or restriction on migration from the North to the South would have to be imposed on a semi-permanent basis.

This conclusion underlines the necessity to provide the Northern economy with capital investment and transfer payments (from the South or from abroad) as quickly as possible and to (temporarily) restrict the migration
of labor. Consequently, the creation of a common market (subsequent to a customs union) would be only feasible if it is initially "restricted," so that it temporarily protects the North Korean economy. Particularly, restrictions would be necessary with respect to the harmonization of technical, environmental, and social standards for specific products as well as the free mobility of labor. Owing to the substantial development gap between North and South Korea, the former can hardly be expected to successfully compete in a common market if it has to adjust its production processes to South Korean standards. Similarly, as long as a huge inter-Korean income gap and a (partially) politically controlled North Korean economy exist, free movement of labor may imply mass migration on the peninsula, which would overburden the absorption capacity of the South and make the North suffer from a substantial brain drain. Thus, the creation of a common market—one that ensures the free mobility of goods, services, capital, and labor—would be conceivable in the very long run, if the North Korean economy will have achieved sufficient progress in economic reforms so that it is prepared to compete with South Korean companies. Finally, a full economic union would require a harmonization (and standardization) of the economic policies of the two Koreas. This particularly relates to the introduction of a single currency and the adoption of common labor market, fiscal, and welfare policies. Such a union would eventually crown the integration process in the very long term, if a potential unification is seriously discussed.

**External Flanking**

The idealized model, portrayed in Figure 19, shows, however, yet another factor determining the integration process: an external framing of peninsula integration is necessary for North Korea not only in order to get access to financial and technical assistance from abroad, but also (and even more important) in order to externally safeguard the integration process from a geopolitical and security perspective. Without resolving the problems relating to a military confrontation between the Koreas and the security threat that North Korea imposes on the international community,

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economic cooperation will remain at a low level. As Kim (2002: 280) argues: "It is common sense to believe that North Korea will build up military capabilities if it recovers economic strength. This is the main argument why the South Korean people do not want to go further with the sunshine policy." This is in fact also a concern of third countries such as Japan and the United States.

In order to align the preferences of all parties involved, the process of North Korea’s economic opening needs to be institutionally safeguarded through the integration of economic, political as well as security initiatives (Lee, 2001a; Wit, 2000). Moreover, difficulties of integration as well as specific concerns of third states could be more easily overcome by employing a “two-plus-x formula” in an external flanking of the integration process (Pfennig, 2001). In particular, countries that have a stake in Northeast Asian development—such as China, Japan, Russia, the United States, and the European Union—should be involved and could possibly assume a mediating role. In this context, it is of utmost importance that the external frame not be interpreted by the North Korean regime as an attempt to undermine its political sovereignty. Therefore, external safeguards and support have to go hand in hand with confidence building measures, (possibly) the international recognition of the North Korean regime as well as accepting the notion of coexistence. The latter two aspects in particular may allow North Korea to regard its nuclear and military programs “as valuable but not vital, [so that] it may presumably be possible to negotiate an end to those programs in exchange for some particular package of benefits” (Eberstadt, 2002: 28). Similarly, international recognition of the North Korean regime in combination with the principle of coexistence may convince political leaders in the DPRK that their regime is not threatened from the outside and could survive next to South Korea. In such a case, a North-South peace agreement and a genuine “one nation, two states” policy might be possible (Eberstadt, 2002: 28).

Last but not least, North Korea could and should be involved in regional economic cooperation in Northeast Asia as quickly as possible. In this context, the Northeast Asia Economic Forum (NEAEF), in which North
Korean representatives already participate, provides a good example. The NEAEF is a non-governmental organization aimed at the facilitation of dialogue, the dissemination of information, and the promotion of research on Northeast Asian economic cooperation. Through informal institutions and networks, it has become possible for this organization to actively involve all Northeast Asian countries including the DPRK in an ongoing and fruitful dialogue and thus to enhance trust. In addition, Valencia (1994) suggests the possibility of establishing an Association of Northeast Asian Provinces and common forums to discuss issues relating to a regional labor market, regional communication and transportation, or environmental problems. All these opportunities for an active engagement of North Korea through channels that provide benefits and hence incentives for all parties involved will help to build trust and confidence and might strengthen the position of those individuals in the North Korean state apparatus, which are basically open-minded regarding reform. Such a strategy would be, as Valencia (1994: 65) argues, “consistent with a common Asian perspective that to change a society one must engage it and influence it through a wide spectrum of multilateral initiatives.”

Creating an “Integration MEGS”

The realization of a staggered approach to integration is a highly complex and politically sensitive process. Effective economic integration and underlying policy reform require credible commitments that political promises are actually delivered, an adequate administrative capacity of state institutions, and the technical and political capability of policy makers to implement new policies and enforce new rules of the game. In this regard, the governance structure underlying the integration process is of utmost importance.

An “integration MEGS,” which could serve as an appropriate foundation for the sketched staggered integration strategy, should not rely on the objective to achieve unification. A gradual and staggered integration approach should be rather based on the notion of peaceful coexistence and mutual recognition and be driven by pragmatic flexibility and politically
feasible policy steps, which benefit both sides. In this respect, a valuable lesson from Germany's Ostpolitik in the 1970s could be learned. As Hans Maretzki (1999: 25 and 27), a former ambassador of the German Democratic Republic to the DPRK, argues:

It would be highly useful if ROK strategy toward North Korea discriminated more strictly between normalization inter-Korean relations and envisaging actual unification... The experience of the inter-German rapprochement in the 1970s indicates that positive momentum arises from strict efforts to focus all agreements on contemporary utility; only a pragmatic approach fosters reduction of mistrust. In the specific situation between the two Koreas it would be important to avoid slogans about reconciling the two halves; coexistence needs reciprocal feasibility. To manifest emphatically national intentions to embrace the other side produces only a retreat of the weaker and more suspicious party.

Cooperative coexistence rather than unification should be the primary principle guiding integration. Note that it is not only the past, but also the expected future that matters for present choices and political decisions. Expectation dependence, i.e. “the influence of expectations of the future on the present” (Richter, 1999) can impede or reinforce public policies in the present. If, e.g., the South Korean engagement policy explicitly aims at unification, two sets of expectations would be raised: first, the North Korean political elite would expect the South Korean government to unilaterally dictate North-South integration according to its own rules; secondly, South Korean people may associate the realization of long-cherished hopes, but also the incurrence of substantial costs for themselves with such an objective. As a result, South Koreans may lose their initial optimism and withdraw their support of government policies vis-à-vis the North. The North Korean leadership may in fact be willing to agree with the South’s engagement policy but only in order to bargain for further aid by conducting “cosmetic” economic reforms. Both reactions would be detrimental to an integration process. Institutionalizing “coexistence” as the primary principle that underlies official policy statements and bilateral agreements would affect the expectations of the parties involved, increase

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the likelihood of mutually beneficial economic cooperation, and each party could be expected to support the overall integration process.

In order to avoid opportunistic behavior by one of the two governments, the “integration MEGS” needs to provide institutional arrangements that ensure specific reciprocity, i.e. “conditional exchanges on a quid pro quo basis” (Keohane, 1986: 25). For example, funds provided by South Korea and other countries to modernize the North’s infrastructure should be offered only if Pyongyang conducts tangible reductions of its military threat potential (Wit, 2000). Without specific reciprocity, South Korea and third countries may fear the danger of continued brinkmanship on the part of the Kim Jong-il regime, while the North Korean leadership may fear a loss of political power, control, and bargaining leverage in international negotiations.

Keohane (1986: 24) argues that specific reciprocity is a suitable principle guiding international relations especially if “norms of obligation are weak ... but when the occurrence of mutually beneficial cooperation seems possible.” The likelihood of cooperation between governments, which exercise specific reciprocity, will be the higher the more interests they have in common, the greater the expected benefits from future cooperation, and the smaller the number of actors participating in cooperative undertakings. Thus, an inter-Korean integration process may be suitably based on institutional arrangements that link the North and the South together and foster specific reciprocity.

An example, proposed by Wit (2000), would be to establish a Korea Reconciliation Fund (KRF) that may be used for promoting inter-Korean economic cooperation, supporting agricultural development in the DPRK, and providing humanitarian programs. In addition, the KRF would include a cooperative threat reduction program. Such a program could encourage cooperation between North and South Korea and third countries with respect to demilitarization, the conversion of defense industries, and monitoring military technological development. In order to avoid any suspicion of North Korea that a single country (e.g., the United States) seeks to dominate integration and restructuring policies on the Korean peninsula, a KRF
Guiding principles: cooperative coexistence, mutual recognition, and specific reciprocity

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<th>Externally framing economic integration</th>
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</thead>
<tbody>
<tr>
<td>• “2+”-party talks, bilateral economic assistance, support of international organizations, regional economic cooperation, international NGOs(e.g., NEAEF) Korean peninsula development fund</td>
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</table>

Figure 20. Instituting an ‘Integration MEGS’

needs to be set up under multilateral leadership (including North and South Korea).

Figure 20 portrays the long-term integration process as being divided into four phases (from normalization to market integration to policy coordination to eventual unification) and assigns fundamental components of “integration MEGS” to these phases. These components comprise intergovernmental or supranational political institutions and organizations, which serve to monitor and safeguard the integration process internally and externally. Since the design of a concrete strategy of institution building will be contingent on specific future developments, the figure only sketches possible key components of such a strategy.
Gradually increasing inter-Korean consultation and cooperation in the economic realm as well as in areas that do not relate to core political controversies represents a suitable starting point for the normalization of North-South relations, because such activities may serve the interests of both parties. In the normalization phase, when a formal institutionalization of inter-Korean cooperation will not yet have taken place, joint projects, policies, and strategic planning should be conducted through informal "summits of equals" bringing together the heads of state or high-ranking officials. Formal institution building becomes necessary at the stages of market and policy integration, in order to coherently steer economic cooperation and coordination. In this context, institution building needs to ensure participation and equal representation of both Koreas, i.e., the existence of various channels through which both Korean governments can equally initiate and contribute to institutional reform proposals. Activities in Phases II and III should be governed by an intergovernmental commission with equal representation of the North and South Korean governments. This commission would be responsible for policy implementation and has to take decisions unanimously. Its work would be guided and supervised by a North-South council, i.e. meetings of the heads of state as well as of ministerial councils at regular intervals. If policy integration will become increasingly important, further institutions and organizations need to be created ranging from an anti-trust agency policing the common market to a fiscal council coordinating public finances and eventually a common central bank. In addition, a Korean Court of Justice would help in resolving economic disputes that may occur more frequently with deepening integration.

Furthermore, the integration process could be reinforced from the very beginning by strengthening the Korean Peninsula Energy Development Organization (KEDO) and establishing complementary organizations and institutional arrangements such as a Korean Agency for Training and Public Administration (KATPA) to modernize the economic bureaucracies in both Koreas, a Korean Environment Agency (KEA), a Korean Agricultural Development Organization (KADO), or a Joint Commission
for Historical and Cultural Research (JCHCR). Especially the latter may be a suitable instrument for building confidence and trust. North-South projects in cultural and historical research may facilitate the identification of common ground and roots in non-political areas and should benefit both parties (Pfennig, 2001).

Finally, the external framing of the integration process will be guided not only by official bilateral and multilateral forums, in which security and economic matters of common concern need to be resolved. In addition, international non-governmental organizations (NGOs) such as the NEAEF or the East-West Center in Honolulu, Hawaii, could play a key role in confidence and trust building and prepare the ground for official rapprochement through informal discussion networks. Moreover, NGOs could possibly serve as mediators, which—as non-political, non-profit organizations—might be better suited than (Western) governments to impartially administer funds and international agreements that support reform and integration on the Korean peninsula. Once crucial security problems are overcome, North Korea will be able to gain access to the funds and technical assistance of international financial organizations such as the IMF, the World Bank, and the Asian Development Bank (ADB). In the meantime, the integration process may be financially safeguarded through the creation of a multilateral Korean Peninsula Development Fund that pools resources for public and private investment and provides them to North and South Korea according to the degree of progress that is achieved in the integration and reform process.

Economic Transition à la Pyongyang?

Although it has one of the strongest military forces in the world, controls virtually every aspect of its country’s political and most aspects of its economic life, and has a government-party apparatus that is able to exercise tremendous discretionary powers, today’s North Korea is a weak state. It is weak in the sense that neither can it feed its people nor is it able to create and enforce the basic conditions for implementing economic development and growth policies. Its public administration is inefficient
and hardly prepared to manage economic reforms, policy making is neither transparent nor predictable, and the political elite is not held accountable for its actions. Leaders in government, the Korea Workers’ Party, and the military act in collusion at the expense of society as a whole. Under such circumstances, even a reform-minded political leader faces severe problems to implement reform policies that contradict the interests of the military, the bureaucracy, or Communist Party. Even if economic reforms were announced and partially implemented, they would hardly be durable owing to a lack of credible commitment and enforcement devices and the resistance of potential losers from economic reforms, who try to block their implementation.

As pointed out earlier, however, more recent developments seem to indicate that a window of opportunity may have opened in the DPRK, the more so as the political leadership publicly admitted recently that the economy has fallen into decay (Hassig and Oh, 2002). Aside from its diplomatic campaign vis-à-vis Japan, Russia, and Western governments and cautious steps in improving economic cooperation with South Korea, the government undertook several rudimentary reform steps. Political authorities started to streamline the government apparatus and to restructure the bureaucracy, making it a younger and more technically oriented administration. Moreover, limits relating to private property were relaxed, rudimentary cost accounting standards were established, and the notion of price, cost, and profit were introduced in economic management. In addition, constitutional amendments emphasize the economic goal “growth and prosperity of the Fatherland,” that strikingly differs from the earlier prescription aiming at the “country’s independent development.”

Furthermore, Babson (2001b: 87) observes that with the growth of the informal market economy, forces have also emerged that are working to break down the strict control of the state over the freedom and lives of the population.... Diversion of goods from the state distribution system and foreign aid, asset stripping, and other forms of stealing from the government are weakening state control over people’s behavior. Embezzlement and corruption are now replacing duty and
conformity. Thus, the emergence of the informal economy in North Korea is accelerating the likelihood of fundamental political and economic reform.

Last but not least, with the end of the Cold War, North Korea lost political and economic support from its former Eastern European allies and was robbed of “its economic lifeline and its socialist legitimacy” (Babson, 2001b: 84). In this context, the economic transition process in China and its enhanced relations with the United States and South Korea even accelerated North Korea’s international isolation. In the end, the DPRK has lost even its former military edge owing to its deteriorating economy and the decrease in arms supplies from Russia (Kim, 2000). All these changes may entail a new policy direction, which may turn out to be more market-friendly and outward-oriented. Hence, North Korea may be regarded as a country cautiously moving toward a hybrid economic system, Pyongyang style.

Basically, North Korean authorities could achieve an immediate relaxation of their dire straits by seeking access to international markets and the funds and technical assistance of international organizations, and above all cooperating more closely with South Korea. Opening up the economy would not only help to overcome the long lasting famine but also greatly facilitate the implementation of market-oriented reforms. International integration and domestic economic reforms presuppose, however, a reform-minded political leadership and an adequate politico-institutional foundation, i.e. a MEGS, through which political commitments to change can be made credible and reform measures actually implemented.

A binding side condition for constituting a MEGS in North Korea is that economic reform will be feasible only if it does not undermine the power of the North Korean elite. Particularly, this implies that reform and integration must not question the sovereignty of the North Korean state. They need to be designed in a way that they can be justified through ideological shifts, they have to be in the interest of the North Korean leadership, and they should create no losers. As discussed above, a MEGS rests on four pillars:
a strong state that is able to credibly commit to economic reforms, protect property rights, and enforce contracts

- institutions that limit state authority in order to avoid predatory government behavior
- capacity building in the public sector in order to ensure policy implementation
- key economic institutions that constitute a market-oriented economy.

**Enhancing State Strength for Economic Policy Making**

With respect to the first component of a MEGS, most scholars agree that state strength is a *conditio sine qua non* for enhancing the capability and sustainability of policy making. It helps to avoid the capture of the state apparatus by narrowly defined interest groups, enhances political stability as well as the long-term predictability of the political system and hence can contribute to stabilizing the expectations of (private) economic actors and prolonging the time horizon of policy makers. In today’s North Korea, authority is vested in persons—not to say in one (!) person—and not in rules, and a shift to a rule-of-law state cannot be expected under current political conditions. How can North Korea become a strong state in the sense that it is capable of implementing growth-enhancing economic reforms, protecting property rights, and enforcing legal rights and contracts? States are considered strong if they show at least two characteristics which help to overcome problems of collective action: (1) they must be autonomous and hence shielded from the influence of vested interest groups in order to formulate policies independently; and (2) they need to exhibit sufficient degrees of centralization and internal cohesion in order to overcome collective action and principal-agent problems and to implement policies effectively (Doner, 1992).

Assuming that the Kim Jong-il regime actually intends to gradually open up and reform its economy, the notion of the developmental state, the economic development processes in several high-performing Asian economies in the 1960s and 1970s may offer some pointers of how to enhance state strength for economic policy making. According to Johnson (1987: 140, 142-143), developmental states
are generated and come to the fore because of the desire to break out of the stagnation of dependency and underdevelopment; the truly successful ones understand that they need the market to maintain efficiency, motivate the people over the long term, and serve as a check on institutionalized corruption while they are battling against underdevelopment. A developmental elite creates political stability over the long term, maintains sufficient equality in distribution to prevent class or sectoral exploitation (land reform is critical), sets national goals and standards that are internationally oriented and based on non-ideological external referents, creates (or at least recognizes) a bureaucratic elite capable of administering the system, and insulates its bureaucrats from direct political influence so that they can function technocratically. It does not monopolize economic management or decision making, guarantee full employment, allow ideology to confuse its thinking, permit the development of political pluralism that might challenge its goals, or waste valuable resources by suppressing noncritical sectors (it discriminates against them with disincentives and then ignores them).

The main characteristics of developmental states include: (1) stable political rule ensured by a political-administrative elite that does not accede to political pressures which could impede economic growth; (2) cooperation between the public sector and the economy that is guided by an economic planning agency; (3) investment in universal education and policies aimed at a more equitable distribution of opportunities and wealth; and (4) a government whose members understand the need for market-conforming policies and interventions (Johnson, 1987; 1999).

A most critical feature of a strong (developmental) state is the necessity to ensure the autonomy of both the economic bureaucracy and the political elite who are in charge of strategy formulation and economic policy making. Hence, public sector reform, particularly public administration reform, is a key governance issue in order to strengthen the state apparatus, which has to be addressed at an early stage of the reform process. It concerns the core institutions of government and includes (1) strengthening of central mechanisms for economic policy formulation, coordination, and implementation; (2) public financial management reform, including strengthening audit capacity; and (3) civil service reform. Economic reform and transition call for new kinds of professional and managerial expertise.
Strong and effective institutions are needed to perform market-friendly government functions including the provision of public goods and a legal and regulatory framework for market transactions, protection of property rights, and contract enforcement.

However, administrative professionalism is only a necessary, not a sufficient condition for effective policy reform. Other institutional key features of public administration reform include the replacement of political appointments and dismissals by the introduction of meritocratic standards in promotion and in recruitment, providing civil servants with opportunities for long-term career rewards, and setting transparent rules for hiring and firing.\textsuperscript{34}

Finally, state strength also depends on the legitimacy of the political regime. An interesting facet of the recently emerged “new thinking” is that even the \textit{Juche} doctrine has been subject to reinterpretation. As Kim Jong-il stated in May 2001: “We should have a correct understanding of self-reliance. The nature of self-reliance we referred to in the past is qualitatively different from the one we refer to know,”\textsuperscript{35} namely enhancing efficiency and promoting technology. A gradual shift in political articulation and action toward a “socialist market-based economy, North-Korean style” and the overall goal to pursue “growth and prosperity of the Fatherland” may in fact help the political elite to undertake gradual economic reforms under the umbrella of socialism without losing its face.

\textit{Strength without Limits?}

While a strong government is essential to formulate and implement economic reform, it raises the risk that policy makers are tempted to violate economic rights of entrepreneurs and to confiscate citizens’ wealth, thereby creating disincentives for economic actors to carry out long-term investment and to provide information, which in turn blocks thriving (or in the North Korean case: the emergence of) markets, and eventually impedes economic development. If there are no institutional safeguards that hinder policy makers from altering rights, laws, and regulations at will, it is almost impossible to make credible commitments to economic actors and es-
pecially to foreign investors. Hence, for a MEGS to evolve and to survive, public officials (and also economic actors) must have incentives to abide by the system's rules. Policy makers must find it in their own interest to observe a set of (private) economic rights as well as the limits on government behavior. Therefore, a MEGS need to include institutional arrangements, which monitor the behavior of public officials and penalize misbehavior, reduce information asymmetries, stabilize expectations, and provide economic actors with exit and/or voice options. In general, a relatively effective means to raise the political transaction costs of establishing power cartels is to institute several independent channels of control over government agencies and individual public officials. Another complementary means is to craft institutions that provide citizens with information about political activities and help to coordinate their actions so that they can react in concert if political officials transgress private rights.  

Therefore, in advanced countries with developed market economies, state strength is usually limited through a subtle system of checks and balances, a horizontal and vertical separation of power, free and general political elections, appropriate state-business-society interfaces, the work of independent domestic NGOs and watchdog organizations, or systems of market-preserving federalism. But none of these options appears to be available in today's North Korea. If, however, a strong North Korean state is an unalterable precondition for effective market-oriented reforms, what would be a suitable mechanism to limit such a possibly emerging strong government? One approach would be that the government binds its own hands at least with respect to specific policy realms and imposes limits upon its activities (e.g., through establishing an independent central bank in the course of a major reform program). At present, this option cannot be realistically expected, although its realization may become feasible in the long run. The only currently feasible alternative is to establish limits on the government through external flanking of North Korea's reform and integration process as discussed above. Even if the engagement and international involvement of the DPRK is an imperfect disciplining device, it may be appropriate to provide the Kim Jong-il regime with incentives to
conduct domestic economic reforms. Gradually opening up the economy and increasing its exposure to foreign competition as well as membership in international organizations such as the World Bank and the ADB and hence the obligation to abide by these organizations’ rules and policies might slowly help to make a potential commitment to reform credible.

**Capacity Building**

Successful economic reforms require not only a secure political foundation, but also the capacity of the state apparatus to implement and enforce political decisions, public policies, and regulations. Strategies, programs, and decisions aiming at economic reform neither change policy nor yield desired results automatically. Even if policies are well-designed, substantial implementation problems may occur.

Capacity building refers to measures at three levels: (1) institution building (i.e. replacing a less efficient by a more efficient set of rules and functions); (2) organizational restructuring (i.e. the design of organizational forms better suited to the new set of institutions); and (3) human resource development (in particular education and training). Capacity is the ability of public sector organizations to perform appropriate tasks effectively, efficiently, and sustainably. Beyond the set of irreducible public sector functions such as establishing law and order and setting the rules of the game for economic and political interaction, appropriate tasks are those defined by necessity, history, or specific situation within a given country (Grindle and Hilderbrand, 1995). In this context, it should be emphasized that human resource development without institution building and organizational restructuring will have no sustainable effect. This argument particularly holds for North Korea, where those administrative institutions and organizations, which are essential for the functioning of a (rudimentary) market-oriented system, are virtually absent.

A systematic and coherent approach to constitute a MEGS in North Korea must go beyond measures to foster human resource development and seek to reform existing institutions and to craft new ones that perform core governance functions. Sector-specific steps to overcome weaknesses
in governance must be supplemented by cross-sector and macro-level attempts. For example, in the absence of a sound macroeconomic policy framework, initiatives at the sector level will not yield the desired results. Similarly, since the structure of the public administration imposes a uniform stamp on all public agencies, a broad macro-level attempt to resolve administrative impediments is needed to increase the chances of efficient project implementation and the benefits to a wider segment of society.

Given these interdependencies, the reform of the economic bureaucracy will be more effective if it is approached wholesale. Since measures such as higher salaries, performance-based employment, downsizing of surplus staff, and organizational restructuring are central to improving the implementation capacities of weak executing agencies, it is necessary to complement sector-level capacity building with measures that must be applied to public administration in its entirety. This appears to be even more important if one considers that implementation depends not just on line agencies but also on the ministries and departments that oversee their work. It is these civil servants, directly under the political leadership, that allocate resources, and take or influence the decisions that critically determine the outcome of economic projects and policies. Much more so than in the case of line agencies, reforming these core government functions requires integrated approaches focusing on the public administration as a whole.

A systematic approach to overcome major institutional and structural impediments to sound and market-oriented economic management would, for example, include

- the introduction of hard budget constraints in the public sector
- strengthening personnel management through merit-based recruitment and promotion schemes
- competitive wages for bureaucrats that can increase integrity and professionalism
- independent personnel agencies that reduce external pressure on appointments and patronage
- effective accounting and auditing practices to enhance the financial accountability of policy makers
\* statutory boards partitioning the policy space by assigning single policies to special agencies that help monitor bureaucratic performance
\* publication of government documents and data (e.g., rules and statutes, budgets, and revenues)
\* anti-corruption agencies which reduce bureaucrats' propensity to use their specific information for extra-legal activities
\* improving and enforcing legal and regulatory frameworks
\* clarification and institutionalization of the relations between the central government and local authorities
\* establishing institutionalized linkages to the nascent private sector and promoting its development.

Such steps aimed at public administration reform would not threaten the political regime per se, so that their realization appears to be feasible even in the North Korean context. To be effective, however, institutional and organizational reforms must be accompanied by improvements in human resource development, the more so as knowledge of market economics and modern management techniques is virtually absent in North Korea. Moreover, civil servants have been accustomed to following directives from their superiors and discouraged from taking their own initiatives, cooperating horizontally across government departments, reporting deficiencies of the administrative system, or making suggestions for its improvement. Therefore, bureaucrats need to develop new behavioral routines and work ethics, which may be facilitated through investment in human resource development. In this context, it is of utmost importance to strengthen the overall education system and to accept technical assistance, which can be provided by international organizations such as the ADB or the United Nations Development Programme. More specifically, owing to the huge training and capacity building needs, one may, e.g., think of cost-effective and sustainable measures such as hiring long-term foreign consultants to provide on-the-job training, seminars, and workshops on market economics and modern management techniques, which enhance skills and improve the communication among public officials, and
train-the-trainers programs, study tours, and long-term training abroad. In order to ensure that the North Korean government can assume full ownership of any reform program, capacity building measures, which are conducted in collaboration with foreign consultants or international organizations, need to be based on commonly understood goals possibly embodied in a memorandum of understanding, and donor organizations and their North Korean counterparts should jointly develop a road map for projects and reform programs.

**Building Economic Institutions**

Today, it is widely recognized that macroeconomic stabilization, privatization, and price reforms are necessary but insufficient steps in economic transition and that appropriate economic rules and regulations must be crafted as early as possible in order to make incentives work and markets perform well, to reduce transaction uncertainties between economic actors, and hence to support market development and coordination. But which are the key economic institutions that matter for market performance? A useful starting point is the set of *constitutive principles* of a market economy elaborated by the German ordo liberal school and, in particular, by Eucken (1990/1952). Ordo liberals derive their prescriptions for public policy making from the notion of *order*, which is a fundamental precondition for making governance structures effective.

Order means that repetitive events or actions fit into a discernible pattern which allows people to have confidence that the pattern of future actions, on which they may depend, can be predicted reasonably well. If the world is ordered, complexity, and hence the knowledge problem, is reduced and economic agents are better able to specialise. Institutions serve to facilitate the emergence of order. (Kasper and Streit, 1998: 151; emphasis omitted).

*Ordo* liberal scholars favor order policy (i.e., supporting and enhancing the economic and social order of society) over process intervention. This maxim is essentially based on three axioms: (1) cognitive abilities of in-
individuals are limited so that an order that allows recognizable patterns to be uncovered, will improve living standards through an enhanced division of labor and give citizens distinctive realms of freedom; (2) individual economic freedom is an unalterable prerequisite of competition; and (3) order is required to make binding commitments possible and to enforce formal rules in order to overcome problems of asymmetric information and the temptations of opportunistic behavior (Kasper and Streit, 1998).

The constitutive principles of order policy which promise to enhance and maintain competitive markets include a flexible system of market prices, monetary stability, private property rights, open markets (i.e., freedom of entry and exit), liability of economic actors for their actions and commitments, freedom of contract, and the steadiness of economic policy making. Since the proper functioning of a competitive order is based on the decentralized ex post coordination of individual plans and actions through market transactions, establishing a system of flexible market prices will be the focal point of creating and maintaining a market economy. Only a price system that reflects the scarcities of goods, services, and the factors of production can efficiently fulfill the functions of a competitive system.

These principles need to be complemented by so-called regulating principles, because actual market-oriented economies may show weaknesses and deficits that require correction. Eucken thus emphasizes the need for anti-trust policies in order to prevent the emergence of monopolistic power, the need to correct income distribution in order to enhance social justice, the need for social safety nets and the protection of employees, and the need for institutions that help internalize external effects. Furthermore, as emphasized by more recent research findings, substantial market and coordination failure frequently impede economic growth particularly in developing and transition countries. Thus, it is critical to understand that regulation may go beyond issues such as securities regulation, financial supervision, and anti-trust. Rodrik (1995 and 1999) and Lau (1997) persuasively argue that, e.g., imperfect capital markets and coordination failures require strategic government interventions in order to trigger socially desirable pri-
vate investment. By referring to the experiences in East Asia (particularly in South Korea and Taiwan in the 1960s and 1970s), they show that governments effectively coordinated private investment decisions, provided targeted subsidization and thus helped to initiate a process of sustained growth. However, while institutions such as staggered entry procedures regulating market access, financial restraint, and the provision of contingent rents worked effectively in these countries, similar mechanisms failed elsewhere. This fact does not call into question the usefulness of specific policy interventions per se, but indicates the need to sustainably improve the quality of the domestic governance structure, which determines the efficacy of government action in a given country setting.

Which economic institutions should be established in North Korea if it pursues a gradual reform process and aims at a staggered economic integration with South Korea? Although the constitutive principles are interdependent and hence ought to be crafted simultaneously, such a radical institutional change is politically not feasible. With respect to economic integration, such an approach would not be necessary either, until the two Koreas decide to found a free trade area or a (restricted) common market. Therefore, the North Korean leadership may enjoy some degrees of freedom in institution building during the early stages of the integration process. Thus, it appears to be reasonable to aim at an economically second-best solution, which is pragmatic and politically feasible.

Establishing macroeconomic stability is an unalterable precondition for any reform program. This presupposes a market-oriented price system and a (possibly) independent central bank as well as prudent fiscal management of public expenditures and at least a rudimentary market-oriented tax system. However, in the North Korean context, a complete price liberalization will hardly be realized, because such a move would contradict the interests of the political leadership. Similarly, although privatization of state-owned enterprises (SOEs) is a critical step in transforming a centrally-planned into a market economy, large-scale privatization will not be feasible in the short run. This could hardly be justified within the present Juche framework and would take the government into an ideological
cul-de-sac. Moreover, owing to the fact that much of the industrial capital stock will be rendered obsolete in the course of economic transition, a quick large-scale privatization would, in the absence of (foreign) investment capital, lead to numerous bankruptcies (or continuing massive government subsidies). This, in turn, would threaten to undermine emerging confidence in the functioning of market forces and could impede overall economic reform. In this context, it may be more promising to legalize and extend already existing small-scale private transactions as conducted in farmers markets and in the retail sector.\footnote{Promoting newly emerging small and medium-size enterprises and would create a labor-intensive private sector gradually in a bottom-up manner. This could reinforce a (partial) price liberalization, support a badly needed supply-side reaction of the economy, and foster job creation. This, in turn, would help to absorb labor that will be laid off in the course of agricultural and industrial restructuring.}

Given the current political conditions, it is reasonable for North Korea to formulate an overall economic reform strategy that is based on a dual-track approach—similar to that of China. In fact, after an “unofficial” trip to China in January 2001, during which Kim Jong-il inspected Shanghai’s vibrant market economy, *Nodong Sinmun*, the Communist Party’s newspaper, pronounced that things are not what they used to be in the 1960s... . With the start of the new age of the 2000s, an all-around re-examination should be given to outworn patterns and practices... . We should bring about technical modernization by boldly doing away with what needs to be abolished, instead of being shackled by ready-made ideas or hanging on to old and outdated conceptions. (*Nodong Sinmun*, quoted in Eberstadt, 2002: 24-25)

This “new economic thinking” may have been greatly inspired by economic reforms in China. At least, North Koreans seem to regard the Chinese model as a suitable reference (Eberstadt, 2002).

Several scholars, however, argue that following the Chinese path of reform would be a mistake, because initial conditions as well as policy pri-
orities considerably differ between post-1978 China and today’s North Korea.\(^{38}\) They argue that China had an agricultural and rural society, whereas the DPRK is industrialized and urbanized; that the Chinese economy had achieved macroeconomic stability, which is absent in North Korea; that money had played a much more significant role in economic transactions in China; that China had (at least temporarily) conducted cutbacks in its military manpower and defense industries, whereas the Kim Jong-il regime sticks to its “military-first politics;” that China could rely on ethnic Chinese abroad for support—an option that may not be available to North Korea at present; and that an effective implementation of a Chinese-style gradual, dual-price strategy would presuppose substantial state capacity as well as macroeconomic stability, which are absent in North Korea. Eberstadt (2002: 33) concludes that if

North Korea were to experiment deliberately with a new economic direction, one might expect the chosen path to comport less with the recent “China model” than with the “military as modernizer” template familiar from the political economies of prewar Japan and Park Chung-hee’s South Korea.

Although these arguments are to be taken seriously and a successful reform strategy cannot be easily transferred from one country to another, the suggestion of adopting a dual-track approach to reform should not be rejected. In fact, any kind of effective economic reform (big-bang style or gradual) needs to be based on a macroeconomically stable environment and can be implemented only if the state apparatus has sufficient capacities and capabilities. Thus, strengthening the North Korean governance structure as well as the government’s ability to stabilize the economy need to be given a high priority on the reform agenda. Aside from that, it may be reasonably expected that, once North Korea pursues economic reforms seriously, substantial funds will be available from South Korea as well as the international community.

Additionally, under the current political conditions, a proper sequencing of economic reforms may mean that agricultural reform should precede in-
ustrial restructuring. Even if the starting position for North Korea (with an estimated share of roughly 33 percent of the labor force employed in agriculture) is not as favorable as it was in China at the end of the 1970s (more than 70 percent), it is much better than in the transition economies in central and eastern Europe. Moreover, given the chronic food shortages, agricultural reform needs to be given priority. In addition, agricultural reform promises to yield visible and instant success, which might increase confidence in market forces and strengthen the support of further reforms at later stages (Lee, 1997). The price reform in July 2000, which brought prices and wages closer to market levels, can be basically interpreted as a step in the right direction, if the North Korean leadership allows the supply side of the economy to react accordingly. Thus, in order to benefit from these changes, economic actors must be allowed to act according to price incentives and be provided with the respective means. Essentially, this requires quickly legalizing and expanding the nascent market conditions, which already exist in North Korea, and abolishing agricultural collectives (McMillan, 1997).

A greater impediment to economic reform is the current heavy-industry bias. A large-scale restructuring of industry would not only be costly and time-consuming, but also overcharge the present administrative capacity of the state and contradict the interests of the political elite. This is another argument that supports the adoption of a dual-track approach. Such an approach would allow for maintaining parts of the planned economy for a transition period, until a possibly emerging private sector will have gained sufficient economic strength so that it can absorb surplus labor from heavy industry. Qian (1999: 17) succinctly summarizes how the system worked in China:

Under the plan track, economic agents were assigned rights to and obligations for fixed quantities of goods at fixed plan prices as specified in the pre-existing plan. In addition, a market track was introduced under which economic agents participated in the market at free market prices, provided that they fulfilled their obligations under the pre-existing plan. With this approach, real market prices and markets as a resource allocation institution
were created in China in the very early stages of reform.

Although this approach was frequently criticized by neoclassical economists for distorting resource allocation, more recent theoretical work as well as the Chinese experiences show that dual-track liberalization can be and in fact was efficient. Equally important, this approach provided the means to compensate potential losers from market reforms (Lau et al., 1997 and 2000). While the market track provided economic actors with the opportunity to increase their welfare, the plan track implicitly provided transfers that compensated potential losers from marketization by delivering the previous rents, which continued to exist under the maintained plan arrangements. Eventually, the dual-track liberalization served to reduce opposition to economic reforms \textit{ex ante} (because it temporarily protected status-quo rents) and increased the opposition to reform reversal \textit{ex post} (because an increasing number of agents benefited from the reforms in the course of time).

A dual-track approach in North Korea would not only help to gradually overcome obstacles to industrial reform, it would also be a reform that could be ideologically digested. Furthermore, it would be consistent with the gradual opening strategy suggested in the preceding section. Moreover, such an approach requires neither a complete price liberalization nor the introduction of full currency convertibility nor a large-scale privatization of SOEs. Nevertheless, it would be possible (and necessary) to create competition under a dual-track approach: by fostering the emergence of private businesses in sectors such as agriculture, retail trade, and light manufacturing, strengthening the corporate-control structures of, and introducing hard budget constraints for, SOEs (in addition, they may be put under the authority of regional or local administrations similar to China's so-called township and village enterprises). Finally and most important, this approach does not presuppose major political change.

Another major—perhaps the most critical—challenge to politics will be the migration flows to South Korea, but also to China, that are to be expected during an economic opening and integration process. Owing to the
large income gap between North and South Korea as well as limited economic and suppressed political freedoms, numerous North Koreans may be inclined to emigrate. This would entail a heavy brain drain for the DPRK, social and fiscal problems for South Korea, and potentially even political problems for China. Since massive migration will not be in the interest of any of the policy making parties, policy measures will be necessary to reduce the threat of an exit option. Even if the so-called demilitarized zone is maintained in order to control the movement of people, this may prove to be an insufficient device to discourage migration, especially if the border to China is not closed. Thus, even if border controls are maintained—and they should be, until the Koreas agree on establishing a common market—additional policy measures are needed that provide North Koreans with incentives to stay.

Remedies for potential exit, which could be used in a "creative response" (Hirschman, 1978: 104), must provide people with some "attractions," which would reinforce their normal reluctance to leave and enhance their loyalty vis-à-vis the North Korean regime. In this context, one may think of improvements in the provision of public and private goods. More specifically, a shared-growth strategy, which provides people with real assets, may prove to be a suitable incentive system (McMillan, 1997). Real assets may include granting private property rights to the North Korean population regarding the houses and apartments in which they live, pieces of land that they could cultivate, as well as free education and health care. In addition, fostering labor-intensive manufacturing, public investment in infrastructure, and land reform may help people to exploit their assets more effectively.

Moreover, such a shared-growth strategy may serve as a credible signal indicating the political leadership's commitment to reform and economic development. In addition, it can help, in combination with the dual-track approach, to create win-win situations, i.e. a reform without losers. This would enhance the legitimacy of the political leadership, reduce potential resistance to reform, and reduce incentives to migrate.

After all, a dual-track approach would not contradict the establishment
of the pillars of a developmental state as it was created in South Korea in the 1960s. If these pillars, which are discussed above, are adjusted to North Korean conditions, the incentive compatibility of policy making could be enhanced and—in combination with a dual-track liberalization—reform and integration could be gradually promoted.

**Conclusion**

The envisaged integration process on the Korean peninsula is, without doubt, one of the most complex and challenging issues now facing the Northeast Asian region. Whether or not economic rapprochement and cooperation between the two Koreas proves to become a viable policy option depends on the reform-mindedness of the North Korean leadership, the design of South Korea’s Nordpolitik, and the way in which third countries such as the United States, China, Japan, and Russia approach the Kim Jong-il regime.

Gradual economic reform and integration policies on the Korean peninsula need to be based on a secure political-institutional foundation. Sketching a conceptual road map regarding future economic integration provides reference points, which may help governments to avoid ad-hoc policy making and to navigate more systematically through the complicated terrain of institutional and policy reform. Thus, given the assumption that the North Korean leadership is willing to gradually open up its economy vis-à-vis South Korea and third countries, the central hypothesis of this paper is that it is of utmost importance to institutionally safeguard such a process by crafting an effective market-enhancing governance structure (MEGS) that improves the incentive compatibility of all parties involved in this process.

First of all, increasingly closer economic cooperation requires an "integration MEGS" that is suitable to (1) creating trust and confidence between the two Koreas and between the DPRK leadership and governments of third countries that play a significant role in Northeast Asian politics;
(2) governing a staggered integration strategy through the creation of institutions and organizations; and (3) externally framing and safeguarding the overall integration process. This "integration MEGS" should not explicitly aim at unification but rely on the notion of peaceful coexistence and mutual recognition and follow the principle of specific reciprocity. Institution building should be driven by pragmatic flexibility and politically feasible policy steps, which benefit both sides. Second, inter-Korean economic integration presupposes the creation of a domestic MEGS for North Korea, which enhances the capability and capacity of the government to implement economic reforms. The envisaged staggered integration strategy will provide the North Korean leadership with some degrees of freedom with respect to the scope, pace, and timing of reforms. Thus, at the early stages of integration, it will not be necessary to realize all constitutive principles of a market economy. Instead, North Korea could opt in favor of a politically feasible dual-track approach to reform similar to that of China.

Before concluding, several limits of the preceding analysis are briefly to be discussed. First, within a gradual reform-cum-integration scenario, it is not only necessary to craft an "integration MEGS" and a MEGS for implementing reforms in North Korea, it is also essential to adequately adjust the current South Korean governance structure to new political, economic, and international side conditions. Therefore, it would be desirable to extend the analysis and examine the institutional adjustment needs that would be faced by South Korea. Secondly, with respect to economic reforms in North Korea, the preceding considerations focused on basic reforms, which would be required at the early stages of economic cooperation. In the course of deeper integration, i.e. at the stage of a free trade area and beyond, many more reform measures are to be considered and conducted. This concerns, e.g., the questions relating to the introduction of currency convertibility, the choice of the exchange rate regime, the design of foreign trade policies, the privatization of SOEs, the creation and financing of social safety nets as well as the development of financial markets. Thirdly, as emphasized at the beginning of this paper,
the gradual reform-cum-integration scenario is only one scenario among
others. Since especially the collapse-cum-absorption scenario cannot be
ruled out ex ante, it would be useful to elaborate institutional safeguards
for this and other scenarios as well in order to prepare policy makers for
different contingencies. It is beyond the scope of this paper to address
these questions, but the mentioned limits may define a future research
agenda, which might contribute to a better understanding of the options
and constraints, the risks and benefits of inter-Korean policy making.

Economic and political development on the Korean peninsula is at a
critical moment. The North Korean economy is in the midst of decay,
famine is widespread, and the number of refugees to South Korea and
China has been significantly increasing. At the same time, since Kim
Dae-jung’s term in office is coming to an end in 2002, the design of South
Korea’s future Nordpolitik is far from clear. China and Russia appear to
support actively a constructive engagement policy vis-à-vis the DPRK,
whereas Japan and the United States take a rather ambivalent position. All
this may imply that the Kim Jong-il regime is seriously willing to normal­
ize relations with South Korea and other countries and to conduct gradual
economic reforms. But at present, the North Korean leadership is not able
to credibly commit to the transition toward a more market-based system.
Hassig and Oh (2002: 106) conclude:

In projecting trends, should one assume a linear trend in which North Korea slowly but
steadily opens up...? Or should one expect accelerating change, or a stop-and-go series of
openings and retrenchments? Of the many factors involved in influencing change and its
trajectory, arguably the most important is the logic of regime survival. Because North
Korea is governed by the will and whim of Kim Jong-II...the costs and benefits of change
should be viewed from Kim's perspective. This is the one constant and knowable factor in
North Korean affairs.

Hence, as long as effective political and economic institutions are not
in place, the pursuit of reforms in North Korea is solely contingent on per-
sonal leadership. This may turn out to be the Achilles heel of potential
market-oriented reforms in the hermit kingdom.

If, however, the Kim Jong-il regime opts in favor of economic reform and integration, a number of lessons can be learned from other transition economies, especially from China. In this context, it is important not to plan or anticipate the entire reform process but to craft MEGS that are sufficiently flexible to adjust to changing economic or political circumstances. Moreover, policy makers should not aim at economically (theoretically) efficient outcomes, but consider the political feasibility of reform and integration measures ex ante. Thus, institution building should aim to achieve two objectives: to enhance economic efficiency and competition and to create a win-win situation and thus make reforms compatible with the interest of the North Korean elite, the North Korean population, and South Korean citizens.

Finally, note that even gradual reforms accompanied by (slowly) increasing international cooperation in terms of food aid, financial and technical support, improved diplomatic relations, and normalization of relations with South Korea, Japan, China, Russia, and the United States may gradually unfold economic and political dynamics in the reform and development process which could put increased pressure on the government to further open up the economy. If political power and stability are not undermined, economic progress may make it easier for the government to support further reform steps as long as the sovereignty of the country, the legitimacy of the ruling elite, and its political monopoly are not adversely affected.

Notes

4. Notable exceptions include, e.g., Noland et al. (1998 and 2000), and Kim (2000).

6. For detailed descriptions of these scenarios, possible variations and deviations as well as policy implications, see Pollack and Lee (1999) and Noland (2000b and 2002).

7. Regarding the conflict scenario see the detailed analysis in Pollack and Lee (1999).

8. A comprehensive evaluation of the inter-Korean summit can be found in Chon (2002).


10. See Eberstadt (2002), Hassig and Oh (2002), and Economist Intelligence Unit (2002).


12. See, e.g., Noland (2000b) and Pollack and Lee (1999). Pollack and Lee (1999) account for yet another scenario, that is theoretically conceivable but, at present, hardly realistic: If the North Korean polity should enter an enduring stage of disequilibrium but not ultimately collapse and if external powers, in particular China, decide to support the weakened regime, its chances of survival would be substantially enhanced. Although the Chinese authorities are currently not inclined to do so and rather support Kim Dae-jung’s sunshine policy, Pollack and Lee (1999: xvi) identify three sets of circumstances which may lead the Chinese government to change its viewpoint: “(1) if the North...signals its readiness to ‘tilt’ toward Beijing in exchange for enhanced economic and political support; (2) if the indicators of instability in the North and its repercussions for stability and security in contiguous border areas convince the Chinese that they need to act to manage the risks to their security and ensure their long-term interests; or (3) if the ROK and the United States embark on unilateral actions to counter instability in the North that China believes would undermine its long-term political and security interests.”

13. The outcomes of these talks include an agreement on several future talks with respect to economic cooperation, promoting tourism, and the establishment of a permanent place to meet for separated families. However, no agreement was reached on a date for military talks, which are critical for a potential reopening of cross-border transportation lines; see “A ray or two of light in the gloom,” The Economist, August 15, 2002.

14. The disadvantage of such an engagement approach may be the risk of strengthening and rewarding a totalitarian regime and prolonging the suffering of millions of North Koreans, while the ruling elite benefits from foreign aid and investment; see Hassig and Oh (2000).

15. These assumptions essentially follow the line of reasoning in Noland (2001b).

16. This assumption may not hold, if the scenario referred to in note 12 occurs. Should,
e.g., China offer North Korea substantial cooperation and support in order to maintain the rigid North Korean regime and hence its prevailing disequilibria, collapse is less likely. However, this scenario is supposed to be least likely given the present (geo)political situation in Northeast Asia; see Pollack and Lee (1999).


19. Impediments to institutional change are discussed at length in Bardhan (2000) and Lin and Nugent (1995).


21. For further in-depth elaboration on this argument see, e.g., North (1995), North and Weingast (1989), and Ahrens (2002b).

22. Of course, this argument holds only for the gradual reform-cum-integration scenario. In the collapse-cum-absorption scenario, a North Korean political elite that needs to benefit from external economic relations does not exist.

23. For an overview of the discussion of governance and its impact on policy reform see Ahrens (2002b).

24. For a discussion of these principles and the corresponding imperatives for institution building see Ahrens (2002b).

25. See Ahrens (2002b) for an in-depth discussion of this analytical concept of governance. In addition, see Root (1996), Olson (1997), and Kaufman et al. (1999). Recent research by development and institutional economists has persuasively suggested that market-enhancing government activism is critical to economic development (Aoki et al., 1997, World Bank 1997). But since government interventions can also severely impede economic development, if it is badly designed and implemented, governance-related reform measures need to accompany or even to precede policy reform.

26. This aspect touches a politically highly sensitive issue: If, e.g., North and South Korea agree to cooperate more closely in economic terms and South Korea makes some specific investment in the North’s economy (say in the transportation sector), it must be ensured that no holdup occurs, i.e. a situation in which North Korean policy makers behave opportunistically, do not comply with the mutually agreed upon rules of the game and instead seek to capture the rents that would actually accrue to the investor from the South.

27. See Keohane (1986) for a critical discussion of the concept of reciprocity and its application in international relations.

29. Parts of this section draw upon, but considerably extend, the discussion in Ahrens (2002a).

30. See Economic Intelligence Unit (2001 and 2002). For a detailed stocktaking of North Korea's foreign trade regime and performance as well as a discussion of data reliability, see Noland (2000b) as well as Eberstadt (2001). In addition, see Noland (2001a) for an analysis of North Korea's unconventional and illicit activities to finance the chronic trade gap.

31. See Litwack and Qian (1998), who persuasively argue that SEZs could be used as effective catalysts of economic integration and reform even in transition economies that do not adopt a bold economic transformation program.

32. In this context, a Northeast Asian Development Bank, the establishment of which has been discussed and promoted for more than ten years particularly by the NEAEF, could play a key role in fostering an inter-Korean integration process; see Katz (2001) and Rowley (2001).

33. See Babson (2001a), Hassig and Oh (2002), and Xintian (2001).

34. For making meritocratic personnel policies work, governments need to place strong emphasis on education policies in order to create a pool of highly qualified potential civil servants. Note in this context that, although establishing effective economic bureaucracies is a complex task, it is not as time-consuming and difficult as one might expect. Countries as diverse as South Korea and Taiwan or France and Austria, whose bureaucracies were considered to be incompetent, ineffective, and non-meritocratic in the first half of the twentieth century and even into the 1950s, managed within some 20 years to establish high-quality public administrations through comprehensive civil service reforms; see, e.g. Chang and Cheema (2002).


36. For an extensive discussion of this argument, see Ahrens (2002b) and the literature referred to therein.

37. According to estimates of South Korea's Ministry of Unification, more than 300 "unofficial" markets exist, which meet more than 70 percent of the urban population's consumption needs (Babson, 2001b).

38. See, e.g., Eberstadt (2002) and Noland (2002).

39. See Noland (2000b). Thus, North Korea may not enjoy the advantage to liberalize its agricultural sector and release surplus labor into a potentially emerging light manufacturing sector to the extent that China was able to realize. Nevertheless, its employment share in agriculture is relatively high, so that agricultural liberalization could help to release needed la-
bor into other branches of the economy.

40. See Qian (2001) for an analysis of how institution building aiming at these two objectives worked in China.

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The Technology-Institutions-Productivity Nexus in the DPRK: A Comparative Perspective with the ROK

Youngil Lim

One needs to understand organizational change as usually a handmaiden to technological advance, and not a separate force behind economic progress.

—Richard Nelson

It was the adaptively efficient characteristics of the institutional matrix that produced an economic and political environment that rewarded productive activity of organizations and their development of skills and knowledge.

—Douglass North

Introduction

In recent years, historical events (e.g., the German unification, the death of Kim Il Sung, and the DPRK-ROK summit meetings) have been raising the specter of unification possibilities in the Korean peninsula. The events also raised the need to provide research on the consequences of unification scenarios. In this essay, I attempt to answer the following two questions. What does the incentive structure for learning new technology and for risk-taking look like in these economies?
How well does the difference in incentive structures as embedded in the system explain the performance gap in productivity between the two economies? These questions remain unanswered demanding further research, despite intensified debates in recent years. Given the expected political thaw and an increase in interactions, and negotiations between the two Koreas, it is timely to ask, what does the available evidence show? This essay attempts to provide an approach useful for answering the questions.

We begin by comparing productivity indicators between the two economies. The productivity difference, presented and evaluated in this paper, is the dependent variable to be explained. The major theme (or hypothesis advanced) is that the productivity difference is explained by a combination of three factors: the accumulation of industrial technology (knowledge), the accumulation of human capital (skills), and the accumulation of institutional-organizational assets (the crafting of "social technologies" to motivate risk-takers). The following sections analyze each factor in this order. Section two delves into the university system as the supplier of knowledge as well as human capital in the form of scientists, engineers, managers, and leaders in decision making. Section three examines the mode of enterprise organizations, particularly with respect to how the Taean enterprise management system (Kim Il Sung’s invention) works as a learning institution (versus the chaebol in the ROK). The common query addressed in these sections is: In what manner have incentive devices been embedded in institutions and organizations, and how have they motivated the actors (e.g., decision makers, managers, researchers, engineers, technicians, production-line workers, students and professors, etc.) to learn new ways of doing things?

**Productivity Indicators: A Comparative Review**

This section presents a set of selected indicators pertaining to productivity growth of the two economies. The questions addressed are: what
The trend of productivity (e.g., labor productivity and total factor productivity) during the thirty-year period 1965-95? What is the source of technological knowledge in each of the two economies? I juxtapose comparable numerical data from the two economies in order to assess the trend of productivity differences and hypothesize how productivity is linked to technological capability development.

The set of variables for review includes: labor productivity, the capital value-added ratio, and total factor productivity (TFP). A careful comparison of these variables (and others, e.g., industrial energy consumption per unit of value added) reveals the time pattern of productivity changes and enables us to speculate on its relationship with technological improvement or learning. This exercise paves the way for explaining the productivity gap in terms of institutional, historical “appreciative” theorizing à la Nelson.¹

**Labor Productivity**

Figure 21 shows the time shape of labor productivity from 1963 to 1995 for both Koreas. Since North Korea has never published actual employment data, a proxy indicator has to be compiled for our calculation of labor productivity. Fortunately the Korea Institute of National Unification (KINU) has recently published economically active population figures. Thus for labor productivity, the GDP figure is divided by the number for the economically active population. For North Korea, three different labor productivity series are shown in Figure 21. The first time series is calculated by using the Bank of Korea estimates of GDP (1963-97). The second and third series are based on Eui-Gak Hwang’s estimates of GDP (1963-90), using trade-related exchange rates and official exchange rates, respectively. The BOK series is calculated by using South Korean prices and North Korean physical output figures of goods and services following the United Nations system of national accounting (SNA). Thus, the BOK estimates avoid the use of North Korean exchange rates, which are controversial.²

The labor productivity so measured exhibits several points worth noting.

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Figure 21. Worker Productivity in North and South Korea, 1963-97

First, notice in Hwang's lenient estimates that North Korean labor productivity shows continuous gains reaching the US$6,000 level in 1980 from a little over US$1,000 in 1963. Subsequently the figure fluctuates within the US$5,000 to US$6,000 range. After 1990, labor productivity drops to about US$4,000. The labor productivity figure for South Korea has been soaring continuously without pause from US$331 in 1963 to US$23,469 in 1995 (all in current US dollars), an increase of more than seventyfold. This contrast in performance of productivity growth needs to be explained.

Second, observe that the labor productivity curves of the North and the South cross each other in 1979 if Hwang's "lenient" estimate of GDP is used. The crossing occurs in 1975 if Hwang's GDP estimates are adjusted using trade exchange rates, and in 1969 if the BOK's GDP figures are used. Much of the difference arises from which exchange rate is adopted: the official rate or the trade rate. Which exchange rate represents the true value is at issue, which will prompt research and debate for years to come. For our discussion here, it suffices to recognize that the productivity curves of the two Koreas crossed sometime in the 1970s. The three estimates of labor productivity for North Korea move almost in "parallel," to wit, all three soared before 1980, began fluctuating after 1980, and regis-
tered decreases from 1990 on. This parallel movement prompts us to ask what factors led to the abrupt braking of North Korean productivity around 1980? And also, what factors led to the decline in productivity starting in 1990?

The factors explaining the productivity drop in 1990 appear relatively easy to identify. The demise of the Soviet bloc (1989) looms large as the major factor. For decades the Soviet bloc provided aid for development, technology transfers often in the form of factories and equipment, petroleum at friendship (subsidized) prices, and dispatches of engineers to solve problems in North Korean industries (see Table 16). The sudden demise of this relationship in 1990 wrought havoc on North Korea. The industries could not adjust to the abrupt stoppage in supplies of technology. They were unable to recover via alternative sources of new machines to replace obsolete ones, machine parts, raw materials, feeding stock and oil. Furthermore, the major markets for North Korean exports disappeared. In short, although the ideology of national self-reliance was the dominant guiding economic principle for several decades, the economy failed to become truly independent in any sense of the word (even in a limited sense). In addition, the continuously bad weather (alternating between floods and drought) for almost a decade brought about an unprecedented famine. Starvation was reported to have resulted in a death toll variously estimated from 300,000 to 3 million. The bad weather incapacitated the rationing system particularly of rice and other grain, prompting industrial line workers to hunt for food rather than attend to production lines. From 1990 to 1998, North Korean GDP recorded negative growth figures consecutively, thanks to the double blows, the fall of the USSR, and the weather. Defectors testified that the industrial sector was operating in recent years at only 20 to 30 percent of output capacity. The lost ground over almost a decade resulted in the need for a massive infusion of capital and restructuring of industries and infrastructure.

Regarding the stoppage in 1980 of the ascending productivity trend, a number of events could be enumerated as contributing factors. First, the 1979 global oil crisis did trigger a downward spiral in trade which hurt

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Table 16. Industrial Development Aid from Socialist Countries and Its Contribution to the Industrial Output Capacity of North Korea, 1970

<table>
<thead>
<tr>
<th>Product</th>
<th>Output Capacity Increase Due to Aid (% of total capacity)</th>
<th>Type of Aid</th>
<th>Country Providing Aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>10</td>
<td>grant</td>
<td>Poland, USSR &amp;</td>
</tr>
<tr>
<td>Electricity</td>
<td>84</td>
<td>loan &amp; grant</td>
<td>Czechoslovakia</td>
</tr>
<tr>
<td>Coking coal</td>
<td>27</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Pig iron</td>
<td>21</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Steel</td>
<td>4</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Metal rolling</td>
<td>51</td>
<td>grant</td>
<td>USSR, Poland &amp; Czechoslovakia</td>
</tr>
<tr>
<td>Electrolyte zinc</td>
<td>9</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Electrolyte copper</td>
<td>23</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Non-metal rolling</td>
<td>100</td>
<td>loan</td>
<td>Czechoslovakia</td>
</tr>
<tr>
<td>Metal cutting</td>
<td>29</td>
<td>grant</td>
<td>Czechoslovakia &amp; Hungary</td>
</tr>
<tr>
<td>Tools</td>
<td>100</td>
<td>grant</td>
<td>Czechoslovakia</td>
</tr>
<tr>
<td>Ammonia fertilizer</td>
<td>44</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Hydrochloric acid</td>
<td>20-25</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Sulfuric acid</td>
<td>3</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Tire</td>
<td>100</td>
<td>loans</td>
<td>China</td>
</tr>
<tr>
<td>Cement</td>
<td>26</td>
<td>loans &amp; grant</td>
<td>USSR, Romania &amp; Czechoslovakia</td>
</tr>
<tr>
<td>Magnesia clinker</td>
<td>26</td>
<td>grant</td>
<td>China</td>
</tr>
<tr>
<td>Window glass</td>
<td>60</td>
<td>grant</td>
<td>China</td>
</tr>
<tr>
<td>Miscellaneous fiber</td>
<td>44</td>
<td>grant</td>
<td>USSR &amp; China</td>
</tr>
<tr>
<td>Paper</td>
<td>18</td>
<td>loans</td>
<td>China</td>
</tr>
<tr>
<td>Leather shoes</td>
<td>5</td>
<td>loans</td>
<td>China</td>
</tr>
<tr>
<td>Canning</td>
<td>100</td>
<td>grant</td>
<td>USSR</td>
</tr>
<tr>
<td>Sugar</td>
<td>100</td>
<td>loans</td>
<td>China</td>
</tr>
<tr>
<td>Radio broadcasting</td>
<td>95-100</td>
<td>loans</td>
<td>USSR, China &amp; Czechoslovakia</td>
</tr>
</tbody>
</table>


North Korean earnings of foreign exchange. In the early part of the 1970s, North Korea resorted to the large-scale importation of industrial plants and equipment financed by loans from a group of OECD countries. This move was to counteract the dwindling Russian aid to North Korea (originally due to China-Soviet disputes and North Korea’s equal-distance diplomacy in the 1960s). However, the failure of North Korea to service mounting foreign debts (leading to a repayment moratorium) in the late 1970s led to the loss of its credit worthiness in world financial markets. Consequently North Korea was severely constrained in the import of technologies, machines, parts, oil, and input materials for the industrial sector. Though trade volume has occupied only a small proportion of GDP (US$3.2 billion worth of imports in 1988, the peak year, or 5.7 percent of GDP, compared with US$51.8 billion or 30 percent of GDP in South Korea), imports of these goods have been critical to sustaining productivity growth in North Korean industries. The 1979 oil shock only aggravated already existing foreign exchange constraints, and this in turn contributed to retarding productivity growth in industry.

The second cause for the halt in productivity gains was that the North Korean regime was burdened by what one might call “regime maintenance expenses,” namely, defense and monument building. The primacy of these expenses added to the rigidity of the economic system weakening its capability of restructuring to respond to external shocks. The confluence of this long-run sclerotic tendency and the 1979 oil shock cum bad harvest in the same year provides an explanation of the sudden stoppage of productivity growth.

The ROK Statistics Office estimated that in 1980, the DPRK spent 24.0 percent of GNP for defense, compared with the ROK figure of 6.3 percent. During the Six-Year Plan (1971-76) period, a whopping 83 percent of investment went to heavy industries while light industries (mainly consumption goods) received only 17 percent of investment. In South Korea, by contrast, 68 percent of investment went to heavy industries and 32 percent to light industries during the 1974-81 period when the drive for heavy industrial development was at its peak.
Capital-Value-Added Ratio

The capital-output ratios can be conveniently compared between the two economies without the need to convert data into dollar figures, as shown in Figure 22. Observe that the North Korean series show a consistently higher capital-output ratio than the South Korean counterpart. (Output in this case is value added.) In large part the North Korean emphasis on heavy cum defense industries, as noted earlier, accounts for the gap in the ratio, a hypothesis that ought to be tested further as more data becomes available. It must be added also that waste due to micro-level inefficiency (e.g., due to slipshod engineering), inter-firm coordination problems (turf interests), and input-hoarding associated with target bargaining may partly account for the North-South gap in capital-output ratio. The rising trend of the ratio, in conjunction with negative TFP growth as well as other indicators as shown below, hints at a serious long-term deterioration of efficiency.

Industrial Energy Consumption per Unit of Value Added

North Korea was blessed with abundant energy resources, mainly rich coal deposits and hydro-electricity generation. The latter is a part of the
legacy of the Japanese arsenal buildup in the North Korean region. Thus, North Korea had a start-up advantage over South Korea so far as energy supply was concerned in the race to industrialize. From the beginning of the industrialization process, North Korea followed energy-intensive, resource-intensive, and heavy industry policies. South Korea, in contrast, entered into heavy industries in a wholesale manner only in the 1970s after a labor-intensive and light-industry period in the 1950s and 1960s. So, a North-South comparison of energy-intensity of the industrialization process is of interest to our inquiry of productivity performance.

Table 17 presents the figures for total energy consumption devoted to the production of industrial goods as well as the same figures per US$1 million worth of GDP in the two economies. Note that North Korea's total industrial energy consumption exceeded that of South Korea until 1988. Note also that in terms of the consumption figure per unit of value added (per US$1 million worth of GDP), North Korea recorded a higher figure every year during the 1971-92 period. The ratio of the North and the South ranged between 2.0 and 4.2 with a rising tendency after 1985.

Juxtaposing the energy consumption ratio and the capital-value-added ratio with labor productivity, one could argue that North Korea has been less efficient than South Korea in the race to industrialize. Relatively low labor productivity in North Korea compared with South Korea is associated with a higher requirement of capital and energy per unit of value added. The performance gap gauged in these indexes corroborates with an estimate of total factor productivity as shown below.

**Total Factor Productivity**

Though controversy abounds regarding what total factor productivity really measures, it allows us to observe the productivity growth of capital and labor as a joint input. I regard TFP as a convenient method of gauging "the pace of learning" in a summary index, although some call it an "index of our ignorance" because we do not know yet what determines TFP. Despite methodological debates, a useful study of TFP for the North Korean economy has been published, permitting us to compare North and
Table 17. Energy Consumption in Industry, Total and Per Unit of GDP, in North Korea and South Korea, 1971-92

<table>
<thead>
<tr>
<th>Year</th>
<th>Energy Consumption in Industry Total (1,000 tons oil equivalent)</th>
<th>Energy Consumption (1,000 tons oil equivalent) per US$ million GDP</th>
<th>Ratio (North/South)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(A) North</td>
<td>(B) South</td>
<td>(C) North</td>
</tr>
<tr>
<td>1971</td>
<td>21,868</td>
<td>5,411</td>
<td>1,931</td>
</tr>
<tr>
<td>1972</td>
<td>17,461</td>
<td>5,749</td>
<td>1,323</td>
</tr>
<tr>
<td>1973</td>
<td>18,793</td>
<td>7,442</td>
<td>1,202</td>
</tr>
<tr>
<td>1974</td>
<td>19,458</td>
<td>7,780</td>
<td>918</td>
</tr>
<tr>
<td>1975</td>
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<td>16,500</td>
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<td>37,208</td>
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<td>1992</td>
<td>26,375</td>
<td>44,349</td>
<td>581</td>
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South productivity performance. It is worth keeping in mind that the meaning of what is measured by TFP differs between the North and the South. In the North, prices are not determined by market competition but by the state planning authority. Hence the measured TFP reflects, not consumers’ preferences, but the state’s preferences. But it is still useful to compare the time shape of TFP of two different economic systems because it serves as a method of measuring the pace of learning in the long term. See Table 18 for TFP of North Korea and Table 19 for TFP of South Korea.

Note first in Table 18 that the North Korean TFP growth (annual rate) declined from +2.5 percent (1971-77) to −1.9 percent (1978-86). In general, TFP growth slowed over the whole period (1966-90), averaging only a 0.4 percent growth annually. In comparison, as shown in Table 19, the South Korean TFP grew at 1.7 percent annually for the whole (1966-90) growth from 1.3 percent annually (1966-70) doubling to 2.6 percent annually (1985-90).

Note also that capital stock grew at almost the same rate for the whole period for both economies, that is, at 12.4 percent annually for North Korea and at 12.9 percent annually for South Korea. It is striking to observe that, given similar efforts for investment, one economy (the South) learned to accelerate productivity growth over a long (25 year) period of time while the other (the North) retrogressed (i.e., became less and less efficient over the long run). This means that in North Korea, for a given increment of output, production requires a greater amount of labor and capital than in earlier periods. The opposite applies to the South Korean production function. For the production of a given increment of output, less inputs (capital and labor combined) are required. The phenomenon of the TFP performance gap between the North and the South require an explanation.

Short-run triggers, which could result in economic downturn at any given moment in time, include shocks and sudden unexpected events such as oil-crises, breakdowns in trade due to political revolution, poor harvests due to bad weather, and the like. But the long-run gains or slowdown of
Table 18. Annual Average Growth Rates of Capital, Labor, and Total Factor Productivity in North Korea, 1966-90

<table>
<thead>
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</tr>
</thead>
<tbody>
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<td>GNP (A)</td>
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<td>12.1</td>
<td>7.1</td>
<td>5.2</td>
<td>8.8</td>
</tr>
<tr>
<td>Capital (B)</td>
<td>10.1</td>
<td>14.1</td>
<td>13.4</td>
<td>9.9</td>
<td>12.4</td>
</tr>
<tr>
<td>Labor (C)</td>
<td>3.0</td>
<td>3.6</td>
<td>3.4</td>
<td>2.7</td>
<td>3.3</td>
</tr>
<tr>
<td>Capital productivity (D)</td>
<td>0.1</td>
<td>-2.2</td>
<td>-6.3</td>
<td>-4.7</td>
<td>-3.6</td>
</tr>
<tr>
<td>Labor productivity (E)</td>
<td>7.2</td>
<td>8.5</td>
<td>3.7</td>
<td>2.5</td>
<td>5.5</td>
</tr>
<tr>
<td>TFP (F)</td>
<td>3.2</td>
<td>2.5</td>
<td>-1.9</td>
<td>-1.6</td>
<td>0.4</td>
</tr>
</tbody>
</table>


Note: GNP (A) is estimated at 1985 constant prices. Capital (B) is estimated by Tongho-ho Cho, “Optimal wages and labor productivity in North Korea: an inquiry into the quality of North Korean labor force,” Hanguk Kaebal Yonku (KDI Korean Development Studies), Vol. 15, No. 4 (Winter 1993), P. 55. Labor (C) is “economically active population,” estimated by Korea Unification Institute (see Cho, ibid). D = A - B, E = A - C, F = A - (0.563 x B + 0.437 x C). Cobb-Douglas production function is used to estimate the coefficients for capital and labor.

Table 19. Annual Average Growth Rates of Capital, Labor, and Total Factor Productivity in South Korea, 1960-90

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>7.7</td>
<td>14.4</td>
<td>9.5</td>
<td>9.3</td>
<td>8.5</td>
<td>10.7</td>
<td>10.3</td>
</tr>
<tr>
<td>Output</td>
<td>6.9</td>
<td>16.7</td>
<td>12.1</td>
<td>15.8</td>
<td>10.2</td>
<td>10.5</td>
<td>12.9</td>
</tr>
<tr>
<td>Labor</td>
<td>6.2</td>
<td>9.5</td>
<td>5.2</td>
<td>4.0</td>
<td>3.1</td>
<td>6.1</td>
<td>5.4</td>
</tr>
<tr>
<td>TFP</td>
<td>0.5</td>
<td>1.3</td>
<td>1.9</td>
<td>0.2</td>
<td>2.4</td>
<td>2.6</td>
<td>1.7</td>
</tr>
</tbody>
</table>


Note: The estimates are for the whole economy excluding agriculture. The estimates of TFP for the manufacturing sector only show a 3.0 percent average annual growth for the whole period (1966-90) compared with only 1.7 percent noted above. See for details, A. Young, ibid.
TFP period. Furthermore, the general tendency was a rising pace of TFP growth requires an examination of what happened to the systemic capability to restructure. An analogy may illustrate the point.

An epidemic influenza virus may cause sickness in some people, while not affecting others who are exposed to the same virus. In addition to the viral shock to a community, the comparative strength/weakness of individual immune systems must be considered in analyzing the final result. Likewise, in explaining the difference in TFP performance, the institutional architecture of the two Koreas needs to be compared analytically. Our hypothesis proposes that the incentive structure embedded in the economy differs greatly, and the structural difference explains, to a large extent, the diverging TFP trends in the long-term. In particular, our inquiry scrutinizes the incentive structure motivating managers and line-workers alike to take risks in learning new ways of doing things (new technologies).

_Explaining Long-run Productivity Performance_

The brief review of the set of selected indicators leads us to a number of observations. First, in the 1950s and 1960s, the indicators suggest North Korea’s productivity and the pace of learning technologies progressed ahead of South Korea’s. But sometime in the 1970s (or even in the 1980s depending upon the specific index or exchange rate we use in our analysis), North Korea began to lag behind South Korea in terms of productivity performance. How can long-run productivity gains (or losses) be explained?

A brief description of the conceptual approach (or a set of propositions) adopted for this study is as follows. The first theme proposes that productivity growth (however measured such as labor productivity or total factor productivity) is determined by a combination of knowledge assets, human capital assets, and organizational-institutional assets. The major players in creating these assets include (1) universities and colleges, suppliers of knowledge (science and technology) and human capital (e.g., scientists, engineers, managers, etc.), and (2) enterprises and organizers-exploiters of technological knowledge and human capital at the micro-level.
The University System as Supplier of Knowledge, Scientists, and Engineers

A university system, capable of supplying well-trained scientists and engineers, is increasingly recognized as a long-term determinant of technical progress in a country, regardless of its stage of development. This section compares the university system of North Korea with that of South Korea. Emphasis is placed on the difference in incentives embedded in the architecture of university organization, incentives for professors and students to learn new ways of doing things, and to take risks in experimenting and creating innovative ideas. We review curriculum contents, graduation requirements, post-graduation job allocation, monitoring mechanisms for teaching and research, and promotion criteria for teaching staff. Special attention is paid to how ideology shapes the architecture of institutional devices, and thus leads to different behaviors and substance of learning among professors and students.

Kim Il Sung realized the importance of a university system rather early, although he himself never attended one. He established an exemplary university bearing his name in 1946. His ultimate aim was to construct a system of higher education to lead in theorizing his revolutionary ideas and to provide ideological training for party cadres as well as scientists and engineers. Kim started this endeavor in 1945 when Japanese professors and engineers withdrew following World War II. He was provided with a clean slate, namely, there was virtually no teaching or research capability at the university level. But Kim Il Sung succeeded in luring a number of renowned professors and engineers from South Korea by offering incentive packages containing attractive salaries and housing, full professorships, the promise of well-equipped research labs and opportunities for study in the USSR.

The contribution of these professors to North Korean education in sci-
ence and technology was highly valued by Kim Il Sung. In the late 1940s, two-thirds of the professors and researchers at Kim Il Sung University hailed from South Korea and they provided the initial thrust in the university’s academic development. Thus, the race for raising industrial productivity and technological upgrading on the Korean peninsula started with a contest over the minute extant pool of scientists and engineers (human capital).

**Quantitative Growth of Higher Education**

From the very beginning, Kim Il Sung was the main architect of higher learning institutions, especially with respect to implementing the Juche ideology as the guiding principle in designing curriculum, teaching methods, and performance criteria for compensation. An often-cited anecdote has it that he visited the university more than 120 times during the first twenty-year (1946-66) period in order to give “on-the-spot-guidance.”

Evidence suggests that North Korea has been investing a hefty sum of resources in raising the level of people’s education since the beginning of the DPRK regime in 1948. The DPRK launched a tuition-free compulsory education program for primary schools in 1956, middle school in 1958, and an 11-year compulsory program in 1972. The South Korean government prepared in 1953 a Compulsory Education Accomplishment Plan 1954-59, a plan for primary schools, but the plan secured only 38 percent of funds required. Primary education reached a 98.1 percent enrollment level only in 1971.

The number of colleges and universities in North Korea has also multiplied. Only four were reported to have existed in 1946-47. As of 1992, the number reached 280 with 314,000 students enrolled. But South Korea, by comparison, has 132 colleges and universities with 1,183,000 students enrolled in the same year (see Table 20). Considering that North Korea has about one-half of the population size of South Korea, the latter has achieved a higher proportion of enrollment (i.e., about twofold). The number of students enrolled in colleges and universities in South Korea has soared at an exceptional pace since the late 1970s, eroding North

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15. The Technology-Institutions-Productivity Nexus in the DPRK: A Comparative Perspective with the ROK
Table 20. Number of Universities and Colleges, Students Enrolled, and Teachers: North Korea and South Korea, 1946-92

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Universities and Colleges</th>
<th>Students Enrolled (1,000)</th>
<th>Students Enrolled per 10,000 Population</th>
<th>Number of Teachers in Universities and Colleges</th>
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<td>South</td>
<td>North</td>
<td>South</td>
</tr>
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<td>-</td>
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<td>-</td>
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<td>258</td>
<td></td>
<td>314.0</td>
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</table>


Note: * = Estimates by KCIA.

Korea’s lead in the 1960s.

**The University Party Committee**

Unlike South Korean universities, North Korean universities have been highly politicized. Every North Korean university is guided and controlled by the WPK Central Education Committee through party branches in every important aspect of higher education. Kim Il Sung explains the arrangement as follows:

15. The Technology-Institutions-Productivity Nexus in the DPRK: A Comparative Perspective with the ROK
The principal task facing university and college Party committees is to establish the monolithic ideological system of the party firmly among the teachers and students and to train all students as able cadres, find builders of communism, as the Party requires. These Party committees should organize the implementation of party education policy responsively and discuss every major university and college problem collectively, adopt sound measures and carry them out. The Party committees must consolidate their own and the LSWY (League of Socialist Working Youth) organizations in universities and colleges, increase their part and always control and guide the organized and ideological life of the teachers and students.14

The Party Committee of University dominates not only policy directions and guidelines, but also performance evaluations, and even the punishment of students and faculty members. The Institute of Peace Studies of Korea University (in Seoul) carried out an extensive study which enumerated the following functions of the Party Committee: (1) organize and implement projects establishing a “monolithic system of thought”—i.e., the Juche ideology, (2) provide systematic training of cadres in subsidiary organizations—e.g., the League of Socialist Working Youth, Occupational Unions, and Women’s Association, (3) implement projects to unite faculty and students around the party philosophy, (4) provide guidance to upgrade the functions of primary party units, (5) supervise methodology and direction of projects undertaken by intramural (student’s) organizations, (6) provide guidance to university administration and educational programs, and (7) assure military mobilization projects with thorough training and readiness of students and faculty for battle.15 The secretary of the University Party Committee assumes the position of vice president and carries the power and responsibility as commander of the intra-university military organization. All major issues of the university must receive guidance and approval from the University Party Committee. The vice president, though administratively subordinate to the president of the university, holds the real power to oversee the implementation of Juche ideology in all aspects of university life. He even monitors the behavior of the university president.
The university thus has an intertwined system of dual command channels. One channel administers the academic activities (teaching and research), and another implements the party’s objectives (indoctrination and implementation of Juche ideology). Figure 23 provides an organizational summary of this dual structure. The upper-right trunk of the organization represents the party organization within the university and the lower-left trunk the academic branches. Everyone must belong to one of the branch organizations in both trunks. For example, a student majoring in physics studies under the physics department and at the same time must belong to the League of Socialist Working Youth (LSWY or Sarochong in Korean abbreviation). A professor of biology is a faculty member in the biology department and also must join the Occupational Association. Thus, one is subject to double monitoring and double control (i.e., academically and ideologically). Of course, instructions and commands coming from the University Party Committee supersedes others (e.g., directions issued by the administration, departments, etc.) in all decision making as well as evaluation of performance.16

One of the major functions of the Party Committee is to oversee the translation of the Juche ideology into the university educational program. The ideology demands that university lectures should be combined and coordinated with research on factory-floor issues so as to train engineers to solve problems, and also to invent technologies for self-reliant industrial growth. That is, universities should supply industries with new technological ideas and home-trained engineers to eliminate dependence on foreign technologies, foreign researchers, and foreign raw materials.

A model case that was often cited by Kim Il Sung is the invention of a chemical fiber called Vinalon. Professor Soong-gi Yi developed a new technology to transform limestone together with anthracite into a man-made fiber (an input for textile material, and a substitute for cotton). He designed the plant and equipment as well as trained engineers to man the Vinalon factories. North Korea claims thus to have solved the problem of clothing people, and hence largely eliminated the need to import cotton. The Vinalon project provided the perfect model for Juche ideologues. It

15. The Technology-Institutions-Productivity Nexus in the DPRK: A Comparative Perspective with the ROK
Figure 23. Kim Il Sung University Organization Chart, 1997
showed that curriculum and research programs of chemistry departments could be organized to develop more Juche (self-reliant) industries.

The Juche ideology thus empowered the party to define priority sectors for R&D programs as well as science and engineering curriculum. The priority for research during the 1960s and 1970s included items such as man-made rubber, gasification of coal to help solve energy problems, technology to use abundant anthracite instead of coking coal (domestically unavailable) in making steel, technology to transform limestone and anthracite into carbide and the latter into fiber (Vinalon), machines and parts of all kinds (e.g., ball bearings), robotics, and so on. A self-reliant industry, as defined by Kim Il Sung, produces output with at least 70 percent of inputs coming from domestic sources. A creative scientist means therefore that a researcher should be creative within the confines of the priority areas (i.e., technologies to fulfill the 70 percent requirement) selected by the party.

Furthermore, the party authority (i.e., the Science-Education Department of the WPK) has the power to determine basic policy direction. After the party conference adopts the policy direction, the plan document is sent to the Science and Technology (S&T) Planning Department of the National Planning Commission. Here S&T policy is coordinated with other economic plans for consistency in resource allocation. Subsequently, the National Academy of Science provides technical details of R&D targets, which are then allotted to research institutes in universities, specialized colleges as well as R&D institutes of the Academy and the research sections of government departments. By the time specific projects reach individual researchers, the aim, the scope, the duration (deadline), the budget, and the expected results are mapped out in such detail that the researcher has little leeway or flexibility to adjust the research project. Under these circumstances, individual researchers are likely to attempt to meet the quantity target (i.e., numerical indexes, namely, deadlines, budget, and the number of expected results) with minimal effort.

In South Korea, on the other hand, the higher education system has no organization equivalent to the North Korean University Party Committee,
nor an autarkic and xenophobic ideology as the guiding principle of education. Typically, a South Korean university adopts a motto based on universal values such as freedom of thought, the accumulation of knowledge in diverse fields, the development of aesthetic culture, the study of civil ethics, the development of an individual’s innate talent, or contributions to nation building efforts as well as to the progress of humanity. These ideas are broadly consistent with the Confucian notion of self-cultivation (Inkyok Wansong).

Moreover, the science and engineering curricula in South Korean universities and colleges are generally patterned after their US counterparts. The Korea Advanced Institute of Science and Technology (KAIST) for example provides a model of successful emulation of US higher education in science and technology. In general, the South Korean S&T curriculum follows the US model in that the scientific body of knowledge in any specific field has its own life and growth-path with no purpose of serving an overarching political ideology. Further, publications in renowned international academic journals are considered the most objective and desirable form of achievement and hence recognition.

What Do Students Learn?

The purpose of having a university in North Korea is unambiguously defined in all published documents on education. The university ought to supply revolutionary leaders that the party needs in every field of socialist nation-building including science and technology. What is to be taught and how it should be taught, therefore, ought to be guided by the party. In Kim Il Sung’s own words:

Scientific and technical education should be wholly keyed to the Party policy. Instruction in all subjects should be fully based on the Party policy and linked to the actual situation in our country. We should thus make sure that the students learn what is badly needed for our revolution and apply their knowledge and techniques to revolutionary practice.

Kim Il Sung also organized the content of revolution into three catego-
ties, ideological, technological, and cultural. All three dimensions of revolution must complement each other. To wit, a technological revolution has to serve the ideological revolution by inventing technologies so as to help eliminate discrimination in work content between different social classes. This idea provides a guiding principle in research. For instance, the mechanization of mining work combined with robotics and electronics, should be able to reduce the hardship of miners to the level of light-labor workers. Likewise, new technologies could help close the gap of work intensity between men and women as well as between blue- and white-collar workers. The goal of making social classes obsolete should provide the motivation and zeal for students studying science and technology.

In the same vein, a cultural revolution could help to promote the ideological revolution—for instance, changes in life style from “individualistic mode” (e.g., competitive behavior serving narrow-minded self-interest) to “collectivist mode” (e.g., cooperative behavior or self-sacrifice benefiting the society or the nation). Old habits hindering progress (e.g., laziness, belief in fatalism, illiteracy, ignorance, opportunism, factionalism, distrust, etc.) should be replaced by revolutionary enthusiasm, loyalty to Kim Il Sung and his family, self discipline, earnest study habits, and so on. The university is charged with a mission to produce graduates who will lead in learning and to provide a role model in carrying out the “Three Revolution Movement.” The university system exists only for this purpose. Any dissenter (faculty or student) is guilty of heresy and faces the prospect of being purged. By implication science for the sake of science is useless, so the argument goes, and therefore cannot be tolerated.

The mission of the university so defined informs the content of curriculum, faculty rules, and organized activities, for example, at Kim Il Sung University. Table 21 presents a piece of evidence on the weight of ideological training in the 1960s and 1970s. Note that general requirement courses (i.e., ideologically oriented courses) take up 1,050 hours of the total of 5,400-5,600 teaching hours (almost 20 percent). These courses are designed for thorough indoctrination of students in Marxist and Leninist ideology (though since 1990, courses on Juche ideology and Kim Il Sung

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and Kim Jong Il’s history of revolution have virtually replaced Marxism and Leninism). A former doctoral candidate at Kim Il Sung University (now a defector studying in South Korea) recently wrote:

In the course work of natural science students at the University, ideological courses occupy about 30 percent of total hours of instruction. They include the biography of Kim II Song, the biography of Kim Jong II, the Selected Works of Kim Il Sung, the Collected Documents of Kim Jong II, Political Economics, and Philosophy. These courses do not help scientific research activities, but rather prove an unnecessary baggage robbing off valuable time.  

Kim Il Sung opined that the curriculum for science and technology must be created reflecting the North Korean stage of industrial development. Professors ought to visit factory floors to identify technical problems, to develop new theories needed to solve problems, and to teach the theories so created. The University Party Committee should schedule and oversee the program of such curriculum development. The incentive effects of such
a system could be quite perverse. Helen-Louise Hunter, a life-long student of North Korean affairs, aptly concluded:

Teachers and students are quick to realize what really matters. In a system that puts a premium on political loyalty, over and above everything else, the bright and ambitious cultivate their political skills and worry less about academic proficiency. In such a system, educational standards inevitably fall victim to political pressures. As much as it may hope to raise educational standards, the regime is ultimately faced with the basic contradiction between many aspects of its national ideology and the pursuit of higher learning.  

**Monitoring of Teaching and Research**

Professors are also subject to the guidance and control system instituted in the university. They are required to submit (six months ahead of time) a detailed lecture plan for the courses that they are assigned to teach. And, upon completion of the courses, professors must submit a report on the lectures delivered for appraisal. Through this process of monitoring, the curriculum is to be constantly reviewed, revised and upgraded according to the needs of the students, the needs of factories and enterprises, and of course, the needs of the party. One of the qualities that the monitoring process follows in university lectures concerns whether (and how) the subject item connects with an aspect of Juche ideology (or the history of Kim Il Sung’s revolution). Monitoring often serves as a device to detect a lecturer’s pro-revolutionary or anti-revolutionary tendency. An example illustrates the point. A biology professor was reprimanded when he explained in his lecture the habitat of sardines and he attributed the disappearance of sardines off the east coast of the Korean peninsula to changes in ocean currents around August 15, 1945. The University Party Committee chairman, hearing the lecture by chance, summoned the lecturer to advise him that the lecture “failed to point out that the atomic bombs dropped by Americans in Hiroshima and Nagasaki in addition to testing atomic bombs under the ocean changed currents world-wide...and American imperialism is responsible for the disappearance of sardines.”

Faculty research activities also follow and implement the tenet of Kim
Il Sung’s philosophy on education. Professors are regularly sent to production lines in order to figure out what is needed there and accordingly reorganize their research as well as lecture content, all under the guidance of the party. In addition, the National Academy of Science coordinates, by providing technical details, the overall plan of nation-wide research programs based on the Central Party Committee’s decision as to the general direction of research needs. The research program also reflects the requests collected by government ministries from the enterprises under their jurisdiction. A set of research projects is assigned to universities and research institutes according to the competence of each research unit. Priority (research resources allocation) is placed on solving technical problems in order to (1) promote the use of domestic natural resources, (2) solve practical factory-floor problems, and (3) develop basic (theoretical) research to assist the first two areas.

Professors are allowed to engage in independent research at their own initiative but only with permission from the project evaluation council in universities. Such projects are granted, provided that no financial assistance is requested. The researcher must purchase research materials and other expenses using personal funds. Professors may also take temporary leave from teaching duties and join research institutes within the university or elsewhere in the country if deemed appropriate.

The emphasis placed on the three areas mentioned above prompts professors to visit the factories where research problems originated. Indeed, party policy encourages interaction between researchers and factory engineers. The “Scientists Shock Brigade” campaign (Kwahakja Dolkyoktae Undong), launched in 1978, symbolizes the policy stance. A group consisting of 20 to 30 scientists, engineers, professors, university students, and party cadres is dispatched to a troubled enterprise. The group's mission is to identify and grapple with technological problems. The identified problems are brought back to university labs or other research units for analysis. If the brigade succeeds in solving the problems, the scientific aspects of the solutions are published in professional journals such as Kwahak Tongbo, a research bulletin designated as the official jour-
nal reporting on "frontier research" worthy of documentation in North Korea, and in other scientific journals.

How advanced is North Korean research in science and technology? The National Federation of Scientific and Technological Associations of South Korea (or Kwa Chong, a Korean abbreviation) and the KCIA (Korean Counter Intelligence Agency) have jointly organized an investigative project with the aim of evaluating how far North Korean science and technology disciplines have progressed. A group of scholars examined 802 papers published during the 1982-89 period in the following journals: Kwahagwon Tongbo (National Academy of Science Bulletin), Suhak (Mathematics), Mullihak (Physics), Saengmulhak (Biology), Hwahak mit Hwagonghak (Chemistry and Chemical Engineering), and Jijill mit Jirihak (Geology and Geography). These are regarded as the prime journals of North Korea. A summary of the investigative findings is as follows:

(1) Papers on practical problems dominate in number, and some on basic research concern the aspects of industrialization mostly related with the national development plan. In general, depth and creativity are deficient.
(2) Most of the papers indicate simplistic experimental data if any (perhaps owing to severe budget constraints and expensive equipment of high quality). (3) Some papers represent topics totally unrelated to world trends. Most references are linked with papers published in USSR journals; there are not many references to papers published in Western European, Japanese, or US journals where leading edge research is conducted. (4) One discerns easily that the exchange of information with research centers in the world is rather sparse. The quality of research has been hampered by a lack of modern research infrastructure. (5) Koreanization of scientific and engineering terminologies following Juche ideology is not helping North Korean researchers catch up in the age of globalization. (6) Virtually all the papers published do not specify the name of author(s), their affiliation, or academic degrees. In addition, the lack of experimental data as supporting evidence diminishes the reliability of conclusions.24
Highly politicized regimentation characterizes North Korean higher education. Juche ideology permeates and dictates the rules and regulations of colleges and universities, e.g., curriculum content, student selection, professors' qualifications, extra-curricular activities, and even the schedules of students' daily life. This system seems to have succeeded in producing perfect conformists with the party's decisions whatever they may be. The graduates are trained (or rather indoctrinated) to follow orders from above obediently at their place of work, i.e., what to think, how to behave, and what to say. Such conformity is needed, party officials believe, to maintain a society driven by *Juche* ideology. Creativity stemming from individualism, self-interest and free thought has no place in North Korean society. In Kim Jong Il's view:

Scientists and engineers ought to struggle with utmost devotion to revere the Party and the leader and to bring the Party's plan to its full realization. Scientists and engineers must truly believe that in the path of serving the leader there lies the victorious revolution, happiness of the people, and the nation's eternal prosperity. When they pursue a scientific (or technical) problem to solve, they must follow the wishes of the leader and the Party, and must solve the problem exactly as demanded. When a research result is reported, the outcome must meet the leader's total satisfaction at the highest level of perfection.25

In contrast to North Korea's *Juche* ideology, South Korea has adopted the Confucian precepts, that is, learning leads students to greater knowledge, virtue, respectability, wisdom, and the achievement of "character perfection." *Hong-ik In-gan* is the abbreviated expression summarizing the ultimate, lofty goal of education: namely, "benefits to all mankind." A mundane version of the ideology today is that education can empower one to earn higher income, achieve greater intelligence, and gain power and social status. The severity of competition to enter colleges and universities has become a serious social and political issue. By and large, open competition in education under set rules and regulations has served as an in-
stitution (a social technology) needed to select for training elites. In contrast, in North Korea, loyalty to Juche ideology and to the Kim family has served as one of the prime criteria to determine who will succeed in education and in the society at large.

The Juche ideology has also been used to justify shutting off possible channels of exchanging scientific and technological ideas with universities abroad. In virtually all rapid industrializing economies, foreign sources have provided a crucial, strategic avenue of technological accumulation. South Korea is no exception. South Korea has skillfully designed its trade regime as a learning institution. One important element in the design was to continuously send students, technicians, and engineers abroad en masse to acquire expertise in new technologies. Today, Korean scientists and engineers who are working as professors and researchers in the United States (over 10,000 doctorate degree holders), Germany, France, and the United Kingdom, provide a pool of high-powered human capital, which could be tapped to meet South Korea's needs for high-tech knowledge. But North Korea has abnegated to exploit Western sources of technology accumulation, thanks to the ideology of self-reliance. The demise of the USSR and COMECON, both major technology sources for North Korea, has exacerbated the situation. With this change, North Korea withdrew its students from the (former) socialist countries.

To summarize, the higher education system in North Korea grew rapidly, as in South Korea, starting from an abysmally low level of research capabilities. The North Korean system produced a large number (approximately 2 million) of college and university graduates meeting the needs for experts, scientists, and engineers in the party and enterprises. The graduates were indoctrinated thoroughly in Juche ideology. The lack of reported incidences of student dissent may be due to the thoroughness of the indoctrination program. Recall that South Korean university students have often resorted to demonstrations and street violence against the government. However, with respect to the professional and technological competence of graduates, indirect evidence suggests that the graduates may have acquired substandard training on the average. The overpowering in-

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doctrination program has incurred significant disadvantages; most im­
portant is that creativeness and risk-taking attitudes were discouraged. This 
assessment gains cogency if the situation is compared with that of the 
ROK. We now turn to the issue of how efficiently the trained labor force 
has been organized at the enterprise level in North Korea.

The Taean Enterprise Management System as Learning Institution

This section reviews the incentive implications of the Taean Enterprise 
System from the perspective of managers. Kim Il Sung invented the sys­
tem in 1961 and commanded that all industrial enterprises in North Korea 
adopt the model. He introduced a set of new features in the organizational 
structure. (1) A party cell was installed in each work-team (the smallest 
organized unit in a factory hierarchy) to consolidate party control. (2) 
Collective decision making replaced the system of factory managers with 
sole responsibility. (3) A centralized national system of input-supply guar­
antee replaced the practice of each enterprise dispatching teams of in­
put-procurement officers to individual input suppliers. These features of 
the Taean System are briefly reviewed. Subsequently, we examine the con­
straints and encouragement that have confronted North Korean managers 
in learning new technology. Comparisons with South Korean counterparts 
(e.g., chaebol organization managers) shall be made in an effort to explain 
the difference in productivity growth.

Organizational Reform and Strategies for Learning

Kim Il Sung believed that party leadership to reform workers into revo­
lutionaries was essential in raising the productivity growth of enterprises. 
For the purpose of consolidating party leadership, he invented a "tight" 
control mechanism. One of the critical devices was to have party cells in­
stalled in work-teams (the smallest organizational unit) for monitoring. 
However, as shall be argued, tight controls brought about organizational 
rigidities inimical to learning and innovation.
A bird’s eye view of the party’s involvement in the Taean System is given in Figure 24. Notice that the Party Committee of the factory sits at the top of the entire system. Party cells are installed in work-teams, penetrating the smallest unit of enterprise. One does not find such tight one-to-one couplings of subunits in enterprise and the party in the former USSR. The Primary Party Committee has representation only at the level of the enterprise manager. This signifies that the Party Committee of the factory is the ultimate source of all power and leadership in decision making and also in surveillance. By implication, the party's influence is greater than that of the managers or even economic logic. The managers de facto do not have authority in decision making with respect to production, managerial strategies, technological innovation, investment, and appointment of personnel. The managers function only to administer what is decided by the Party Committee. The Party Committee consists of representatives from laborers, engineers, and managers as well as party cadres. The size of the Party Committee varies with the size of the enterprise. For instance, the Taean Electric Machinery Enterprise had a committee with 35 members in 1962. The Party Committee meetings provide the venue for deliberation and “collective decision making.” The Party Secretary (at the enterprise) is responsible for providing the agenda and also introducing the wishes of the Party Central Committee (in Pyongyang) for discussion.

As expected, the collective decision making system raised the problem of who was really in charge. The large size of the committee (e.g., 35 mentioned above) exacerbated this problem. The distinction in the division of labor between economic administrators and party cadres often became obscured. The latter interfered, in an increasing manner under the Taean System, in day-to-day production operations with the justification of monitoring whether norms were adhered to. Furthermore, the organization department of the party controlled the promotion of personnel. This concentration of power in the hands of the party apparatus prompted an economist to apply the “plan-bargaining model” to explain the behavior of DPRK managers and party cadres. In the enterprise hierarchy, the managers along with laborers bargained as agents while the party members be-

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Figure 24. Organization Chart of the *Taean* Enterprise Management System

haved as the principal (owner). Equally important, one of the tasks of the party organization within the enterprise structure was to educate, indoctrinate, and reconstruct workers to make them revolutionaries. The revolutionary work forces, so reconstructed, were to devote their total loyalty, utmost work effort, wisdom seasoned with experience and creativity for the fulfillment of Juche ideology. Workers with production skills coupled with revolutionary zeal (i.e., DPRK human capital) were to provide an important factor in raising productivity. In other words, if the ideology successfully converted workers with skills, it would be an important input in the “socialist production function.” How could such productive forces be harnessed? One way, so the argument went, was to strengthen party leadership via enhanced control. Therefore to carry out the task, the party ought to penetrate the organizational structure of an enterprise in a most intricate manner. There was to be a one-to-one correspondence between the each level of hierarchy within the enterprise and that of the party. The smallest party element was the “cell committee” (Dang Sepo) organized within the enterprise counterpart: the work-team, which consisted of 20 to 30 workers. This thorough and deep penetration of the party was not seen even in China under Mao, let alone in the former USSR.

The most intimate contact between the party and the enterprise occurred at the work-team/party cell level. At this level, everyone knew what everyone else was doing, because they could physically observe each other’s work on a daily basis. Suppose a work-team was comprised of 25 workers; then about 10 of them were party members and they formed the party cell. The cell secretary, appointed by the sectoral party committee (Bumoon Dang Wiwonhoe, one level above party cell), presided over the party cell committee and the cell-level weekly chong-hwa (“summing up”) meetings. In the latter meetings, self-criticism and mutual criticism were exchanged between work-team members. There, mistakes and shortcomings were discussed for evaluation and subsequent correction. The most important item was to observe whether one’s daily (or weekly) output quota was fulfilled. If not, one had to provide the reasons for failure. Also, the members re-
affirmed their loyalty to Kim Il Sung and his revolution according to the Juche ideology. Each worker’s statement was recorded and kept for future reference (to be used for promotions, recommendations, etc.).

Everyone present took turns in performing a 4-5-minute perfunctory or serious self-criticism. Other party cell members might be agents from various departments of the party, government, or military establishment, e.g., the security department (Anjonbu), the defense department (Boweebu), occupational associations (Jing-maeng), League of Socialist Workers Youth (Sarochong), the Organization Department of the Party (Dang Jojikbu), and so on. These agents, i.e., party members who had special connections outside the work-team, collected information for monitoring purposes on the morale, political inclinations, and unusual behavior of the team workers. But the workers did not know who the agents were. Under constant surveillance, workers guarded what they said and how they behaved. The creativity of workers was likely obstructed under such circumstances. Although it is impossible to measure the impact of party controls on workers’ motivation, one could hypothesize with respect to its negative incentive effect.

Furthermore, the non-party members of the work-team had an obligation to belong to one of the following organizations: Socialist Workers Youth League, Occupational Associations (Jing-maeng), or Women’s Association (Yomaeng). These associations had a mission to function as the lifetime school where workers study Juche doctrines. Each of the associations had its own program of weekly chong-hwa meetings, political studies, lectures, campaigns for mobilizing workers, and so on. These activities took up after-work hours, namely, from 19:00 to 22:00, in addition to the morning period, from 7:00 to 7:30, devoted to reading bulletins issued by party organizations or newspapers.

These hours of studying, party ideologues believed, provided lessons that would help workers to fortify the Juche spirit and morale, and therefore ultimately contributed to raising productivity. The studies and lectures usually dealt with Juche thought such as (1) the principles of Juche ideology, (2) loyalty to the party and to the Great Leader (Suryong), (3) poli-
cies of the party, and (4) revolutionary traditions (history). The last subject emphasized the history of Kim Il Sung's anti-Japanese guerilla activities and the lessons from it, that is, to devote one's life to the cause of the party and Juche ideology without even the hope of being rewarded.

Sources of Knowledge and Mode of Transfer

The idea of nurturing technological self-sufficiency placed a critical constraint on managers and engineers in the DPRK because it virtually closed off access to the "global technology shelf" Nevertheless, during the 1950s and early 1960s, the DPRK had pragmatically relied on imported factories from the USSR for the postwar reconstruction (see Tables 22 and 23). These are the periods when the DPRK out-performed South Korea in raising productivity. It should be added that during that time, North Korean students and trainees were sent to the USSR in droves. For instance, in 1962, there were over 7,000 students studying in the former USSR and other CMEA countries, 4,900 of them majoring in science and engineering. Furthermore,

by 1962 the USSR had handed over 2,581 technical documents. It is noteworthy that, of these, 935 were drawings of complete plants or machinery. Soviet sources mention work-benches, ships, diesel motors, cranes, compressors, agricultural machinery, pumps, electric motors, perforators, and transformers.

During the 1970s, North Korea experienced dwindling technological aid from the USSR. North Korea attempted to switch technological imports from the OECD countries and to finance imports of capital goods with loans from suppliers. But a succession of events (i.e., the 1979 oil crisis, the 1980 harvest failures, and the collapse of international markets for North Korean exports, mainly of primary goods) compelled North Korea to default on the servicing of mounting loans. This put an end to North Korea's efforts to import technologies from OECD countries.

The learning of imported technologies as well as internal sources of technologies appeared significant in building the DPRK's capabilities, con-
<table>
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<td>Total Imports (US$ million)</td>
<td>Per Worker (US$)</td>
<td>Total Imports (US$ million)</td>
<td>Per Worker (US$)</td>
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<td>33</td>
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<td>174</td>
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Table 23. North Korea's Imports of Capital Goods from the USSR by Categories, 1961-70 (US$1,000)

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<th>Year</th>
<th>Metal Machine Tools</th>
<th>Rolling Equipment</th>
<th>Light Industry Equipment</th>
<th>Complete Factory Parts</th>
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<td>250</td>
<td>296</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>9,804</td>
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</tr>
<tr>
<td>1964</td>
<td>371</td>
<td>0</td>
<td>267</td>
<td>18,710</td>
</tr>
<tr>
<td>1965</td>
<td>108</td>
<td>0</td>
<td>263</td>
<td>13,163</td>
</tr>
<tr>
<td>1966</td>
<td>291</td>
<td>0</td>
<td>28</td>
<td>17,511</td>
</tr>
<tr>
<td>1967</td>
<td>472</td>
<td>0</td>
<td>373</td>
<td>3,143</td>
</tr>
<tr>
<td>1968</td>
<td>3,796</td>
<td>74</td>
<td>1,082</td>
<td>16,831</td>
</tr>
<tr>
<td>1969</td>
<td>736</td>
<td>28</td>
<td>406</td>
<td>30,114</td>
</tr>
<tr>
<td>1970</td>
<td>113</td>
<td>0</td>
<td>336</td>
<td>73,779</td>
</tr>
</tbody>
</table>


Considering the report that "by 1968 the self-sufficiency rate in machinery was 98.1 percent, which means that really all machines needed in the DPRK can be made domestically," indeed, the DPRK has a system of research institutes patterned after that of the USSR, namely, the National Academy of Science, numerous institutes housed within universities and those under industrial ministries. Our query here is how R&D results in these institutes are transferred to serve the needs of industrial enterprises. For this purpose, the DPRK invented a set of campaigns (or a form of "social technology" à la Richard Nelson). The "Scientists Shock Brigade Campaigns" and "Three Revolutions Team Movement" illustrate the North Korean style and method of linking academia and industry.

*Scientists Shock Brigade Campaigns.* To solve the problems of a factory, the party mobilized a group of scientists with expert knowledge and sent them to the factory. Often, the group was called the "2-17 Scientists Shock Brigade" since it was initiated on February 17, 1978. Typically some 20 to 50 scientists from universities and research institutes formed
a shock troop with a mission to investigate the situation and formulate technological solutions. After learning about the factory problems, the scientists returned to their universities and institutes to conduct research for solving the problems. If their research successfully arrived at a solution for the factory problems, their results and theorizing were published in DPRK scientific journals. Such publications also served as text materials for new curricula.

This mode of mobilizing scientists and engineers from academia and linking them to industry is founded on a basic tenet of Juche ideology. The campaigns were designed to instill revolutionary spirit in scientists by encouraging comradeship between factory workers and elitist experts. The scientists were to appreciate the wisdom and local knowledge that factory line workers possess. Scientists' attitude of superiority, their individualistic inclination, and their mysticism (according to Kim Il Sung, a cult-like belief in the profundity and supremacy of science) were corrected through mutual advice and criticism between brigade members and the employees of an enterprise.

As of October 1995, the 170 brigades had mobilized a total of 26,000 scientists to solve factory problems since the late-1970s when the first group was formed. While the Scientist Shock Brigade Campaigns tackled factory problems of national importance, there was a lower level, but similar, innovation movement called the "4-15 Innovation Shock Brigade." This activity involved 150,000 brigade members in 11,300 brigade units since its first appearance in 1980; altogether 1,307,000 innovative ideas were put into practice during the 1980-95 period. By the year 2000, the number of innovations climbed to 1.8 million cases.

Three Revolutions Team Movement. The Three Revolution Team Movement (TRTM) first emerged as a project in the agricultural sector in February 1972, but gradually spread to the industrial sector. Its purpose was to eradicate inefficiency and backwardness by spreading revolutions in three areas, namely, thought, technology, and culture via an integrated approach. First, policymakers noted that old habits of thought (i.e., conservatism, selfish group interests, bureaucratization, laziness, ignorance of
modern technologies, etc.) had to be replaced by the revolutionary Juche ideology (i.e., sacredness of work, collective philosophy as against individualism, zeal for socialist construction, loyalty, hard work, and adoption of innovative ideas, etc.). Second, new ways of doing things had to be introduced in order to eliminate wasteful behaviors in production processes. This would be achieved by having the team demonstrate the power of modern science and technology. The team consisted of 20 to 30 (or up to 50 sometimes) university students, professors, engineers, scientists, economists, party cadres, and planning experts. Third, enlightenment was needed to help change the life style of workers and cadres, for instance, hygienic habits, cooperative attitudes, scientific inquisitiveness, sense of responsibility, punctuality, etc.

Every year, hundreds of these teams were dispatched to factories and farms to live with workers and farmers, to learn, hands-on, the nature of the problems, and to solve them collectively. In September 1984 (12 years after its commencement), a general conference convened to evaluate the movement noted that (1) 108,700 persons were involved, (2) 41,600 were active at the time, and (3) 35,400 received national awards.

It is nearly impossible to measure quantitatively how effective this movement has been in terms of raising productivity (partly owing to the lack of basic data.) However, some qualitative results can be illustrated by Kim Il Sung’s statement suggesting that it contributed to more favorable economic outcomes.

Before the Three Revolutions Team Movement was dispatched, not a small number of cadres and workers in enterprises violated laws and orders instead of respecting and protecting them. For example, some administrative workers misused raw materials, engaged in constructions outside of planned areas, and diverted laborers rampant disregarding the decisions by the party and the Jongmuwon (Administrative Council of Ministers). But the Three Revolutions Team Movement helped to remove almost all of those kinds of violations.38

15. The Technology-Institutions-Productivity Nexus in the DPRK: A Comparative Perspective with the ROK
Human Capital Management

In a market-oriented economy, enterprise managers have the authority to hire (personnel recruitment and placement) and fire (dismissal) as managerial tools. This variable, along with others such as investing or divesting) enables managers to operate efficient factories and create profits, the ultimate goal of companies in such a system. Innovation normally requires a varying mix of labor, capital, and technologies as well as a higher quality of inputs. But managers under the Taean System have not been provided with any of these managerial tools. The task of allocating human resources belongs to the party. The annual national plan for human resource allocation determines the particular assortment of workers with various skills that each enterprise receives.

Once a worker is placed at an enterprise under the annual national plan, neither the worker nor the manager of the enterprise has the power to reassign him or her to another enterprise or region. By law, a change in one’s job location requires the approval of the national planning office. The worker’s job location is virtually fixed for his or her lifetime, except in the case of a special occasion, national industrial restructuring, or an emergency. A researcher concluded:

This kind of labor fixation policy (Ro dong ryuk ko jung jung chek) has been detrimental to the efficient allocation of human resources because workers are not allowed to move from one organization to another, one industry to another, or one area to another by their own choice. Under such a system of immobility, workers can hardly be motivated to produce more, to learn more, or to demonstrate their creativity.39

Furthermore, traveling is restricted if it is for personal reasons. The rationing system for daily necessities like rice, coal for heating houses, basic clothing, etc. germane only to one’s job location reinforces party control of individual travel. National control of information, travel, and job allotment virtually eliminates an employee’s options for occupational improvement. This restriction on the mobility of human resources in the
DPRK has an important negative bearing on workers' motivation to learn and take risks to do new things. (In South Korea, by contrast, there is no legal restriction for travel or to change one's residence in pursuit of additional training and a better occupation.)

In North Korea, one is encouraged to improve his or her skills via the in-house educational facilities of an enterprise. The new skills acquired could help one to be promoted within the enterprise. In the Taean System, the "factory college" is installed on site, especially in the case of large enterprises. Through this arrangement enterprises train employees, while working, to become engineers as the need arises locally. The factory floor serves as the classroom as well as the lab. Experienced local senior engineers deliver lectures. A technical degree takes three to four years while an engineering degree takes five to six years. Students are paid normal wages and salaries while attending classes. In June 1999, North Korea had 113 factory colleges (out of a total of 310 colleges and universities), and 180,000 students were enrolled at factory colleges out of 414,000 students enrolled at all colleges and universities.40

International Linkages as a Learning Device

The autarkic policy stance of the Juche ideology meant forfeiting some fundamental economic advantages that could be exploited for learning new technologies. First, the performance of enterprises could be defined and measured in many different ways; and a certain definition could be superior to others for encouraging innovation. In the North Korean case, excess output over and above the production quota served as the index of performance. Enterprises were rewarded with bonuses, medals, and flags according to this index. In contrast, South Korean enterprises were rewarded according to export performance. This difference in performance criteria brought about a significant difference in learning behavior.

In North Korea, enterprise managers tried to maximize the (excess output) performance index by negotiating with central planners for a maximum amount of inputs given the production quota (or for a given amount of inputs, a minimum production quota). Furthermore, more often than not,
enterprises experienced *input shortages* in the sense that machines had to lie idle because of delays in delivery of input supplies. The enterprise behavior of hoarding inputs added to the shortage problems. Having inputs in reserve was advantageous in producing excess output over and above the quota. Given such circumstances, the short-run objective to maximize the performance index overshadowed the long-run possibility of increasing production via taking risks of learning new ways of doing things.

While the North Korean performance index had little to do with trade, the South Korean performance index was defined in terms of how much an enterprise earned via exports (in value added, rather than gross output). Enterprises were rewarded with low-interest loans, access to foreign exchange to finance necessary imports of inputs, low-cost or free information on new technologies, foreign markets, tax benefits for training, and social recognition during national annual celebrations of export achievements. In this way, the risks and uncertainties of engaging in export activities were largely removed. Export proved to be a profitable avenue of learning and accumulating wealth quickly. Improvements in the quality of output were rewarded immediately as foreign markets accepted the quality and price of new products that South Korean enterprises exported.

The second impact of *Juche* ideology on learning was the forfeiting of access to the "global technology shelf" that could be exploited for raising productivity. The global technology shelf can be defined as the entire international body of knowledge available for an enterprise to choose from. The options range from simple ideas to solutions at the highest level of sophistication. South Korean enterprises continually chose state-of-the-art technologies and mastered them as fast as possible. Table 22 compares differing speeds of DPRK and ROK in their use of foreign technology in the form of capital goods imported. Access to the global technology ladder can provide an overwhelming advantage.

Third, competition for export growth in South Korea provided fierce pressures for the economy to select the fittest (faster learner) enterprises. In particular, the market entry-exit mechanism functioned to raise aggregate productivity via the exit of inefficient learners coupled with the en-
try (and survival) of more efficient learners. One recent study of the South Korean economy, using plant-level data for the 1990-98 period, concluded that plant turnovers reflect the underlying productivity differential in Korean manufacturing, with the “shadow of death” effect as well as selection and learning effects all present. Also, there is a persistency in plant productivity. Thus, plant exit and entry, particularly birth and death, are mainly a process of resource reallocation from plants with relatively low and declining productivity to a group of heterogeneous plants, some of which have the potential to become highly efficient in future.42

In North Korea, the threat of demise does not exist for an enterprise thanks to the total lack of market competition. Furthermore, “soft-budget constraints” seem to eliminate the threat of bankruptcy, since managerial mistakes and losses were compensated for by the largess of this system. In providing incentives for learning, the so-called DPRK socialist mode of competition (i.e., vying for a hero’s title, medals, honors, promotions, etc.), proved to be ineffective compared with South Korea’s entry-exit rules based on market competition.43

Conclusion

A comparison of learning organizations (i.e., universities and enterprises) between the DPRK and the ROK enables us to answer the question posed at the beginning of this essay. How well does the comparison explain the performance gap in productivity between the two economies? The evidence speaks loudly that the performance gap largely stemmed from the differences in payoff—incentives—imbedded in the institutional constraints. Many studies have concluded that the DPRK has been handicapped by the centralized and closed system in trade and investment. This essay contributes to the debate by explaining that it is technology acquisition and learning that were specifically hampered. An array of the system
components as shown in Table 24 summarizes the formidable set of barriers in exploiting available technologies from abroad. The system worked to hinder the accumulation of knowledge, human capital, and organizational assets, especially in comparison with the ROK. The ROK counterpart emphasized the crafting of incentive devices in motivating managers and engineers to speed up the process of accumulating knowledge, human capital, and organizational assets.

In sourcing new technologies, managers and engineers in the DPRK were virtually denied access to the global technology shelf (option possibilities), thanks to the Juche (self-reliance) ideology. Meanwhile, managers and engineers in the ROK were allowed unrestricted access to state-of-the-art technologies from abroad (e.g., imports of capital goods, licensing, joint ventures, and so on) along with state assistance to encourage learning.

In managing human capital, DPRK managers and engineers were seldom given managerial power to combine and recombine the skill-mix of the enterprise to improve efficiency and productivity. This consequence was due to the system of central planning for labor allocation often dubbed labor fixation policy (Nodongnyok Kojong Jongchek) whereby the mobility of laborers outside of the planning framework was prohibited. Furthermore, managers were bound by the national policy stance of 100 percent employment. In the ROK, managers and engineers had the ability to hire, fire, train, and promote personnel in order to speed up innovation and learning.

In motivating enterprises and workers, the DPRK adopted the excess of production, over and above the planned quota for an enterprise, as the method of measuring performance for reward. This method tended to neglect product quality and to emphasize short-run efforts. In contrast, the ROK adopted the export record of an enterprise as the method of measuring performance. Export markets rewarded quality improvement with higher prices. Further, market competition as well as rules of entry and exit shaped by survival-of-the-fittest pressure encouraged innovation through learning new technologies.
Table 24. Constraints Imposed on Enterprise Managers and Engineers with Respect to Learning: A DPRK-ROK Comparison

<table>
<thead>
<tr>
<th>North Korea</th>
<th>South Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Technology</strong></td>
<td><strong>Technology</strong></td>
</tr>
<tr>
<td>(1) access denied to global technology shelf, in line with Juche policy</td>
<td>(1) unrestricted access to global technology shelf, network externality</td>
</tr>
<tr>
<td>(2) Party initiative with S&amp;T campaigns emphasizing the wisdom of working masses</td>
<td>(2) private entrepreneurs' initiative under survival pressures to acquire state-of-the-art technology</td>
</tr>
<tr>
<td>(3) R&amp;D for 70% domestic resource content</td>
<td>(3) R&amp;D for increasing export volumes</td>
</tr>
<tr>
<td><strong>Human Capital Management</strong></td>
<td><strong>Human Capital Management</strong></td>
</tr>
<tr>
<td>(4) restrictions on managing the skill mix of enterprise owing to labor fixation policy</td>
<td>(4) managerial power to hire, fire, train, and promote skilled personnel</td>
</tr>
<tr>
<td>(5) no open labor market to tap new skills but factory colleges can train personnel</td>
<td>(5) labor market (external and internal) for skilled personnel plus in-house training of executives</td>
</tr>
<tr>
<td>(6) dwindling supply of personnel trained abroad (mostly USSR)</td>
<td>(6) increasing supply of personnel trained abroad (mostly USA)</td>
</tr>
<tr>
<td><strong>Incentive Devices for Learning</strong></td>
<td><strong>Incentive Devices for Learning</strong></td>
</tr>
<tr>
<td>(7) reward for exceeding plan quota neglecting quality improvements</td>
<td>(7) reward for export performance including quality improvements</td>
</tr>
<tr>
<td>(8) soft budget constraint, bureaucratic paternalism, ratchet effect (output quota never below the best record)</td>
<td>(8) survival pressures from domestic and international competition, survival of the fitter, exit-entry rule</td>
</tr>
<tr>
<td>(9) straitjacket of internal organization under Taean management system for all enterprises in the economy</td>
<td>(9) diffusion of knowledge via learning by imitation, free trial and error, inventing corporate culture</td>
</tr>
</tbody>
</table>

Source: Author.
In sum, the difference in incentive structure, as summarized in Table 24, is a powerful determinant of productivity difference between the DPRK and the ROK. The table represents a prototype of institutional matrix (à la Douglass North) of the DPRK. It is currently infeasible to determine the relative weight of each individual factor that contributes to national productivity. Figuring out interactions between the component factors offers an even more formidable challenge for researchers. Hence, the connection between learning and productivity remains a working hypothesis to be tested further as more pertinent statistics and other information become available.

Notes

1. Professor Nelson defines appreciative theorizing as "the descriptions and explanations of what is going on that economists put forth when they are paying considerable attention to the details of the subject matter. While less abstract than formal theorizing, this attempted description of what is going on certainly is a form of theorizing, albeit theorizing relatively close to the empirical subject matter. Formal theorizing can sharpen up, correct, and lead appreciative theorizing. In recent years most formal theorizing has been mathematical. Earlier it was mostly verbal. But whether expressed mathematically or verbally, when formal theorizing does not pay attention to or has little contact with appreciative theorizing, that is a sign of trouble. The formal theoretical enterprise then becomes self-referential and loses much of its contact with the subject matter it purports to be about." See Richard R. Nelson, The Sources of Economic Growth, Cambridge, Massachusetts: Harvard University Press, 1996. p. 5.

2. Hwang considers that "it is not fair to intentionally underestimate North Korea's income by using the trade exchange rate instead of the official exchange rate." Eui-Gak Hwang, The Korean Economies, A Comparison of North and South, Oxford: Oxford University Press, 1993, p. 120, note c. He also devised his own method of reconciling diverse data sources and estimation procedures (see ibid.). Hwang's estimates (i.e. those converted into dollar figures by official exchange rates) are the most "lenient" among all of the estimates published. His estimates set the upper limit, while the BOK estimates are the lower limit.
3. In the late 1950s and 1960s, North Korean labor productivity surged noticeably ahead of South Korean figures. Recovery from the devastation of the Korean War, with the largess of aid from COMECON countries (especially the USSR), moved forward at quite a brisk pace. Joan Robinson raved then about North Korea as the model case of socialist construction, “a nation without poverty.” She seemed to attribute North Korea’s success to the method of planning. “Workers are consulted by management when the Plan is being framed and encouraged to make suggestions about methods of work. Through these means, startling increases in productivity are achieved.” See her “Korean Miracle,” *Monthly Review*, Vol. 16, No. 9 (January 1965), pp. 542 and 544.


5. During the 1970-75 period, North Korea financed its imports from OECD countries by borrowing a total sum of $1,242 million. This sum compares with $902 million worth of loans from the Soviet Union during the same period.

6. The rice harvest declined by 29 percent in 1980, further adding to economic difficulties.


9. I used Hwang’s (1993) “lenient” estimate of North Korean GDP series as the divisor, which implies that the results serve as the lower limits.


11. The government in both Koreas plays an important role as an institution-designer. But a discussion of this factor is not included in this paper due to space limitation. See the chapter on “Government as Institution Designer” in my forthcoming book, *Technology and Productivity: A Race Between Two Koreas*.

13. Kim, Sun Ho, "Education in North Korea: Technical Manpower and Ideological Development," Doctoral Dissertation, George Peabody College for Teachers, May 1981, p. 211. "On-the-spot-guidance" is a device Kim II Sung invented to visit and bestow his ideas on solving problems on site at enterprises, schools, military installations or party organizations. His statements made during on-the-spot-guidance often signaled important shifts in policy and carried legal weight. His statements were an important source of information for North-Korea watchers because his statements contained hard-to-come-by statistics such as per capita GNP figures, the number of scientists and professors, etc.


16. The autocratic influence of the Party Committee can be illustrated by the wholesale demotion (or purges) of professors in 1967. The Party decided to replace 2,500 senior instructors and "obsolete professors" with young professors freshly trained by the Party. The reason for the decision had to do with the Party's distrust of the old professors who often failed to show fervent enthusiasm in advocating Juche ideology. Many of them, originally drafted as "volunteer soldiers" from South Korea during the Korean War, were purged and relocated to colleges remotely situated from Pyongyang. See Kim, Sung Chul, *Policy Changes on Intellectuals in North Korea*, Research Report 95-03 (in Korean), Seoul: Korea Institute of National Unification, 1995, p. 89.


20. Kim, Myong-Se, "My Student Days at Kim Il Sung University" in *The Education I Received in North Korea*, edited by Choi, Young-Pyo et al. (in Korean), Seoul: Korea Education Development Institute, 1994, p. 201.


22. In comparison, South Korean professors are not subject to surveillance. Their com-
petence in their field of specialization is taken for granted, although this privilege has sometimes been abused. There exists an unwritten university rule of lifetime tenure at the time of employment as described in Youngil Lim, *op. cit.*, Chapter III.

23. A number of examples like this is provided in Choi, Kwang-Suk, “Kim Il Sung University,” *Shin-Dong-A*, June 1968, p. 155. The writer is a former professor of philosophy at the university.

24. See Kim, Byong-Mok et al., *The Task and Response to Science and Technology Cooperation between North and South Koreas*, (in Korean), Seoul: Science and Technology Policy Institute (STELP), 1994, pp. 52-54.


26. Bang-Soon L. Yoon reported that as of October 1989, a total of 1,707 high-powered scientists and engineers had returned to South Korea (1,008 permanently, and 699 temporarily). See her “Reverse Brain Drain in South Korea: State-led Model,” *Studies in Comparative International Development*, Spring 1992, Vol. 27, No. 1, p. 10. Opendoors on the web (www.opendoorswe.org) reported that, as of 1999, 41,191 students were enrolled in US colleges and universities.


28. South Korean company managers, in contrast, have the power and responsibility in manipulating all of these managerial variables for efficient outcome, namely, profit making.


30. It is well known that the Organization Department of the Party carries enormous power of promotion, demotion, personnel allocation, and organizational decision making in all parts of the Party, the government, and the military.

31. *Pukhan iyagi* (North Korean Stories Told by North Korean People), edited by Johun Buddle (Good Friends), Seoul: Jungto Chulpan Publisher, 2000, pp. 312-316. This book is a collection of testimonies given during the 1997-99 period by North Korean defectors (reportedly over 100,000 of them) now living in Northern China which borders the DPRK.

32. Chor Hwan Kim, *Pukhan ui Kwahak Kisul Jongchaek Yonku* (Science and Technology Policy of DPRK. A Study), Seoul: National Unification Board, 1990, p. 28. By comparison, South Korea had 2,310 students enrolled in colleges and universities in the

15. The Technology-Institutions-Productivity Nexus in the DPRK: A Comparative Perspective with the ROK


36. Ibid. p. 100.


41. The metaphor of climbing the technology ladder aptly captures the sense of step-by-step learning over time.


43. Some analysts characterized South Korea as a “command economy” owing to “heavy handed government interventions.” But the inter-chaebol rivalries for market shares coupled with competition for export growth provided sufficient pressures for learning. To wit, static distortions due to market intervention were sufficiently compensated by dynamic gains through learning, a hypothesis worth testing. In comparison, no