

## **Korea as an Economic Hub in Northeast Asia**

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In this paper, the possibility of the formation of an economic community in Northeast Asia is discussed, along with the probable role of Korea in this endeavor. In order to meet two great challenges of the so-called 'China shock' and the 'shock of knowledge-based economy' with which Korea has been facing recently, four measures are suggested. Lastly, the possibility of building an economic hub in Korea, particularly logistics and business hub, is presented together with the idea of building an international free city. If an economic hub is built successfully in the Korean Peninsula, it will be greatly beneficial not only to Korea but to all other countries in Northeast Asia as well as western hemisphere.

JEL Classification: F02, O53, L91, N75, P45

Keywords: an economic community in Northeast Asia, economic hub in Northeast Asia, logistics and business hub in Northeast Asia, international free city

### **1. INTRODUCTION**

The development of Korea as an economic hub in Northeast Asia is one of the major national agenda items for the new Korean government. It would be a desirable policy direction for Korea since Korea is surrounded by four big nations, China, Japan, Russia and the United States of America. The concept of an economic hub here does not mean the 'No. 1 economy' or leading economy in Northeast Asia. It simply means that, in one sense, in terms of physical location, Korea will be able to develop a plaza or a hub

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area for promoting the exchange of human and material resources along with culture, similar to that of the Netherlands in Europe, and in another sense, in terms of functionality, Korea will be able to play a role as a 'facilitator' or 'mediator' to organize an economic community in Northeast Asia, similar to that of Belgium in Europe.

In other words, the countries surrounding Korea can conveniently utilize Korea for business and cultural exchanges. Of course, at this moment, the North Korea problem is one of the most serious hurdles for developing Korea as a hub country. However, we expect that the North Korea problem will be mitigated substantially over time because, without economic cooperation from other Northeast Asian countries, North Korea may not be able to maintain itself economically.

China has been experiencing rapid economic development since 1979, when the Chinese structural reform and open-door policies began. Over the past twenty-two years, China has recorded an unprecedented high rate of average annual economic growth of 9.6 percent. In particular, China's status, economically and politically, has substantially risen since the 'Asian currency crisis' of 1997. Considering its population and fast economic growth, China's potential capacity as a production base and as a market for goods and services is expected to reach that of Japan in about 10 years, and that of the U.S.A. in about 20 years.

Japan has been suffering from almost zero economic growth during the so-called 'lost 10 year' period. The manufacturing sector, which had been the locomotive for successful Japanese economic growth since 1950, has been losing its competitive edge in international markets. Most small- and medium-size manufacturing firms, which specialized in producing parts and components, and integrated with manufacturing firms affiliated with one of the big business groups, have closed down their businesses because they were no longer able to keep their competitive edge against Chinese products.

Korea has been facing two great challenges in the beginning of the 21<sup>st</sup> century. One is the so-called 'China shock' and the other is the 'shock of knowledge-based economy'. Korea has been very successful in achieving a

certain level of economic development over the last 40 years by importing rather common manufacturing technologies from advanced countries and adopting them very sensibly. However, due to the emergence of China, the manufacturing sector in Korea, which is based on imitating foreign technologies, is also losing its competitive edge, like Japan. Professor Paul Kennedy of Yale University suggested that in order to maintain sustained economic growth in Korea, Korea has to develop strategic industries which would be able to efficiently absorb the added value created by China. Perhaps knowledge-based service industries, such as logistics, education, medical services and knowledge-based industries, and other sophisticated industries could help Korea to have a competitive edge over China.

## **2. ONE OF THE CORE NATIONS**

Northeast Asia is becoming one of three principal axes of the world economy, the others being the European Union and the North American Free Trade Area. Out of the total GNP generated by East Asia, about 90% is generated by three Northeast Asian countries, China, Japan and Korea. However, the Northeast Asian countries have not organized any kind of regional economic bloc such as EU, NAFTA or ASEAN. If an economic bloc is formed among these three countries, then it would substantially expand the size of the market and accelerate labor specialization. Moreover, it would help achieve regional peace and prosperity, along with a stronger voice of the international community. Then, the question arises as to why some form of regional economic integration in Northeast Asia has not yet taken place.

There are three main reasons for this. First, there is still a wide range of differences in economic systems and income levels among the three countries. Second, the historical problems of the Japanese invasion during the World War II still remains as a political issue. Third, the North Korea problem still creates political and military tension in the region. If we look at the

recent trend of regional integration in Asia, APEC has a schedule to liberalize both trade and investment before the year 2020. ASEAN also has its own schedule to have its member countries implement zero tariff rates prior to the year 2015. Moreover, China's recent attitude towards FTAs has changed in a favorable direction since its participation in the WTO.

Considering the fast changes in the political and economic attitudes in China and the unprecedented high rate of economic growth in China, perhaps, about 20 years from now, the wide range of differences in both the economic systems and income levels among the three countries will be narrowed substantially. The problems of the historical past among the three countries and the North Korea problem are also expected to be mitigated greatly, because the younger generation is getting more interested in economic gains, rather than ideology, and also more interested in the present situation, rather than past history. Nearly fifty years ago, just after World War II, not many people were able to conceive of the European Union of the current form. However, continuous dialogue and patience among intellectuals from the European countries made it possible to open a new area constituting the European Union. Likewise, as some experts project, an economic community in Northeast Asia will be formed within about twenty years from now.

In the past, relations among the three countries in the Northeast Asia were characterized as hostile. However, in the future, considering the worldwide trend towards globalization and localization, the three countries have to make special efforts to re-discover their historic and cultural similarities and to foster economic cooperation. Korea is geographically located in the center of Northeast Asia, Russia and the United States of America and also located somewhere in the middle among the countries of this region in terms of stage of economic development. Since Korea's land area and population are very small compared with the big four nations, Korea would not be so much of a threat to any of these big nations. Therefore, Korea is the most desirable nation to be a 'facilitator' or 'mediator' of the process to design and implement economic cooperation in the region, and also to act as a 'buffer state' to

mitigate the frustrations and competition among the other Northeast Asian countries, Russia and the United States of America. Realistically speaking, Korea would probably be the most suitable nation for facilitating economic cooperation among the Northeast Asian countries.

In this regard, Korea should prepare itself well to efficiently carry out its role as a facilitator of economic cooperation among the Northeast Asian countries, Russia and the United States. The fields of interest for economic cooperation will be trade, investment, transportation, communications, logistics, energy, information technology, agriculture, tourism, environment, science and technology. Indeed for Korea, it is a very rare, golden and historic opportunity to be one of the core nations in the region by devoting itself to serve other nations in the process of fostering economic integration in the various fields mentioned above. In turn, it will help Korea improve its status in the region. Indeed, if Korea could have an opportunity to be a mediator and a buffer state in the region, it will be greatly beneficial not only to Korea but to all other countries in Northeast Asia as well as in western hemisphere.

### **3. SURVIVAL AND DEVELOPMENT**

Under the free trade environment within and without the region, considering China as an economic giant, what could the Korean economy do to promote further economic growth? Four measures may be suggested. The first measure would be to change the economic structure as soon as possible from one that is based on imitating technologies to a knowledge-based economy by developing sensible industrial policies and proper educational systems. The Korean economy should continuously advance itself in knowledge-based industries in comparison to competing countries in order to keep its competitive edge.

Second, by utilizing its geographical advantage, Korea should hurry up to

build a 'regional distribution center for logistics' for Northeast Asia. To be a 'regional distribution center', there must be regional headquarters of multinational logistic corporations, such as Fedex, DHL, UPS and TNT, located in Korea as the base for the provision of their full range of logistics services. In order to attract these multinational logistic corporations, Korea needs to have an 'International Free City' so that it could provide all of the necessary institutions, facilities and infrastructure, just like cities of advanced countries. China could be considered as an alternative location for a 'regional distribution center'. However, there are a number of disadvantages inherent in the Chinese social system. Moreover, China is still in the less-developed stages of information technology and networking systems. It would also be difficult to build a 'regional distribution center' in Japan because of its disadvantages in location and very high labor costs and costs for other services. However, if Korea delays in exerting special efforts to build a 'regional distribution center' within the near future, Korea may forfeit this golden opportunity to other countries in the region.

Third, the current major traditional manufacturing industries, such as steel, automobiles, shipbuilding and electronics, should upgrade their levels of productivity by adapting modern management and production processes, based particularly on the proper utilization of information technologies. In the coming century, only countries with industries that have levels of productivity superior to those of competing countries will survive economically.

Fourth, in order to prepare for FTAs and the formation of a Northeast Asia Economic Community, the Korean government should pay special attention to comparatively less competitive industries, such as agriculture and labor-intensive industries, in order to come up with appropriate measures to deal with them, and to create a consensus view among those individuals in those industries affected by these changes.

#### **4. BUILDING A LOGISTICS AND BUSINESS HUB**

In recent years, the life cycle of manufacturing products has been shortened rapidly along with fast changes in the behavioral pattern of consumers. Therefore, producers tend to take the so-called 'postponement strategy' that is to postpone the production of their final products until they find a definitive pattern of consumer behavior in order to maximize both the competitiveness and added value of manufacturing products. Under this 'postponement strategy', the key issues are how to minimize production costs and delivery times. If producers could have an integrated logistics services of the so-called 'supply chain management (SCM)' system, they could minimize both production costs and delivery times. SCM services, which can only be provided by big multinational logistics corporations such as Fedex, DHL, UPS, TNT, means that one logistics corporation will deal with the purchase and delivery of most of the parts and components that manufacturers need, as well as the delivery of the final products to each of the consumers through one channel. Therefore, high-tech and high value-added manufacturers tend to locate their manufacturing firms where they could have access to SCM services.

With respect to logistics systems, the general trend for the efficient management of inventories for both input materials and final products is to adopt a 'regional distribution center' system in a strategic location, such as Rotterdam in Europe. In the case of South Asia, the 'regional distribution center' is located in Singapore, and a number of multinational logistics corporations are located there from which they provide SCM services. In recent years, the average annual FDI in Singapore was approximately 7 billion U.S. dollars, of which about 80% was invested in the high-tech manufacturing sector, and the rest in logistics and other services.

The question that arises is whether Korea can meet all of the preconditions for a regional distribution center or a regional logistics hub. As already mentioned above, considering its geographical location and economic ability, Korea is the ideal country to be a regional logistics hub. Moreover, taking

into account the fast growing economy of China and the lack of logistics facilities in China, Pusan, Kwangyang and the Belt of Kyungki Bay, including Kaesung, Incheon, Shihung and Pyungtack, in Korea are the most suitable areas for the development of a regional logistics center. The already existing large industrial parks located in the hinterland of the Belt of Kyungki are ready to attract a large number of high-tech manufacturing firms.

In addition to the geographical and economical preconditions, Korea should meet the following 8 preconditions, particularly for the purpose of attracting the multinational logistics corporations mentioned above. These 8 preconditions are: (i) operating a market system smoothly like in advanced countries, (ii) having a transparent management atmosphere, (iii) maintaining peaceful relations between labor unions and management, (iv) having an open society where foreign residents can work and live without experiencing any serious cultural difficulties, (v) having a very comfortable living environment, including housing, schools, hospitals, shopping and other cultural facilities and activities, (vi) having very modern transportation and communication facilities, (vii) having advanced information technologies, and (viii) having sufficient numbers of young professionals in international trade and e-business who are able to speak at least 3 foreign languages. If Korea is not ready to meet the 8 preconditions above quickly, it may lose its historic and golden opportunity to become a regional logistics hub, since there is a possibility that competing countries like China, Taiwan, and Japan may meet these preconditions ahead of Korea. Professionals in Korea insist that in about 5 years, Korea should prepare the fundamental conditions for definitively proving to foreign investors that the Korean government is fully committed to building a regional distribution center in Northeast Asia.

If Korea tries to meet the 8 preconditions above all over the country, it would take a long period of time and require an unmanageably large amount of investment funds. Therefore, one way would be to choose a certain area where the 8 preconditions above could be met and to build an 'international free city' in that area by making special administrative arrangements and intensively putting in resources so that the 8 preconditions above could be

met within a reasonably short period of time and with a manageable amount of investment funds. Then, this 'international free city,' which would be similar to Singapore, would not only be a center for regional logistics but also a center for tourism, international business and banking in Northeast Asia. Moreover, it could serve as a center for forming the Northeast Asian Economic Community.

Eventually, the idea of building an 'international free city' will be gradually spread to coastal areas, as well as inland cities, all over the country, so that the whole country will become an economic, social, cultural and political exchange hub in the region. If an ideal 'international free city' is built and developed in Korea, it could be an example of a special and ideal city where modern Western culture, based on rationalism, strong legal enforcement, and a merit-based system could co-exist with Eastern culture, which is rooted in family ties and moral order. In order to achieve such a historic task, the Korean government ought to formulate long-term and short-term action plans, and have a national consensus view on these plans.

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