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in Northeast Asia and Financial Cooperation**

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# **The Paradigm Change of Regional Cooperation in Northeast Asia and Financial Cooperation<sup>1</sup>**

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## **Abstract**

In the post-Cold War world, Northeast Asia has experienced dramatic changes in the waves of globalization. Local governments and NGOs were the main constituents in the early period of regional cooperation. But central governments have now become a mechanism of regional cooperation. In that Japan, China and South Korea approached each other rapidly, we can say that the paradigm of Northeast Asian regional cooperation has changed. The three countries will form a core of regional cooperation, and must take the leadership initiative jointly. The establishment of a regional multilateral cooperative institution can be contrived when the region draws the ground design for mid- to long-term development and thinks of it from the perspective of regional financial cooperation. When thinking about each country's economic development status and potential problems in the future, China would be the natural headquarters for the development bank, South Korea for recommending investment, and Japan for the currency foundation. This model addresses the problem of Northeast Asia financial cooperation on a step-by-step basis.

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## 1. Introduction

In the post-Cold War world, Northeast Asia has experienced dramatic changes in the waves of globalization. Since the 1990s, in this region, relations that had been strained by crises and the mutual distrust of war and detente are being replaced by regional cooperation. In other words, although many observers choose to emphasize regional crises, steady progress is being made in pursuit of mutual cooperation, peaceful coexistence and mutual prosperity.

Though economic, human, and cultural exchange currents in Northeast Asia are expanding rapidly, the move towards community hasn't developed naturally in the international relations of this region. To promote the regional development, the expansion of cooperation in economics and trade is very important, but I recognize that the most important problem is financial cooperation.

As for the necessity of financial cooperation in Northeast Asia, it has been proposed by experts from South Korea and China in 1991, at the international conference held by the Northeast Asia Economic Forum<sup>2</sup>. At that time, financial cooperation was not yet recognized as a realistic goal. However, over the past 10 years, the situation in Northeast Asia has changed. The changing environment is largely the result of two factors – the rapid economic growth in China and its accession to the WTO, as well as the tripartite discussions between Japan, China and South Korea through the "ASEAN Plus Three" framework.

Informal talks between the leaders of Japan, China and South Korea began in Manila in November, 1999, and have become normalized since then. Communication channels among the three governments have been promoted, and received the attention of this summit. What impact will increased communication have on the region? Can these three countries become a core and can they lead the efforts at Northeast Asian regional cooperation? For now, the three countries framework is seen as different from a Northeast Asia regional cooperation framework, but that may change in the future. In any case, the three countries are thinking seriously about the issue of Northeast Asian cooperation.

On the other hand, regional economic integration of the market economies is moving ahead rapidly with a background of the globalization within the three countries of Japan, China and South Korea. Regional trade and investment among the three

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<sup>2</sup> NAM Dock-woo, a former Prime Minister of Republic of Korea (South Korea), proposed the necessity of creating a financial mechanism for the development of Northeast Asia in the first international conference of "*The Northeast Asian Economic Forum*" which was hosted in Tianjin, China, September 2-7, 1991.

countries is expanding rapidly and economic interdependence is rapidly increasing. It is possible to regard this as being a *de facto* economic integration process.

The economic scale of the Northeast Asia region accounted for about 20 percent of the global economy already (measuring the GDP scale and the trade scale) following the growth in the 1990s. It has quickly become one of the three poles in the global economy. Most remarkable of all, in the Northeast Asian countries, the domestic savings and the foreign reserves totals accounted for more than half of the worldwide total, because of the rapid expansion of exports among the partners. In other words, it becomes a mature relationship based on mutual respect and cooperation, in one of the "rich regions" of the world.

However, because there is a large population in the Northeast Asia region and there are many developing countries nearby, a constant shortfall of financial support for regional development and cooperation is a prominent contradictory point. In other words, the big mismatch has occurred on the supply side of the financial resources. It is a very important problem that must be solved in the future for Northeast Asian regional cooperation to continue to grow.

This paper will focus to the subject of financial cooperation in the Northeast Asia Region. To explain the paradigm change in Northeast Asian regional cooperation, it will examine the historic conversion evidenced by the formation of the cooperative framework between Japan, China and the South Korea. It concludes by clarifying some problems on the subject of financial cooperation and Northeast Asia Regional Cooperation in the future.

## **2 . The Paradigm Change in Northeast Asia Regional Cooperation<sup>3</sup>**

### **1) TRADP and Northeast Asia Regional Cooperation in the 1990s**

The 1990s were characterized by rapid and upbeat changes for most for the Northeast Asia region. The Cold War ended and the stalemate of East-West opposition was broken. Actors in Northeast Asia began actively seeking a new form and ideology of regional cooperation.

Several dynamic changes in Northeast Asia occurred in the 1990s. The first

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<sup>3</sup> I discussed the paradigm change in Northeastern Asia cooperation formerly in a paper, "The Forming of a Frame for The Northeastern Asia finance cooperation," *International Finance Journal* Vol.1091, September 2002. The Institute of Foreign Exchange and Trade Rsearch, Tokyo, Japan.

development was “The International Conference for Northeast Asian Economic and Technological Cooperation”, which was held in Chang-Chun city, China in July, 1990. Participants included scholars and experts from countries throughout the region, as well as staff from the United Nations Development Programme (UNDP). At the conference, an expert from Jilin province in China unveiled the Tumen River Golden Delta development concept, which attracted wide attention. Later, with the UNDP taking the lead, China, North Korea and Russia, as well as Mongolia and South Korea, participated in the "Tumen River Area Development Programme" (TRADP). The TRADP was promoted throughout Northeast Asia, and attracted attention as the first multilateral international development project.

Concerning this TRADP promotion, a framework for international cooperation was formed by the UNDP and the concerned countries. "Three agreements"<sup>4</sup> were signed by the countries involved, and two organizations ("the Coordination Committee" and "the Consultative Commission") were established as cooperative institutions between the governments in December, 1995. Japan participated as an observer member from the beginning, but local governments of Japan Sea rim actively expanded the current of exchange activities with other members, independent of the central government.

However, during the past decade, cooperation under the TRADP did not match the high expectations of its architects, and as a result, the countries involved have not proceeded with full-scale multilateral cooperation on complex issues. It is possible to say that the paradigm of Northeast Asian regional cooperation is changing the status of the region and resulting in dynamism in relations and economic development.

## **2) Formation of the Japan – China – South Korea Framework**

The Asian financial crisis of 1997 spread to the Northeast Asian countries, taking a heavy toll in South Korea and Russia. The crisis effected regional cooperation as well, and the Tumen River Development Project gradually lost momentum.

However, within the “ASEAN Plus Three” framework, the crisis provided an

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<sup>4</sup> The Three Agreements consisted of the following: "The Agreement about the Establishment of the Tumen River Area development Coordination Committee," (Among China, Russia and North Korea) and "The Agreement about the Establishment of the consultative committee for Tumen River Economic Development and the Northeast Asia Development," (Among the above three countries plus Mongolia and South Korea) and "The memorandum about the Tumen River Economic Development and the Northeast Asia Environmental Standards," which depends on five countries.

opportunity to advance regional cooperation. An “ASEAN Plus Three” summit, consisting of ASEAN countries with Japan, China, and South Korea, was held on the thirtieth anniversary of the founding of ASEAN in December, 1997. The summit has been held annually since then, and in 1999 was normalized and expanded to include meetings of the ministers of economy, finance, and foreign affairs, as well as other cabinet-level officials from the 13 member countries.

The "ASEAN+3" frame was institutionalized in Manila meeting in November, 1999. At that time, the leaders of Japan, China and South Korea conducted an informal breakfast meeting<sup>5</sup>. Held at the suggestion of South Korean President Kim Dae Jung, it was the first historical and informal summit of the three countries. The opening topics were about the three countries' common points in culture, history and tradition, and mostly concerned with economy and trade. The second summit meeting of the three countries was held in Singapore in November, 2000. The three leaders then agreed to the normalization of the meeting and its continuation in the future. The pace of cooperation increased as the three countries implemented joint research on economic cooperation and agreed to promotion of cultural and personal exchanges, IT cooperation, and cooperation on environmental issues. In November, 2001, the summit meeting was held for the third time in Brunei and a joint report on economic cooperation, conducted by research organizations from the three countries, was released<sup>6</sup>. The leaders agreed to hold meetings for the ministers of economy and finance. They also agreed to extend government support of cooperation to the business world.

### **3) Characteristics of the Paradigm Shift**

In that Japan, China and South Korea approached each other rapidly, we can say that the paradigm of Northeast Asian regional cooperation changed. This characteristic can be derived from some of the following viewpoints.

( ) The geopolitics of regional cooperation in Northeast Asia is changing. In the beginning of the 1990s, the Northeast Asia Regional Cooperation included the Japan

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<sup>5</sup> Ministry of Foreign Affairs home page (<http://www.mofa.go.jp/>).

<sup>6</sup> In accordance with the common understanding reached by the leaders from China, Japan and Korea during the Manila Summit in November 1999, the joint research on "Strengthening Economic Cooperation among China, Japan and Korea" was officially launched by the representative institutes from the three countries, namely the Development Research Center of the State Council of China (DRC), the National Institute of Research Advancement of Japan (NIRA) and the Korea Institute for International Economic Policy (KIEP) in November 2000.

Sea rim and of Bo-Hai and Yellow Sea rim (a narrow concept). But the concept of Northeast Asia region must include the six countries of all of Northeast Asia at present—Japan, China, South Korea, North Korea, Mongolia and Russia, as well as Taiwan and Hong Kong of China<sup>7</sup>. This “wide view” of regional cooperation is essential for its success. It is meaningless to discuss East Asian economic relations without including Hong Kong and Taiwan, because they are part of the region geographically. Also, it is very important for Northeast Asian economic development to capture the dynamism of areas which might be excluded. With the exception of Singapore, all of the Asian NIEs are included in this “wide view”.

( ) Northeast Asian regional cooperation in the past could be spontaneous, mainly occurring in the “Natural Economic Territory” (NET)<sup>8</sup>, e.g. local economic blocs based on shared waters, such as the Japan Sea rim economic bloc, the rim of Bo-Hai and Yellow Sea economic bloc, the Huanan economic bloc, the Taiwan Straits economic bloc, which all developed naturally. This was the inevitable development of the historic turning point after the end of Cold War. However, in every country in East Asia that was affected by the Asian financial crisis, it is the one of the intervals of the states at present. Regional cooperation through agreements (such as free trade agreements or “economic cooperation”) and so on is developing rapidly. It is moving in the direction of systematic integration and the activity of the local economic bloc shows movement that is absorbed by systematic integration. It is necessary to recognize that the momentum toward economic integration is moving closer to the models presented by the European Union and NAFTA.

( ) Local governments and NGOs were the main constituents in the early period of Northeast economic cooperation. But central governments have now become a mechanism of regional cooperation, and are quickly becoming the main players. Central governments, local governments, and NGOs are like the wheels on the car of regional cooperation. It should be recognized that the speed of cooperation is rising rapidly and also that the paradigm is changing from a theory of regional cooperation into a theory of regional integration.

( ) The Japan – China – South Korea summit meeting signifies that the

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<sup>7</sup> When thinking of the forming of an area cooperation body as the systematic frame, one should put Japan, China and Korea in the core and Far East Russia, North Korea and Mongolia in the category of the Northeast Asia, and it should include Hongkong and Taiwan in my view.

<sup>8</sup> Robert. A. Scalapino, winner of the Nobel Prize in economics and Professor at Pennsylvania University (U.S.A.), described a potential Northeast Asia economic area as a NET (Natural Economic Territory).

cooperation frame is extending to the level of top political leadership. In this environment, agreement on regional cooperation can be promoted politically. Cabinet ministers, as well as the government and school levels can then promote cooperation based on political agreement. The impact is different compared with cooperation initiatives spearheaded by local governments, as occurred in the "two committee" structure of the Tumen River Development Project.

In short, when any dialog channel among the central governments results in further regional cooperation in Northeast Asia, the idea of progress in inter-local government exchange (such as the Tumen River development project, or Japan Sea rim exchange) gains momentum. But it may be said that progress in cooperation among central governments that entails the institutionalization of multilateral regional cooperation is the present objective.

### **3. A Cooperation Frame for Japan, China and South Korea and Their Leadership**

Because of the complicated historic problems in relations between Japan, China, and South Korea, the basis for regional cooperation was very fragile until the mid-1990s among these three countries, which occupy the core position of a potential Northeast Asian economic cooperation paradigm. However, one important result of the turbulence after the Asian financial crisis was the emergence of the Japan – China – South Korea Summit Meetings and the formation of the “ASEAN Plus Three” framework.

The Japan – China – South Korea Summit Meetings are the beginning of a new era in Northeast Asian regionalism, and it can be argued that this development was also an historic inevitability. The three countries have share many common points and common interests in politics, economics, and culture, and in their relations with countries outside of the region. The three countries will be able to play a leadership role in Northeast Asian regional cooperation if the union strengthens. But, it is desirable for each country to have a balanced role in the triangular relationship, since there have been many problems in past political and economic relations.

#### **1) Politics and economic reliability**

First, the domestic politics of each country is stable. I think that the basis for Northeast Asia cooperation is formed if three countries are united and take leadership jointly, because stability is crucial for smooth relations among the three countries.

## **2) The mighty economic scale**

Next, the three countries GDP scales (in 2002) account for about 19.1% of the world economy and constitute the core of the Northeast Asian economy. The three countries account for 15.7% (or 19.2% if Hong Kong is included) of global trade and this secures core status in Northeast Asia region as a whole (22.6%). With China's accession to the WTO in November, 2001, economic mutual interdependence is rising rapidly with trade within the region, foreign direct investment, technology transfer, human movement and so on. Accordingly, the intra-region trade ratio increased from 14.1% 1992 to 20.0% in 2002. Also, in the balance of trade, it is respectively in Japan vs. China, China vs. South Korea, and South Korea vs. Japan. In other words, the balance of trade forms a triangle in which each nation has a surplus to one nation and a deficit towards the other. The balance of trade issue is difficult to solve. The mutual complementary relationship is strong on trade, and it is desirable to construct a free trade area in this light.

## **3) Strong cultural relations**

Japan, China and South Korea share similar cultures (all three use *kanji*), and deep historical relationships in human and cultural exchange. In the last century, an unfortunate period of war, invasion and colonization coincided with the imperialistic policy in Japan. The Cold War era emerged after the second World War, preventing the Northeast Asian countries from building cooperative relationships. However, the current era of exchange and interdependence began after the Cold War. Without precedent, in 2002, the World Cup for soccer was co-hosted by Japan and South Korea. China also entered the event for the first time, and the mood of three countries of private alternating current is rising at a breath. Since 2002, the three countries have promoted alternating currents and are quickly taking steps to build a relationship of mutual trust.

## **4) Stable relations with neighboring countries**

Lastly, the three countries maintain strong political and economic relationships within and outside of the region. Within the region, there is the problem of Korean Peninsular relations. Faced with the problems of unification and national economic

integration, South Korea needs to promote a current of exchange with the North. China has friendly relations and a strong economic relationship with North Korea, and will provide a good model for North Korean economic development by the precedence of reform and opening economy. Japan will have to address the history problem eventually and it is now in a position where normalization of relations with North Korea is especially important. Also, as areas with transitional economies, Mongolia and far-Eastern Russia must keep good political and economic relationships with Japan, China and the South Korea, and learn the development experience to gain status within the region.

On the other hand, in the relations with countries the outside of the region, Japan and South Korea are in alliances with the US, and China is in a position which the US cannot ignore because of its rapid growth in economic power and market scale. Economically, all three countries have strong ties to the US, the EU and ASEAN. In other words, each country independently has strong enough relations with extra-regional countries to ease global acceptance of regional cooperation.

The expectations for the leadership roles of Japan, China and South Korea will rise in Northeast Asia regional cooperation and for East Asia as a whole.

#### **4. The Proposal to Build A Northeast Asia Capital Circulation System**

Cooperation between the three countries is a necessity, and moreover the advancement of Northeast Asian economic cooperation to the next step requires the joint leadership of the three countries. Currently, East Asian regional cooperation through the "ASEAN+3" framework is highly regarded. However, from a mid- to long-term strategic viewpoint, the inclusion of nearby countries such as Mongolia and North Korea is essential to maintaining peace, stability, and sustainable development throughout the region. Therefore, Northeast Asian regional cooperation must be accompanied by a strong movement towards East Asian strategic cooperation.

The 1997 Asian financial crisis made the necessity of economic cooperation apparent. In the case of Northeast Asian regional economic cooperation, the relevant countries began to recognize that financial cooperation is of the utmost importance, especially addressing the problem with financing development. Currency stabilization and the development finance problem are of equal importance, and need to be dealt with simultaneously.

First, the establishment of a Northeast Asian multilateral cooperative institution can be contrived when the Northeast Asia region must draw the ground design for mid-

to long-term development and thinks of it from the perspective of regional financial cooperation. Also, as shown in Table 1, the Northeast Asia region possesses considerable foreign currency assets. Now, the foreign reserves have reached 1.58 trillion U. S. dollars – over the half of the world total – and Northeast Asia has become one of the “rich regions” in the world.

**Table 1. The foreign reserves in the Northeast Asia countries (Unit: 100million U.S\$)**

<b>Countries</b>	<b>1990</b>	<b>1995</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Japan	694.87	1,724.43	3,616.38	4,038.80	4,697.28	6,735.29
China	285.94	735.79	1,655.74	2,122.00	2,864.07	4,033.00
(Hongkong)	245.70	553.98	1,075.45	1,112.00	1,119.00	1,161.00
(Taiwan)	724.41	903.10	1,096.00	1,212.00	1,616.60	1,766.86
South Korea	144.59	319.28	961.98	1,082.00	1,214.10	1,553.52
Russia	n.a.	148.72	279.72	366.22	440.54.	609.00.
<b>Total</b>	<b>2,095.51</b>	<b>4,385.30</b>	<b>8,685.27</b>	<b>9,933.02</b>	<b>11,951.59</b>	<b>15,858.67</b>

Note: The data is for the end of each year. North Korea and Mongolia are omitted because data is not available.

Source: statistics of International Monetary Fund and Ministry of Finance of every country.

## **5. The Initiative of a Triangular Finance Mechanism in Northeast Asia**

When thinking of utilizing such rich foreign currency assets and domestic savings and building an intra-regional circulation system, three financial mechanisms can be contrived. A general cooperative institution will be necessary to supervise the creation and operation of the three mechanisms. China, South Korea and Japan can attempt a mutual balance by jointly promoting this concept and placing the headquarters of one mechanism in each of the three countries. When thinking about each country’s economic development status and potential problems in the future, China would be the natural headquarters for the development bank, South Korea for recommending investment, and Japan for the currency foundation. This model addresses the problem of Northeast Asia financial cooperation on a step-by-step basis.

### **1) The Asian Monetary Found (AMF) Initiative should be restored**

When promoting Northeast Asian financial cooperation, first, it will be necessary to establish an Asian Monetary Found (AMF) to stabilize currency and

exchange in the East Asia region. Japan proposed this conception when facing the Asian currency crisis in 1997. It wasn't possible to promote this idea, which the U.S.A. and International Monetary Fund (IMF) oppose, when the three countries lacked a consensus on the concept. However, in recent years, the voice of the AMF foundation has become stronger, and there is less active resistance to such proposals from the USA and IMF. The countries should discuss and promote the issue jointly once more to realize AMF initiative.

The AMF initiative is not limited to Northeast Asia; it aims to include all of East Asia and should be described as “an East Asian financial cooperative institution.” It should function to support the adjustment of exchange rates in the whole region, the adjustment of the foreign currency balance, and service of the financial system, including Northeast and Southeast Asia. It will be able to facilitate the adoption of a currency swap agreement in East Asia based on the Chiang Mai Initiative (CMI), which was agreed to in 1999, by developing it further and making it a multilateral agreement. There is a problem how to win the support of countries outside the region (e.g. the U.S.A or EU) and international organizations once consensus has been reached among regional countries (ASEAN+3). The country best suited to leading the AMF initiative is Japan, because it has the strongest financial system in Asia and is the greatest economic power in the region.

## **2) Establish a Northeast Asia Development bank (NEADB)**

The Northeast Asia region includes not only Japan and South Korea, but also large developing countries like China, Russia, and Mongolia, which are in transition from a planned to a market economy (as well as North Korea, which is likely to begin transition soon). To build sustainable development and prosperity in this now-unbalanced region, development support to the countries in transition is indispensable. Technically, the ADB should support these programs, but historic complications make it difficult for North Korea and Russia to join. Also, because there are so many developing countries in the whole of Asia, and because the percentage of population in poverty is more than half the global total, the ADB does not have enough resources to meet the needs of Northeast Asia and the rest of Asia as well.

The NEADB initiative will compliment the role of the ADB in Asian development, focusing on the needs of Northeast Asia. It would be responsible for financing projects such as cross-border infrastructure development, such as gas pipelines and expanded

rail connections throughout the region. It would also provide specialized knowledge necessary for expanding “hard” and “soft” infrastructure in the region’s developing countries.

As a country that is successfully switching over from a planned to a market economy and experiencing continued economic expansion, China is the natural model for the regional developing countries. These countries (North Korea, Mongolia, and the far East of Russia) also share borders with China. Japan and South Korea are in a position to jointly provide funding and technological support for these countries, as they have for China in the past.

### **3) The foundation of "Northeast Asia Trust Fund" (NEATF)**

When thinking about international development and financial cooperation in the Northeast Asia region, another important problem remains. It is the development of North Korea and the issue of Korean unification. Even if Korean unification is politically difficult at present, this historic problem must be rectified in time, and significant steps forward have occurred through North-South summits in recent years. However, it is necessary to recognize that the economic recovery of North Korea, and its international revival after a long period of isolation, present a pressing issue for every country in the region. If Northeast Asia aims to build a regional community, it will not be possible without economic reform and recovery in North Korea.

Therefore, the important problem which is thought of as an aspect of financial cooperation is to found a "Northeast Asian Trust Fund" with the NEADB. The NEATF is necessary to assist with the economic revival of North Korea and the eventual reunification of North and South Korea. South Korea is best suited to host the Trust Fund because of its advanced market economy and for obvious reasons. South Korea must take the initiative in building the Trust Fund to further its goal of reunification. The active support of Japan and China is also essential.

Lastly, the three-part financial mechanism discussed above will be easy for Japan, China and South Korea to accept because of their strengthening relationships and the specialized role of each country. Of the three mechanisms, the NEADB has the highest priority at present, as development will be necessary before progress can be made in other areas of economic integration. If the NEADB initiative is realized, the other two initiatives will quickly gain support.

## **6. Conclusion**

The Northeast Asia Regional Cooperation paradigm is changing, with relations between Japan, China and South Korea improving rapidly after the Asian financial crisis of 1997. It may still be too early to say that cooperation between the three countries amounts to Northeast Asian regional cooperation, but a framework for regional cooperation will certainly emerge in the near future. Japan, China and the South Korea will form the core of regional cooperation, and must take the leadership initiative jointly.

It's possible to say that, among the Northeast Asian countries, only Japan showed a negative reaction to the idea of cooperation, but in recent years, Japan has greater incentive to support the creation of a multilateral financial institution for regional development and to reconsider the importance of regional cooperation. Japan must recognize that the cost of establishing a Northeast Asian Development Bank is small compared with the strategic benefits and the strengthening of peaceful relations in the region.