

A New Perspective and Strategy for National Integration: An Economic Approach

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Economic Integration as a Starting Point for National Integration

National integration refers to the process by which a nation, once divided, regains its social and national identity under a unified state. Here integration can be further classified into two types: a substantive integration and a formal integration. A substantive integration refers to the process by which the residents of two divided countries become homogenized in political, economic, and social aspects, while a formal integration or an institutional integration refers to the completion of the basic frame for integration. Integration, in its strict sense, refers to a substantive integration.

National integration, defined in this way, must be a long-term objective, whether it is achieved gradually or drastically. For a complete national integration presupposes a substantive integration, whose completion requires a long period of time. It is simply impossible to complete the process in the short term.

National integration must begin in the economic aspect. In other words, any attempts at political and social integration without economic exchanges and integration could bring about enormous chaos in the society. The importance of economic integration can be confirmed by two historical cases of national integration: Germany and Yemen.

The difference between the German-style and Yemenite-style

integrations is not whether it was achieved by one side's absorption of the other or mutual agreement. The really meaningful difference is whether the process was accompanied by citizens' active involvement, or primarily led by the state. To be more specific, it was the question of how active private economic exchanges had been before a formal integration process began.

The German case, although it is often referred to as a typical case of abrupt unification by absorption, can be characterized as having maintained continuous economic exchanges and cooperation between East and West Germany from the beginning of the division till the time of unification. The pre-unification exchanges and cooperation took many different forms, including inter-German trade, governmental transfer payments, cooperation between West German public enterprises and East German state enterprises, and postal, communication, and personal exchanges.

The East-West German exchanges and cooperation had three main characteristics. First, it was the economic trade that predominated the first stage of inter-German cooperation. What followed next was personal exchanges building mutual understanding and confidence. It was only at the later stage that governmental transfer and joint venture contracts began.

Second, the West tried to provide the East with what the East needed most economically. In return, the West received many concessions from the East in other areas, such as postal, communication, and personal exchanges.

Third, despite a decrease in the volume of inter-German trade due to the recession of the East German economy in the eighties, the inter-German cooperation became strengthened. This was possible because the West's provision of aid and other cooperative ventures for political and humanitarian reasons more than compensated for the trade reduction.

In contrast to the German case, Yemenite integration was a state-dominant one. The whole process of unification and integration was led by the state, while the private sector's role including pre-unification exchanges and cooperation was minimal. In other words, on the basis of political integration achieved by both sides' political leaders, economic and social integration was imposed

upon the people.

North Yemen and South Yemen continued to talk about national integration for 20 years, but the talks failed to result in any significant achievements. There are several reasons for the failure. First, neighboring countries such as the former Soviet Union and Saudi Arabia intervened in the process, thinking that the division of Yemen would be in their national interests. Second, politicians of both sides used their unification policies as a means of power struggle, thus putting a greater emphasis on regime stability than on unification. Third, both North and South Yemen had no capability to mobilize social forces for the implementation of their unification policies.¹

The German and Yemenite integration experiences provide us with several implications. First, they show that economic integration must be given priority over political and social integration. In the German case, despite a considerable level of pre-unification economic exchanges, the abrupt political unification resulted in economic chaos. In Yemenite case, the integration was largely a result of politicians' political decision. This political nature implied, however, that the integration could break down at any time with changes in the political situations.

Second, the experiences strongly imply the importance of economic exchanges and cooperation before unification. In general, the level of pre-unification economic exchanges will have a positive effect on the level of economic integration after unification. In Yemen, the lack of pre-unification economic exchanges in the private sector was a major obstacle to carrying out consistently the integration process after political integration. In Germany, however, the gradual expansion of economic exchanges and cooperation before unification contributed not only to achieving the political integration (that is, unification), but also to facilitating social and economic integration after unification.

North Korean society is far more closed than the East German society. It will take a considerable amount of time for North Korean residents to adjust to the South Korean system. Therefore, it is beyond doubt that more active economic exchanges and coopera-

¹ Kim, G. S. (1993). *A Case Study of Yemenite Integration*. Research Institute for National Unification, pp. 87-88.

tion between North and South Korea are needed before political unification.

Merits and Problems of Existing Theories of Economic Integration

Classical Theories of Economic Integration

The most representative of classical theories of economic integration is Balassa's theory. According to his theory, economic integration proceeds in six different stages.² The first stage is focused on sectoral integration, where more than two different markets are integrated only at the level of particular sectors or industries. The second stage is characterized by the formation of a "free trade area," which guarantees free trade among participating states while allowing each state to have its own protectionist measures against non-participating states. The third stage features a "customs union," which is a more developed form of a free trade area. Participating states in a customs union can not only trade without tariffs among themselves, but also set up a common tariff structure against goods imported from non-participating states.

The fourth stage is represented by a "common market," which guarantees a free flow not only of commodities but also of production factors such as labor and capital among participating states. The fifth stage is characterized by an "economic union," where participating states not only have a common market, but also try to make common economic policies through various forms of policy coordination. The sixth stage is that of a complete economic union. Participating states establish a supra-national organization, which then performs a central role in coordinating, integrating, and managing those states' social and economic policies. At this final stage, one may say that all the participating states have been integrated into one unified economy.

In addition to this stage-oriented approach, economic integration can be also classified on the basis of the length of time for integration process as well as of the types of integration. Focusing on

² Balassa, B. (1969), *The Theory of Economic Integration*, George and Allen Unwin Ltd., London, p. 1.

the length of time economic integration takes, one may speak of gradual integration and radical integration.

Focusing on the types of integration, economic integration can be classified into institutional integration and functional integration. Institutional integration refers to a type of integration where conditions and forms of integration are decided upon by participating economic actors' agreement. Functional integration refers to a more natural process of integration, where private actors motivated by their own economic incentives first engage themselves in supra-national economic activities, thus forming naturally a regional economic bloc.

Balassa's classical theory of economic integration provides us with two important implications. First, it seems desirable to have a gradual integration process that goes through several stages. Second, the movement to a higher stage in the integration process can be made possible by consultation and agreement among participating states.

There are several problems, however, that we may face in applying this theory to the case of Korean integration. First, Balassa's theory presumes an economic integration between states with the same type of economic system. Thus it cannot be applied without qualifications to the case of integration between North and South Korea, which have two totally different economic systems. Second, Balassa's theory ignores the problem of sovereignty, which can be a critical factor in the case of Korean integration. Third, the huge difference between North and South Korea in terms of their economic development and scale makes it difficult to apply Balassa-style integration.

Existing Theories of North-South Korean Economic Integration

Existing studies on North-South Korean economic integration can be classified into two kinds. One is those focusing on a gradual process of economic integration, asking what is the most desirable form of economic activities before political unification. The other is those studies that focus on the post-unification economic integration, presupposing an abrupt unification. Here we will review only those studies focusing on the strategy for pre-unification economic

integration.

Studies on the gradual economic integration of Korea can be further classified into three types. One is those based on classical theories of economic integration, the second is those based on theories of regional economic integration, and the third is based on the spider web approach.

Representative of those based on classical theories are Yim's³ and Lee's studies.⁴ Yim proposes the following five stages as a new unification strategy. The first stage focuses on the normalization of North-South Korean relations and reciprocal economic cooperation, the second stage on economic integration, the third on social integration, the fourth on political integration, and the fifth on system integration.

Here the first and second stages are basically the stage of economic integration, which are further classified into five sub-stages. The first sub-stage is concerned with laying the foundation for economic cooperation by signing various treaties and agreements. The second sub-stage focuses on the expansion of indirect trade via a third country and the pursuit of personal exchanges, while the third focuses on joint participation in international organizations for economic cooperation, joint development of the Rajin-Sonbong free economic zone, and joint construction of infrastructure. The fourth is concerned with construction of common economic special zones, and joint investment for capital and technology cooperation. The final, fifth sub-stage is the stage of completing economic integration by gradually moving from tariff union, common market, economic union, monetary union, to economic integration.

As another study based on classical theory of integration, Lee's study classifies the process of inter-Korean economic integration into four stages: the stage of economic exchanges, that of economic cooperation, that of a common market, and finally that of economic integration. The first stage of economic exchanges is further divided into the stage of indirect trade and that of direct trade. The second stage of economic cooperation is further divided into the stage

³ Yim, Y. T. (1993), *The Third Way for Korean Unification*, Maeil Economic Daily.

⁴ Lee, S. M. (1996). "North-South Korean Economic Integration," in *The Theory of Unification Environment*. Orum.

of provision of mutual conveniences, that of industrial cooperation, and that of joint ventures. The third stage, characterized by the formation of a common market, is composed of the following four stages: sectoral integration, free trade zones, a tariff union, and then finally a common market. The final fourth stage of economic integration can be further divided into economic union, monetary union, and social union.

Representative of those studies that search for a model of Korean economic integration from the perspective of regional economic integration is Kim's study.⁵ He presumes that all economic activities are closely related to their regional spaces, and further argues that the concept of economic region has its boundaries not artificially drawn, but naturally formed according to market forces.

In general, an economic region is formed by various factors such as the expansion and concentration of production structures, the specialization of production, the expansion of sub-contracting, the expansion and development of service industries, the expansion of technology and infrastructures, and the increase in the interdependence between different industrial sectors. He points out that we should develop a new theory of Korean economic integration by applying this concept of an economic region. The limitation of his study, however, is that it does not tell us specifically how to analyze the Korean economic integration from the perspective of economic region.

Kim's study is very interesting in that he looks at the problem of Korean integration from two peculiar theories of the "spider web approach" and the "kite model."⁶ He suggests a "spider-web strategy," according to which we reach the final destination of economic integration by weaving webs of economic cooperation. He also models the external environment surrounding the Korean peninsula as a kite, and argues that the kite can float in the sky through joint projects based on regional cooperation. The only shortcoming of the study is that discussion of economic integration

⁵ Kim, Y. Y. (1995), "The Applicability of Classical Theories of Economic Integration to the Case of North and South Korea." *Reunified Korean Economy*, September.

⁶ Kim, Y. H. (1996), *Tasks and Strategy for North-South Korean Economic Integration*; Kim, Y. H. (1995), "Northeast Asian Economic Cooperation and North-South Korean Economic Cooperation," in *North and South Korean Economic Systems and Integration*.

is over-simplified, with a weak theoretical basis.

To recapitulate, the existing theories of Korean economic integration have several problems in common. First, there is a tendency to apply classical theories of economic integration to the Korean case without making due qualifications. Second, most studies rely heavily on the German experiences, while the German and Korean cases differ not only in terms of the level of economic development, but also in terms of the nature of economic systems. Third, most studies tend to focus too heavily on the question of unification costs or that of efficiency.

A New Model of Economic Integration

Integration is a real and historical process. Therefore, theories of economic integration must be realistic in nature. At the same time, they must be based on clear logic. Unfortunately, existing theories of Korean integration seem to lack a perspective from which we can consider logic and reality simultaneously.

This study does not attempt to completely deny the existing theories. It merely attempts to overcome their limitations by applying them in a different way. In this process, the study takes advantage of the perspective of system theory.⁷

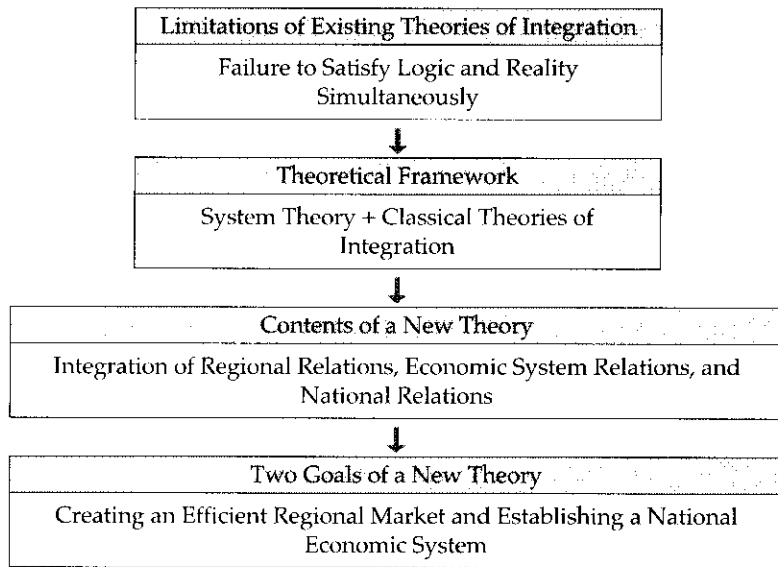
First of all, it must be noted that economic integration as a prerequisite for national integration implies in actuality integration of three different relations. One is regional relations, referring to economic integration between different regions. The second is relations of economic systems, meaning economic integration between different economic systems. Finally, the third is national economic relations, meaning economic integration within one nation.

Implicit in these three relations is the dualistic nature of economic integration. It has a positive meaning of creating a more efficient market through regional integration on the one hand. It also has a normative meaning of establishing a new national economic system that is in line with the ideal of national identity. Viewed in this way, economic integration has two different goals: the creation

⁷ Laszlo, E. (1996), *Evolution - The General Theory*, Hampton Press; Laszlo (1996), *The Systems View of The World*, Hampton Press.

of an efficient regionally integrated market, and the establishment of a proper national economic system.

<Figure 1> The Formation of a New Model of Integration



The new model of integration makes following assumptions. First, the German-style unification by absorption is neither desirable nor feasible at this time. Second, gradual inter-Korean economic exchanges and cooperation could help indirectly the transformation of the North Korean economic system. Third, institutional integration and functional integration are closely related, affecting each other.

From these assumptions, the theory derives the basic directions of Korean economic integration. First, we concentrate our initial efforts on economic exchanges and cooperation at the private sector level, and then set up institutional arrangements, which would in turn accelerate economic exchanges and cooperation. Second, North and South Korea first designate a particular region connecting the two sides as a special economic zone, and then gradually expand its scope and size with a long-term perspective. Third, after focusing on inter-Korean economic cooperation, we gradually

expand its scope so that it can be closely connected to the international economy. Fourth, we induce the North Korean system to be transformed into a market system gradually rather than abruptly. Fifth, we do not predetermine the mode and timing of integration, but leave them to be decided by circumstances of the time.

Based on the above assumptions and basic directions, here we propose a theory of "hive making" that focuses on the private sector's active involvement in the integration process.

System integration refers to the process by which more than two individual systems form a new self-completing system by establishing a close relationship between themselves.⁸ For two systems to be integrated, two general conditions must be satisfied. One is that the two systems' abilities to maintain and develop themselves reach a limiting point, and the other is that integration of the two systems into a new one guarantees a mutually beneficial outcome.

A limit to an existing system can come either internally or externally. Internally, an increasing complexity of internal relations might strengthen internal conflict and confrontation, thus destroying the system's self-completeness. Externally, due to drastic changes in the environment an existing system might find itself incapable of adjusting to the new environment.

Currently, both North and South Korea seem to be facing some limits of the existing systems. South Korea experienced a serious financial crisis in late 1997. The fundamental reason for the crisis was, of course, the inability of our economic system to adjust to the fast-changing external environment. In order to overcome this crisis, therefore, we need to build a new economic system that is compatible with international standards. Likewise, North Korea has been in severe economic difficulties since the early nineties, and no one believes that the country can solve its economic problems without changing the existing system. Thus, it can be argued that basic conditions for system integration are being satisfied on the Korean peninsula.

Given this situation, how do we go about integrating the two different systems? First of all, it must be noted that the process of system integration occurs not by an external maneuver, but by the

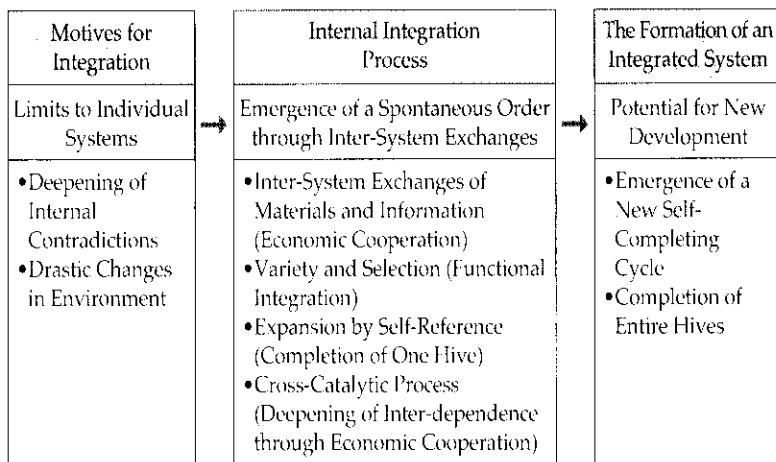
⁸ Laszlo (1996), *Evolution: The General Theory*, Hampton Press Inc., pp. 34~37.

emergence of a spontaneous order. The emergence of a spontaneous order, in turn, relies not so much on inter-governmental agreement as on voluntary cooperation in the private sector.

The mechanism for the emergence of a spontaneous order consists of three components. The first is variety and selection. After trying out various relationships and methods, the process selects one particular relationship. The second is the expansion by self-reference. The selected relationship gradually expands into other areas, as it becomes the reference for the emergence of other relationships. The third component is the cross-catalytic process.⁹ With the emergence of new relationships complementing the selected relationship, there occurs the cross-catalytic process between them, thus resulting in a synergy effect. As these spontaneous orders get more and more specified, there emerges a self-completing cycle, thus showing potential for new development.

Then, how does a spontaneous order emerge in Korean integration? Inter-Korean economic cooperation in the private sector will increase inter-dependence between North and South Korea. From various contacts, the most desirable form of inter-dependence is selected. Using the analogy of hive making, after trying

<Figure 2> Conditions and Process of System Integration

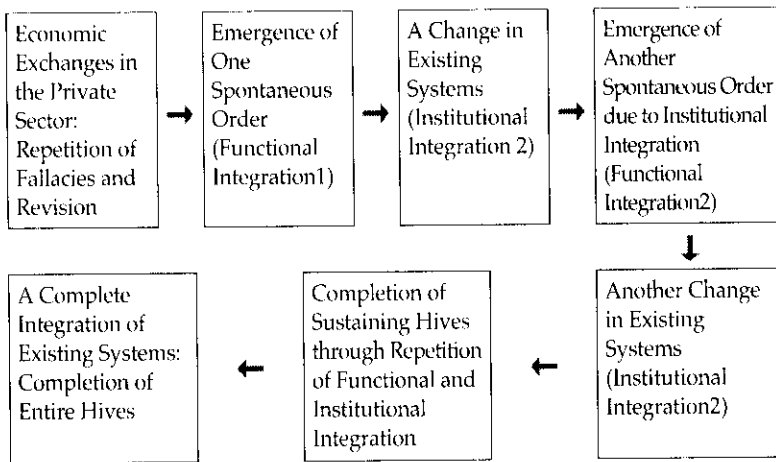


⁹ Laszlo (1996), pp. 30~34.

out triangular and quadrilateral hives, they finally discover that a hexagon is the most desirable form of hive. Therefore, a hexagonal hive is completed, and is used as the reference for the formation of other hives, which implies a gradual expansion of hexagonal hives.

It must be emphasized once again that the process of Korean integration should begin not with devising a particular design, but with arranging the environment so that there emerges a spontaneous order. In other words, it is the software of "the emergence of a spontaneous order," not the hardware of "institutional arrangements" that determines the integration of economic systems. Moreover, it must be noted that economic exchanges would play an important role in the emergence of a spontaneous order, while political and ideological relations play its role as a device to coordinate the flow of goods and information.

<Figure 3> Theoretical Process of Korean Economic Integration



Stages of Korean Economic Integration

The process of Korean economic integration will proceed in three different stages. The first is the stage of North Korea's opening and economic cooperation, the second the stage of North Korea's structural reform and economic cooperation, and the third the stage of economic integration.

<Table> Stages of Korean economic Integration

Stage	North Korea	South Korea	North-South Korean Relations		
1st	System Yet To Be Transformed	Building Fairness and Rationality of Economic Structure	North's Opening and Cooperation	1st Substage	Expanding Exchanges in the Private Sector
				2nd Substage	Preparing Institutional Device for Cooperation
2nd	System Transformed: Socialist Market Economy	Increasing Economic Capability and Preparing Institutional Arrangement for Integration	North's Structural Reform and Cooperation	1st Substage	Sectoral Integration
				2nd Substage	Limited Free Trade Area
				3rd Substage	Limited Common Market
3rd	System Transformed: Democratic Market Economy	Market Economy Guaranteeing Transparency, Fairness, and Free Competition	Deepening of North's Reform and Economic Integration	1st Substage	Institutional Integration
				2nd Substage	Substantive Integration

The first stage is when North Korea allows partial opening without transforming its economic system. At this stage, we can promote and hasten North Korea's opening by actively pursuing free inter-Korean economic exchanges, we can hasten North Korea's opening. This stage can be further divided into two sub-stages. The first is the stage of expanding exchanges in the private sector, and the second that of preparing institutional arrangements for cooperation.

The second stage presumes the situation in which North Korea makes considerable efforts at reform. North Korea gradually pursues various forms of economic reform while maintaining the socialist system. From this stage on, the North Korean economy will have close relations not only with the South Korean economy, but also with various international economic organizations such as Asia-Pacific Economic Cooperation (APEC), World Trade Organization (WTO), and Asia Development Bank (ADB).

At this stage, inter-Korean economic cooperation will make huge progress, as North Korea will take a more cooperative attitude toward economic cooperation. This stage can be further divided into three substages: the stage of sectoral or industrial cooperation, that of

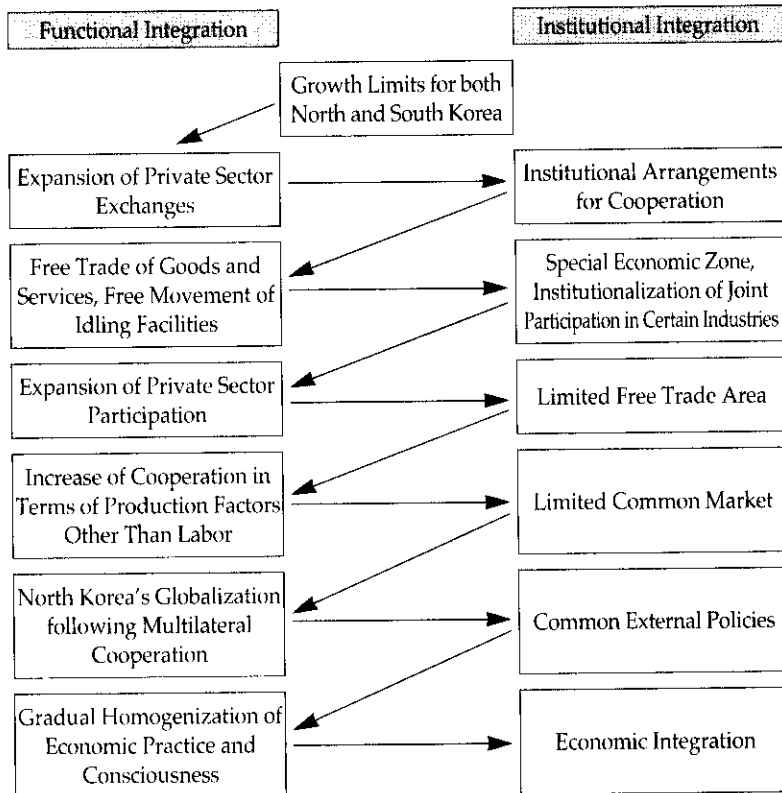
a limited free trade area, and that of a limited common market.

The third stage completes the integration. This stage assumes that North Korea's reform will be deepened, thus transforming its economic system into a democratic market economy. By establishing a monetary union, North and South Korea will be able to make common monetary policy.

If we apply the theory of hive making, the above mentioned stages of Korean economic integration can be explained as <Figure 4>.

The stages of Korean economic integration discussed thus far are a logical reconstruction of what we believe to be the most desirable integration process. The real integration process, however, does not move logically. Logic and reality are two different things. In fact, German integration also proceeded not by the force of logic

<Figure 4> Stages of Integration From the Perspective of Hive Making

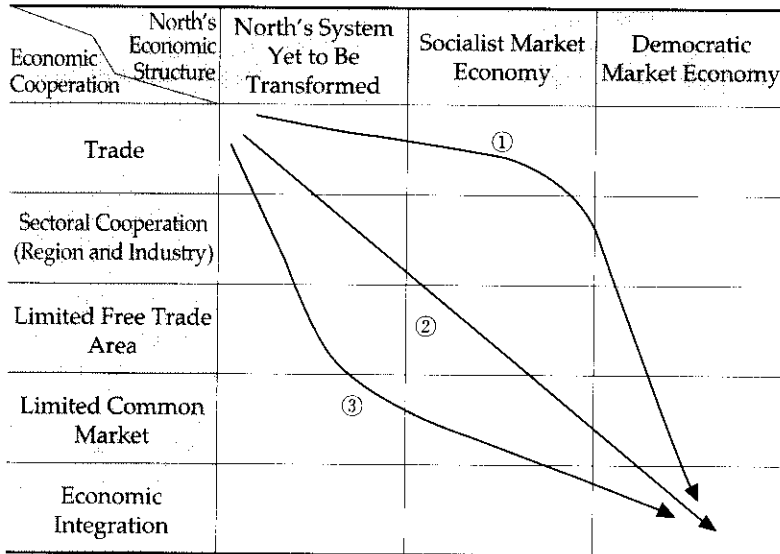


but by the force of reality.

Therefore, it is instructive to speculate possible integration paths in reality. For simplicity, we limit the analysis to only two aspects of integration: North Korea's economic structure and inter-Korean economic cooperation.

As seen in <Figure 5>, the real integration process can take various paths. Our previous discussion of integration stages was based on the path ②, but the real process may take different paths. Path ③ indicates that inter-Korean economic cooperation makes fast progress without transformation of the North's economic structure. On the other hand, path ① suggests the possibility that the North's system transformation is not accompanied by an expansion of inter-Korean economic cooperation. Therefore, we must be also prepared for these other paths.

<Figure 5> Paths of Korean Economic Integration



Source: This figure was redrawn on the basis of Kim, Y. H. (1996), p. 8.

Conclusion: A New Possibility of Cooperation and Future Tasks

Existing studies and previous discussion on Korean integration

relied too heavily on the aspect of political relations. Up until the early nineties, integration was mainly regarded as an institutional integration to be led by state, thus belittling the role of civil society. As a result of this one-sided approach, the Basic Agreement signed by North and South Korea in 1991 has now become a useless paper.

Our past experiences have demonstrated the importance of civil society's, and particularly the economic sector's involvement in the integration process. The reversibility of inter-Korean relations that we have so often observed is largely a result of over-reliance on the political aspect. If civil society's voluntary participation in the process can build up a sufficiently high level of inter-dependence, inter-Korean relations will not be reversible any longer.

The new government has proposed the principle of separating politics from the economy in its new North Korea policy. This principle has grave significance and implication, for the principle can establish the irreversibility in inter-Korean relations by heightening the level of inter-dependence. According to this principle, the government is reduced to the role of suggesting a large frame of integration policy, while the civil society becomes active participants in the integration process.

Now is the time that we move on toward Korean integration with the civil society's active involvement. As demonstrated by our model of "hive making," unintentional and spontaneous cooperation between North and South Korea would be the most important premise for Korean integration.

Based on this premise, the government's main task should be to prepare institutional arrangements so that the private sector's voluntary involvement could have positive effects on the integration process. In the mean time, the private sector should continue to search for those areas in which inter-Korean economic cooperation can bring mutual benefit. By faithfully doing their tasks, the government and the private sector would be able to go hand in hand toward the goal of national integration. ■■■