

# Towards a Free Trade Agreement beyond the Unitary

East Asia and South Korean Strategy

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## *<Abstract>*

The global economy has showed progress in terms of a new reign of multilateral cooperation represented by the World Trade Organization (WTO). On the other hand, regional integration creates economic benefits as illustrated by the creation of the EU and NAFTA. East Asia has also seriously pursued prospects for economic integration, producing considerable successes thus far. A Free Trade Agreement is a useful tool to assist in this evolution of trade relations, and South Korea, one of the major economies in East Asia, is uniquely situated to play a significant role in future negotiations. From this perspective, this paper surveys the global structure and organization of international trade, problems of regional economic integration emphasizing East Asia, and attempts to articulate a plausible South Korean strategy.

**Key words: East Asia, South Korea, Economic Integration,  
Free Trade Agreement, World Trade Organization,  
International Trade.**

## Introduction

The theory of free trade has been preached not only by the General Agreement on Tariffs and Trade (GATT) system, but also by the International Monetary Fund (IMF). The global economy is enforced by the

World Trade Organization (WTO), whose governance in 1995 was founded on globalism and purports to intensify free trade and investment. The birth of the WTO was partially due to the failure of GATT negotiations in perfecting free trade ideals, as detailed in Article 24 of GATT, authorizing discriminatory taxes or tariffs.

Even after the transformation to the WTO structure, the world's nations experienced the formation of diverse regional economic blocs in the form of FTAs and economic integration (Goto et al, 1995). The idea of global free trade has occasionally been challenged since this kind of regionalism drives countervailing discrimination against non-members.

The global economy now accelerates the mixture of multilateralism and regionalism within the system of economic integration. In general, economic integration can be conceptualized in terms characterized by a series of actions that produce the capital accumulation and free flow of products and production elements. This is achieved by coordinating and deliberately introducing common economic standards, while external economic barriers are being removed (Frederic S. Pearson et al, 1999). Also, the stage of economic integration can be classified into five categories based on its progress in terms of degrees of integration, free trade areas, customs unions, common markets, economic union, and complete economic integration (Balassa, 1969; El-Agraa A.M., 1989). From this perspective, the EU, NAFTA, and AFTA evidence a diverse approach of economic integration (El-Agraa A.M., 1998).

Needless to say, the economic effects of free trade is meant to increase global welfare through enhanced productivity and intensify competition between states through the optimal distribution of economic resources (Balassa, 1969).

So far, South Korea has not acted proactively toward the integration of regional economic blocs besides obtaining membership in Asia-Pacific Economic Cooperation (APEC). It is noteworthy that the present South Korean government has made progress with Japan seeking the possibility of an FTA

This paper aims to explore a South Korean strategy on the prospects of

East Asian economic blocs and the corresponding worldwide spread of regional economic integration. Should South Korea remain passive (i.e. limited involvement in APEC at only the principle stages of FTA discussions)? Or, should South Korean policy actively engage in the formation of FTAs both bilaterally and multilaterally?

### The Trend of Expansion toward the Regional Economic Integration

Since the end of the 1990's, globalization has hastened economic integration, as

the information network and rapid enlargement of the service trade correlated with the growth of foreign direct investment (FDI) to facilitate the flow of commercial products. EU and NAFTA can be illustrated as the most representative example. These organizations increased deeper integration, in which international trade is liberalized within specific regions (along with standardization, unified rules of competition, common environmental and labor policies, and a unitary currency).

The most ideal form of economic integration appears to be the multi-lateral free trade model for accumulating capital, which requires the establishment of institutional arrangements or uniform commercial practices, as well as organizing international bodies for policy coordination. The WTO was launched to meet this purpose. However, the WTO seems to be headed down a very difficult road after the Seattle Round of talks failed to make progress on the gap between participating states and regions. This occurred mainly as a result of discrepancies between cultures, tradition, institutions, and trade policies (Hufbauer, G., 1999). With these practical limitations at the WTO meetings, regional integration (local FTAs), serve to act as an alternative toward the realizing liberalized economies worldwide.

In this context, regional integration has to be seen in light of its nature, which pursues the quest for a globally-cooperative trading regime. Unfortunately, the recent trend of global economic blocs tends to show an adversity toward confronting each other to check countervailing strategies. Provided that the regional blocs tend to grow and increase their balance of

power on an international scale, they certainly will continue to compete among one another to exert more influence and power. The consequence is that only several large trading blocs may survive to determine the structure of the global economy. The nature of these blocs will be either "cooperative" or "competitive".

The exclusive or discriminatory policies of the EU and NAFTA against smaller blocs can multiply the production of a myriad of regional blocs in the course of protecting their own interests (Young, Soogil, 1993). Actually, the prevalence of bloc formations on a regional scale is often ascribed to a countervailing measure against the powerful influence of the EU and NAFTA. In fact, most regional economic integration tends to entail political objectives enhancing bargaining power with other regions for larger scale integration. If these two behemoths are reluctant to expand their membership or reinforce discriminatory measures against other states, the formation of smaller trading blocs or the consolidation of them by larger FTA organizations will continue. Currently, the EU and NAFTA have ruled out the possibility of one-to-one cooperation or integration with other regional blocs. All of this exposes the interrelational friction and competition with each other. The recent trend toward new FTAs - a universal form of regional economic compacts - appears to account for the exclusive nature of the EU and NAFTA.

In terms of the ideal toward economic integration at global scale, regional blocs need to have common boundaries to realize the structure of global integration (Young, Soogil, 1993). This sometimes requires each member state to withdraw from sovereignty claims as well as to conform to the institutionalized common norm for bloc economies. In addition, it has to be prearranged to accommodate possible political integration. Even the EU and NAFTA remain a dimension of common economic interest, but just show the possibility of political integration. Much progress was achieved in the EU by reaching a unitary currency, but it is still doubtful that a unitary political entity will form. EU members seem to be shying away from expanding its membership to the less-developed European or African countries (El Agra, 1998). Member states may have to put up with unitary

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economic policies by sacrificing some measure of state economic authority. Moreover, such unitary policies can only be realized if the economic interests of each state are cleared or at least not severely harmed. In reviewing FTA cases, the recent regional trade blocs (particularly those originating from underdeveloped FTA nations), tend to lack a keen association sufficient enough to signify the prospect of global interests. Most of FTAs are comprised of states that have particularly painful memories of being victimized by imperialists. They have a strong tendency to avert the maxim "political integration."

However, with the exception of East Asia, the phenomenon of economic integration, for states in close proximity to each other, is now almost universal. The EU realized a unitary currency, and NAFTA confers on the visionary scheme of dollar currency while MERCOSUR incorporates diverse states, including Brazil and Argentina, into a common market of South America. The EU and MERCOSUR agreed on a free trade compact in June 1999.

It is very unfortunate that East Asian states remain hesitant on regional integration besides the meager accomplishment of AFTA and APEC. This passivism principally stems from a bitter history of imperialist rule and diverse nature of national or governmental systems. This factor operates to discourage them from any active interaction or initiative. Nonetheless, it signals the possibility of creating greater economic integration, where regional trade and investment rapidly grow under the influence of market forces (Jang-hee Yoo, 1995).

(Table 1) Trend on the Export ratio of Major Economic Bloc  
(Intra-regional v. External)

(Years & percentage)

	EU			NAFTA			ASEAN			MERCOSUR		
	1970	90	97	1970	90	97	1970	90	97	1970	90	97
Intra-regional	59.5	66.0	60.8	36.0	41.4	48.9	--	18.9	23.6	9.4	8.9	24.4
External	40.5	34.0	39.2	64.0	58.6	51.1	--	81.1	76.4	90.6	91.1	75.6

Source of Data : WTO, International Trade Statistics, IMF, Direction of Trade

As the trend toward a regional bloc economy intensifies, intra-regional trade accordingly escalates at a rapid scale (See table 1). In comparison of export ratios within each region between 1990 and 1997, NAFTA shifted from 41.4 % to 48.9%, and MERCOSUR exhibited a tremendous increase shifting from 8.9 % to 23.6%. In contrast, ASEAN reported a small increase from 18.9% to 23.6 %. The EU has dwindled its share of intra-regional exports, due to the depression of regional economies and an increase of exports to East Europe. Given that membership is might be extended to Eastern Europe in the near future, it will likely be reversed. Special attention needs to be drawn to the highest rate of the intra-regional trade in the EU, which is approaching 60%.

What implications does this entail for FTAs to expand and intensify their way toward global integration within the structure of the WTO (Krugman, P., 1991)? We understand the trends in terms of each state's strategic position for coping with a global force. As the global economy enters a new phase of intense competition, major states tend to rely on FTAs in order to maintain growth rates as well as secure stable foreign markets. South Korean policy has still been passive about engaging FTAs in order to maintain protectionist policies to prop up domestic industries. This position is contrary to the propensity of its major trading partners who are eager to participate in FTAs. The number of regional FTAs amounted to as many as 107 according to a report by the WTO in April 1999. (76 agreements were reported after 1991). Taking into account the unreported FTAs, they outnumbered all the WTO member states. The WTO's Commission of Regional Trade Agreement predicted that FTAs continue to grow. It has to be noted that the fact that FTAs, led by the developed states and based on GATT 24, have become the standard practice of international commerce.

### Endogenous Growth of Interdependence among East Asian States

During the past 30 years, the economic growth of East Asia has endured

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because of a tremendous growth in exports to the U.S. This pattern of growth was recently supplemented by exploiting regional demands and increasing capital flows. APEC, organized in 1989, singled out its mission as "open regionalism", yet it remains nominal for its extreme diversity and uneven development (Jang-hee, Yoo, 1995). Despite the organizational support at the regional level, interdependence on trade and investment tends toward intensification through the operation of market forces.

The "compression of global finance" and "synchronization of regional interests" across all of East Asia throughout the 1997 currency crisis, created a mood that actualized discussions to forge economic ties beyond traditional political hypocrisy. In this current, the "common recognition of the environment and ecological system" also echoes to move the government and civil society (Ferrantino, Michael J., 1999).

Economic interdependence was proven as feasible at the height of the Asian financial crisis (Corsetti, G., Pesenti, P., and N. Roubini, 1998), but APEC was so feeble in confronting it. In consideration of how East Asian states network through each other in economic terms, East Asian states have begun to discuss the way of curing the financial instability on a consolidated basis. Japan floated the idea of a prospective Asian monetary fund, also proposing a mechanism for policy exchange to stabilize any future financial crises. South Korean and Japanese scholars also stressed the strong need of FTAs.

Despite an absence of formal economic blocs, East Asian states (Japan, China, Taiwan, Hong Kong and ASEAN member states) divulged that trade should increase at a more rapid pace relative to the EU and NAFTA between 1985 and 1995 (World Bank, 1994), as shown in table 2. It enlarged rapidly by moving from 37.3% in 1985 to 51.2 % in 1995. During the same period, the trade rate between East Asian states and NAFTA dwindled from 28.5 % to 21.4 %. That rate in relation with the EU ascended between the first half of 1985 and 1990, but eventually decreased to 14.3% in 1995.

(Table 2) Share of Trade by East Asian States against the EU, NAFTA as well as Intra-regional

Trading Partner	1985		1990		1995	
	Dollars	Share (%)	Dollars	Share (%)	Dollars	Share (%)
The EU	79,967	11.6	219,699	15.0	369,287	14.3
NAFTA	195,568	28.5	349,990	24.0	551,507	21.4
East Asia	256,406	37.3	588,477	40.3	1,320,876	51.2
Total World Trade	687,129	100.0	1,460,969	100.0	2,577,935	100.0

Source of Data: IMF (1996), Direction of Trade Statistics Yearbook

The direct investment in East Asia is driven principally to economize production costs as well as to construct a foreign industrial base. East Asian developing countries including China are severely pressured by a shortage of social infrastructure. Given the reduction of investment risk in these countries, direct investment within this region will prosper. China recently opened its markets for attracting foreign investment in social infrastructure. If China launches a program to exploit Far Eastern Russia's resources along with the economic reforms of North Korea, it will provide a wonderful chance for investment.

As shown in table 3, the statistical data suggests that the trade rates of East Asia will continue to increase until 2010 as has been previously predicted. It marked 19.1% within the world trade in 1986, rising to 28.6% in 1996. The rate is expected to increase to 32.4%. Dr. Ahn described it as a growth pattern of "flying geese" between economic growth and trade interdependency (Ahn, 2000).

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(Table 3) Comparative Share of Trade by Major Economic Bloc among the World Trade

(unit: %)

Region		1986	1996	2010
The EU		44.3	39.2	36.8
APEC		43.4	50.6	53.5
	NAFTA	22.2	19.8	19.2
	United States	16.2	14.2	12.6
East Asia		19.1	28.6	32.4
	AFTA	2.4	4.6	6.1
	Northeast Asia	16.7	24.0	26.3

Source of Data: DRI (1997), World Economic Outlook

Importantly, the new international division of labor (NIDL) within East Asia may shift from a "vertical division" to "horizontal form." To illustrate, textiles, iron and metals, and machinery can be manufactured using a horizontal division of labor between Japan and South Korea, as well as between Japan and China. Between China and South Korea, petroleum chemicals, textiles, iron, electric machinery, and telecommunication equipment are inclined to rise as trade focuses on those sectors. Until now, trade between Japan and South Korea has centered on iron, metal products, automobiles, special machinery, and electronic products.

Interdependency is more significant regarding "capital flows" between regional states. Since the Plaza Agreement of 1985, the yen has continued to manifest itself as a strong currency. This has positioned East Asia as having some of the most promising emerging markets, enabling some of the highest profit ratios of capital investment in the world. Since the 1980's, ASEAN took an aggressive stance for attracting FDI. The active participation of Japan, South Korea, and Taiwan in China's FDI program, significantly contributed to the growth of direct investment in China (Yong-gul Won, 1996).

On the other hand, a portfolio-type investment has also grown in this region. Along with the high rate of the yen, Japan's share of stock

investments into East Asia surpassed those of the EU and North America in both 1986 and 1996. Because of this immense investment, the financial structures of East Asian nations became inextricably intertwined. As a result of this interdependence, the financial crisis that began in Thailand with the collapse of the baht, quickly mushroomed, enveloping adjacent countries. The consequence is that the close financial reliance among the states makes it essential to develop the free trade regime in East Asia.

### Economic Blocs of East Asia and South Korea

The current South Korean government has shown extreme faith by committing to

the multilateral structure of the WTO in principle, as well as the ideal prototype of an integrated global economy. Regionalism continues to expand even after the birth of the WTO, but Japan, South Korea and China remain a bit hesitant by maintaining a non-engagement policy of FTAs among East Asian countries. Even within the theoretical understanding of FTAs as temporary steps toward multilateral trading regimes, it seems to be indispensable to organize an economic strategy for dealing with the demands of regional economic blocs. What are the underlying factors the South Korean government should consider adopting regarding this new trend of regionalism?

First, it has to be more aggressive in dealing with the economic regionalism at the government level. This means active participation in regional blocs is found to be advantageous to the South Korean economy. This position has not departed from the "principled position of firm belief" of the WTO. APEC's regionalism may operate as a guide through this action plan/strategy (Jang-hee Yoo, 1995).

Second, export capacities have to be stabilized by remedying the entrenched vulnerabilities of the economy. The expansion of high-tech based production into foreign markets is deemed vital when considering the level of dependency on foreign trade. South Korea has to consider its growing tendency of discriminatory practices from other FTA groups. FTAs provide a

high chance for technological transfer or cooperation in marketing strategy (Byung-hae Son, 2003). From this point of view, FTAs are highly recommended for South Korea.

Third, FTAs will lead South Korea into being more financially transparent in accordance with international norms, thereby reducing any risk of dispute with global economic powers or other trading blocs.

Fourth, FTAs contribute to the growth of foreign investment and help secure foreign production bases (Byung-hae Son, 2003). The effect of "expanding domestic markets" stimulates new investment. Foreign investment functions to secure international capital without the burden of loans. Fair competition with FTAs serves to ameliorate the structural flaws of the South Korean economy, increase competitiveness, and develop our economy.

Fifth, a combined approach of FTAs with the investment compact enables the acquirement of high technology and know-how, as well as international respect (Bazerman, M. H. et al, 1992). U.S. and Japanese firms, including those of other multi-national corporations, seem to be good partners for strategic alliances with South Korean enterprises.

Sixth, FTAs are considered essential in the global economy. They are very persuasive vehicles in terms of bargaining power with other trading or economic powers, which may produce high-level cooperative ties between blocs. South Korea needs to take steps toward this major global economic trend, thus, reinforcing its strategic position with regional alliances. The post-Cold War experience about forming blocs in the pursuit of the national interest, provides a good lesson. Bloc economies in this region can also reduce friction between the two Koreas.

#### *Motivation and Strategy of FTAs between Japan and South Korea*

The background of regional economic zoning discussed by these two governments is traced back to the middle of the 1980's at the height of the radical "high yen" phenomenon, in which the structure of international divisions of labor (IDL) was reshaped around East Asia. The possibility of

forming an East Asian economic bloc, bloc around the rim of West Sea, or bloc around the rim of East Sea" was scrupulously probed (Kwan, C. H., 1996). Unfortunately, no consensus has been reached about promoting the idea of a regional Asian economic bloc. Hence, economic ties are relegated to mere inter-governmental dialogue. Nonetheless, the free flow of trade and capital, division of labor at the corporate level, and free investment of stocks or security funds have flourished.

The recent proclamation by Japan to play a key role for the Asian community has stirred public attention and stressed the need for a FTA and is consistent with the tide of regionalism in the EU and NAFTA. Since the demise of the Cold War, major economic players have comprised the bulk of the global economy and focused on their region to pursue their interests. Accordingly, Japan has long sought a foreign industrial base and product market within a regional context because of its massive foreign dependency. The "Miyazawa Plan" contained the core idea of "inseparable relations" among Asian countries, which in retrospect considered the recent Asian financial crisis. Japan keenly recognizes the strong need for regional economic cooperation, emphasizing industrial restructuring on an international scale. This has been motivated by the long-term recession of the Japanese economy over the past 10 years as global competition has intensified.

Therefore, Japanese prospects on a FTA with South Korea can be perceived in terms of the global transformation of the economic environment, as well as the pressure to restructure the Japanese economy (Goto et al, 1995). Japan evidently realized the new division of labor within Asian countries by directly investing in high-tech or high priced products produced by domestic industries, while low quality or priced products were outsourced to other countries.

On the other hand, economic relations with South Korea and Japan turned into a rivalry as South Korea played catch-up. The production mode and industrial structure of South Korea has grown to be assimilated with Japan, while competitive structures becoming more intense. In this context, FTAs exist to create a cooperative regime for policy coordination and the

maximization of mutual interests. Historically, both East Asian countries have suffered from emotional antagonisms arising from previous imperial reigns, the problems of comfort women and a chronic trade deficit in South Korea. The recent administration of Kim Dae-jung (1998-2003), established a progressive attitude toward Japanese products which were unleashed from past regulatory practices in South Korea, enabling them to compete in the South Korean marketplace. The economic restructuring of South Korea by the WTO after the financial crisis, coerced South Korea to mobilize foreign investment from the EU and US, while Japan's role remained minimal. These factors startled both governments to pick up the FTA card.

The commercial ministry of Japan pronounced an outline of economic cooperation, in which the concept of bilateral investment treaties (BIT) entered the stage of regional trading theories. On the other hand, the general approach for FTA scheme has been given a less emphasis. Japan endorsed a basic policy dealing with the agenda of each industrial sector since it requires special matters according to the particular technology of each industry. The Japanese government also focused on stimulus of investment. Agreements other than that with developing countries were stipulated while it considered prior experience of common projects with South Korea as well as the enhanced status as an OECD member.

Both countries have continued cooperative positions in APEC since its inception. They have consistently supported free trade and investment for the dynamic progress of their economies. The efforts of institutional compliance with the financial standards have been poor in terms of tax and tariff systems, competition rules for intellectual property rights and the service industry, governmental procurement and import procedures.

The advantage in overcoming the IMF crisis in South Korea and the long-term

recession of Japan, principally concern the size of capital investment and industrial facilities within the iron, petroleum chemical, semi-conductor, automobile, electronic products, and transport industries (Yong-gul Won, 1996). Restructuring of these industrial structures has to be approached on an international scale, while requiring more desirable trade between foreign

and domestic enterprises, participation in the foreign sales of businesses, and foreign capital investment or business ties.

South Korea has continued to face a unilateral trade deficit with Japan. This chronic problem is rooted in a high dependency of capital products and core components from Japan. The globalization of the Japanese economy can embrace a FTA with South Korea as one of its strategic cards. In this case, an FTA can offer South Korea a good opportunity to cure that chronic situation. South Korea has already begun to internationalize their economy by adjusting to the loan conditions of the IMF. South Korea struggled to restructure its economic system in accordance with international requirements in various sectors (including capital and financial markets, trade regulation, corporate organizations, etc.). The South Korean situation on this economic surge, coupled with a "Japanese vision of Asian prosperity", can embark on a twin venture for win-win prospect.

#### *Prelude for East Asian Economic Blocs*

A new paradigm/model has to be thought up for multilateral cooperation within

East Asia, which reciprocates within the framework of diversity (Harris P.R. and Moran, R.T., 1996). The financial crisis that swept this region in 1997 has stimulated many countries to diagnose their problems as early as possible and to find a quick solution. They confronted the strong need to reveal a new economic dynamic when considering their developmental stage among constituent states. Japanese may play a leading role to stimulate this dynamic because of the high technology and amassing capital (Kwan Choi, 1996). South Korea and Taiwan can contribute in terms of their mature experience of economic development. Other ASEAN states can offer their natural resources. The new rising industrial states of Asia and the Chinese leap toward capitalism, also merit a useful opportunity to settle any emerging problems.

In particular, the triad of Japan, China, and South Korea have to play a key role in forging a new East Asian economic project. Japan exerts its

potential to extricate their economy from the deep abyss of the 1990's economic recession. South Korea reforms its bubble economy under the tutelage of the IMF. By winning the hot debate on the attainment of membership in WTO, China successfully incorporated itself into the global economy. The strategic alliance of these three surely expands their economic future and common survival.

## Conclusion

While the global economy celebrates the unitary rule of the WTO as an adequate

context for economic multilateralism, the WTO's policies do not necessarily cure every local trade and economic manifestation in all regions. Regarding the discussion above, the following points can be summarized to deal with FTA in East Asia.

First, the global trend toward capitalism manifests an "importance of regional

foci" beyond the WTO mission. The regional integration in economic terms emerges to demonstrate a conflict with the ideal form of globally liberalized scheme of economies. However, it also supplements with it by providing a more keen regional association for the deregulated free trade within a particular region.

Second, FTAs are very useful tools to liberalize regional economies, and comports to the purpose of WTO while operating to defend the interests of region against the discriminatory practices by other powerful regional integration.

Third, the current trend of international trade within East Asia has rapidly grown to necessitate some degree of institutional planning, as proposed above. FTAs is a useful vehicle in actualizing this track of economic development.

Fourth, the recent economic crisis including the IMF foreign currency problem in East Asia as well as the Japanese economic depression requires exploiting foreign markets where East Asia can mutually benefit.

Fifth, South Korea also faces a new phase of state economic program to diversify its foreign market beyond the traditional economic connection to U.S. and THE EU, in which the FTA project within East Asia is a helpful alternative .

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