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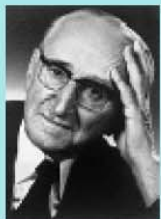
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# Ordnungspolitische Diskurse

## Discourses in Social Market Economy



**Ralph M. Wrobel**

**The Double Challenge of  
Transformation and Integration:  
German Experiences and Consequences  
for Korea**

**Diskurs 2009 – 1**

**Ralph M. Wrobel<sup>1</sup>**

## **The Double Challenge of Transformation and Integration: German Experiences and Consequences for Korea**

### **Abstract**

While the DPRK (North Korea) is on its way ahead to reform the socialist based economic system, since a few years the Republic of Korea (South Korea) is integrating into East Asian economic structures like "ASEAN plus 3". In this way a possible reunification of Korea as well as a single transformation process in North Korea in the near future will be connected closely with the question of economic integration in Northeast Asia. Fortunately, this situation is not singular in economic history but has some models in Europe. For instance, in 1990 Germany reunified during an important deepening phase of the European Union. When Western and Eastern Germany became unified in 1990, Western German political, economic and social institutions were transferred to the former German Democratic Republic (Eastern Germany) by a one-to-one imitation process. The institutional transfer from Western Germany to the "Neue Bundesländer" (new federal states) meant that Eastern Germans had to accept not only Western German laws, legal norms, organizations as a whole. Additionally, East Germany had to accept the "acquis communautaire", the set of rules of the European Union. Considerable changes were achieved and Eastern Germans today enjoy a standard of living much higher than in all other transformation states in Central and Eastern Europe. But also problems of the coincident process of transformation and integration must be mentioned. As will be discussed in this paper lessons to be learned in Korea from the German case are a lot.

### **Keywords:**

Institutional economics, transformation, economic integration, Germany, Korea

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## **The Double Challenge of Transformation and Integration: German Experiences and Consequences for Korea**

### **1. Transformation and Integration: a double challenge**

While the DPRK (North Korea) is on its way ahead to reform the socialist based economic system, since a few years the Republic of Korea (South Korea) is integrating into East Asian economic structures like “ASEAN plus 3”. In this way a possible reunification of Korea as well as a single transformation process in North Korea in the near future will be connected closely with the question of economic integration in Northeast Asia.

Fortunately, this situation is not singular in economic history but has some models in Europe. For instance, in 1990 Germany reunified during an important deepening phase of the European Union. When Western and Eastern Germany became unified in 1990, Western German political, economic and social institutions were transferred to the former German Democratic Republic (Eastern Germany) by a one-to-one imitation process. The institutional transfer from Western Germany to the “Neue Bundesländer” (new federal states) meant that Eastern Germans had to accept not only Western German laws, legal norms, organizations as a whole. Additionally, East Germany had to accept the “acquis communautaire”, the set of rules of the European Union. Considerable changes were achieved and Eastern Germans today enjoy a standard of living much higher than in all other transformation states in Central and Eastern Europe. (Seliger and Wrobel 2000: 10) But also problems of the coincident process of transformation and integration must be mentioned.

It is the purpose of this paper to compare the transformation in Germany under the restriction of European integration with the situation in Northeast Asia. Definitely, the situation in Europe is not comparable to Northeast Asia in detail, but on the other hand, German unification may be a model for each kind of peaceful unification as

well as transformation under the restrictions of the European integration process. (Seliger and Wrobel 2000: 8) Thus the focus of this paper is not only internationally comparative. The researched political and economic relations are also double-sided. While integration processes influence transformation, transformation processes themselves have effects on the integration process. In this way, the German experience will help to analyze the questions in which way South Korean economic integration will influence a prospective Korean reunification (and North Korean transformation) and on the other hand in which way a Korean reunification will influence economic integration in Northeast Asia. The German experience might hold valuable lessons for Korea.

## **2. Transformation and integration: Germany and Korea compared**

Nowadays, the Korean situation is quite similar to the German case before 1990. Like Germany in the past Korea nowadays is divided into a successful market economy and democracy in the South and a disastrously developing central planned economy ruled by the Kim regime in the North. Like in the German past both governments claim to be the only representatives of the whole Korean people. (Kindermann 2008: 8) But while Germany reunified after the collapse of the Cold War Korea remains the only divided nation worldwide. Hence the German unification gave a strong impact to Korean people to recognize that Korea could be reunified in the near future. But it is quite clear no one can expect the exact timing, as could be seen in the German case. (Park 2006, 42) But unification of the Korean peninsula is quite a natural, inevitable, and destined goal for all Koreans, in the South as well as in the North. Korea has been one nation state since ancient period. They use one language and had one common culture over 5,000 year-old history. Additionally, the division of the Korean peninsula was decided not by Koreans themselves but by external powers after the Japanese surrender. (Park 2006, 33 – 34) Also the experience of the Korean War cannot change these older facts, while of course it will hamper the emotional unification process. (Yeon 1994: 244) Additionally, the economic and cultural gap between North and South Korea is significantly wider than the one between East and West Germany in 1990. GDP per capita was three times lower in the GDR compared to the Federal Republic of Germany in 1990, while South Korea may be 20 to 30 times

richer than the North nowadays. (Herold 2002: 69) Taking this in consideration the realization of reunification of the Korean peninsula seems to be far from realism but who has expected soon unification of both German states in 1988? (Kindermann 2008: 8) Additionally, further economic cooperation between North and South - like the Kaesong Industrial Park or the Mount Kumgang special economic zone – will lead to an influence of reform steps in North Korea to integration steps in the South and vice versa.

Despite of all difficulties and steps back North Korea took first steps to reform its economic system since a few years. These reforms have been characterized by the introduction of some basic monetization into the economy and to reduce the role of the government in setting prices and controlling the distribution system. These changes in North Korea's economic management and operational measures showed similarities to the processes that other transformation economies in Europe or Asia have gone through before. Additionally, the country is opening itself for investors as well as tourists. Special Economic Zones have been established, two in cooperation with South Korea. The possibility of directly comparing living standards as well as the economic and political situation in both parts of the country will inevitable lead people in North Korea to what the current leadership considers undesirable conclusions. (Wrobel 2007, 495 - 496) Despite of current confrontation between North and South Korea medium-dated the development on the Korean peninsula may shift into a situation like the post-cold-war period of cooperation in Europe, especially Germany, in the 1970s or 1980s. As Kim Dae-jung has pointed out himself his "Sunshine Policy" – characterized by cooperation with the North – was a trial to copy the "Ostpolitik" (politics toward the East) of German chancellor Willy Brand in the early 1970s. (Kindermann 2008: 8)

There are good reasons to compare also economic integration in Europe as well as in Northeast Asia. The coherence between integration and unification as well as transformation is a direct one. The European Union was deepening in the 1980s and 1990s while Germany unified and started to transform the East German economy. Nowadays, South Korea is integrating into an Asian community and world free trade while North Korea is on its path to market reforms. Of course, there are remarkable differences. While European economic integration was always centered to the EU

(EEC, EC) East Asian economic cooperation is still a patchwork of bilateral agreements. In Europe economic integration was accompanied by the development of a central bureaucracy - an institutional integration – relying on binding agreements among members. The most important was the 1992 Common Market Project. Unlike other regions in the world North East Asia has not devoted much energy to the establishment of a regional trading block for a long time. But effected by the Asian financial crisis, long-term recession in Japan and the WTO-accession of China nowadays the three countries of North East Asia (China, Japan and South Korea) are strengthening regional economic cooperation. (Lee 2004: 107) Indeed, in contrast to the concentric circles development of EU in East Asia a multitude of groupings can be identified. Historically, the most important were ASEAN and APEC while nowadays ASEAN + 3 is dominating. (Pascha 2006, 39 - 51) Despite these remarkable differences in starting conditions, historical paths, and present challenges, North East Asia can learn from European experiences.

### **3. German Experiences of Transformation and Integration**

#### **3.1 Consequences of Integration for Transformation**

##### **3.1.1 German Unification as Institutional Imitation Process**

Ever since the seminal discussion by Douglass C North (1990), the idea that institutional development can be explained by competition between institutions has been analyzed by institutional economists. The impact of institutional competition as a Hayekian discovery procedure for new institutions [see Hayek (1969)], possible market failure in institutional competition and the necessity of a competition system for institutional competition are some of the issues currently analyzed. Following this argumentation, transformation of economic systems can be defined as borderline-case of long-term institutional evolution, or – more concrete - as imitative as well as innovative step within institutional competition. (Wrobel 2003: 383) As result, targets of transformation processes are endogenous variables. Political restrictions and public resistance must be taken in consideration. One main restriction of institutional development is integration into political or economic organization (e.g. like the EU, ASEAN etc.). From an institutional point of view these organizations can be seen as “harmonization cartels”. Additionally, it must be asked how far harmonization of formal in-

stitutions is hampering the economic development in transformation countries which are characterized by other informal institutions. Those informal institutions like a specific culture or behavior may be not compatible with elaborated market rules in developed market economies – or with overregulation and institutional sclerosis in welfare states. (Wrobel 2002: 65)

Therefore German unification and EU membership of the former GDR in 1990 means becoming part of a harmonization cartel for Eastern Germany. At a first glance this included a lot of advantages for the transformation process. No tedious search for reform strategies was necessary. (Goedicke 2006: 44) A blueprint of the transformation path was given by the West German as well the European law. All West German formal institutions as well as the whole European “acquis communautaire” were directly transferred to East Germany. This took place within two steps. The first one was the German Monetary Union of 1990, July 1<sup>st</sup>, the second German Unification of October 3<sup>rd</sup>, including an interim phase intermediate. A common commitment of the GDR government to bring East German law into line with EU law during the interim period was self-evident. For instance, the GDR promised to introduce the European agricultural law immediately in July 1990. (Günther 2001: 168 – 183)

The fast institutional transfer was enforced by the mass migration of East Germans to West Germany voting with their feet for the West German institutions. (Goedicke 2006: 45) Between November 1989 and March 1990 more than 600.000 people from East Germany emigrated to the West. (Seliger and Wrobel 2000: 9) An economic collapse of the GDR was imminent at this time. Therefore both governments agreed to introduce the Deutschmark, the West German civil and business law as well as the West German social security system in the GDR by the way of an economic and monetary union. By a low exchange rate of 1:1 or 1:2 of Deutschmark to GDR Mark purchasing power of East German consumers rose immediately, limiting the migration process soon. But the low exchange rate was a disaster for competitiveness of East German enterprises. (Goedicke 2006: 46) Additionally, there was only little time to establish a functioning administration in the GDR. From the European perspective it must be mentioned that the implementation of the Monetary Union in Germany affected the German monetary coordination duty as member of the European Union. (Günther 2001: 157)



Formal reunification was negotiated together with the former oppression powers (USA, UK, France and the USSR) at this time. Formally unification took place by accession of five newly found East German federal states according to article 23 of the Basic Law of the Federal Republic of Germany. (Goedicke 2006: 45) In the reunified Germany “Treuhandanstalt” (privatization agency) was instituted to privatize state assets as soon as possible. (Brunner 1994: 329) Additionally, a functioning legal system, access to capital markets as well as staff for top management positions in firms could be provided. This was unique among transformation countries. (Goedicke 2006: 48) By this way the transfer of Western German political, economic and social institutions took place by a one-to-one imitation process within a very short time. Thus the East German transformation is a very good example of shock therapy. (Krakowski 1993: 17) This abrupt establishment of rule of law led to stable expectations for investors as well as for consumers. The disputes about law, the uncertainty about future investment, the weak enforcement of law, all this was absent in Eastern Germany. (Seliger and Wrobel 2000: 9) By this way reconstruction of the East German economy could start very soon in contrast to other states in Central or Eastern Europe.

### **3.1.2 Adaptability of European Institutions**

But it is questionable if the legal framework of Western Germany and the EU was really adaptive for a transformation country like East Germany at this time. (Krakowski 1993: 12) High standards of social and environmental regulation existed without an immediate convergence of income in East Germany. (Seliger and Wrobel 2000: 9) Thereby, a non-application of EU law in the new federal states during a transitional period was discussed. But to establish clear and equal rules within all of Germany the full application of EU law was decided. (Günther 2001: 73 – 74) Until October 1990 about 80 percent of the *acquis communautaire* was implemented in Eastern Germany. (Günther 2001: 203) Only a few exceptions were made, e.g. a temporary permission of the East German “Trabbi”, a car not complying with EU emission standards. (Günther 2001: 204) However, this led to a breakdown in production in the Eastern part of Germany because of non-compliance of environmental regulations and too high social contributions. Too high wages because of the chosen con-

version rate induced a process of industrial breakdown and firing. This process was strengthened by the introduction of all social regulations including the adoption of the West German labor relations and the most inflexible West German labor law. (Fichter 1997: 395) As result, unemployment rose rapidly. Additionally, EU overregulation overstrained East German enterprises. Knowledge deficits and suboptimal adaptation, e.g. in the fields of promotion of industry, institutional limitations for new entrepreneurs etc. hampered the economic development in East Germany. Indeed, most East Germans knew West German formal institutions from West German TV. But it turned out later, that the perception of this information was often distorted. (Krawowski 1993: 19) For instance a lot of East Germans were advantaged by West German insurance agents in the first month of economic unification. Additionally, informal institutions were quite different in East and West Germany. Different behavior as well as philosophy of life can be detected until now. In contrast successful transformation states like Estonia started by implementing very simple rules of a market economy. For instance a flat tax was chosen. The first competition law contained only a few pages. (Wrobel 2000, 182) By this way the learning process was simplified in Estonia. People got time to understand the new rules and to build up an adaptive system of formal institutions compatible to their informal institutions. Coincidentally they could learn and adapt their informal institutions step by step. This led to an innovative adaptation of Western market economy rules.

By the formal German unification the former GDR became part of the European Single Market which is characterized by four freedoms. The idea of the Single Market is that all goods, services, investments and people can move without restrictions. The Single Market was introduced into the GDR by an EU-GDR tariff union of July 1990. (Günther 2001: 223) Fortunately, the Federal Republic of Germany had exempted the inner-German trade from European law by negotiations already in 1957. By this way the introduction of European foreign trade law by the German monetary union was not problematic from the EU point of view. But while already in summer 1990 trade barriers to Western Europe were abolished by the implementation of the union coincidentally tariffs and quotas were introduced for GDR foreign trade relative to third countries. (Günther 2001: 174 - 187) For the East German enterprises the Single Market meant a lot of advantages but also disadvantages. Main advantage was the chance to export goods as well as services into the rest of EU without tariffs or

other restrictions. (Günther 2001: 71) Because markets in Central and Eastern Europe, e.g. in Russia, broke away in these times the free access to new large sales markets in Western Europe cannot be underestimated. Of course, directly after reunification also exports from Eastern Germany to the West collapsed because most products were too expensive when former subsidization by administered exchange rates came to an end. (Hax 2003: 27) But during a process of adaptation openness became a privilege other Central and Eastern European states could not enjoy as soon as East Germany. They had to negotiate different agreements with the European Union and full membership was achieved only in 2004 respective 2007, more than a decade after the beginning of transformation. Additionally, fast opening to the EU can be seen as incentive for trade-oriented investors to build up new enterprises in East Germany where labor costs were low but free transfer of goods and services allowed. Coincidentally, free movement of capital within the Single Market facilitated the flow of foreign direct investments to Eastern Germany from all over Europe. (Günther 2001: 71)

In contrast, free Europe-wide working migration supported the brain drain from Eastern Germany. But because of the common German language and culture the emigration of young and well educated people from Eastern Germany targeted first to West Germany. Migration into the rest of EU was insignificant. Additionally, East Germany lost control of its borders and protective duties. Foreign enterprises got the same conditions for access to the East German market as to other markets in the European Union. (Goedicke 2006: 47) Already by implementation of the German monetary union prices of tradable goods in East Germany tied to prices in West Germany and the rest of the European Union. An exchange rate would have maintained flexibility of domestic prices but this flexibility disappeared with the monetary union. (Hax 2003: 21) By this way European as well as West German competition pressurized East German enterprises. Until now there exists a lack of competitiveness in Eastern Germany. Especially in the first years after unification productivity was low (e.g. 60% of West Germany in 1996). (Watrin 1998: 59) Also yet, industries with a higher level of productivity than in West Germany are still exceptions. (Goedicke 2006: 61) Wages were too high because of money conversion by 1:1. Also East German enterprises lacked time for reconstruction and improvement of efficiency. (Lichtblau 1998:

156 - 159) Additionally, all these negative aspects of unifying an economically divided nation were strengthened by the integration of West Germany into the EU.

The German government tried to cushion these disadvantages by different subsidies for East German enterprises. But the Single Market includes European competition policy which is – among other things – characterized by a lot of restraints of national subsidies. These restraints are assumed as distortion of the functioning of the Single Market. Thereby already in the interim phase in summer 1990 the West German Government had to take EU aid regulations into consideration while subsidizing the GDR economy. (Günther 2001: 194) Also after reunification it was not possible to support the new federal states by implementation of special tax incentives for investors like Poland has done in its special economic zones. (Deichmann 2005) Thereby it was necessary for the German Government to negotiate temporary exemptions from harmonized EC-law for so-called “einigungsbedingte Lasten” (unification costs). Anyway, European aid law limited the possibilities of East German transformation in a lot of economic fields, e.g. in the sphere of privatization. The Treuhandanstalt, the German privatization agency, supported East German enterprises by credits, guarantees, and equity capital flows. Therefore the Treuhandanstalt was supervised by the EU Commission. For instance, a disposal of state enterprises below par was prohibited. (Günther 2001: 248) In contrast, subsidies for the shipbuilding industry in Mecklenburg-Western-Pomerania as well as for iron and steel industry in all of Eastern Germany were allowed as special and temporary regulation. (Günther 2001: 249 – 250) However, the possible path of development – the window of opportunity – became smaller by the influence of the harmonization cartel EU. Some innovative measures of institutional competition were not possible in the German case.

Often European agricultural as well as structural policy has been mentioned as main reasons for Central and Eastern European states to join the EU. But as the German case shows they were advantageous as well as disadvantageous for the transformation process in Eastern Germany. By this elaborated system of subsidies social and environmental projects, agricultural production, restoration of countless houses and monuments as well as improvement of infrastructure in Eastern Germany could be supported. (Watrin 1998: 49) From 1991 to 1993 structural funds support for Eastern Germany was one core measure of EU regional policy. Goal of this measure was the

fast integration of the new federal states in Eastern Germany into the community. Supported were infrastructural measures, productive investments, the development of the agricultural sector, as well as all measures supporting the development of labor markets. (Günther 2001: 232 – 240) Between 1990 and 2006 the New Federal States enjoyed a 17.9 billion Euro inflow from Brussels, of course, only a small transfer compared with 980 billion Euros transferred from Western Germany in this period (1990 – 2003). (Goedicke 2006: 51) On the other hand, already in the interim period in summer 1990 the GDR had to implement the European agricultural law, including pegging of agricultural prices and agricultural foreign trade regulations. (Günther 2001: 187) This can be designated as a typical case of implementing overregulation into a transformation country. As result of subsidizing and overregulation no self-feeding economic recovery took place in Eastern Germany. Until now East German federal states are dependent on transfers. While living standard is rising continuously the dependence of East Germany from aid from the West is strengthened. Compared with East European countries standard of living is much higher but self-confidence of East Germans is low. The feeling of being a citizen of second class is common in East Germany while Polish or Hungarian people are proud on their economic development and the rise of their standards of living. Therefore economic sense of subsidizing a transformation country is questionable.

### **3.2 Consequences of Transformation for Integration**

Transformation and integration is a double-sided challenge. While integration influences transformation processes also transformation may influence the integration process itself. Disturbance of the integration process may occur by the decision of one integrated partner state to unify with a transformation state. German unification was such a case. Other member states of the European Union had to accept German unification juridically as well as politically. (Günther 2001: 162 - 170) At this time it was not obvious that German unification would have also economic results for other members of the EU as well as for the deepening of the integration process at all. Because the GDR was quite small compared to the rest of EU no direct negative influence of the transformation process on the integration process could be recognized. But there were some changes in the political as well as economic behavior of Ger-

many as a reunified, enlarged and partly transforming state. Especially European monetary and fiscal cooperation suffered from German unification in the following decades.

A first indicator for change in the monetary behavior of Bundesbank, the German central bank, was its behavior in the disturbance of the European Monetary System (EMS) in 1992, only two years after German unification. The EMS was characterized by fixed exchange rates between the European currencies. Indeed, there existed a symmetric commitment of central bank interventions but the German Deutschmark was dominating currency. In contrast to the years before since 1978 realignments were scarce and inflation in some member states required a devaluation of their currency. While German Bundesbank in the past has managed monetary policy mostly in cooperation with its European partners, in 1992 - because of different needs as a newly unified economy - it raised base rates. By this way a financial crisis was induced, which hampered – but fortunately did not stop – the process of monetary integration in Europe. As planned in 1999 the Euro as common European currency was implemented. But negotiated criteria for membership in the European Monetary Union were weakened by the crisis. As reaction on the crisis in 1992 the European governments decided to enlarge the fluctuation band of EMS currencies from regular  $\pm 2.25$  percent to  $\pm 15.00$  percent with exception of the Gulden-Deutschmark relation. (Krugman and Obstfeld 2006: 709) By this way one of five criteria for membership in the European Monetary Union was softened fundamentally. As result the European process of monetary integration was not satisfactory from an economic point of view and the implementation of the Euro was too fast.

One decade later, between 2002 and 2005, Germany as most powerful economy in Europe failed to maintain fiscal stability because of financial problems in relation with the economic development in Eastern Germany. In 1992 the German government negotiated the European Stability and Growth Pact which required maintenance of all fiscal and monetary criteria for members of the Euro area. Beside other criteria an annual maximum budget deficit of 3.0 percent of GDP and a maximum national debt of 60 percent of GDP should be matched. Members not maintaining these criteria should undergo punishment by the European Union. But when Germany as main initiator of the Stability and Growth Pact failed, the enforceability of the pact became

impossible. During a recession not only Germany but also different other European states like France did not match the criteria, but punishment was not carried through. From 2002 to 2005 German budget deficit amounted for 3.3 to 3.8 percent of GDP. Reason was a dramatic end of a short economic unification boom in the second half of the 1990s. (Goedicke 2006: 47) Until this time the costs of reunification had been underestimated. Now problems of unification like long-term need of transfers for East Germany, migration of young and educated people from East Germany to the West, high unemployment rates in the new federal states got priority. As result fiscal stability in Germany suffered influencing fiscal stability in Europe, too.

In the last years the European integration process was dominated by enlargement but deepening came to a hopefully only immediate standstill. Since the breakdown of the Berlin wall in 1989 not only East Germany became part of the European Union. In 2004 ten countries – eight from Central and Eastern Europe – joined the Union (Estonia, Latvia, Lithuania, Poland, Czech and Slovak Republic, Hungary and Slovenia accompanied by Malta and Cyprus). In 2007 Romania as well as Bulgaria followed. In contrast to the eastern enlargement of the European Union German reunification was only negligible. But German unification as well as eastern enlargement is accompanied by large integration costs – of course in different dimension. They have been already mentioned as advantage for transformation countries: subsidies from the Common Agricultural as well as Structural Funds. Because the European Union is not only a free trade area but additionally characterized by political as well as institutional integration new members can claim to the same subsidies like old members. But someone has to pay these subsidies. In the German case covering of these costs was unproblematic because of the small size of East Germany. But as one can imagine integration of a large number of transformation states – like the European eastern enlargement in 2004 – can arise to a financial problem for the old members of the integration area.

Last but not least the effects of unrestricted immigration from a transformation country into the integration area should be discussed again. As has been mentioned above in the German case migration between East and West was mainly restricted to the enlarged Federal Republic of Germany. But as the experience of EU eastern enlargement in 2004 has shown migration from poor transformation states like Po-

land or the Baltic States into richer welfare states like the UK or Ireland occurs if these do not achieve limitations. West Germany as well as the UK or Ireland benefited from immigration from the East. Mostly, migrants were young, well educated, and motivated. By this way old welfare states in the West could solve partly demographical problems, add complementary supply on the labor market, and by this way improve economic growth. (Hansen 2007: 10 - 12) But at all, integration of transformation countries into an integration area must be evaluated as double-sided: in the short run costs and disturbances may occur but in the long run advantages will predominate.

#### **4. Lessons for Korea**

If Korean reunification will occur in the near future is questionable. At the time only a "one country, two systems" approach seems to be possible. But also by further economic cooperation between North and South reform steps in North Korea and integration steps in South will influence each other. Especially the integration of Kaesong Industrial Park into South Korean free trade agreements with diverse countries in the world is a good example. Because economic integration within the framework of ASEAN+3 – including financial cooperation as well as a growing degree of free trade in East Asia - is top of the agenda in South Korea the problem seems worth of discussion.

Already in 2000 an East Asia Vision Group proposed an East Asia wide free trade arrangement or closer economic partnership including liberalization of trade in all goods, services, investments, and mutual recognition arrangements. Additionally, separate agreements and cooperation on anti-dumping measures, competition policy, investment principles, dispute settlement, and capacity building were proposed. In 2001 the Vision Group submitted a draft version of an East Asian Community with a common regional currency and free trade among its members. (Tongzon 2004: 143) At the ASEAN+3 summit in 2001 South Korea initiated dialogue in the creation of an East Asian economic community or EAFTA (East Asia Free Trade Area). (Lee 2004: 108) By this way, the process of East Asian integration is on its way. Therefore it has to be asked which experiences from the German case can be transferred to Korea.



Despite current cooling down of North South relations a long-term process of unification seems to be the most probable path of development on the Korean peninsula. A monetary and economic union like in the German case may be decided in the future as well as a “one country, two systems” approach. At the moment a political and economic collapse of the North cannot be expected. By this way a time lasting Korean integration process based on political as well economic cooperation is to be assumed. Thereby the first question to be asked is if an institutional imitation process like in the German / European case seems to be a promising approach for North Korea. A one to one imitation of institutions like in the German case may be successful or not depending on the adaptability of formal institutions. In the German case e.g. inflexibility of West German labor market institutions has been mentioned as example for non-adaptability. Overregulation of the European Union in diverse fields completed this.

In the Korean case we have to ask if South Korean institutions themselves are well functioning and should be transferred to the North. For instance the financial sector with personal relationships and government priorities as the dominating criteria to obtain credit, seems not to be perfect as model for a transformation country. (Herold 2002: 73) Economic integration into a community of East Asian nations may improve the situation in South Korea requiring changing institutions in the financial sector. Because financial cooperation in East Asia is pioneering economic integration positive aspects for Korean financial cooperation in the future can be expected. Positive institutions can be channelled through South Korea to the North by this way.

On the other hand, a common Asian legal framework – especially basic common ideas like the protection of private property – may be not advantageous in the Korean case. While in East Germany private property was mostly restituted in line with West German and European law in the Korean case restitution is not possible. Big landowners from the Japanese colonial times in Korea - collaborators as well as Japanese citizens - would be the first to have legal titles to demand restitution of their private property in North Korea. But such kind of restitution would not be in the sense of the Korean people. (Shin and No 1996: 98) Permanent uncertainties for investors in North Korea would be an additional disadvantage for the transformation process. (Park 1993: 38) In the case of deeper economic and political cooperation in Eastern Asia – anyway integrating North Korea - the bilateral acceptance of legal principles

may include the protection of private property. This can be seen as an advantage relative to FDIs into the North Korean special economic zones as well as into the rest of the country in the future. But in the case of a North Korean transformation and opening process coincidentally pretensions of former big landowners from Japan may be supported by such a common law. In Germany for instance since a few years the “Preussische Treuhand” (Prussian Trust) disturbs the Polish – German relations by claiming restitution or compensation of private property in the former Eastern provinces of Germany. While German – Polish agreements exclude restitution and compensation of former German owners the European Union demanded a Polish restitution law. (Wrobel 2002: 64)

As has been mentioned German transformation was characterized by one to one imitation of West German as well as European rule of law. By this way no search for transformation strategies was necessary. But it is questionable if North South cooperation on the Korean peninsula must lead to such an import of stability in North Korea to enforce economic development and transformation. Not only the Chinese or Vietnamese but even the South Korean example has shown that East Asian countries can develop under a dictatorship into a market economy. Rule of law and democracy in the Western sense are not unconditionally necessary. While rule of law is precondition for the development of a market economy in Germany it does not seem to be precondition in East Asia. A substitution by power of state and the ruling party like in China or Vietnam is possible. (Schäfer 2008: 11) By this way no political change is necessary for economic stabilization in North Korea and a transformation without “Big-bang”-unification is possible.

Stabilization of the North Korean transformation process can occur in the future by integration into the East Asian community through special economic zones (like Kaesong, Rajin-Sonbong etc.), free trade agreements, improvement of financial cooperation etc. The South Korean government should try to integrate the North South dialogue into an East Asian integration dialogue. As has been pointed out already, the Federal Republic of Germany exempted the inner-German trade from European law by negotiations already in 1957. (Günther 2001: 25) This may be the right strategy for South Korea, too.

In contrast to the German case a step-by-step integration during the reform or transformation process seems to be advantageous. While East Germany had to suffer from immediately implemented high social as well as ecological standards North Korea has the chance to implement such standards within an East Asian integration process step by step. Fortunately, at the moment East Asian integration is a patchwork of free trade agreements and financial cooperation. By this way, no overregulation or complexity of institutions will affect a North Korean reform process. Indeed, North Korea cannot participate in East Asian free trade without an interim period. Korean cooperation projects like Kaesong Industrial Complex can help to integrate the North Korean economy into world trade in the long term. Of course, the North Korean special economic zones and cooperation projects are only a first step into the right direction.

Assuming a “one country, two systems” approach or an immediate Korean unification in the future South Korean economic integration will be helpful for transformation in North Korea. Already, if free exports of goods produced in Kaesong are possible within an ASEAN+3 free trade area in the future this will support North Korean transformation. Of course, a political change in North Korea, away from confrontation to cooperation, and as a result an abolishment of US sanctions would be necessary to benefit from such export possibilities. (Herold 2002, 76) The North Korean situation would be privileged in contrast to other Asian countries which have to sign free trade agreements themselves with all other ASEAN+3 countries. Additionally, free movement of capital (FDIs) within an East Asian economic community can support the development of Korean cooperation projects like Kaesong. By an opening for FDIs from all over Asia Kaesong Industrial Complex as well as other planned cooperation projects on the Korean peninsula can benefit. Indeed, a deeper North South cooperation and additional trust building in Korea is a necessary precondition. Additionally, within an interim period the North Korean industry should be protected from international competitive pressure because its efficiency is lacking behind enormously. (Herold 2002, 74) Cooperation by special economic zones seems to be a good first-step approach to achieve both targets attracting investments and supporting exports on the one hand as well as protecting North Korean industries from international competition on the other hand.

The Asian integration process is an open process at the moment. As patchwork of different ideas, integration steps, free trade agreements etc. for South Korea it is possible to avoid a non-adaptive legal framework in the future. Thereby the South Korean government should focus on real free trade in future negotiations. Additionally, it should try to integrate RoK-DPRK-cooperation projects into the agreements if possible. In contrast, such agreements should explicitly not focus on social or environmental regulations. Overregulation within the integration area must be avoided as well as harmonization steps of tax competition like regulations of special economic zones or tax rates. These regulations would hamper an inter-Korean cooperation and unification process. Also subsidies in case of transformation must be allowed within an integration area. For instance, the German Government stabilized the East German agricultural market since 1990 by subsidies and market interventions. (Kim 1997, 55) Subsidies for industry and services followed soon. But spending subsidies is problematic within the legal EU framework. It is a very important challenge to the South Korean government to implement rules of integration only if they leave enough institutional range for innovative steps in the case of unification, cooperation and transformation.

If Korea will unify anyway migration will probably take place within the Korean peninsula. A brain drain from the North can be expected like in the German case. But also like in the German case other countries will not be effected noticeably. In order to minimize migration from North Korea to the South realistic short as well as medium term commitments in regard to food supply, improvements in health conditions, and infrastructure projects with immediate positive impact for the people have to be communicated to the North Koreans. (Herold 2002: 71) Integrated or not South Korea will have to take the full burden. Additionally, further transfers to North Korea must be paid by the South alone because there exists no structural policy in East Asia. By this way, a self-feeding economic development may occur in North Korea simplifying a political unification as well as economic unification in the future.

On the other hand it seems to be improbable that Korean cooperation as well as unification will hamper the Asian integration process. In contrast to Germany South Korea isn't economic or monetary leader of the integration community. Compared with China or Japan Korea as a whole is small in political as well as in economic terms.

No disturbances of monetary, fiscal or political integration can be expected. This will help South Korea to carry through unification without opposition from other integrated countries in East Asia. Inter-Korean cooperation projects, interim periods as well as institutional exceptions for the North can be negotiated by the South Korean government during the future process of East Asian integration.

## **5. Outlook**

Summarizing the experiences from Germany unification we have to point on a lot of advantages as well as disadvantages of coincident European integration. While imitation of West German institutions and the European *acquis communautaire* established functioning formal rules of a market economy as soon as possible in Eastern Germany flexibility of adaptation of these rules left a lot to be desired. High social and environmental standards strengthened the crisis of transformation because of its inadaptability with the needs of a transformation country. On the other hand East Germany was stabilized by the fast implementation of market rules and the West German currency.

The European Single Market enabled East German enterprises to export their product to the West instead of breaking down markets in the East. This was a privilege in contrast to other East European transformation states. But by this way also East German enterprises had to suffer from European competitive pressure without interim phase. Also the results of European policy fields like competition policy, structural policy or agricultural policy are double-sided. While the European Union spent a lot of money to support the transformation process in Eastern Germany it hampered German subsidy spending because of disturbances in the Single Market. Surprisingly, despite of large amounts of West German as well as European subsidies no self-feeding economic recovery took place in East Germany until now.

Lessons to be learned from the German case are a lot. First South Korea can improve own institutions by the Asian integration process, institutions which may be later transferred to the North in the case of transformation or unification. Interesting is the question if the rule of law – precondition of successful transformation in Europe –

is necessary in East Asia, too. But also disturbances of transformation steps in North Korea can be expected. For instance, the protection of private property may lead to problems in the case of Korean unification if Japanese landowners from colonial times claim for the restitution of their private property in the North. Additionally, over-regulation and non-adaptive regulations in an East Asian integration area may disturb the reform or transformation steps in North Korea. Therefore it is necessary for the South Korean government to integrate all cooperation steps with the North into FTAs or other integration agreements. On the other hand, no disturbances of the East Asian integration process by inter-Korean cooperation, unification and transformation is to be expected because Korea is economically small in contrast to its large neighbors China and Japan. Therefore the South Korean government should support economic reforms in North Korea while ensuring of present cooperation projects as well as possible future political and economic measures in the East Asian integration process.

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