Incheon-Qingdao Intercity Network and Implications for Building a Trans-border Region

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The Incheon-Qingdao (including Seoul metropolitan-Shandong) intercity network has flourished through geographical proximity and economic complementarities since the opening of the Chinese border in 1992. However, the inter-city relationship characterized by the exploitation of the difference in factor prices over the border has recently begun to see signs of trouble as the Chinese government implemented policies to tighten labor and environmental regulations. The paper deals with the ups and downs of the Incheon-Qingdao intercity network and draws some policy implications for the future development of the trans-border cooperation.

Keywords: Trans-border region, Inter-city network, Incheon, Qingdao, Regional development

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I. Introduction

The world city theory asserts that the landscape of the global economy is increasingly shaped by competition and cooperation among major world-class cities (Friedmann 1986; Sassen 1991). In this view, the world

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is perceived as a hierarchical mega structure with the three key world cities, that is, New York, London, and Tokyo, on top and the second- and third-class cities below. This view has been reiterated in the city-region theory (Scott 2001). Although the city-region theory stresses the functional linkage between a core city and its surrounding regions, it adheres to a hierarchical world-view originally offered by the world city theory.

In East Asia, less than a dozen major city-regions have been responsible for much of the dynamism and growth in the region. These city-regions are the gateways to the global economy and the key spatial links in the East Asian production network. Beijing, Shanghai, Tokyo, and Seoul are among these cities. However, a closer look will show us a different picture that eschews our conventional understanding. The cities mentioned above are traditional national centers of economy and politics (except Shanghai, but in a sense it is also a centre of economy and politics in southeast China) and were developed through the absorption of growth potential from the natural hinterland. However, fast-growing urban clusters, fuelled by the trans-border network, have noticeably emerged in and around the coastal cities in China. For instance, post-handover Hong Kong is consolidating its position as a global financial hub through its integration with the Guangzhou region in mainland China rather than proclaiming its unique international character (Pun and Lee 2002; Chan and Lin 2008). Taipei also rests its future on its economic integration with China, expending its production network into the Suzhou region (Hsu 2006; Chen N. H. 2011). Northern China's coastal cities, such as Qingdao, Yantai, and Dalian, are all advancing rapidly in terms of industrial production and population, propelled by the flourishing trans-border interaction with South Korea and Japan. That is, with the rise of China, "trans-border urban clusters" can now be said to emerge as a new mode of development in East Asia, which is different from the well-perceived models of state-centered and mega-city-oriented developmental patterns.

Given the recent proliferation of trans-border interaction in East Asia, the paper deals with the case of the Incheon-Qingdao intercity network considering Shandong and the Seoul Metropolitan Region (SMR; *i.e.*, Seoul, Incheon, and Gyeonggi). In dealing with the Incheon-Qingdao relations, the surrounding areas are inevitably included in the analysis, mostly due to the cities' functional linkage with the neighboring areas and partly due to the lack of statistical sources available at the city level. Thus, in many ways, Incheon stands for SMR and Qingdao represents the Shandong province in China.

In terms of the interaction of people and goods, Qingdao is the historical counterpart of Incheon. Since the normalization of the Sino-Korean relationship in 1992, Qingdao has become a key destination for Korean firms' burgeoning investments in China. A significant portion of overall investments in Qingdao and Shandong has been occupied by Korean firms, making the regional economy more or less dependent on the "Korean network." Moreover, Incheon and SMR are currently strategically considering their economic future in China. However, the Incheon-Qingdao relationship is still taking the initial steps on the road to a full-fledged trans-border region like those found in the Pearl River Delta in China and many European border regions (Perkmann 2002, 2003; Yeung 2007). The relationship has been dominated by individual Korean firms seeking a low-cost production base in China without any substantial progress in inter-governmental cooperation and institutionalization. No sense of solidarity and mutual trust has been built between the regions. Enduring political tension and bitter sentiment over history linger as obstacles to the further development of the trans-border region.

The paper traces the evolution of the Incheon-Qingdao intercity network with a focus on trade, investment, and the movement of people. First, the paper elaborates on the concept of the trans-border region in an East Asian context and delivers the key features of the dynamics of the interactions and cooperation between Incheon and Qingdao over the past two decades. Some policy implications are then discussed for the further development of the trans-border region.

II. Conceptualizing the Trans-border Region in an East Asian Context

A. Concept of a Trans-border Region

In the tradition of neoclassical economics, borders are conceptualized as barriers to friction-free flows, raising the marginal costs of cross-border transactions. Lösch, one of the founding figures in regional economics, analytically equated the effect of borders to the geographical distance between locations. A border influences the location of economic activities, which often leads to the economic peripheralization of border areas within a national system of production (Nijkamp 1993). At the same time, cross-border differences in factor prices or other conditions can produce negative or positive rents that make the border location attractive for certain types of economic activities (Perkmann and Sum 2002).

The concept of trans-border regions discussed in this paper is the extended version of border economics mentioned above but with the renewed understanding of the recent proliferation of global city-region agglomeration. A trans-border region can be defined as a place of large-scale agglomeration of economic activities that takes advantage of the "differences" across the border, based on geographic proximity, economic system compatibilities, and socioculture or ethnicities.[1]

Globalization and the concomitant erosion of the nation state power are noted to be the major driving forces of trans-border regions (Chen X 1995). The erosion of a national border triggered by the relocation of capital and industries as well as increased mobility of goods and people are considered to be the key factors in creating trans-border regions. In addition, they are premised on a certain degree of economic integration, but it does not necessarily mean a full-scale political and economic integration as in the case of the European Union (EU).

There is no natural foundation for trans-border regions. Empirical studies indicate that many trans-border regions are derived from a historically specific process of social construction. Nonetheless, the following factors are widely known as the key variables explaining the emergence of trans-border regions: geographic proximity, economic system compatibilities, socioculture or ethnicities, and effective governance structure (Kim 2004). According to OECD reports (OECD 2003, 2010) reviewing the European and North American trans-border cooperation, a shared common vision, economic exchange, integrated physical infrastructure, a socio-cultural network, and a good system of governance are listed as conditions for trans-border regional development.

B. Emerging Trans-border Regions in East Asia

When it comes to regional integration, East Asia lags behind the coun-

[1] In the European Union, "cross-border region" is a more commonly used concept, and it has a connotation similar to trans-border region. The definition of cross-border regions adopted by the Council of Europe is as follows: "characterised by homogenous features and functional interdependencies because otherwise there is no need for cross-border cooperation" (CoE 1972, quoted from Perkmann 2003). In general, a cross-border region enunciates an economically integrated space that emerged mostly due to geographic proximity, especially between neighbouring countries. Conversely, trans-border regions can be formed even through the interaction between distant regions, for instance, the case where regions are separated by sea, as seen in the cases in East Asia.

tries in Europe and North America. European countries are far ahead from the rest of the world in terms of regional integration, as it launched a common European currency in 1992. In North America, as initiated by the United States (US), North American Free Trade Agreement (NAFTA) was established as a regional bloc of free trade in 1993. However, in East Asia, the degree of economic and political interdependence lowered after the Second World War.

A key reason behind this is that the countries in East Asia, such as Japan, South Korea, and Taiwan, pursued a developmental state model that relies on trade and investment with off-shore countries, particularly the US, rather than expanded their economic cooperation with neighboring nations in the region. In this regard, the US played a pivotal role as a demand absorber, and accordingly, the industrial structures of the nations turned out to be competitive rather than complementary. Under this situation, these countries did not have any motivation to develop multilateral ties. Second, the region's colonial past became a hindrance to any kind of regional integration. Building a regional economic bloc initiated by Japan, which is an indispensible move considering Japan's economic power in the region, for many states was reminiscent of the past nightmare of *Greater East Asia Co-prosperity Sphere*, the colonial ideology imposed on the region by imperial Japan. Moreover, the difference among states in the region is huge, particularly when compared with Europe and North America in terms of size of territory, ethnicity, and developmental stage of economy. Combined with a negative historical legacy, the difference among nations may hinder interactions based on mutual trust.

Nevertheless, the trans-border interactions in the region have dramatically increased over the last 20 years. The background of this dynamism accounts for the rise of the Chinese economy after 1990. China's growth rate hit 13% in 2007, and its Gross Domestic Product (GDP) jumped to USD4,910 billion in 2009, taking the second place in the global ranking after the US. Currently, the spectacular rise of China's economy has become a major engine pulling the regional economy (SERI 2004; Nicolas 2005).

Inter-local cooperation is a natural response by local areas to minimize risks in an increasingly volatile global and regional economy. In principle, it can reduce any negative effect on local economies by enabling alliances with other local economies within and across the border (Perkmann 2003). Generally, the recent proliferation of trans-border interaction in the region is perceived as the result of the economic adjustment of each region, driven by the rise of China. As a result of China's active participation in the regional production network, the degree of economic integration has intensified, making the fates of all economies in the region much more closely intertwined. Neighboring countries, such as Singapore, Hong Kong, Taiwan, and Korea, are seeking new opportunities in relation to China using various strategies from exploiting the vertical division of labor to building a new market in China (Kim 2011).

The Pearl River Delta Region, after Hong Kong's return to China, is perhaps the most advanced trans-border region in East Asia. The area has been formed by the development of economic relations across the *de facto* border under, so to speak, the "one-country two-system policy" in China (Chan 2011). The Taiwan-China Strait area is one of the regions undergoing significant transformation due to the economic pull of mainland China. Driven by Taiwanese enterprises that sought cheap labor and land in the mainland for export production in the 1990s, the interdependence of both regions across the sea has deepened (Chen N. H. 2011).

Touching upon Northeast Asia, the three most interesting cases are the Pan Yellow Sea Region, the Pan East Sea Region including the Tumen River Area, and the Korea–Japan Strait Zone. The Pan Yellow Sea Region, which centers on SMR in Korea and Shandong in China, is a market-led case without substantial involvement of the public sector. However, the Tumen case is unique not only because there are concerned central and local governments in the area but also because the United Nations Development Program is involved. Conversely, the Korea–Japan Strait Zone has been developed mostly through inter-governmental cooperation rather than through private sector initiation (Takaki and Lim 2011).

III. Changing Economic Landscape of Incheon and Qingdao

A. City Profiles of Incheon and Qingdao

Incheon is a major seaport and airport on the west coast of South Korea near Seoul. When the port was founded in 1883, the city, which was called Jemulpo at the time, had a population of only 4,700. Incheon, now home to over 2.5 million people, is South Korea's third largest metropolis. The city is regarded as a part of the greater Seoul metropolitan area because it borders Seoul, and also the fact the city is integrated with Seoul in terms of infrastructure and people's daily activ-

FIGURE 1
MAP OF THE INCHEON-QINGDAO AREA IN THE YELLOW SEA

TABLE 1
BASIC FIGURES OF INCHEON AND QINGDAO (2007)

	Korea		China	
	Incheon	SMR (Seoul, Incheon, Gyeonggi)	Qingdao	Shandong Province
Population (thousand)	2,693	24,185	7,715	94,000
Area (㎢)	994	11,730	10,654	156,700
GRDP (billion USD)	44.0	428.7	65.2	455.3

Source: Statistical Authority of each nation.

ities.

Incheon is a domestic and international transportation hub in Korea. Incheon International Airport, which opened in 2001, immediately became one of Asia's major airports in terms of cargo and passengers. It is currently the third largest in the world for cargo. Moreover, Incheon's seaport is the second largest port in Korea after that of Busan. The International Passenger Terminal located at the port provides ferries to major coastal cities in China such as Dalian, Qingdao, Tianjin, and Weihai.

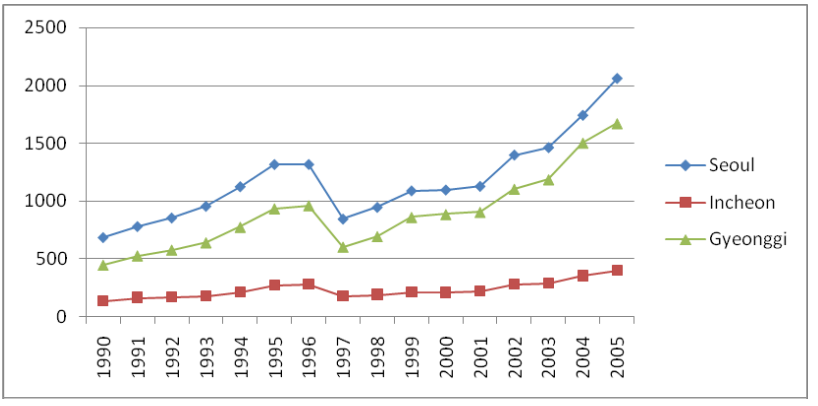
Across the Yellow Sea, Qingdao city is located in Shandong province in eastern China. Qingdao is a special economic development port and a leading industrial city in the Shandong peninsula. Leased to Germany in 1898 as part of the Kiaochow territory, the city became the administrative centre of the leasehold and developed into a modern city. Qingdao's GDP has grown steadily at an average pace of 16% annually, and its GDP per capita reached USD7,616 in 2008. In 1984, the Chinese government named a district of Qingdao as a *Special Economic and Technology Development Zone* (SETDZ). Along with this district, the entire city has gone through a remarkable development in secondary and tertiary industries. As an important trading port in Shandong province, Qingdao flourishes with foreign investment and international trade. South Korea, in particular, made extensive investments in the city. As a result, approximately 100,000 Korean citizens currently reside in Qingdao.

B. Changing Economic Environments in Incheon and Qingdao

Since the reestablishment of formal diplomatic relations between China and Korea in 1992, there has been a surge in the bilateral economic exchange. In 2003, China became Korea's primary export country, overtaking the US. China also became the primary nation for Korea's foreign direct investment (FDI) outflows. The economically complementary structures of the two countries, as well as their geographic proximity and cultural familiarity, all contributed greatly to the rapid increase in economic exchanges. The Korean economy, which had expanded by 5.1% annually in the period of 2000-2005, significantly benefited from China's boom.

However, Incheon seemed sidelined by the trend, even with its geographical advantage poised to exploit the rise of China. After the establishment of a large-scale export-oriented industrial complex in the 1960s, Incheon had been led by manufacturing industries. In the 1980s, the city's manufacturing industries reached its peak, posting more than 50% out of the total industrial output. Automobile, machinery parts, and electronics are among Incheon's leading industries. However, since 2000, manufacturers in the city have lost their ground, lowering the shares of employees below 30%.

Incheon's problem is that it lost time in transferring its industrial structure to a value-added and knowledge-based one. The nation's economy accelerated with the help of knowledge-based industries after the Asian financial crisis in 1997, but Incheon was relatively left behind in



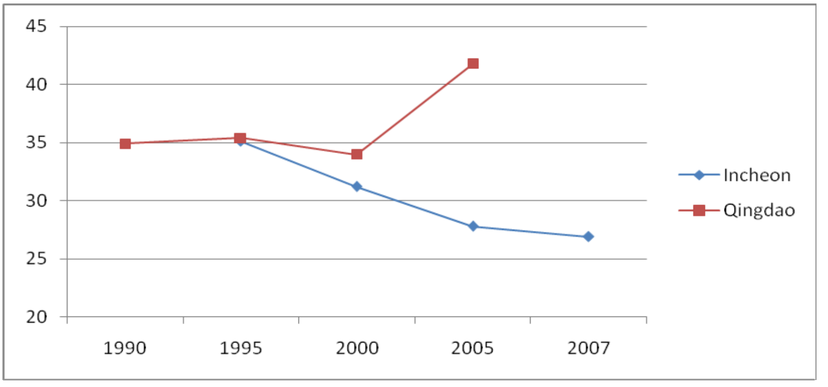
Source: Statistics Korea (www.kosis.kr).

FIGURE 2
TREND IN THE GRDP OF THE CAPITAL REGION IN KOREA
(USD100 MILLION)

the trend. Manufacturing sectors are composed of small-and medium-sized labor-intensive companies with lesser value-added. In the service sectors, albeit growing at a rapid pace, the proportion of knowledge-based service, such as finance and business services, is lower than that of other metropolitan regions in Korea. As shown in Figure 2, Incheon's recovery pace is far slower than that of neighboring Seoul and Gyeonggi, the nation's base for IT and other knowledge-based industries. For example, Incheon's GDP portion of IT services in the nation reached 5.3% in 1991 but dropped to 4.6% in 1998 after the financial crisis; it still has not regained its previous position.[2] This indicates that, unlike Seoul and Gyeonggi, Incheon is vulnerable to an external shock due to its outdated industrial structure (Yun 2007).

Amid this backdrop, Incheon's manufacturing companies, pressed by high costs at home, started to relocate their production base to China, especially in cities in Shandong province, including Qingdao. Under the circumstances, the rise of China was considered a threat to the local economy. In response to China's activities and to change the threat into an opportunity, the city is now preparing to turn itself into a financial and corporate hub. The Incheon Free Economic Zone (IFEZ) is at the

[2] Statistics Korea (www.kosis.kr).



Source: Statistics Korea (www.kosis.kr) and Qingdao Statistical Authority (www.stats-qd.gov.cn).

FIGURE 3

TREND IN THE SHARE OF MANUFACTURING INDUSTRY EMPLOYEES IN INCHEON AND QINGDAO

heart of this effort.[3]

We can obtain a clear picture if we compare the proportion of manufacturing workers in Incheon with that of Qingdao (Figure 3). Whereas Incheon's manufacturing industry is shrinking its portion of the city's total number of employment, the manufacturing industry of Qingdao is expanding, powered by the upsurge of inbound FDI in the city. Although it is difficult to precisely calculate the interrelation of these facts without any appropriate data, Qingdao's rise in the manufacturing industry appears to be benefited from the companies that moved from Incheon and SMR. In fact, in Namdong industrial park, the largest of its kind in Incheon, the fear of hollowing-out has increasingly been felt as many companies have moved their production bases to China, including Qingdao, since 2000.

[3] The IFEZ, 51,739 acres (20,938 ha) of development project, is designed to transform the area into hubs for logistics, international business, leisure, and tourism for the Northeast Asian region. The term "Free Economic Zone" applies to the development in three areas (*i.e.*, Songdo, Yeongjong, and Cheongna) with the aim of improving the business environment for foreign-invested enterprises and the living conditions for foreigners. The zone, the first of its kind in Korea, was officially designated by the Korean government in August 2003. For more details, see the official homepage of the IFEZ at www.ifez.go.kr/.

IV. Evolving Dynamics of the Incheon and Qingdao Intercity Network

A. Expanding Trade and Investment Network

Shandong and Korea's west region, which centers on Qingdao and Incheon, is a historical counterpart to each other in terms of trade and other economic exchanges. First, the geographical proximity linking two cities by a mere hour and a half *via* air travel is a key resource to their intertwined histories. The sea separating the two cities has functioned as a channel for lowering logistics costs for economic transactions. It was only after the normalization of diplomatic relations between China and Korea in 1992 that the Incheon-Qingdao intercity network started to expand at such a rapid pace.[4] After the Chinese border opened up, Korean investors lost no time in searching for business opportunities in China, lured by the low wages of its labor forces and its potential as a base for export operations. Bilateral trade and Korea's direct investment in China have been on the rise since 1992, excluding the period of financial crisis.

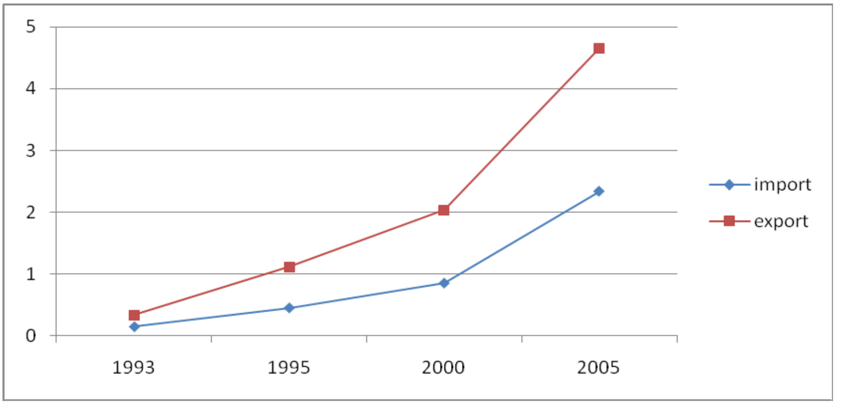
Trade between Korea and Qingdao has surged, with the total amount of import and export reaching USD6.99 billion in 2005. On the Qingdao side, the volume of export to Korea posted USD2.3 billion, accounting for 13.3% of the total export, whereas the amount of import from Korea was USD4.65 billion, 34% of the total import (Figure 4).

Figure 5 illustrates the trend in the amount of investment in Shandong province from SMR (capital region), including Incheon, from 1990 to 2008. The overall pattern indicates that the investment in Shandong province increased steadily except during the financial crisis. However, as shown in the picture, Incheon's performance is unimpressive compared with that of the capital region, with Seoul and Gyeonggi significantly contributing to the increased volume of investment.[5]

There are some marked features of the Korean companies making in-

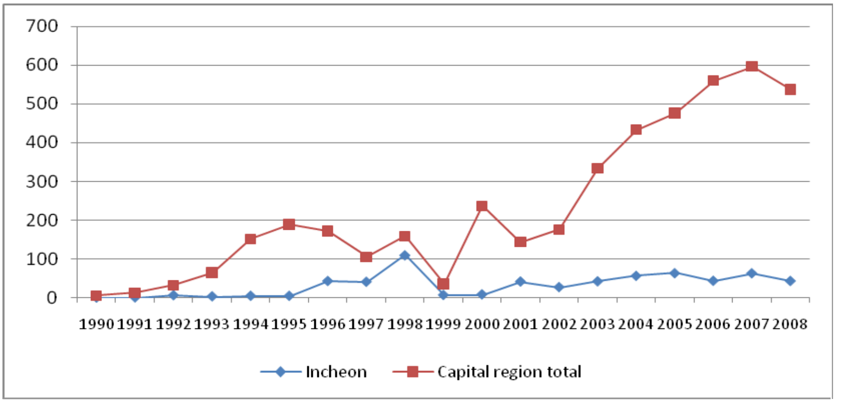
[4] In fact, the relationship based on geographical proximity dates back more than 100 years ago, when Chinese military forces landed at Incheon in 1882 during the backdrop of Korea being influenced by the rivalry between China and Japan. Still, around 20,000 Chinese from the Shandong province live throughout Korea, including Incheon.

[5] According to a research on Korea's investment in Qingdao, Incheon accounts for 17.6% of investment in Qingdao among local governments in Korea, taking the third place and following Seoul 38.8% and Gyeonggi 21.4% (Pan 2007).



Source: Qingdao Statistical Authority (http://www.stats-qd.gov.cn).

FIGURE 4
AMOUNT OF TRADE BETWEEN KOREA VS. QINGDAO (BILLION USD)



Source: Korea Eximbank (www.koreaexim.go.kr).

FIGURE 5
TREND IN THE AMOUNT OF INVESTMENT IN SHANDONG PROVINCE FROM THE CAPITAL REGION IN KOREA (MILLION USD)

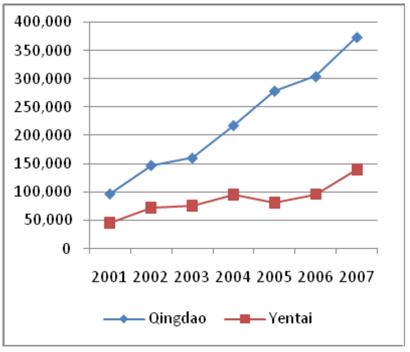
roads into Shandong province. Companies are mostly small-and medium-sized labor-intensive ones looking for low labor cost in Qingdao. At first, many firms invested an average of a mere USD1 million, but investment volume increased to around USD100 million beginning 2000, as large conglomerates joined the investment. As for the type of business, most companies are in the traditional, light manufacturing sector such as textiles, toys, leather, and apparel, which is marginalized at home with the high cost of labor and land. Only recently has the service business, such as finance, real estate, and logistics, participated in the investment in Shandong province. In terms of management strategies, up until the 1990s, Korean companies in the region targeted global markets, such as the US and EU, with no interest in opening the Chinese domestic market. In other words, they made use of Qingdao solely as a production base to release their products into the global market with a competitive price.

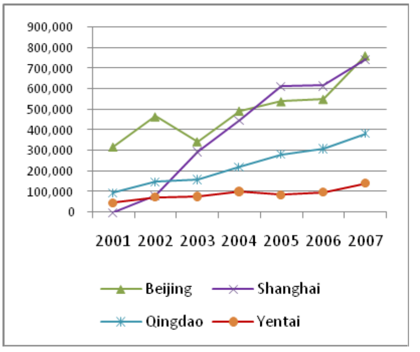
B. A Surge in the Peoples' Movement[6]

As the Chinese border opened, the people's movement between the regions has soared dramatically. The number of passengers arriving at Incheon airport from every airport in China has steadily increased. In 2007, the number of passengers from Qingdao reached 382,431. The number of outbound passengers from Incheon airport to Qingdao and Yentai airport has also climbed steadily, reaching 373,491 and 139,623, respectively, in 2007. Qingdao occupies approximately 10% of the total number of Chinese passengers, taking the third place among the major airports in China after Beijing and Shanghai. Unlike Beijing and Shanghai, where visiting is motivated by tourism and education, in Qingdao, people's interaction with Korea reflects Korea's flourishing FDI.

The link by sea shows a pattern different from the airway interaction (Figure 7). The number of travelers using ferries, which link Incheon to major coastal cities in China, is not as impressive as that of visitors by airway, with a decreasing number of passengers since 2006. Whereas investors prefer to use planes, ferries appear to have largely remained for retailers engaged in small-scale businesses across the border. The declining number of ferry users indicates that these activities are as not as profitable as they once were.

[6] In the analysis of the exchange of people between two cities and regions, there is a difficulty in interpretation due to the lack of reliable data source. Both Incheon and Qingdao have their own airports and seaports, but data on the exclusive direct interaction between cities are unavailable. In many ways, the figures do not represent the city or the region, which we know from fact that the Incheon International Airport stands for the nation, not the Capital Region or Incheon. Our approach to these figures must be cautious.

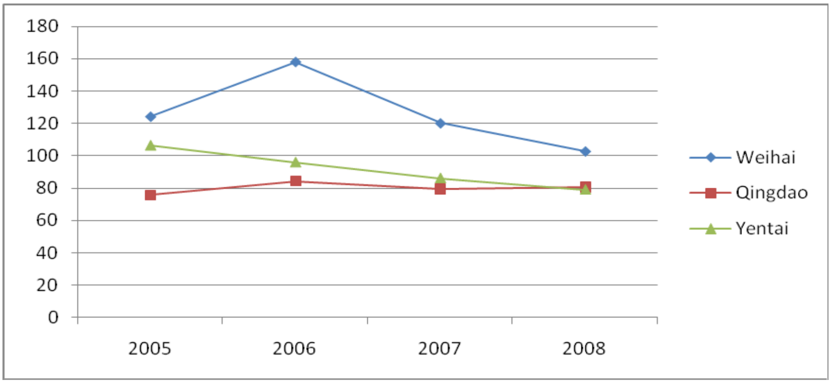




Source: Incheon International Airport.

FIGURE 6

ANNUAL NUMBER OF PASSENGERS FROM QINGDAO/YENTAI TO INCHEON AIRPORT (LEFT) AND FROM INCHEON TO MAJOR AIRPORTS IN CHINA AIRPORT (RIGHT)

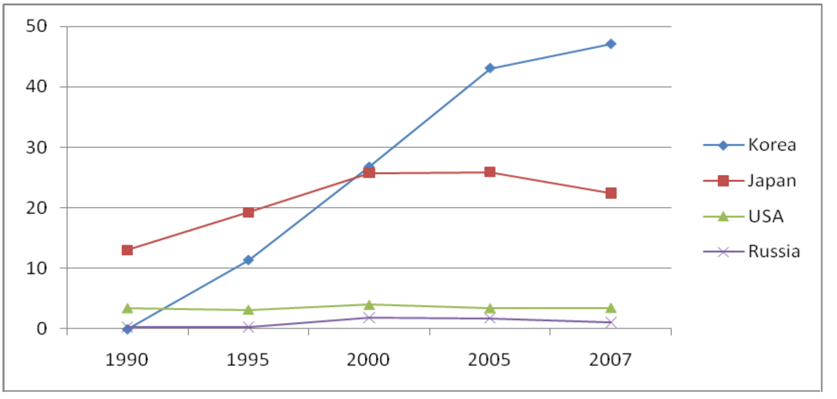


Source: Incheon Regional Maritime Affairs and Port Office (http://www.portincheon.go.kr/).

FIGURE 7

TREND IN THE NUMBER OF FERRY PASSENGERS BETWEEN INCHEON AND SHANDONG

On the other hand, Figure 8 illustrates that Koreans are, in effect, leading Qingdao's internationalization in terms of people interaction. The number of foreign visitors in Qingdao steadily increases, reaching a million persons in 2007, with Koreans representing overwhelmingly more



Source: Qingdao Statistical Authority (http://www.stats-qd.gov.cn).

FIGURE 8
TREND IN THE NUMBER OF FOREIGN VISITORS TO QINGDAO BY NATIONALITY

than half. Due to Korea's investment, the flow of people now spreads from Qingdao into the neighboring Yentai and Weihai, even transforming the regional identity of the entire Shandong province.

V. Searching for a New Mode of Cooperation: Difficulties and Beyond

A. Changes in China's Industrial Policy

Korea's investment in Qingdao, based on the model of exploiting a vertical division of labor, began to show signs of trouble in the early 2000s. Korean factories in Qingdao mostly belong to labor-intensive or low-technology industries sensitive to labor and land costs. As early as 2003, the rising cost of Qingdao, a natural result of a successful economic development, drove some Korean companies away. A good number of Korean factories were shut down, which led to lost jobs.

The direct reason behind this slowdown is the rising labor and land use cost caused by the rapid industrialization of China's coastal regions, including Shandong province. However, the shift in the industrial and environmental policies of the Chinese government, both central and local, is a contributing factor. Around the year 2000, the Chinese government shifted its industrial policy from quantitative expansion to quali-

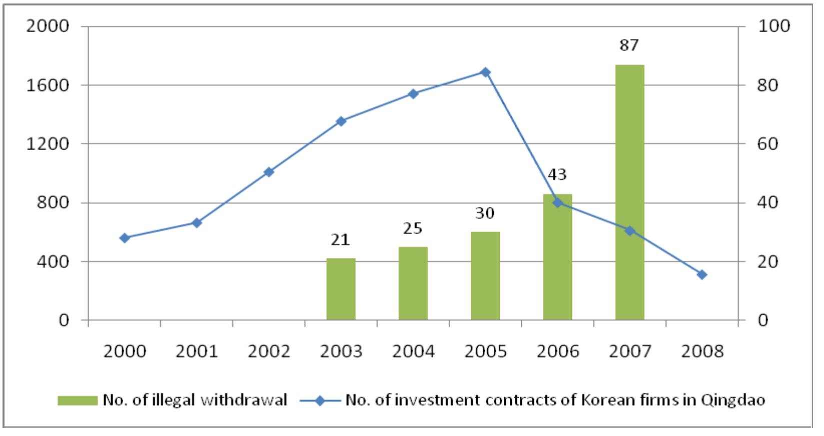
TABLE 2
POLICY CHANGES OF THE CHINESE GOVERNMENT AND EFFECT ON KOREAN FIRMS

Policy changes	Effect on Korean firms
Revision of corporate tax - Increase from 15% to 25%	Decreasing profitability
Ban or restriction on processing trade - Abolishment of additional tax and custom refund measure	Increasing approximately 8% of the cost
Installing labor contract law - Introducing a life-long employment system and a retirement allowance - Introducing 5 insurances	Increasing labor cost
Tightening land use regulation - Introducing land use tax	Increasing cost for land use
Tightening environment regulation - Levying sewage management tax - Enhancing control on illegal	Requiring more environment facilities Increasing cost

Source: MIPR (2008).

tative growth. In accordance with the policy shift, Shandong province increased its corporate tax, tightened environmental regulation, and introduced new labor laws stipulating life-long employment and adequate insurance.

This was part of the Chinese government's industrial restructuring strategy that began around 2000. After China's entry into the World Trade Organization, the Chinese national government began to prioritize industrial policy in upgrading its industrial structure. As part of its efforts, in 2005, the Chinese government released a "list for restructuring industrial structure," enumerating the encouraging and discouraging industries. In a bid to boost the listed encouraging industries of the high-tech and knowledge-based industries, financial and administrative incentives were offered, whereas all supporting measures in the field of land use, urban planning, and environmental management were discontinued for discouraging industries. The FDI policy, the engine of the Chinese economy for decades, was also changed to put spurs on industrial restructuring. In the early years of industrialization in the 1980s and 1990s, the Chinese government pushed ahead with policies for attracting foreign investment in almost every field. However, with the de-



Source: MIPR (2008).

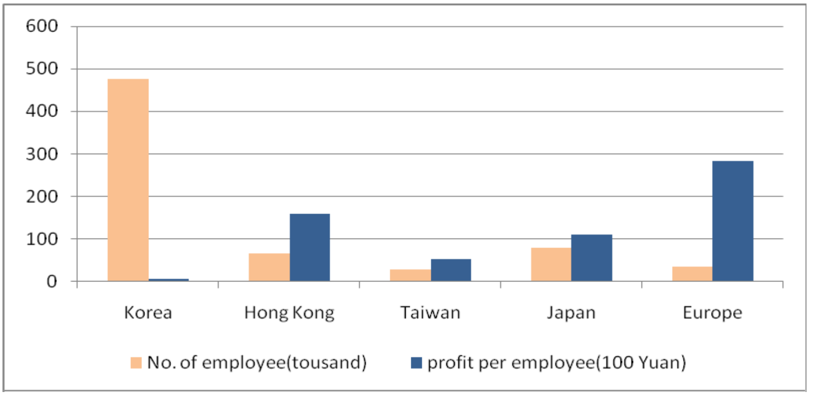
FIGURE 9

TRENDS IN THE NUMBER OF INVESTMENT CONTRACTS OF KOREAN FIRMS IN QINGDAO AND THE NUMBER OF ILLEGAL WITHDRAWAL (2000-2008)

velopment of the coastal regions, China became selective in introducing foreign investment. Under the "qualitative growth" strategy, the government favored foreign investments in the areas of technology-intensive and knowledge-based industries while controlling the entry of low-tech industries (Lee 2006).

This policy was also applied in Shandong and Qingdao. In July 2003, "the guideline for the development of a manufacturing base in Jiaodong peninsula" was released by Shandong province as part of the efforts towards industrial upgrading throughout the region. According to this guideline, the Shandong government prioritizes large-scale investment and high value-added industries. In contrast, labor intensive and pollution-causing industries are not welcome and even screened. Another important point of the guideline is the introduction of the balanced regional development strategy between the developed coastal area and the under-developed inner land area (Lee 2006). In Shandong province, as in all of mainland China, the developmental gap between west and east regions has been a serious issue. To address the problem, the government began to attract foreign investment strategically into the inner east regions, which still had cheaper land and labor.

Thus, from the perspective of Shandong and Qingdao, cooperation with Korean investors should be aligned with the principles of "large scale



Source: Qingdao Statistical Authority (http://www.stats-qd.gov.cn).

Figure 10
Number of Employee and Profit Per Employee in Foreign Firms in Qingdao by Country (2005)

investment, preference for tech-heavy industries, and balanced regional development." Consequently, the Korean firms that were inconsistent with the altered industrial policy of China had difficulty in Shandong.

B. Faltering Korean Companies and Friction with Locals

Figure 10 delineates the difficulty Korean firms faced in Qingdao in the mid-2000s. The number of investment contracts with Korean investors in Qingdao reduced dramatically beginning 2005, whereas the number of reported illegal withdrawals increased. The business environment for Korean firms in Qingdao was aggravated around the period of 2002-2005. The illegal withdrawals of Korean companies were dubbed "overnight escape(s)" by the local press, condemning Korean companies' misconduct of fleeing "overnight" and leaving all their facilities and Chinese workers behind. In some cases, the Korean investors simply left without any advance notice, especially during the Chinese holiday season. The workers returned to the factory as usual after the break to find that the equipment has been shipped away and that the building had been locked down. In these cases, unpaid bank loans, employee wages, and payment to suppliers were difficult to clear.

One driving factor behind the illegal withdrawals was the complicated liquidation process in China. At that time, the firms going into liquidation would return all the incentives they had ever received from the government.[7] It was too difficult for individual firms to handle. However, the bottom line is that Korean firms in Qingdao and Shandong were so labor intensive and cost sensitive that they could not survive the rising costs. As early as 2000, the cases of illegal withdrawal began to be reported in the local press, with the reported cases reaching 87 in 2007 in Qingdao (MIPR 2008). From 2006 to 2007, the number of illegal withdrawals reached 129 cases, with 200 million Yuan of accumulated debt loans and 15,000 related workers.[8] Figure 8 explains the uniqueness of Korean companies making inroads into Qingdao by comparing the companies with those from other nations. In terms of the number of employees, Korean firms occupied an overwhelming share, but profit per employee was diametrically opposite, indicating that the Korean companies were extremely labor intensive. As a result, they found it hard to adjust to the altered business environment introduced by the Chinese government, prompting them to leave.

Promptly, this led to a negative perception of Korean investors among some of the local population who were aware of the investors' short-term motives for investment in Qingdao (Chen and Liu 2010). The ordinary people in Qingdao generally considered Korean investors to be rude, arrogant, and incapable of keeping their promises. Others complained that Korean people always acted superior to the Chinese. Such problems, combined with the social atmosphere of the Korean investors' withdrawal, led to a general reluctance of the Chinese to cooperate with the Koreans (Chen and Liu 2010).

Moreover, the issue of illegal withdrawals soon escalated into a diplomatic issue for both countries. The Chinese government released "the Guideline for Improper Withdrawal of Foreign Firms" in November 2008, explicitly targeting the Korean firms located in Shandong province, especially Qingdao. The guideline detailed the Chinese government's official response to the illegal practices of Korean firms. Consequently, the Korean

[7] After the illegal withdrawals escalated into a diplomatic issue between China and Korea, the legal procedure of liquidation in Shandong has been streamlined.

[8] Yet, according to a local interviewee, the 300-400 Korean firms withdrew from Qingdao in 2007 alone. Thus, the real cases were far more than this figure. Moreover, according to the investigation of the Korean government, these illegal withdrawals were reported mostly in Shandong, not in any other areas in China. Thus, the incidents were attributed to the unique characteristics of Korean firms in Shandong. I collected much of the information by interviewing related personnel during my field trip to Qingdao in May 28-30, 2009.

government dispatched government delegates to Shandong in February 2008 to investigate the situation of Korean firms. The Ministry of Industry and Primary Resource released the supporting measures for troubled Korean firms to prevent their further misconducts in Shandong (MIPR 2008).

In sum, the incident of Korean investors' withdrawals indicated the end of the existing mode of interaction between Incheon and Qingdao. Shandong province and the Korean investors were inconsistent in terms of what each wanted from the other. Korean investors, mostly small and labor intensive, required a less costly production base without consideration for local matters. However, Shandong and Qingdao had an increasing need for technology, capital, and quality regional development. The mismatch generated friction. Currently, a new mode of cooperation between both regions is required.

VI. Concluding Remarks: Policy Implications for the Incheon-Qingdao Trans-border Region

The Incheon-Qingdao intercity network has flourished based on geographical proximity and economic complementarities since the normalization of Sino-Korean relations in 1992. Economic complementarities became the main driving forces linking the two cities and the surrounding regions. The Korean companies, hard-pressed by a high-cost factor at home, found new business opportunities in the opening of the Chinese border. They transferred assembly lines to Qingdao and imported intermediate parts from Korea to supply products in global marketplaces.

The Incheon-Qingdao intercity network is market led, asymmetrical, and less institutionalized (Kim 2004). Despite the remarkable increase in trade and people's movement, it is hard to say that cooperation between Incheon and Qingdao has matured. In their relationship there is no strong partnership or companionship. Inter-governmental cooperation in the form of a sister city relationship is active but has remained a simple and friendly exchange and has not brought any meaningful development in the relationship. Cooperation between the two regions has been limited in the area of economic activities of the private sectors. Civil society and public sectors are mostly sidelined in the network.

Now is the time to reconsider the current mode of relationship between the two regions, and a more horizontal and institutionalized form of cooperation should be considered. The following are some policy suggestions for building a full-fledged trans-border region:

A. Sharing a Common Vision

Sharing a common vision is a key element for the long-term development of a trans-border region. Currently, the stakeholders' views of the region are incoherent. Korean investors and the two regional governments have different ideas and strategies with no clear vision. Korean investors have been primarily occupied by short-term profits, whereas Shandong and Qingdao seek quality development propelled by technology-intensive industries. The governments of Incheon, Seoul, and Gyeonggi have remained fragmented with uncoordinated policy goals. In view of the situation, fostering a common ground that every stakeholder can share is necessary.

To build a common vision, cooperation and interaction among all the actors in businesses, governments, and non-government organizations should be encouraged further. Current business-oriented and one-sided cooperation needs to be expanded to inter-governmental and civil society-level collaboration. Conducting a joint project in the field of logistics and infrastructure is a good starting point. Tightening networks in the areas of culture and tourism can be a catalyst for promoting the wider participation of stakeholders across the border, accordingly creating a mutual understanding (OECD 2010).

B. Setting a New Model of Horizontal Cooperation

The regions should find a new model in a horizontal division of labor often found in the mature trans-border regions in Europe. For instance, the Netherlands and Germany, with an almost equal level of economic advancement, have built the structure of a horizontal division of labor. In the area of chemical industry, the Netherlands specializes in precise chemistry, whereas Germany focuses on basic chemistry, making the two countries complementary to each other. In the case of the Incheon-Qingdao relationship, they should find complementary fields in industries and technologies for their mutual benefit. For example, Korea focuses on value-added areas in the production chain such as research and development, design, and branding, the areas that China has difficulty relying on for in-house production (SERI 2004).

Taking the recent changes in the Chinese industrial policy into account, Incheon and the SMR governments should focus on what the Chinese government requires. While encouraging large-scale investment, overcoming the shortcomings of small investment requires creative efforts, such as a building a consortium or collective investment under the coordination of local governments. In addition, the localization strategy of Korean firms should be emphasized. Through active participation in the local society in the form of providing job/language education and holding cultural events, Koreans can pay more attention to local needs. The business model should be developed in a way that is mutually beneficial to both sides and allows them to grow together through cooperation.

C. Enhancing Inter-governmental Cooperation and Institutionalization

Good governance is particularly important because a trans-border region is not a legal entity in the conventional sense. However, in the Incheon-Qingdao network, although government-level interactions for mutual cooperation are frequently observed, serious efforts to build an institutional framework for promoting trans-border cooperation are not yet in effect (Yang 2008).

First, central and related local governments should make an effort to create favorable conditions for building a trans-border region. They should pursue the alleviation and removal of domestic regulations and institutional barriers that hinder effective cross-border exchanges at the local level. To make this happen, local governments should consult closely with the relevant agencies of the central government and should cooperate with the private sector. The introduction of measures designed to network special economic zones within two regions can be the first step to be considered. Both regions are already pushing forward the ambitious plan to build large-scale special economic zones: the IFEZ in Incheon and the SETDZ in Qingdao. By networking these special zones, both regions can expect trade expansion, investment expansion, and the formation of a complementary industrial structure (Kim 2001).

Second, a trans-border region requires a stable political environment. Trans-border regions in Europe flourish because they have a favorable political environment and institutional setting at the supra-national level. In East Asia, the turbulence in regional politics has become a key barrier in nurturing cooperation. Nevertheless, the efforts to create a trans-border region may have a positive effect on regional political stability through the deepening of economic interdependency. In this regard, creating a full-fledged trans-border region is not just a task for the economic development of the region but also for promoting a shared regional identity and political stability.

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