



**China-Korea Relations:
Pursuing Super Economic Cooperation**

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The torrid growth in Sino-Korean bilateral trade relations has slowed by half to the 20 percent range in the first part of 2005 after expanding by almost 40 percent to \$79.3 billion in 2004. Nonetheless, South Korean firms are working with their government to lobby for expanded access to China's domestic market in key sectors. This quarter, the focus included the Chinese energy, insurance, and automobile sectors, cooperation in nanotechnology research, and facilitation of Korean expanded cultural exports to China. A bevy of South Korean ministers, CEOs, and opinion leaders flocked to Beijing – including separate visits by the prime minister and the Grand National Party (GNP) opposition leader – to meet Chinese counterparts and to lobby for expanded Sino-South Korean economic cooperation. Presidents Hu Jintao and Roh Moo-hyun met briefly on the sidelines of a ceremony commemorating the end of World War II in Moscow, and Foreign Ministers Ban Ki-moon and Li Zhaoxing also met on the side of an Asia-Europe Meeting (ASEM) in Kyoto for consultations on the North Korean nuclear issue, including a “balanced” rebuke to both the U.S. and DPRK for exchanging vituperative rhetoric instead of face-to-face negotiations.

The Sino-Korean contact that did not take place this quarter was an anticipated call by PRC President Hu Jintao on the Dear Leader in Pyongyang. Despite extensive China-DPRK diplomatic activity in early April, including a visit to Beijing by Kim Jong-il's trusted advisor Vice Minister Kang Sok-ju, the Chinese made no apparent progress in securing the DPRK's participation in the Six-Party Talks. (The talks marked the first anniversary of their suspension in June.) While Washington tried to turn up the heat on Beijing to turn up the heat on Pyongyang, Chinese diplomats blew hot and cold in public comments about when and whether North Korea would return to the talks. Following a mid-May jolt from *The New York Times*, which reported that the U.S. intelligence community was debating an imminent North Korean nuclear test, Chinese and South Korean officials downplayed the possibility of a test and treated the reports with skepticism.

Empty talk about Six-Party Talks

The quarter opened with apparent prospects for progress in China's diplomacy toward North Korea, quickly followed by a serious dose of pessimism as the failure of those efforts became clear. DPRK Vice Minister Kang, known as a close advisor to Kim Jong-il, traveled to Beijing to discuss with Chinese counterparts the circumstances under which North Korea might return to the Six-Party Talks. A working-level Chinese party delegation visited Pyongyang at about the same time with no apparent result. An anticipated return visit by President Hu to Pyongyang following Kim Jong-il's visit to Beijing in April of 2004 did not occur (although no date had actually been fixed for the visit). Given the Six-Party Talks stalemate, a political prerequisite for any visit by President Hu is Pyongyang's return to the table and progress toward denuclearization. A March 31 DPRK Foreign Ministry statement declaring that the future agenda for Six-Party Talks should be nuclear disarmament rather than North Korea's denuclearization (not to mention the DPRK's demand that Secretary of State Condoleezza Rice apologize for referring to North Korea as an "outpost of tyranny") ratcheted up the stakes with all members of the talks. Through this statement, the North Koreans complicated the Chinese diplomatic task and put yet another obstacle in the way of returning to the table. The more the U.S. insisted that China bring its "client" under control, the more North Korea flouted its role as "client."

Chinese diplomats held out hope, but to no apparent end, rejecting U.S. suggestions of oil or food cut-offs as overly heavy-handed and as risking North Korea's destabilization, continuing their efforts to woo North Korea back to the table through persuasion. PRC Ambassador to the UN Wang Guangya warned in late April that a push for UN sanctions would "destroy" the Six-Party Talks and predicted in early June that the talks would reconvene "in a few weeks." Kim Jong-il reiterated his commitment to the talks in discussions with ROK Minister of Unification Chung Dong-young during commemorative activities in Pyongyang on the sidelines of the fifth anniversary of the inter-Korean summit, repeating the position he first revealed in a February meeting with Chinese Communist Party International Liaison Secretary Wang Jiarui, but not committing to a specific date for resumption of the talks.

Former PRC Vice Premier Qian Qichen, in remarks at the Kim Dae-jung Presidential Library to commemorate the fifth anniversary of the inter-Korean summit in June, urged closer China-ROK cooperation as the neighbors most affected by the crisis, to the apparent disadvantage of the U.S. Although the U.S. push for tougher measures has subsided for the moment after peaking in late May, newly appointed Under Secretary of State Robert Joseph clearly signaled in late June the expectation that China should and could use more pressure to bring North Korea back to the negotiating table. As long as China and South Korea are looking over their shoulders at each other while trying to prod the North Korean leadership to action, any successful U.S. strategy for addressing the North Korean nuclear issue must manage and seek to exploit the continued convergence of Chinese and South Korean perspectives toward the North.

Bilateral nuclear talks are on . . .

Whether China can bring North Korea back to nuclear negotiations remains to be seen, but there should be no question that the likely expansion of China's nuclear energy capacity has attracted the interest of South Korean firms, many of which have been integrally involved in the development of South Korea's domestic nuclear energy sector and are looking to move into the export market as domestic plant construction slows. South Korea has long envisioned a role in the international nuclear energy market, having seen support for the North Korean light-water reactor project in the mid-1990s as a stepping-stone to promote its expertise internationally.

South Korean Doosan Corporation is currently in the lead in pursuing a foothold in the Chinese nuclear energy sector, which is projected to expand significantly as China's energy demand continues to rise. Doosan has cleared the first hurdle by being selected as a preferred vendor for two 600,000-kilowatt nuclear reactors planned for construction in Zhejiang province. Doosan has pulled out all the stops to get South Korean government support, gaining the endorsement of South Korean Prime Minister Lee Hae-chan in talks with PRC Prime Minister Wen Jiabao in Beijing on June 22. At the same time, PRC Minister of the State Commission of Science, Technology, and Industry for National Defense Zhang Yunchuan led a delegation of over 40 Chinese nuclear energy experts for discussions with ROK Minister of Commerce, Energy, and Industry Lee Hee-beon on nuclear cooperation and exchange of technical experts. The delegation also visited South Korean nuclear facilities and major companies, including Doosan Heavy Industries and Construction Company.

Economic cooperation continues full speed

Since former President Kim Dae-jung's visit to China in 2000, the China-ROK relationship has been characterized as a "full-scale cooperative partnership." In the economic sphere, there is no question that the relationship has lived up to its name. The bilateral trade volume reached \$79 billion last year, and several years ago, the hope was that bilateral trade might reach \$100 billion by the 2008 Beijing Olympics. At current growth rates that mark might be reached by the end of this year.

Despite a relative slowdown in the rate of growth of the bilateral trade relationship from record-setting levels, there is no evidence that South Koreans want to ease up, despite the apparent risks of competition from Chinese goods in third-country markets and the increasing perception that China has almost caught up with South Korea on the technology ladder. The most recent survey of South Korean firms by the Institute for Global Management reveals that almost one-fifth of South Korean firms believe that China has already reached South Korea's technical level, while almost half of South Korean firms believe that China will reach South Korea's level within four years. Despite South Korean efforts to insure entry as suppliers to China's domestic market, the Korea International Trade Association notes that South Korea is the most common target of Chinese anti-dumping or import restriction measures – focused in the petrochemical goods and steel sectors – with 26 cases against Korean export items since 1997.

Despite these obstacles, the South Korean calculation appears to be, if you can't beat 'em, join 'em. In the end, China's exports may well dwarf South Korean exports to the rest of the world, but if South Korea can gain prime position as an early entrant into the Chinese domestic consumer market, the logic appears to be that prospects for economic expansion should be sufficient to counteract losses from competition to Chinese goods in third-country markets. Increasingly, the South Korean growth strategy appears to be to bind itself to a consistently bullish Chinese economy and hang on for the ride.

During the last quarter alone, at least five South Korean ministers met bilaterally with their Chinese counterparts; this list includes President Roh's meeting with President Hu in Moscow on the sidelines of the Russian commemoration of the end of World War II. More impressive than the frequency of top-level ministerial meetings, however, are the range and sensitivity of the economic cooperation efforts under discussion. In addition to the potential for cooperation in the nuclear energy production sector mentioned above, ROK Prime Minister Lee and PRC Prime Minister Wen signed an agreement June 22 to develop joint research projects in nanotechnology through cooperation between the Korea Advanced Institute of Science and Technology and the Chinese Academy of Sciences.

Less than a week later, ROK Deputy Prime Minister and Minister of Finance and Economy Han Duck-soo discussed ways to expand energy and information technology ties with his counterpart, PRC Minister of Finance Ma Kai. Han lobbied for faster approval of a Korea Electric Power Corporation coal-fired power plant project in Henan province and lobbied for more IT and mobile communications joint venture opportunities between South Korean and Chinese partners in the run-up to the 2008 summer Olympics. A series of National Assembly delegations, including one led by GNP leader Park Geun-hye, flocked to Beijing during the legislative recess in May. Over 200 business and opinion leaders from Korea attended the 2005 Korea-China economic conference in Beijing in June entitled "Pursuing Super Economic Cooperation in East Asia" to expand contacts with Chinese counterparts.

Six South Korean life and non-life insurance companies are positioning themselves to operate in China's domestic market, but have faced strict regulations since setting up offices in China in 1995. In June, Samsung Fire and Marine Insurance became the first foreign insurance company to gain approval from the China Insurance Regulatory Commission to upgrade its Shanghai branch into a wholly-owned subsidiary in a Chinese domestic market projected to grow at 20 percent annually through 2007. Korean banks such as the Korean Exchange Bank and Industrial Bank of Korea have opened up branch offices in China thus far mainly to serve Korean customers opening in China. The Korea Asset Management Company, based on its success in handling disposal of nonperforming loans during the Korean financial crisis, is providing staff and consulting to other countries with nonperforming loan problems including China.

The Ministry of Foreign Affairs and Trade has sought negotiations to streamline the complex arrangements needed to allow the entry of Korean cultural products and artists who go on tour in China in an attempt to maximize the impact of the "Korean wave" (in Korean, "*hallyu*"), capitalizing on the popularity enjoyed by Korean artists, movies, and

dramas in the Chinese domestic market. In anticipation of continued growth in the number of Chinese tourists visiting South Korea, there is an elaborate project to build Korea's first "Chinatown" at Ilsan. The Ministry of Culture has selected popular Hong Kong singer Chen Huilin as a goodwill ambassador in China to promote Korea's tourism industry, and is supporting Chinese restaurants serving authentic Chinese cuisine. SK Communications Company has released a Chinese language version of the popular Korean Cyworld site, which allows South Koreans to manage their own personal web pages, links, and blogs.

Korea and the Chinese automobile sector

Korea's automobile sector has taken advantage of China's lower labor and production costs with an eye on both the global market and the Chinese consumer market, which is enjoying double-digit growth. The establishment of Korean automobile manufacturing plants in China has also forced transfer of production facilities to China of Korean automobile parts supply companies that need to be close to their main customers. Now that Korean automobile factories are up and running in the local Chinese market, several Korean car companies and their affiliates are seeing strong sales. Three Korean companies, each with differing sales and production strategies targeting the Chinese market, unveiled new models at the Auto Shanghai 2005 last April.

GM Daewoo introduced its Kalos compact sedan, known in China as the Chevrolet Aveo. GM Daewoo cars are primarily produced in Korea for the global market, with China as a primary target. Ssangyong Motors, recently purchased by the Shanghai Automotive Industry Corporation (SAIC), unveiled its sports utility vehicle Rodius, and is hoping to take advantage of SAIC's strong existing sales network in China to rapidly expand its sales there.

After entering China's domestic passenger car market in 2002 through investment in a factory in Beijing, Hyundai is now expanding into the commercial vehicle market through a joint venture with Guangzhou Motors Group to produce and sell trucks, buses, engines, and automobile parts in China. Hyundai's Tucson SUV is available from June on the Chinese market and Hyundai is expanding the number of dealerships in China from 220 to 300 this year. Hyundai's Elantra and Sonata models have been top sellers in the Chinese market since their introduction in 2002. Hyundai has plans to market up to 800 of its Equus luxury sedans in China this year to complete its sales line.

Hyundai's investments in China have had knock-on effects for suppliers such as Hyundai Mobis, which seeks to become one of the leading automobile parts suppliers globally. Expansion of China-based production is an integral part of this strategy. Kumho Tire Company has bet heavily on China, having obtained a 14 percent share in China's domestic tire sector. Kumho Tire Company completed the expansion of its Nanjing plant and has broken ground on a new factory in Tianjin in April. Kumho Asiana Group, the parent company of Kumho Tire Company, announced that it would spend over \$400 million in the next two years to expand its share in China's domestic market.

Debate over impact of possible yuan revaluation

As U.S. political pressure builds on China to liberalize its fixed currency rate, there is increasing speculation that China will revalue the yuan. Early assessments from the Bank of Korea suggest that a 10 percent strengthening of the yuan would have a positive effect on the South Korean economy, increasing exports by at least \$2.4 billion over the year following such an adjustment. Korean exporters to China worry, however, that an appreciation of over 10 percent would be difficult to absorb. As more money has flowed into the Asian region on the basis of speculation that China will revalue, some analysts believe that a revaluation of less than 5 percent might spark short-term capital inflows into China on the rationale that the initial revaluation is insufficient and that additional measures would be required. Such a move might also increase the proportion of short-term capital in the Korean market, increasing volatility with negative effects on the South Korean financial environment.

Burdens of history and the future

The emergence of Sino-Japanese tensions over Japan's textbooks and Prime Minister Koizumi's visits to Yasukuni Shrine – along with the widespread perception in South Korea that Japan's move to the right carries with it the threat of Japan's remilitarization – might seem to push South Korea and China closer together. South Korea did show a willingness to cooperate in a three-way history committee proposed by China at a trilateral meeting of foreign ministers on the sidelines of the ASEM in May. However, there has been a measure of caution thus far in Seoul about making common cause with China too actively at the expense of Japan. Instead, President Roh's "balancer" concept suggests a desire to assist in promoting China-Japan reconciliation, but also implies a certain level of distance or impartiality between China and Japan. After all, South Korea and China have their own bilateral historical and refugee issues to deal with, as outlined in previous issues of *Comparative Connections*.

Although the Roh administration denies that the "balancer" concept is applicable to China-U.S. relations, the more telling and more challenging issue for President Roh has been the question of how to reconcile the "balancer" concept with the U.S.-ROK alliance. This potential conflict would come into relief in the event of heightened tensions or even strategic competition in the U.S.-PRC relationship. At the same time, emerging trends in the Sino-South Korean economic relationship find strong parallels to key developments or challenges in Sino-U.S. economic relations, especially in the area of "off-shoring" or hollowing out of key manufacturing sectors where neither South Korean nor U.S. workers can compete with China's low-wage advantage. In addition, the South Korean debate over whether the Shanghai Automotive Corporation should be allowed to buy out Ssangyong Motors late last year parallels many of the issues raised by the current Chinese National Overseas Oil Company's (CNOOC) efforts to purchase Unocal, a U.S. company. Given the dramatically increased level of South Korean economic interests at stake in the relationship with China through a burgeoning bilateral trade and investment relationship, South Korean interests will be severely conflicted in the event of heightened Sino-U.S. confrontation.

Chronology of China-Korea Relations April-June 2005

April 2-5, 2005: DPRK Vice FM Kang Sok-ju leads delegation to Beijing to discuss Pyongyang's possible return to the Six-Party Talks on its nuclear weapons program.

April 3-5, 2005: Delegates from Foundation of Medical Professional Alliance in Taiwan and Taiwan Medical Association visit Korea to draw support for its entry to the WHO.

April 5, 2005: Korea International Trade Association (KITA) announces that over 2.84 million South Koreans visited China in 2004, a 46 percent increase over the previous year. Only Japan surpassed South Korea in the number of visitors to China.

April 6, 2005: PRC Ambassador to the ROK Li Bin voices support for South Korea's plan to play the role of a "balancer" in Northeast Asia as long as it contributes to peace and prosperity in the region.

April 8, 2005: A survey of Korean companies by the Institute for Global Management finds that most Korean executives believe Chinese companies will reach South Korea's technical level in four years or less; 18 percent responded that China has already established an equivalent technical footing with Korean companies.

April 9, 2005: Newspaper reports speculate that President Hu Jintao may visit Pyongyang in late April following consultations with DPRK Vice Minister Kang. The visit did not materialize.

April 13, 2005: Senior officials from South Korea, China, and Japan meet in Beijing and discuss rising tensions over historical issues between Japan and its Asian neighbors and to plan the agenda for the trilateral foreign ministers' meeting in Japan set for early May.

April 18, 2005: Korea National Tourism Organization chooses popular Hong Kong actress and singer Chen Huilin as goodwill ambassador for Korea's tourism industry.

April 21, 2005: Kumho Tire Company completes expansion of plant in Nanjing, doubling production capacity in China, and announces that it will invest over \$400 million during the next two years to expand China-based production, including a new plant at Tianjin.

April 21, 2005: Korean carmakers unveil three new models for production in the Chinese market at Auto Shanghai 2005.

April 21, 2005: Korea Meteorological Association announces that the six yellow dust storms that have hit South Korea during March-April of 2005 are the most since 1990.

April 22, 2005: Seoul Chinatown Development announces that it will start construction of “Chinese Street,” the first of three phases in the construction of a Chinatown in Ilsan, Kyunggi Province.

April 28, 2005: Hynix Semiconductor and STMicroelectronics hold groundbreaking ceremony for a cutting-edge memory chip manufacturing facility in Wuxi in Jiangsu Province.

May 1-2, 2005: Heads of the development banks of China, Korea, and Japan meet to promote stronger financial sector cooperation for regional economic development.

May 6, 2005: Doosan Heavy Industries & Construction Co. says it has been chosen as the preferred negotiator to build a nuclear power plant in Zhejiang Province, the first step in pursuit of export of South Korea’s domestically built nuclear reactors to China.

May 6-7, 2005: ROK FM Ban Ki-moon and PRC FM Li Zhaoxing express concern about the exchange of invective between the U.S. and DPRK and its implications for the resumption of Six-Party Talks on the sidelines of an Asia-Europe Meeting in Kyoto.

May 9, 2005: PRC President Hu and ROK President Roh Moo-hyun meet in Moscow on the sidelines of the 60th anniversary commemoration of the end of World War II.

May 10-14, 2005: A 10-member National Assembly delegation of the Korea-China Friendship Association led by Vice Speaker Park Hee-tae visits China for meetings with Chinese counterparts.

May 16, 2005: KITA announces that China either imposed import restriction measures or initiated anti-dumping investigations on 26 Korean export items, accounting for the largest number of restrictions imposed on foreign import items.

May 21, 2005: Bank of Korea reports that the revaluation of Chinese yuan would benefit the Korean economy, dismissing concerns that the currency adjustment could undermine South Korea’s economic growth potential.

May 23, 2005: ROK Culture and Tourism Minister Chung Dong-chea announces that the ministry would support 100 selected Chinese restaurants to serve the increasing number of Chinese tourists to South Korea.

May 23-28, 2005: Grand National Party opposition leader Park Geun-hye visits China to discuss the North Korean nuclear crisis with top Chinese leaders including Wang Jiarui, director of the International Department of the Chinese Communist Party.

May 26, 2005: Middle school history text book “History to Open the Future” is published by a team of scholars and civic organizations from China, Japan, and Korea.

May 30, 2005: ROK Ministry of Foreign Affairs and Trade asks China to streamline complex procedures imposed on South Korean cultural projects taking place in China to help facilitate the Korean wave, or “*hallyu*.”

June 8, 2005: Korean Internet company SK Communications Co. unveils a Chinese-language version of their popular Cyworld weblog services (www.cyworld.com.cn).

June 8, 2005: Seven North Korean refugees enter the Thai embassy in Vietnam, seeking asylum to South Korea.

June 16-19, 2005: Over 400 business and opinion leaders from Korea and China attend the 2005 Korea-China Economic Conference entitled “Pursuing Super Economic Cooperation in East Asia” to promote interactive economic ties and to encourage investment in China prior to the 2008 Beijing Olympic Games.

June 20, 2005: Former South Korean prisoner of war Jang Pan-seon arrives in Seoul, but the fate of family members remains uncertain as they reportedly remain in the hands of Chinese brokers.

June 21-23, 2005: ROK PM Lee Hae-chan meets with PRC PM Wen Jiabao during a three-day visit to Beijing and signs a memorandum of understanding to cooperate in developing cutting-edge technology and cooperation in the field of nano-technology.

June 22-27, 2005: PRC Minister of the State Commission of Science, Technology, and Industry for National Defense Zhang Yunchuan leads a team of officials and private sector leaders to Seoul for a six-day visit to discuss joint nuclear energy projects and to meet with ROK Minister of Commerce, Industry, and Energy Lee Hee-beom.

June 24, 2005: PRC Finance Minister Ma Kai and ROK Minister of Finance and Economy Han Duck-soo meet in Beijing to discuss ways to enhance bilateral ties in the energy and information technology sectors.