



China-Korea Relations:

## **Six-Party Success and China's Peninsular Diplomacy**

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After over a year of anticipation, the fourth round of Six-Party Talks finally reconvened and even made progress, concluding with a joint statement of principles that will serve as guidelines for a more specific agreement on how to resolve the North Korean nuclear crisis. China was the linchpin and host of the diplomatic effort to achieve an agreement, the outcome of which was largely influenced by a combination of Chinese efforts to woo the North Koreans back to the talks and Beijing's increasingly steadfast alignment with South Korea as factors that ultimately constrained and induced concessions from both the DPRK and the United States. PRC State Councilor Tang Jiaxuan's visits to Pyongyang and Washington in July for meetings with Chairman Kim Jong-il and President George W. Bush, respectively, were emblematic of China's diplomatic efforts to push forward the six-party process. Although the Bush administration's willingness to initiate bilateral negotiations with the DPRK inside the six-party framework was a prerequisite for progress and South Korea's enhanced efforts through a revived inter-Korean dialogue also facilitated the process, Chinese diplomacy with North and South Korea was possibly the critical factor in shaping – and limiting – the parameters of a deal.

The impact of China's yuan revaluation reverberated in South Korea this quarter with mixed effect. On the one hand, the South Korean won is one of the currencies against which the Chinese yuan will "float," a tangible recognition of the rising importance of the Sino-South Korean trade relationship; on the other hand, South Korean companies nervously watched the effect of the revaluation on exchange rate margins on their operations in China and anticipated whether and to what extent those margins may be adjusted. A spate of tainted food cases involving imports to South Korea from China was a public health concern for Korean families that slowed but has not derailed a more active interest within the private sector for a China-South Korea free trade agreement (FTA) to complement China's regional and ASEAN-focused FTA efforts.

## **The Sino-Korean triangle and the six-party process**

Both critics and supporters of the Sept. 19 joint statement that marked the end of the fourth round of Six-Party Talks have unanimously given China credit – or blame – in facilitating the outcome of the talks. The extent to which China's influence was critical in achieving the outcome requires careful consideration of three sets of parallel interactions in support of the talks: between China and North Korea, South Korea, and the U.S., respectively. It remains to be seen whether a process in which China is the primary facilitator and host will yield a lasting agreement that all sides will faithfully implement. This is a critical question given that China's involvement as host, arbiter, and presumably as implementer, of a multilateral process is one of the key distinctions that differentiates the current negotiation process from the failed Agreed Framework, itself the outcome of a bilateral process between the U.S. and the DPRK. The answer awaits the outcome of follow-on negotiations set to resume in Beijing in November.

This preliminary assessment will focus on the complicated diplomatic challenge China has faced in managing the first two relationships. What does Beijing's management of its triangular relationship with the two Koreas during the latest round of the six-party process tell us about its preferences, objectives, and capacity to shape both the future of the Korean Peninsula and Beijing's future relationship with the Korean Peninsula?

The PRC relationship with North Korea remains exceedingly complex as China continues to test the utility of various tools for influencing Pyongyang in the talks. Two key variables in recent Chinese thinking appear to be the need to provide North Korea with sufficient confidence so that it does not disengage from the diplomatic process and the need to pursue an outcome that reaffirms China's own interests in countering North Korean nuclear proliferation and preventing North Korea from becoming a de facto nuclear weapons state while perpetuating regional stability. Chinese diplomats are reported to have played a key behind-the-scenes role in facilitating U.S.-DPRK bilateral contacts that led to the resumption of the Six-Party Talks following the DPRK Foreign Ministry's statements of Feb. 10 and March 31. These statements appeared to signal the permanent breakdown of six-party diplomacy, as the DPRK announced the indefinite suspension its participation in the six-party process and declared that the agenda for future talks should focus on mutual arms reductions. On the one hand, Chinese diplomats clearly conveyed that any attempt to shift the agenda away from North Korea's denuclearization would be a non-starter. At the same time, China conveyed a set of messages from the North Koreans to the U.S. counterparts and counseled a softer tone in Bush administration public comments that led to the resumption of direct U.S.-DPRK contacts in New York in May and June.

These contacts led to a July 9 bilateral dinner meeting hosted in Beijing between U.S. Assistant Secretary of State Christopher Hill and DPRK Vice Minister Kim Gye-gwan announcing that six-party negotiations would resume in Beijing before the end of July. This declaration came on the eve of a visit by Secretary of State Condoleezza Rice to Asia. While Chinese diplomacy facilitated U.S.-DPRK bilateral contacts that led to the resumption of Six-Party Talks, the North Koreans chose to announce the decision to

return to the talks following the bilateral U.S.-DPRK meeting and prior to a mid-July visit by State Councilor Tang to Pyongyang, upstaging any hint that Chinese pressure had led to North Korea's decision to return to talks. The visit by Tang became an opportunity for the PRC to exchange messages between PRC President Hu Jintao and DPRK Chairman Kim Jong-il prior to the resumption of Six-Party Talks. Subsequently, Tang met with President Bush in late July as part of planning for a September visit to Washington by Hu Jintao, subsequently cancelled in the aftermath of Hurricane Katrina.

The fourth round of six-party dialogue required the Chinese to take on a new responsibility beyond the roles of "host" and "facilitator": Beijing was responsible for producing a draft joint statement acceptable to all parties. Chinese diplomats are reported to have been scrupulously even-handed in attempts to draft a joint statement, working late into the night between negotiation sessions to prepare four separate drafts that attempted to split the difference between the U.S. and North Korean positions during the first stage of negotiations. While neutrality may be an important characteristic to ensure trust among all the parties to the negotiation, one effect has been that both the U.S. and North Korea have been required to make compromises necessary to achieve a consensus agreement. As a result of a last-minute dispute over the question of whether the DPRK would retain a right to peaceful use of nuclear energy under the statement of principles, the Chinese fourth draft was unable to close the gap between the U.S. and DPRK positions, leading to a recess on Aug. 7 and an intensified round of negotiations away from the table to set the stage for a final push upon the resumption of negotiations a few weeks later.

During this period, PRC Vice Minister Wu Dawei helped prepare for a return to the negotiating table with a visit to Pyongyang Aug. 31-Sept. 2. Following that visit, the Six-Party Talks resumed on Sept. 13 for a week to address outstanding issues including North Korea's right to peaceful use of nuclear energy and the desire of the North Koreans to pursue construction of a light-water reactor. Once it became clear the negotiations had reached a breaking point, all parties accepted the Chinese-drafted joint statement.

The Sept. 19 joint statement reflected many key elements that the Chinese side had emphasized in the chairman's statements that have concluded previous rounds of talks, including the commitment to North Korea's denuclearization by peaceful means and through simultaneous steps by the U.S. and the DPRK. Most notably, the PRC Foreign Ministry was quite stern in its response to apparent DPRK efforts to publicly backtrack on its commitments a day after the joint statement was announced. When the DPRK demanded that the U.S. complete the provision of a light-water reactor to North Korea before complying with its denuclearization commitments, the Chinese spokesman sharply and publicly reiterated that North Korean diplomats know what they agreed to and the DPRK will be expected to live up to its commitments. Despite a continuing flow of small snubs and symbolically defiant acts by North Korea, the Chinese successfully brought the DPRK along in the Six-Party Talks without allowing tensions in the bilateral relationship to extend past the breaking point.

A critical new development that has facilitated Chinese leverage and ability to manage both North Korea and the U.S. has been the complementarity in Chinese and South Korean policy interests in and approaches toward the North Korean nuclear issue. This factor became particularly important during the run up to the fourth round of Six-Party Talks as South Korea has sought opportunities to mediate a solution to the North Korean nuclear crisis. The resumption of inter-Korean dialogue provided an opportunity for South Korea to play a role, and Kim Jong-il's decision to publicly signal his willingness to resume the six-party dialogue in a face-to-face meeting with ROK Minister of National Unification Chung Dong-young (the same meeting at which Chung presented an "important proposal" to supply North Korea with 2 million kilowatts of electricity annually if North Korea gave up its nuclear weapons program) enabled South Korea to play a constructive role in facilitating the resumption of the nuclear negotiations.

It is interesting that after having refused to discuss the nuclear issue with South Korea since the beginning of the crisis in late 2002, Chairman Kim chose a meeting with Unification Minister Chung as the moment to give a concrete time frame for the DPRK's return to the six-party process. Given emerging South Korean strategic anxieties about China's overarching economic influence on North Korea (North Korea is dependent on China for over 60 percent of its overall recorded external trade by value) and China's expanding economic reach into North Korea's strategic industries, including natural resources extraction, the rapid resumption of inter-Korean cooperation, which includes inter-Korean economic cooperation in developing coal mining and other mining sector development, the jump-starting of inter-Korean cooperation recalls the first inter-Korean breakthrough on July 4, 1972 between Kim Il-sung and Park Chung-hee, which was stimulated by the Nixon opening to China.

On the other hand, the South Korean and Chinese coincidence of interest in the peaceful and gradual economic integration of North Korea into the regional economy – and more importantly a strong desire to avoid the reverberations from sudden political instability in North Korea – has facilitated common views in Seoul and Beijing toward both Washington and Pyongyang. During the Six-Party Talks themselves, South Korean diplomats were often in the lead in expressing the bottom line outcome of the talks to both the U.S. and North Korea, with China playing a background role that tended to shadow and ultimately reinforce many South Korean perspectives. Among the flurry of diplomatic contacts that occurred following the announcement of the recess in Beijing, ROK Foreign Minister Ban Ki-moon went first to Beijing and then to Washington to seek consensus on how to proceed. While there has been plenty of Sino-South Korean consultation regarding the Six-Party Talks process – aided by the growing experience of Chinese Foreign Ministry professionals such as Wu Dawei, Li Bin, and Ning Fukui in both North and South Korea – there has not yet been overt coordination of Chinese and South Korean positions, a development that would be in direct contradiction with the spirit of the U.S.-ROK alliance relationship.

## **China's currency revaluation: much ado about little**

The significant economic event in Sino-South Korean economic relations this quarter was the announcement on July 21 by the Bank of China that it ended the fixed rate of the yuan's value on global markets and would instead peg the yuan to a basket of major currencies, including the ROK won. This move came in response to increasing political pressures from the U.S. to adjust the value of the Chinese currency, which has been estimated to be undervalued by as much as 15-20 percent. The practical impact of the new arrangements, however, was quite minimal, amounting to an adjustment of only 2.1 percent in the yuan-dollar exchange rate. The immediate effect was also minimal, but did not remove uncertainty, as observers expect that considerably greater adjustments will be required at a future stage.

The South Korean focus on exchange rates may seem overblown until one realizes that the Export-Import Bank of Korea reports that over 10,000 Korean enterprises are operating in China, including a considerable number of small- and medium-size enterprises. Many of these smaller entities would be affected by the increasing cost of labor in China, which would in turn raise the price of China-produced exports to the rest of the world. The vulnerability is due to the fact that sales revenue is valued in U.S. dollars, but operating costs are paid in Chinese yuan. However, following the initial adjustment of only 2.1 percent, a survey by the Korea Chamber of Commerce of 300 export companies revealed that the small size of the revaluation has deflated concerns about the impact of a further revaluation of up to 5 percent.

Another new wrinkle for Korean firms investing in China is that labor-intensive firms in certain sectors are no longer welcome by the Chinese government, which instead prefers foreign inward investment by firms that can also bring technology benefits and not simply exploit China's low labor costs. In any event, China's labor cost advantage is gradually diminishing, especially in established urban areas such as Shanghai and Guangzhou, due to upward wage pressures and an upswing in disputes and strikes conducted by local labor forces.

## **Despite stomach pains, an free trade agreement (FTA) still tempts**

The possibility of a China-South Korea FTA got a big boost from expressions of interest on the part of PRC Premier Wen Jiabao in a meeting with South Korean Prime Minister Lee Hae-chan last June. A formal effort would build on feasibility studies underway since March between the Korea Institute for International Economic Policy and China's Development Research Center of the State Council. These two partners have also been linked for several years in the context of three-way research with Japanese counterparts on possibilities for regional economic integration. Five years ago, Korean researchers responded to Japanese proposals for a Japan-Korea FTA by regularly suggesting a three-way China-Korea-Japan FTA; with negotiations on a Japan-Korea FTA underway but apparently stalled, the Chinese premier's comments have once again raised questions about whether an FTA with China or Japan would be most beneficial to South Korean economic interests. (Meanwhile, South Korea's movie screen quota remains the primary

obstacle to either a U.S.-ROK bilateral investment treaty or FTA.) From China's perspective, an FTA between China and South Korea would complement efforts underway for a China-ASEAN FTA and would facilitate even greater economic interdependence than has developed in the China-South Korea trade relationship, which has grown at over 30 percent annually since 2001.

For South Korea, the primary stumbling block in considering an FTA arrangement with China lies with the agricultural sector. A KIEP working paper released in December of last year projects that South Korean agricultural output would decline by 12 percent if customs duties are eliminated on Chinese agricultural imports. In addition, South Korean labor-intensive textiles and leather industries would be hit with significant reductions due to cut-rate competition from Chinese products. Still, the Korean electronics sector would benefit from expanded access to the Chinese domestic market. In these circumstances, it is questionable whether a comprehensive Sino-South Korean FTA is politically viable.

For the average South Korean consumer, the concerns about Chinese agricultural imports hit closer to home, as Chinese food products have consistently posed serious public health concerns, be it over fake milk product, fish contaminated by lead products, and manufactures of noodles from unsafe sources. Most recently, it was revealed that kimchi imported from China may contain lead content up to five times as high as that found in Korean-made kimchi, sending shock waves through South Korea and threatening strong imports of Chinese-made kimchi. The Korea Restaurant Association reports that over half of Korean restaurants are serving kimchi made in China as a cost-saving measure, and imports of Chinese kimchi to Korea had increased by almost 115 percent in the first half of the year. Chinese trade officials recommended the establishment of joint food safety guidelines in response to Korean concerns and a drastic drop in sales of food imports reported to have been contaminated.

In July, there was a conviction in a case involving the sale import of 1,200 roots of Chinese ginseng sprayed with insecticide that were claimed to be Korean ginseng. In September reports that malachite green, a cancer-causing substance, was detected in six out of seven frozen processed eels imported from China and was detected in carp and edible goldfish have driven Koreans out of the eel market and prompted calls for more effective and timely inspections of food imported from China.

### **Next task for Six-Party Talks: from principles to specifics**

Despite brief speculation in the South Korean press prior to the opening of the fourth round of Six-Party Talks that the venue for the talks should be moved to Jeju Island, China remains center stage as the host and facilitator of a six-party negotiation of a specific agreement that would presumably build on the foundations laid by the joint statement of principles. However, it is interesting to consider whether the constraints that accompany China's hosting role inhibit a more active expression of Chinese views on North Korea's denuclearization, and in what ways a neutral venue would change the dynamic of the talks. Thus far, China's ability to motivate participation by a reluctant North Korea and the Chinese and South Korean influences on the outcome of the joint

statement appear to have been decisive in dictating where and how both the U.S. and the DPRK found themselves with no choice but to make concessions to salvage an agreement. This dynamic, and the heightened influence of both South Korea and China to determine the “lowest common denominator” necessary for an agreement, is an inevitable cost of the six-party format, the Bush administration’s chosen vehicle for addressing the issue. It remains to be seen whether the administration will be able to reap the full benefits of such an approach. Will it enable the other parties to actively share responsibility for achieving the irreversible denuclearization of the Korean Peninsula needed to settle the North Korean nuclear crisis once and for all?

### **Chronology of China-Korea Relations July-September 2005**

**July 8, 2005:** A Chinese man takes a picture of an unidentified flying object hovering over Mount Paekdu, spawning reports of UFO sightings by Korean tourists to the area.

**July 12-14, 2005:** PRC State Councilor Tang Jiaxuan visits Pyongyang as a special envoy of PRC President Hu Jintao and meets with DPRK Chairman Kim Jong-il.

**July 14, 2005:** Grand National Party Assemblyman Lee Ke-jin calls for Seoul to permit the Dalai Lama to visit South Korea to receive the “Manhae Peace Prize,” offered by a local Korean civic group. Seoul has refused to permit the Dalai Lama to visit the ROK to avoid offending the PRC.

**July 21, 2005:** The People’s Bank of China revalues its currency by 2.1 percent while establishing a limited “managed float” mechanism against international currencies, abandoning the previous fixed exchange rate.

**July 26, 2005:** Korea Food and Drug Administration announces that cancer-causing malachite green was detected in one out of seven live eel specimens and six out of seven frozen processed eels imported from China.

**July 26, 2005:** Fourth round of Six-Party Talks convenes in Beijing.

**July 28, 2005:** Finance Minister Han Duck-soo proposes the establishment of a development bank for Northeast Asia to help North Korea integrate into the regional economy of Northeast Asia.

**Aug. 7, 2005:** Fourth round of Six-Party Talks recesses following discussion of four drafts of a PRC-proposed joint statement.

**Aug. 10, 2005:** The People’s Bank of China announces that the South Korean won is one of the components of the currency basket created as part of a new “managed float” mechanism for revaluing the yuan.

**Aug. 11-13, 2005:** ROK Foreign Minister Ban Ki-moon visits Beijing to meet with counterpart Li Zhaoxing on the status of the Six-Party Talks prior to visiting Washington.

**Aug. 13, 2005:** ROK Ministry of Information and Communication announces efforts to strengthen internet security on college campuses following press reports from Hong Kong that Chinese hackers from the Association of China's Red Hackers might try to use Korean servers to launch attacks on Japanese websites.

**Aug. 29, 2005:** Doosan Heavy Industries & Construction announces plans to cooperate with Harbin Power Equipment Company, China's largest power facility builder, in bidding for new projects in China, with a focus on the nuclear energy production sector.

**Aug. 27-29, 2005:** PRC Vice FM Wu Dawei visits Pyongyang and meets with DPRK FM Paek Nam-sun to clarify DPRK positions prior to the resumption of Six-Party Talks.

**Sept. 13, 2005:** Fourth round of Six-Party Talks reconvenes for a second phase of discussions of a proposed joint statement of principles on the North Korean nuclear issue.

**Sept. 15, 2005:** Seoul announces redoubled efforts to inspect food imports and punish those found to accept contaminated goods following reports that Chinese eels treated with a cancer-causing substance called malachite green had been imported to South Korea.

**Sept. 16, 2005:** DPRK Cabinet Vice Premier Kwak Pom-gi meets delegation of the China State Electric Network Corporation headed by its President Liu Zhenya

**Sept. 19, 2005:** Fourth round of six-party dialogue in Beijing concludes with a joint statement of principles.

**Sept. 20, 2005:** DPRK *KCNA* announces that Pyongyang will not dismantle its nuclear program until after Washington provides North Korea with a light-water reactor. PRC Foreign Ministry spokesman indicates that the *KCNA* interpretation is different from the contents of the joint statement that North Korea agreed to in Six-Party Talks.

**Sept. 20, 2005:** PRC FM Li and FM Ban meet on the sidelines of the UN General Assembly meeting in New York.

**Sept. 25, 2005:** Grand National Party Assemblywoman Ko Kyung-hwa releases report from the Research Institute of Public Health and Environment showing that the lead content of Chinese-made kimchi is three to five times higher than that of Korean kimchi.

**Sept. 27, 2005:** The ROK Navy announces that it will set up a naval hotline with China to avoid accidental armed clashes in the West Sea.

**Sept. 28, 2005:** The Korea Shipbuilders' Association (KSA) announced a possible increase in steel imports from China to cut costs. Increasing competitiveness of Chinese steel factories threatens POSCO's market position from the beginning of the year.