



China-Korea Relations:

## Lee Myung-bak Era: Mixed Picture for China Relations

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The South Korean political transition to a new administration under President Lee Myung-bak catalyzed diplomatic contacts designed to size up the new leader and to establish the foundations for a new era in the Sino-South Korean relationship. Accompanying this transition, Beijing redoubled efforts to manage relations with Pyongyang through high-level party-to-party exchanges with Kim Jong-il. Chinese food assistance to North Korea and the North Korean commitments in the Six-Party Talks framework to declare nuclear-related programs dominated conversations with the Dear Leader. The rise in “fly-by-night” departures of South Korean small investors from China resulting from rising Chinese labor costs and changing incentives for investments in China requires diplomatic management between Beijing and Seoul. Finally, “yellow dust,” Tibet, Taiwan, and quality controls on food exports to Korea are nagging issues that cloud the relationship.

### **Transition to Lee Myung-bak**

Immediately following his election Dec. 19, Lee Myung-bak pledged in a congratulatory meeting with Chinese Ambassador to South Korea Ning Fukui that he would “upgrade Korea-China economic relations as China is a critical trade partner for Korea.” However, some analysts in both Korea and China worried that Lee’s prioritization of U.S.-ROK security relations would have negative ramifications for Seoul’s relations with Beijing. Lee’s more conditional approach to the North suggested that there would be less overlap between the Chinese and South Korean approaches to North Korea that existed under President Roh Moo-hyun.

The Chinese government and the newly elected Lee administration exchanged special envoys in mid-January prior to Lee’s inauguration. Vice Foreign Minister Wang Yi came to Seoul as a special envoy of President Hu Jintao, inviting Lee to “strengthen strategic communications and expand mutually beneficial cooperation” while Lee sent Grand National Party (GNP) leader Park Geun-hye to Beijing as a special envoy, at which time Hu reiterated his support for progress in the Six-Party Talks and his commitment to “developing bilateral relations to a higher level.”

The primary Chinese interest in the transition to Lee is to probe the specific implications of a transition to a conservative South Korean administration for policy toward North

Korea. Chinese Communist Party International Liaison Department head Wang Jiarui visited Seoul in November at which time he stated during a meeting with Park Geun-hye that “What North Korea is afraid of is not the GNP’s takeover of power, but rather of a rapid shift of policy toward North Korea if the GNP takes power.” The Chinese leadership is concerned that a downturn in inter-Korean relations might sidetrack progress in implementing six-party agreements resulting in renewed tensions and heightened pressure on China to get tough with North Korea. Chinese analysts also warned that South Korea should be careful not to lean too closely toward the U.S. at the expense of China. In this respect, the resumption of trilateral security dialogue among the U.S., Japan, and South Korea may be a sensitive issue in Beijing if the scope of such talks extends beyond coordination on peninsular issues.

Days prior to Lee’s inauguration ceremony in late February, Ambassador Ning stated that China-South Korean relations are at a “new starting point” and that “the neighboring countries have become vital partners not only economically, but also on the international stage of diplomacy, security, and culture. China demonstrated its will to improve relations with the new government by having State Councillor Tang Jiaxuan attend Lee’s inauguration ceremony. But, China’s representation was low-key as Japan’s Prime Minister Fukuda Yasuo and U.S. Secretary of State Condoleezza Rice gained the lion’s share of press attention during the event.

South Korean Foreign Minister Yu Myung-Hwan made a point of making Beijing his first overseas destination in mid-March, prior to visiting the U.S. and Japan. In Beijing, Yu expressed concerns that the six-party process not stall out and emphasized that “a fortified Korea-U.S. alliance is not a minus to Korea-China relations and both relations need to maintain a win-win structure.” Yu consulted on preparations for an exchange of state visits, including a visit by President Lee to Beijing, possibly as early as May. In addition, Chinese and South Korean leaders might meet on the sidelines of the Asia-Europe Meeting in China in October, the APEC meeting in Peru in November, the ASEAN Plus Three meeting in Thailand in December, and possibly during the Beijing Olympics in August. Yu also mentioned the possibility of a trilateral summit meeting among Chinese, Japanese, and South Korean leaders.

President Lee’s appointment of the former South Korean Ambassador to China Kim Ha-joong as unification minister sends mixed messages. On the one hand, Kim was a loyal supporter of Kim Dae-jung’s Sunshine Policy as his Blue House advisor prior to spending all five years of the Roh administration in Beijing. Kim maintained a relatively low profile in Beijing, but is known to have aggressively pursued information from Chinese officials regarding sensitive issues related to North Korea’s leadership. It remains to be seen whether Kim will be effective in dealing with the North and what type of envoy Lee will select as his ambassador in Beijing.

China also received notification this quarter of approval by Seoul municipal authorities for the construction of a embassy complex in downtown Seoul consisting of a 10-story and a 24-story building, a grand gate, and a garden. The embassy will be the largest

foreign diplomatic compound in Seoul with a total land area of over 17,000 sq. meters, surpassing Russia's 12,000-meter complex in southern Seoul.

### **Lee Myung Bak, North Korea, and the China-DPRK relationship**

One role of Chinese consultations with Seoul has evidently been to provide North Korea with a third-party assessment of the implications of the Lee Myung-bak administration, in addition to helping with information necessary for Lee to shape his own policy toward Pyongyang. CCP International Liaison Department head Wang Jiarui was able to rely on his own conversations in Seoul prior to Lee's election as well as Beijing's initial exchange of special envoys in mid-January. Those visits along with Beijing's assessment of prospects for inter-Korean relations and his visit to Pyongyang at the end of January, when he met Kim Jong Il, made Wang the ideal choice to provide insights on both sides. During his visit to Pyongyang, Wang conveyed a verbal message from President Hu, invited Kim Jong-il to attend the Olympic opening ceremonies, and toured the Kaesong Industrial Complex, no doubt to underscore Chinese desires to see continuity and progress in inter-Korean economic relations and North Korea's own reform and opening to the outside world. Wang was quoted by *Xinhua* news agency as saying that "the present difficulties are temporary and can be conquered," while Kim Jong-il was quoted as saying that "There are no changes in the North's stance to continue pushing forward the Six-Party Talks persistently and implementing all the agreements."

Kim Jong-il followed up the Wang meeting one month later with a rare personal visit to the Chinese embassy in Pyongyang for a dinner and follow-up conversation with Chinese Ambassador Liu Xiaoming. In addition to a discussion of next steps in the Six-Party Talks, one of the topics reportedly discussed was the prospect of a visit to China in the first half of the year, possibly to occur in conjunction with a reported visit by Kim Jong-il to Vietnam to mark the 50<sup>th</sup> anniversary of Kim-il sung's visit to Hanoi. Such a visit would mark a major increase in Kim's international engagement and presumably would only be fully effective in the context of steps forward in implementing North Korea's denuclearization commitments as part of the six-party process.

North Korea is squeezed by a decline in Chinese grain exports caused by tightened Chinese export regulations from the beginning of this year and a global rise in food prices. In addition, North Korea has not yet been willing to request assistance from the Lee administration in the South, possibly fearing that such requests might either be rejected or used as leverage to pressure Pyongyang on other issues. The need for foreign exchange has prompted North Korea to be more active in allowing international and especially Chinese access to North Korean mineral resources, one factor that motivated South Korean interest in a summit under President Roh. But, it is not yet clear how or whether President Lee's early emphasis on "resource diplomacy" may be applied to North Korea. Although reports from South Korean NGOs working in the North are increasingly dire, there are suspicions that China will ultimately decide to provide enough assistance to the North to avoid refugee flows into China that might hurt stability during the Beijing Olympics this August.

## South Korea's "fly-by-night" operators

Rising labor costs, decreasing tax incentives, and a less favorable business environment for low-margin, labor-intensive investments in China have put increasing pressure on South Korean small businesses in the toy, textiles, shoe, and other sectors. Most of these companies sought low-wage workers in China to enhance competitiveness in the U.S. export market. With a new labor contract law making it harder to lay off workers and expiring tax incentives coming into effect at the beginning of 2008, many smaller South Korean businesses were squeezed into the red. As a result, dozens of South Korean firms decided to flee their businesses due to complex investment liquidation procedures. Early this year, an increasingly popular option for those firms was to pack up and leave in the dead of night, leaving Chinese employees in the lurch and with little recourse in their efforts to receive back wages owed by the firms. Other Korean operators faced personal difficulties as they fell behind on payments and Chinese employees decided that they were a flight risk, often forcibly holding them at factories while demanding payment.

The situation was not unanticipated. A survey at the end of last year by Korea Trade-Investment Promotion Agency revealed that one in 10 Korean companies in China was considering withdrawal due to deterioration in the business environment there. Sung Jeung Han of the Korean Society and Enterprise Association in Qingdao estimated that 20-30 percent of the 6,000 Korean firms there are losing money as a result of increases in minimum wages of over 43 percent over the past three years to \$107 per month. In a survey by the Korea Chamber of Commerce and Industry's China branch conducted in mid-January of 350 listed members, it was revealed that 25 percent of firms have seriously considered leaving China, while another 3.1 percent said they are preparing for liquidation. The Export-Import Bank of Korea has estimated that over 200 Korean business owners in Qingdao had illegally shut down their businesses in recent years (comprising 2.5 percent of all South Korean investors there), leaving Chinese workers with no recourse. In Jiaozhou, Shandong Province, 103 of 119 businesses that had illegally shut down since the beginning of the year were reportedly from South Korea. A March report from the bank estimated that the investment environment had worsened in China (along with India and Kazakhstan) due to decreased tax incentives and rising costs for labor and materials.

The political and economic fallout from such pressures led the Federation of Korean Industries to recommend in mid-January that the South Korean government step in to provide assistance to smooth the exit process for Korean firms and to resolve tensions caused by South Korean "fly by night" practices. By February, the South Korean government began to step in to assist companies in managing the process of withdrawing from the Chinese market and held talks with Chinese officials on the matter. The Ministry of Foreign Affairs and Trade established a help desk for distressed Korean firms at the Korean embassy in Beijing and the consulate in Qingdao to provide assistance to South Korean investors in liquidating their assets and to serve as a liaison with Chinese agencies involved in the process. The South Korean government plans to establish a one-stop service to assist companies who want to exit China and press for improved transparency in China's corporate liquidation procedures. In addition, the South Korean

government will facilitate judicial handling of suits against South Korean managers who have fled China so that workers can seek redress for back wages.

### **An ill wind and other challenges for China-Korean relations**

Early predictions by the Korean meteorological service suggest that the spring of 2008 could be the worst year yet for yellow dust from China. The “gatecrasher of spring” is an unwelcome guest in Korea and Japan, but it had until recently been a catalyst for greater cooperation among the respective environmental ministries in Japan, China, and South Korea. But cooperation hit a snag earlier this year as a result of the unwillingness of the Chinese government to share meteorological information with Korea and Japan under the pretext that such information was a “state secret,” inhibiting the capacity of China’s neighbors to make more accurate forecasts for how and when the dust might be at its worst. During periods when the dust does strike, South Korean elementary schools are closed and precision machinery operations in both South Korea and Japan require greater precautions to keep out the dust, which can increase the error rate of precision materials production. The Korea Environment Institute estimates that economic damage resulting from haze created by the dust amounted to ₩5.5 trillion (\$5.5 billion) in 2007, when 13 weather advisories were issued in South Korea, up from only three in 2003.

Another ill omen from China has been the precipitous fall in the value of Chinese equities in conjunction with difficulties in the U.S. markets. Based on the theory that the U.S. and China markets are decoupling, many individual Korean investors had sought to cash in on China’s growth, but found themselves instead exposed to amplified effects of the inability of U.S. markets to properly measure risk. Meritz Securities estimated that Korean fund investments in China amounted to over ₩24 trillion (\$24 billion), or one-third of all overseas investment fund inflows into China. The Chinese market’s drop of over 40 percent from its peak has been an additional blow to Korean investors.

A third negative story from China involves ongoing concerns regarding the quality of Chinese food imports to Korea. But this time the culprit involved a Korean company, Nongshim, which, when confronted with a customer who found rodent parts in a popular snack, claimed that it processed food products in China for sale in South Korea. The fact that a South Korean company faced difficulties as a result of failure to monitor its own food processing operations in China has generated additional pressure on the Korea Food and Drug Administration while defusing the issue as a political problem between Korea and China, unlike the “gyoza” controversy between China and Japan. In the wake of the controversy, the Korean Consumer Agency stated that coffee, sesame oil, and health supplement products from China have also been found to be tainted.

Finally, new cases of industrial espionage involving the stealing of technology and selling it to Chinese competitors were revealed this quarter. This time an LG Electronics engineer has been indicted for teaming up with former colleagues to steal and leak flat-screen TV technology to China’s COC (Changhong-Orion PDP-Chaihong) that was used in a PDP plant constructed in Sichuan province. LG Electronics estimates that the leak will cost the company about ₩1.3 trillion won (\$1.3 billion) in losses. South Korean

prosecutors acting on information provided by South Korea's National Intelligence Service (NIS) have also been investigating allegations of technology leakage at Ssangyong Motor, but the case is more complicated since that company was bought by Shanghai Automotive Industry Corporation (SAIC) in 2004, so any technology transfer made by the company after that time would be legal.

### **Taiwan-South Korea political parallelism**

The election of Ma Ying-jou on March 23 as president in Taiwan extended the parallel political experiences of South Korea and Taiwan. Both Taiwan and South Korea experienced economic growth that contributed to democratization, experienced parallel transitions to opposition rule based on anti-corruption and national identity platforms, and have switched back to conservative rulers focused on recovering lost economic performance. The parallel has been so strong that candidate Ma pledged to focus on the economy like "Lee Ming-bo" (Lee Myung-bak's name in Chinese), and came up with his own "633" pledge (6 percent growth, a per capita income of \$30,000, and 3 percent unemployment) to parallel Lee's "747" campaign pledge to promote 7 percent growth, raise per capita income to over \$40,000 and become the 7<sup>th</sup> largest economy in the world. Ma's election signals a potential opportunity for enhanced cross-Strait cooperation since Ma has also supported an improved economic relationship with Beijing based on a "one China common market," and resumption of dialogue on the basis of "one China, differing interpretations." To the extent that Ma can bring greater "international space" for Taiwan, this might also provide an opportunity to improve political relations with South Korea, which has remained sensitive to Beijing's preferences in its dealings with Taiwan. For this reason, it is somewhat surprising that an international poll on developments in Tibet showed South Koreans to be the most critical regarding Chinese policies and management of Tibet. But a Korean company, Samsung, is a primary Olympic sponsor that would lose out if protests mar the Beijing Olympics.

### **Korean Peninsula: in the balance or out of balance?**

The next quarter will see the renewal of top-level diplomacy in China's relations with the two Koreas, including possible visits by both Lee Myung-bak and Kim Jong-il to Beijing. With Beijing as the center for Korean Peninsula-related diplomatic activity, Chinese policies toward the two Koreas are likely to receive renewed scrutiny in the coming months. President Lee will pursue more active relations with Beijing on the basis of a close U.S.-ROK relationship, rather than with the intent of playing a balancing role in Northeast Asia. This may pose a challenge to Beijing if viewed through the lens of regional geostrategic competition with the U.S. But, it holds the promise of deepening economic relations in many sectors, including the initiation of FTA discussions between China and South Korea.

The Chinese leadership is likely to find South Korean policies toward North Korea more challenging. President Lee's emphasis on human rights and his apparent willingness to challenge the North carry mixed implications for China's own interests and highlight differences with China that had been set aside under more progressive South Korean

leaders. Lee's policies will not deemphasize core shared interests, but his administration also has a different set of assumptions regarding what North Korea must do to pursue economic opening and who has the upper hand in the inter-Korean relationship. Longer-term, however, the objectives of denuclearization, opening, and promoting North Korea's economic development will find a ready audience among Chinese officials interested in promoting regional stability and North Korean reform – if only as a means to reduce Beijing's own burdens from North Korea's "rubber stomach" and endless demands for assistance.

There remains evidence of discord within the Chinese foreign policy community over how to deal with North Korea. Different factions within China's foreign policy establishment argue over how much China can afford to give to North Korea, whether North Korea holds strategic value for China, and the destabilizing costs of Chinese failure to challenge North Korea's most brazen illegal actions even when they occur on Chinese soil. Many of these specific costs are outlined in detail in a book entitled "China's Secret North Korea File," published in Japan and supposedly written by Chinese government officials dissatisfied with Chinese policy. This internal debate has yielded casualties in several branches of the Chinese bureaucracy among specialists who have been put under house arrest both for being too outspoken on North Korea and for alleged corruption. Although there are no perceptible changes in China's policy of trying to gently use its limited capacity to influence Kim Jong-il to move in a direction that accords with Chinese interests, a powerful counter-argument has coalesced in some quarters – as represented by this book – that Chinese policies would be best served by working more closely with the U.S. to achieve North Korea's denuclearization, even at the expense of the stability. Whether such arguments are finally incorporated into Chinese policy toward the Korean Peninsula remains to be seen. Nevertheless, North Korea's full denuclearization and/or future survival may depend on it.

## **Chronology of China-Korea Relations**

### **January-March 2008**

**Jan. 1, 2008:** Municipal authorities in Dandong, Liaoning Province announce plans to construct a large bridge across the Yalu River to North Korea to expand capacity to handle bilateral trade with North Korea.

**Jan. 7, 2008:** Forty illegal laborers, including 13 Korean ethnic workers from China, are trapped and burned in a cold-storage warehouse under construction in Incheon, 50 miles south of Seoul.

**Jan. 14, 2008:** President-elect Lee Myung Bak meets Chinese special envoy Wang Yi during a visit to South Korea to consult on future prospects for Six-Party Talks.

**Jan. 16, 2008:** South Korean companies in China face toughening government regulations and decreasing incentives to operate there, spurring nighttime departures by some South Korean executives and employees.

**Jan. 19, 2008:** The Korean Customs Service reports that China has displaced Japan in 2007 as the largest exporter of goods to South Korea.

**Jan. 20, 2008:** The Bank of Korea releases a report concluding that an economic bubble is unlikely to occur in China.

**Jan. 30, 2008:** Senior Chinese Communist Party official Wang Jiarui meets Kim Jong-il in Pyongyang to discuss the Six-Party Talks and other issues in Sino-DPRK relations.

**Feb. 8, 2008:** Chinese Ambassador to South Korea Ning Fukui says Chinese-South Korean relations are “at a new starting point” in an interview at his office in Seoul.

**Feb 19, 2008:** South Korea’s Ministry of Commerce, Industry, and Energy announces that the government has decided to implement measures to support South Korean investors in China that are planning to withdraw from the country.

**Feb. 19, 2008:** Korea Institute for Industrial Economics and Trade Senior Research Fellow Kim Do-hoon says that Hong Kong and China are likely to be South Korea’s best FTA partners based on his study of the effects on local industry.

**Feb. 19, 2008:** China hosts a bilateral meeting between Six-Party Talks negotiators Christopher Hill and Kim Kye-gwan to discuss issues preventing North Korea from providing a declaration of nuclear-related facilities, programs, and materials as pledged under the Oct. 4 and Feb. 13, 2007 six-party agreements.

**Feb. 25, 2008:** Lee Myung-bak inaugurated as new South Korean president; meets with Chinese State Councilor Tang Jiaxuan.

**March 1, 2008:** North Korean leader Kim Jong-il has “cordial and friendly talks” during a visit to the Chinese Embassy in Pyongyang with Chinese Ambassador Liu Xiaoming.

**March 2, 2008:** President Lee names former South Korean Ambassador to China Kim Ha-joong as his first minister of unification.

**March 4, 2008:** Korea Hydro and Nuclear Power (KHNP) announces that it has signed a \$15.5 million contract with Guangdong Power Engineering Corporation to export nuclear technology through 2013 for reactors at Yangjian, Guangdong Province, which are based on the Korean Uljin plants.

**March 6, 2008:** Prosecutors announce the arrest and indictment of a former LG Electronics engineer for industrial espionage by stealing and leaking flat-screen TV technology to a Chinese competitor.

**March 11, 2008:** South Korea announces that the China has agreed to cooperate to recover the remains of An Jung-geun, the Korean independence fighter who assassinated Japan's first Resident General Ito Hirobumi in China in 1909. An was executed in China by Japanese military officials at Ryojun prison.

**March 12, 2008:** Korea, China, and Japan hold a fourth round of talks on a trilateral investment agreement.

**March 17, 2008:** Korea Development Institute releases a report describing the transition of China from a production base to an export market for Korean manufacturing products.

**March 19, 2008:** South Korea's Business Institute of Sustainable Development announces that ₩5.5 trillion (\$5.5 billion) in lost productivity occurred in 2007 as a result of "yellow dust" from China.

**March 19, 2008:** Korean producers of the film "Crossing," which is based on the story of North Korean refugees who escape to China, hold a press conference in Seoul.

**March 19, 2008:** The Korean Consumer Agency reports that over 10 different cases of spoiled food products from China have gone unreported in the Korean media.

**March 20-22, 2008:** Foreign Minister Yu Myung-hwan makes his first visit as foreign minister to China to plan for a likely May state visit by President Lee to Beijing.

**March 22, 2008:** Ma Ying-jeou is elected president of the Republic of China on a platform that stresses economic performance pledges similar to those of President Lee.

**March 26, 2008:** Korea Fund Ratings reports that Chinese equity funds have lost ₩12 trillion over the past five months. Korean investors represented 32 percent of total funds invested from overseas, according to Meritz Securities.