

China-Korea Relations:
**Economic Interests Uber Alles:
Hitting the Jackpot through Sino-Korean Partnership**

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Driven by continuously expanding dividends from economic cooperation, Sino-Korean government and party contacts were particularly intense in the second quarter of this year. National Party Congress Chairman Li Peng and Chinese Communist Party international liaison department head Dai Bingguo visited Seoul, while South Korean Prime Minister Lee Han-dong, Foreign Minister Han Seung-soo, and Millennium Democratic Party Chairman Kim Joong-kwon paid visits to Beijing. The political prizes: strong Chinese political and psychological support for inter-Korean reconciliation at a time of difficulty in U.S.-South Korean relations and surprisingly rapid Chinese acquiescence to the early departure of a North Korean refugee family that sought asylum in late June at the Beijing offices of the UN High Commission for Refugees.

The underlying driver for such political cooperation is the economic jackpot of major South Korean participation in the opening of the Chinese CDMA (code-division multiple access) mobile phone market, combined with continued strong Korean private sector performance as a transit point and leading supplier of low-priced, quality consumer goods to the Chinese market. These burgeoning economic interests continue to overshadow possible political problems on the horizon, including the question of how to deal with future North Korean refugee cases, perceived dangers to Korean interests inherent in a potentially more confrontational U.S.-PRC relationship, and Chinese national interests and intentions as Beijing strengthens its economic and political role and support for the North Korean leadership.

Powerful Economic Payoffs of Sino-Korean Cooperation

The mutual economic benefits and logic of enhanced Sino-South Korean trade and investment can not be overemphasized and are rarely overshadowed by political considerations. ROK exports and foreign direct investment in China continue to show

high rates of growth despite overall stagnation in export growth resulting from the recent slowdown of the global economy and decreased demand from the United States. For instance, South Korea's May exports showed a 7 percent decline and U.S.-bound exports dropped by 9 percent over the previous year, but exports to China remain an engine for double-digit export growth at 10 percent over last year's level. Sino-ROK bilateral trade

reached over \$31.3 billion and South Korean foreign investment in China reached over \$29.3 billion in 2000. Perhaps for the first time, \$130 million in foreign direct investment from South Korea to China during the first quarter of this year exceeded Korean investment in the United States during the same period, with China capturing over 28 percent of total Korean foreign direct investment during that period. Given the strong negative influence of the downturn of the U.S. economy on Korean economic growth prospects, it is not surprising that circumstances might draw the Korean business sector to pay even stronger attention to China as an engine for profits and economic growth estimated to continue at about 8 percent annually for the foreseeable future.

Most Koreans do not regard China's economic rise as a temporary phenomenon but as a fundamental fact of life and as a once-in-a-lifetime business opportunity. The need to maintain access to such opportunities as an engine for South Korea's own economic prosperity will increasingly be an important consideration as South Korea manages its official relationship with China. The South Korean Prime Minister's Office has projected that Sino-ROK trade will grow from the current \$30 billion/year level to over \$100 billion/year within the next five years, and many Korean analysts expect the overall size of the Chinese market to overtake that of the United States within the next decade.

In almost every South Korean business sector, the prospect of a growing Chinese market is weighing heavily on Korean calculations, with mixed effect and in some cases with important implications for global supply and demand in specific sectors as Korean producers gear up to capture Chinese market share. According to Yoo Jin-seok of the Samsung Economic Research Institute, "China will certainly one day emerge as Korea's fiercest competitor. But this is not necessarily a horror story for Korea, since China is also expected to emerge as Korea's largest export market. Accordingly, how Korea copes with the emergence of China as an economic power will determine the speed and the quality of Korea's economic growth."

The ROK's transportation sector is experiencing rapid growth as an intermediate transshipment point for the entry of goods into the Chinese northeast, primarily due to a lack of capacity and quality of service in China's own transportation sector. Expanded Korean air service at Incheon International Airport since the end of March has provided a regional gateway offering direct cargo and passenger service to many Chinese regional hubs, and Pusan surpassed Kaoshiung as the third busiest container port in the world during 2000 on the strength of its role as an off-loading and transshipment point to smaller Chinese harbors in the East China Sea that lack large container capacity.

South Korean growth plans in infrastructure development are geared primarily to help meet the vast projected Chinese demand for goods and to enhance Korea's role as the primary logistics hub for transshipment of key goods to the Chinese market. The Korea International Trade Association recently released a report suggesting that Pyeongtaek Port, originally developed as a secondary port about 70 kilometers south of Incheon, could be developed to circumvent Pusan as a primary port for export of Korean goods at low cost to the Chinese market, and recommends its expansion from the current size of 24,000 TEU (20-foot equivalent units) to 414,000 TEU by 2011. Korea's second largest

container port at Gwangyang as well as the Mokpo Port in southwest Cholla province are also slated to open expanded facilities within the next few years. The Korea National Oil Corp. (KNOC) recently signed a lease contract with China International United Petroleum & Chemicals (UNIPEC), to jointly stockpile 2 million barrels of crude oil in an arrangement motivated by China's lack of suitable capacity and South Korea's need for increased emergency oil reserves.

The biggest anticipated prizes for the ROK are in the telecommunications sector, and the initial payoff has come in the form of a \$150 million contract to Samsung Electronics to develop 1.13 million CDMA lines in Shanghai, Fujian, Tianjin, and Hubei. The South Korean government has spent considerable time and effort lobbying Chinese counterparts to support South Korean participation in China's CDMA development at virtually every senior leadership meeting since November 1998, including a visit to Beijing for meetings with PRC President Jiang and other senior Chinese leaders by Minister of Information and Communications Yang Seung-taik less than one month before the results of the first round of bidding were announced in May. Although LG Electronics got shut out of its bid to provide CDMA lines to four additional cities, the Samsung Electronics contract is likely bring with it sales of hundreds of millions of dollars worth of Korean-made telephone hand sets in the Chinese market, including those from SK Telecom and other Korean sectoral leaders. To promote Korean CDMA-related exports projected to exceed \$300 million/year, the Ministry of Information and Communication organized a road show to Beijing and Shanghai in June that resulted in export contracts worth \$41 million for the 30 Korean companies, including a \$10.6 million contract in Shanghai for Withus, a venture firm that produces repeaters used in CDMA mobile networks. China's total demand for CDMA infrastructure is estimated to be over \$2.7 billion this year and \$8.2 billion by 2003.

The drive to gear production in response to strong demand in the Chinese market is resulting in some investment and production decisions that are counter-intuitive if one takes into account only South Korea's own domestic market situation. Perhaps the best example is the recent decision by Samnam Petrochemical to expand production of TPA (teraphthalic acid), a key raw material used in polyester fiber, by over 30 percent in the next few years, despite the fact that domestic demand for TPA has decreased with the decline and transfer of Korea's textiles industrial production overseas, including to China. However, Chinese demand for TPA is projected to increase by over 15 percent annually through 2005, and Samnam is positioning itself to meet China's increased demand. Likewise, LG-Caltex is increasing production of para-xylene and benzene in anticipation of increased Chinese demand. The Korea Trade-Investment Promotion Agency (KOTRA) projects that Chinese demand for synthetic resins, which now account for 30 percent of Korean exports to China, will climb to over 24 million tons by 2005, while China's production capacity is likely to expand to only about 14 million tons by that time, leaving a more than 10 million ton shortfall to be met through imports.

Korean manufacturers are also focusing on China's manufacturing sector, and many Korean companies have already made significant inroads. KOTRA reports that a recent survey of Chinese consumers in Beijing revealed that over 20 percent of respondents

picked passenger cars as a product associated with Korea, with 16.7 percent and 11.8 percent choosing mobile phones and TV sets, respectively. LG Group has invested a total of \$1.44 billion to build 24 production bases in China including plants in Tianjin, Changsha, and Beijing, and has established itself as a major provider of reasonably priced household goods for the Chinese consumer market, now including production and sales of 10 models of DVDs at its Shanghai VCR plant. Its total production volume in China is expected to reach \$3.56 billion this year, a level sufficient to warrant a visit to LG's Pyongtaek plant by National People's Congress Chairman Li Peng during his visit in May. Kumho Tire has captured the number one position in China's tire replacement sector, and is projected to top \$100 million in sales for the first time this year. Daewoo Heavy Industry and Machinery Co. has sold 5,000 excavators since 1994, and its Chinese investments have been profitable since 1998. Daewoo attributes its success to the introduction to the Chinese market of installment payment plans to finance the purchase of its equipment. Samsung Electronics Co. launched production last month in Xuzhou of its high-tier Zipel refrigerator models as part of an effort to capture market share in China's high-end refrigerator consumer market.

The steel sector is likely to be a venue for stiff competition led by South Korea's POSCO vs. China's up-and-coming Baoshan Steel, with China's upcoming WTO entry likely to enhance Baoshan's competitiveness in international markets. China has increased year-on-year production in May by 6.6 percent, outstripping the 1.8 percent increase in Korean steel production during the same period despite a slowdown in the global steel industry and likely political repercussions as European and U.S. steel producers moved to protect their markets against global overcapacity by lobbying the U.S. government to initiate anti-dumping investigations. South Korean automobile manufacturers, including Hyundai-KIA Motors Co., are also seeking tie-ups in China. These efforts are consistent with recent predictions by the POSCO Research Institute that Chinese automobile demand will increase by 8.8 percent per year through 2005 and will increase to about 18 percent per year through 2010.

South Korean Prime Minister Lee Han-dong lobbied for the entry of more South Korean banks and insurance companies into the Chinese financial sector during his May visit to Beijing. The Korea Asset Management Corp. signed a provisional contract in June with China Great Wall Asset Management Corp. to sell its expertise in the disposal of distressed assets to the Chinese company and assisted China's Huarong Asset Management Corp. in the sale of asset-backed securities (ABS) worth 1 billion yuan. Samsung Fire and Marine Insurance Company has signed a letter of intent with the People's Insurance Company of China as a vehicle for advancing into China's auto insurance market.

ROK ties at the provincial level have also expanded as Korean trade and investment have become a more significant factor in the Chinese market. Liaoning Provincial Governor Bo Xilai led 600 government and business leaders from 14 different provincial cities for a trade show in Seoul last June, generating 24 agreements worth \$220 million in new investment. Trade with Liaoning province alone represents \$2.5 billion, or almost 10 percent of Korea's overall trade with China, and the governor announced construction of

major new expressways from Dandong, bordering North Korea's Sinuiju, to Shenyang and Dalian, hinting that in the future there may be direct expressway links between Shenyang and Seoul. KITA has also sent delegations as far as Chongqing and other western cities in China to develop Korean trade and investment ties with other provinces.

China's projected November entry into the World Trade Organization continues to be a mixed picture as it represents expanded market opportunity in China at the likely expense of Korea's long-term global economic competitiveness. The Korea International Trade Association has projected that China's WTO entry will widen Korea's bilateral trade surplus with China by \$540 million per year, but that Korean exports will decrease to third countries by \$80 million per year as a result of enhanced Chinese competitiveness in global trade.

For instance, Chinese exports are increasingly posing problems for South Korean agricultural producers, who are losing price competitiveness against inflows of China's inexpensive agricultural products. The export of Chinese garlic to the ROK had become a major trade issue last year, but this year was resolved quickly, as Seoul imposed emergency import curbs on Chinese garlic while simultaneously fulfilling its agreement to fully finance the import quota for Chinese garlic that had been determined as part of last year's settlement of the issue. Although China retaliated last year against Korean garlic import curbs by hiking tariffs on mobile phone equipment and Korean polyethylene exports, the Korean government was unsuccessful in its attempt to convince the Korean manufacturers to buy part of the garlic to be purchased under last year's garlic quota agreement, and eventually ended up purchasing garlic directly to meet the quota. Although Prime Minister Zhu Rongji took issue with Korean curbs on Chinese poultry imports in his meeting with Prime Minister Lee Han-dong, Korea has thus far avoided escalation of disputes over the flood of Chinese agricultural goods that has led this year to major trade tensions between China and Japan.

Sino-Korean Political Dialogues and Cooperation Regarding North Korea

Although the burgeoning Sino-Korean economic relationship has been the primary driver for a flurry of party and government exchanges between Seoul and Beijing during the past quarter, the consistent political objective of Kim Dae-jung has been to maintain momentum for inter-Korean reconciliation and cooperation. For its part, Beijing has been one of Kim's chief international cheerleaders and collaborators, along with the EU, during a period of difficulty and stagnation in the U.S.-ROK relationship following President Kim's March summit meeting with President Bush in Washington, D.C. China's interests in stimulating inter-Korean reconciliation have been consistently and clearly expressed. The economic and political interests of China and South Korea in supporting North Korean economic and political reforms are complementary, and China's political interest in enhancing its role as a significant player and partner of both Seoul and Pyongyang is unmistakable. In fact, as long as South Korean President Kim Dae-jung pursues his Sunshine Policy, improved relations between Beijing and Pyongyang are bound to help Beijing to assert influence and gain credit with Seoul. Chinese Communist Party leader Dai Bingguo's April visit to Seoul was in line with just

such an effort, as one of his primary purposes was to consult with Seoul over plans for PRC President Jiang Zemin to visit Pyongyang as early as September.

Moreover, China is a useful economic conduit and partner in North Korea's economic rehabilitation under current circumstances, particularly as political considerations in light of South Korea's own economic slowdown make it more difficult for President Kim to fulfill the promise of economic assistance that has been key to progress of his Sunshine Policy with North Korea. It has no doubt been in China's own interest to step up assistance to DPRK National Defense Commission Chairman Kim Jong-il in recent months, particularly following Chairman Kim's visit to Shanghai in January. Liaoning Provincial Governor Bo Xilai's pragmatic hopes that rail and highway connections may run via North Korea between Seoul and Shenyang neatly underscore the complementarity of Beijing's economic and political interests, particularly at a time of tension in the U.S.-PRC relationship. The steady flow of party and state leadership contacts has included Chinese encouragement for Kim's political efforts with North Korea as a constant refrain. South Korean diplomats take some small credit for facilitating communications at a critical point in the U.S.-PRC negotiations following the April 1 emergency landing of a U.S. EP-3 reconnaissance plane on Hainan Island, and the prospect of U.S.-PRC confrontation is distinctly unwelcome to the South Korean government's current focus on inter-Korean reconciliation. The most concrete immediate fallout from such tensions has been the increased trouble for South Korean servers that were inadvertently affected by Chinese and American hacking of Web sites on the opposing side.

Although the logic of complementary Chinese and South Korean government interests in dealing with North Korea is impeccably clear, there are already signs that the level and quality of Sino-South Korean cooperation could become a political issue if there are continued tensions in the U.S.-ROK relationship in the run-up to South Korea's presidential campaign next year. Although the emerging theme of opposition party political criticism may be "Who Lost Washington?" and the real target and terms of debate are likely to be shaped by Kim Dae-jung's efforts to conciliate North Korea, the PRC is also a potential unwitting victim of such a debate to the extent that Beijing is perceived as providing political aid and comfort to Kim rather than simply acting on the basis of its own crass – and entirely politically justifiable – economic interests with South Korea.

Clouds on the Horizon?: North Korean Refugees

One indicator of the powerful coincidence of economic and political interest between Beijing and Seoul has been Beijing's swift dispatch of a North Korean family that sought asylum at the offices of the UN High Commission for Refugees (UNHCR) in Beijing during the last week of June. Following the "Hwang Jang-yop precedent" by which the Chinese government allowed a high-ranking defector to depart for Seoul via a third country in 1997, the Chinese government quickly opted to allow the North Korean family to leave on humanitarian grounds via a third country to Seoul, and the family landed in Seoul within four days of their petition to the UNHCR in Beijing.

At first glance, Beijing's handling of the issue was a brilliant exercise in pragmatic decision-making, given that Beijing's own reputation and good behavior were on the line more than ever less than three weeks prior to the International Olympic Committee's decision regarding who will host the 2008 Olympic Games. However, this incident may be a warning sign of potential political turmoil to come over how the Chinese and South Korean governments have ignored the plight of North Korean refugees in China. This issue could become a lightning rod in South Korean domestic politics, a challenge for Sino-Korean relations, and may even become yet another issue of contention between Beijing and Washington.

To understand the symbolic importance of this issue, it is necessary to recall that the Chinese government repatriated a group of seven North Koreans who had been declared as refugees by the UNHCR in December of 1999, heightening concerns among South Korean NGOs who had been trying to assist North Korean refugees in the China-North Korea border area. Since that time, the Seoul-based Commission to Help North Korean Refugees is one group that has steadily built ties with the United Nations and other prominent activists as a vehicle for strengthening the role of UNHCR in responding to the plight of North Korean refugees by challenging and lobbying the Chinese government on this issue. Such groups have also spent much effort developing an "underground railway," through which North Korean refugees might travel to Ulan Bator or as far away as Guangzhou and Southeast Asia to apply for asylum with the South Korean government. These activists may have also assisted the North Korean family to apply for asylum with the UNHCR office in Beijing, and may be preparing to use this case as a vehicle for launching a more visible public campaign against Chinese refugee policy in the North Korea border region.

Despite growing domestic pressure in South Korea to pay greater attention to these matters, the Kim Dae-jung administration has sought to manage this issue through "quiet diplomacy," presumably including a tacit deal between Beijing and Seoul to simply look the other way while South Korean NGOs do as much as they can to take care of refugees on the border. However, this tacit agreement appears to be unraveling, and some South Korean groups, such as the Join Together Society, that had been active along the border have recently been detained and/or forced to curtail their operations in China because they began to attract too much attention to be ignored by the local authorities. Other factors likely to play into this issue include the enhanced interest among some senior members of the Bush administration and an increased interest among Republican staff members and Congressmen on Capitol Hill. Another factor will be an increasingly fractious debate over such "lightning rod" issues in the run-up to the South Korean presidential election campaign, with the distinct likelihood that there will be a political commitment to a more activist approach on these issues, possibly at the expense of further immediate progress in inter-Korean rapprochement. Despite an extraordinarily sunny outlook for Sino-Korean economic relations, new storm clouds may be gathering on the distant political horizon.

Chronology of China-Korean Relations

April - June 2001

Apr. 9-12, 2001: Dai Bingguo, head of the international liaison department of China's Communist Party, visits Seoul and meets President Kim Dae-jung.

Apr. 14-19, 2001: South Korean Information and Communication Minister Yang Seung-taik visits China as a presidential envoy with prominent South Korean business leaders.

Apr. 20, 2001: Minister Yang meets with Chinese PM Zhu Rongji to discuss ways to boost bilateral cooperation in the CDMA (code-division multiple access) industry in Beijing.

Apr. 24, 2001: ROK Commerce, Industry, and Energy Minister Chang Che-shik and Shi Guangsheng, China's minister of foreign trade and economic cooperation, sign an agreement to establish a joint committee as a standing body to encourage bilateral trade and investment.

Apr. 26, 2001: The Korea Asset Management Corp. becomes special advisor to China Huarong Asset Management Corp. for the first asset-backed securities issuance in China, worth \$150 billion.

Apr. 26, 2001: Samsung wins bidding to build 1.13 million CDMA networks, or 9 percent of the 13.3 million up for bids in the first auction, in four Chinese cities – Shanghai, Tianjin, Fujian, and Hebei – in a joint venture with Shanghai Bell.

May 6, 2001: Cheil Industries announces that it has relocated part of the facilities at its main plant in Kumi, North Kyongsang Province, to its Chinese operation in Tianjin.

May 17, 2001: The Korea Logistics Network Corp. (KL-Net) says that trade between South Korea and China will face less paperwork after an electronic data interchange (EDI) system comes on line this year.

May 21-22, 2001: Financial officials from South Korea and China open two-day talks in Seoul on increasing cooperation in the financial sector.

May 23-27, 2001: Chairman of the Standing Committee of the National People's Congress Li Peng visits Seoul to reaffirm "comprehensive cooperative relations" and to strengthen Sino-Korean economic ties through a visit to LG Electronics, one of the biggest foreign producers of consumer goods in China.

May 24, 2001: South Korean national police issue a warning on the increasing number of computer hacking attacks originating from China in the aftermath of the U.S.-China spy plane incident.

May 25-29, 2001: Kim Joong-kwon, chairman of the ruling Millennium Democratic Party (MDP), visits China at the invitation of the CCP to discuss inter-Korean rapprochement and cooperation, East Asian peace, and the recent Japanese textbook issue.

May 26, 2001: South Korean FM Han Seung-soo hints at allowing the Dalai Lama to visit during a meeting with his Chinese counterpart in Beijing.

June 8, 2001: Seoul puts in place emergency import curbs against Chinese garlic until the end of 2002 to protect Korean growers. The Trade Commission also decides to finance the cost of exhausting the import quota for Chinese garlic when private companies do not completely use up the quota during 2001 and 2002.

June 18-22, 2001: ROK PM Lee Han-dong visits China to discuss strengthening economic ties and new developments in inter-Korean relations.

June 19, 2001: Bo Xilai, governor of Liaoning Province, announces during an investment fair in Seoul that his government is now building expressways linking Dandong, located across from North Korea's Shineuiju City, with the provincial capital of Shenyang and Dailian, respectively.

June 24, 2001: Korean telecom equipment companies participating in a road show in China net contracts worth \$51.6 million, according to the ROK Ministry of Information and Communication.

June 30, 2001: The South Korean government welcomes to Seoul seven North Korean defectors who had sought asylum at the UNHCR office in Beijing.

June 30, 2001: A fishery agreement signed in April between South Korea and China comes into force. The four-year agreement allows South Korea to send 1,402 fishing boats into the Chinese EEZ for a quota of 90,000 tons of fish, while 2,796 Chinese fishing boats are allowed to operate in South Korea's EEZ for a catch of 164,400 tons.