

**China-Korea Relations:
Beijing in the Driver's Seat?
China's Rising Influence on the Two Koreas**

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The last quarter of 2002 closed with a rush by Korean automobile manufacturers to invest in the People's Republic of China as a strategy for capturing market share in a country projected to emerge as the world's largest automobile market within two decades. China's economic emergence has become a primary driver for Korea's own economic reforms and strategy as China is increasingly both a source of growth and a stiff competitor, eroding Korean market share in third country markets and some key manufacturing sectors.

By placing North Korea's designated director of a newly established Sinuiju economic zone under arrest, Beijing also made clear that it could put the brakes on North Korea's economic reforms absent prior consultation by North Korea's leadership with Beijing. Likewise, China's economic leverage and potential influence on the response to North Korea's nuclear weapons production efforts became a potentially decisive focal point in shaping the contours of a strategy on which the Bush administration and South Korea's President-elect Roh Moo-hyun have clearly stated differences.

Although top-level consultations between China and South Korea continued this quarter through the Asia-Pacific Economic Cooperation (APEC) forum, ASEAN Plus Three, and bilateral exchanges, it remains to be seen how newly selected leadership in Beijing and Seoul will position itself to manage a maturing and complex China-Korea diplomatic relationship – a relationship that may play an increasingly critical role as part of a likely re-ordering of regional ties in the future.

Pushing for Market Share in China's Automobile Sector and Beyond

Several Korean automotive companies announced plans to build or open factories in China this quarter, signaling a Korean desire to invest in local production to take advantage of lower costs of Chinese labor and to position Korean brands for market share in China's rapidly expanding domestic automobile market. Ssangyong announced negotiations of a 50-50 joint venture with the Jianglin Motor Company to produce sport utility vehicles and large luxury cars. Daewoo Commercial and Baotou North-Benz Heavy-Duty Truck Co., based in Inner Mongolia, signed an agreement on joint truck manufacturing in November. Hyundai Motor's joint venture launched sales of its locally

produced EF Sonata on Dec. 23, with plans to sell over 80,000 cars in 2003 and to expand its production capacity to 500,000 units by 2010 through investments of over \$1.1 billion. Kia Motors has also launched sales of the “Qianlima” in a joint venture with Dongfeng Yueda Kia Motors and aims to sell 50,000 units next year.

Korean investments in China’s manufacturing sector, both in automobiles and more broadly, are consistent with China’s development as a global manufacturing hub on the basis of its labor cost advantage. China is the world’s leading destination for foreign direct investment (FDI). In addition to plant investments in the automobile sector, Korean companies are pouring investment into China in a wide array of sectors including textiles, information technology and telecommunications equipment, machinery components and equipment manufacturing, and chemical/petroleum. Surprisingly, Korean small- and medium-size enterprises are leading the Korean FDI charge in China, primarily focusing on northeastern China, including Shandong province, Tianjin, Liaoning, and Jiangsu provinces, and Shanghai. 2001, the Export-Import Bank of Korea reports that actual Korean FDI to China reached \$466 million in China in 990 different projects, a 50 percent increase over the previous year and marked a partial recovery toward pre-financial crisis levels of Korean investment in China that had peaked in 1996 at over \$835 million. The Korea Trade-Investment Promotion Agency reported that contracted investment in China in the first eight months of this year was the equivalent of the entire amount of contracted investment in 2001, totaling almost \$1 billion.

China surpassed the United States as the primary destination for Korean investment this year. In addition, “greater China” (including Hong Kong) has now surpassed the United States as Korea’s number one trade partner in the first nine months of 2002, according to the Bank of Korea. Greater China and the United States are each receiving around 20 percent of South Korea’s total exports. Sino-Korean bilateral trade in 2001 reached \$31.5 billion, driven primarily by China’s increasing demands for Korean products in the electronics, computer, semiconductor, and telecommunication sectors. In the first nine months of 2002, the Korea Trade Promotion Agency reports bilateral trade with China has reached over \$28.635 billion, a 20+ percent increase from 2001. Final figures for 2002 are likely to show China-ROK bilateral trade at around \$38 billion.

A survey among major Korean conglomerates shows that 43 percent now believe that the technology gap between Korea and China in major industrial fields has been reduced to about four to five years, while 27 percent of Korean firms believe that the gap is only one to three years, and 10 percent of respondents believe that there is no difference in technological levels between the two countries. Most of the firms polled are planning to expand operations, mostly through foreign direct investment. This dovetails nicely with the results of a Korea Industrial Technology Foundation survey of over 1,000 Chinese businesses and research institutes, which revealed strong interest among Chinese firms in Korean capital and technology investments. The South Korean Ministry of Commerce, Industry, and Energy is projecting that Korea’s technological advantages in the automobiles, semiconductors, and shipbuilding will be “greatly reduced” by 2010. One example of the impact of China’s export boom on Korea’s competitiveness in third country markets: South Korea’s share of the U.S. market appears to have “peaked” at

3.31 percent in the year 2000, while China's market share in the U.S. continued to grow from 8.22 percent in the year 2000 to over 10 percent in 2002. A similar pattern has developed in the respective shares of South Korea and China with Japan. Increased Korean investment in China's manufacturing sector reflects a strategy designed to take advantage of heightened efficiencies in market integration between the two countries.

Applying the Brakes to North Korea's Sinuiju Plans

Like a passing tornado that was highly visible yet left no discernible mark on the landscape, Chinese-born Dutch national entrepreneur Yang Bin and his Euro-Asia Agricultural Company took center stage for about two weeks at the end of September as the key figure in a dramatic, failed bid to launch North Korean economic reforms. Yang, a well-heeled flower importer and developer of a Shenyang theme park who had been honored by *Fortune* magazine as one of China's 10 richest businessmen, announced that he had been appointed as the designated director for a planned Sinuiju Special Administrative Region, located on the North Korea-China border and touted as a major step by North Korea to open up its economy to international investment. With press fanfare and special arrangements for leading business journalists to fly from Hong Kong to Pyongyang on Yang Bin's private jet, promises were made and assurances given that Yang Bin had been given the only set of keys to the zone and that there would be no interference and only ("single-hearted"?) support from the leadership in Pyongyang. Indeed, the legal infrastructure for the zone was so well-developed, according to the experts, that the results of a joint research project on how to reform North Korea's economy led by a consortium of Korean government think tanks were reportedly delayed. The reason was that the legal infrastructure for the Sinuiju Special Administrative Region was well ahead of what South Korean specialists had been prepared to recommend.

Despite the hard work of North Korean technocrats and law drafters to provide a legal framework for the Sinuiju Special Administrative Region, the political leadership hijacked the project, as Kim Jong-il chose an individual known for his ability to deliver favors to North Korea in recent years and who Kim is reported to have come to look on as his own son. The major problems were that Yang Bin's meteoric business rise apparently had come through questionable business activities, alleged tax evasion, and relationships with known criminal elements in China. Regardless of which of Yang's qualities or background connections might have been most impressive to the Dear Leader, Yang's rising profile drew the attention of Chinese authorities, who proved to be distinctly unenthusiastic about and unimpressed by Yang's new role and responsibilities.

Having made promises to the international media at the Pyongyang unveiling of his new role as the new "governor-general" of Sinuiju, Yang found his new mini-kingdom falling apart like a house of cards. First, Yang's promises of visa-free travel for South Korean and other foreign journalists to view the Sinuiju Special Administrative Region met with resistance from local North Korean authorities, who failed to provide entry permits despite Yang's assurances. Yang's keys could not unlock the doors to the city of Sinuiju, nor were his abortive efforts able to attract a cent of foreign capital. As Yang was preparing to launch the next stage of his publicity blitz through a planned visit to South

Korea in early October, Chinese authorities detained him and placed him under house arrest under suspicion of tax evasion, where he has remained ever since.

There are plenty of rumors regarding Chinese motives for shutting down Yang's ambitions as the "sovereign" mayor of Sinuiju Special Administrative Region, aside from the fact that outside lists of China's richest tycoons appear to be an excellent way of drawing special attention from Chinese tax authorities. Indeed, China had publicly and privately supported North Korean reforms, so why pull the plug just when Pyongyang appeared to finally be taking Beijing's advice? One popular theory is that China was upset that the North had moved forward with major plans for Sinuiju without informing Beijing of the plans or consulting on their implementation. Such a theory gives credence to views that relations between Beijing and Pyongyang have deteriorated markedly following Jiang Zemin's September 2001 visit to Pyongyang, as Kim Jong-il has evidently focused his primary time and attention on wooing Russian President Vladimir Putin at the expense of relations with Beijing.

Another theory is that Beijing's leaders were in fact in opposition to the Sinuiju Special Administrative Region as a potential drain on South Korean investment in northeastern China. This reported opposition may have been fed by plans on the drawing board in Dandong, the Chinese city opposite Sinuiju, to woo South Korean capital investment to the Chinese side of the border as a springboard for supporting economic opening in North Korea. Another possible motive for Chinese opposition may have derived from concerns that with Yang Bin in charge of the project, Sinuiju would have been likely to attract illegitimate capital as a convenient offshore base for corrupt activities throughout China's northeast and a haven for any of Yang's friends who might be able to run illicit networks with impunity from Sinuiju, where they would be beyond the reach of China's sovereign jurisdiction. Given the North's economic track record and some of its "specialized exports" in the areas of counterfeiting and drug trafficking, it is not hard to imagine that, under the wrong management, Sinuiju might be likely to have more in common with pre-handover Macao than Shenzhen.

The Yang Bin episode and the announcement of the Sinuiju Special Administrative Region provided an apparently contradictory prelude to North Korea's forced admission that it had been pursuing a program to produce highly enriched uranium, having procured centrifuges from Pakistan and possibly other equipment from the People's Republic of China. Although China has not been tied directly to the North Korean program, China's past proliferation of missile technologies to Pakistan indirectly implicates Beijing as a potential source of North Korean proliferation activities as well. Despite China's firm commitment to nonproliferation on the Korean Peninsula as an objective squarely within its national interests, there have been inconsistencies in the implementation of policies designed to assure those objectives.

In addition, the tension between China's need for a strategic buffer on the one hand and the need for a peaceful and stable environment conducive to China's economic development on the other is clearly coming into relief as North Korea breaks out of its commitments to the 1994 Geneva Agreed Framework and the Nuclear Non-Proliferation

Treaty (NPT). Apparent divisions between South Korea and the United States on the proper course of action for managing North Korea's nuclear weapons development activities are another factor that complicates China's response (and gives China decisive influence on the future course of international policy toward North Korea's nuclear development efforts), as is the legitimate question – raised by the Yang Bin incident – of exactly which levers China can effectively use to influence North Korean behavior, given the apparent limits of North Korea's attention to Beijing's perspectives and concerns. On the other hand, who has more potential leverage to bring North Korea in line – in ways that could dramatically expand China's regional influence and “space,” if indeed a U.S. troop presence in South Korea proves unsustainable – than Beijing? Chinese policy makers will address these questions in future quarters.

Tuning up the Relationship under New Leadership

Both Beijing and Seoul have selected new leadership in the final quarter of 2002, both of which will take the helm in 2003. The next generation of leadership in Seoul and Beijing is likely to find enticing the economic foundations that have been laid by their predecessors and will be most eager to build upon them. A major question is whether that economic influence is now so important that it will also open up opportunities in the political and security spheres that may support or catalyze a fundamental restructuring of the regional security order in Northeast Asia. The handling of North Korea's manifest strengths and weaknesses will be one lens through which the relationship between Beijing and Seoul will continue to develop.

South Korean President-elect Roh Moo-hyun has been eager to support regional economic development and integration in Northeast Asia as a foundation and buffer through which political/security conflicts may be avoided. Such economic interactions are an investment in good neighborly relations that President-elect Roh perceives as an attractive way of guaranteeing South Korea's security and prosperity. One interesting question is how Roh's past training as a labor and human rights lawyer will influence his handling of criminal justice or human rights issues as they relate to China and to the management of North Korean refugee issues that have become focal points earlier in the year (see “Clash, Crash, and Cash: Core Realities in the Sino-Korean Relationship,” *Comparative Connections*, Vol. 4, No. 2, July 2002). For instance, the South Korean government has recently given several deportation warnings to Xu Bo, a Chinese democracy activist during Tiananmen, prompting protest letters to the South Korean government from leading Chinese democracy activist Wei Jingsheng in support of Xu's case. Another interesting issue will be whether Roh, a Buddhist, will continue the South Korean government's unwillingness to issue a visa to the Dalai Lama, in opposition to efforts by groups such as Buddhist's Solidarity for Reform to invite the Dalai Lama to visit South Korea for the first time. Thus far, Roh's overall emphasis as it relates to foreign affairs has been that he plans to follow the diplomatic path set by his predecessor, President Kim Dae-jung, a path which is generally favorable to continued expansion of the China-South Korea relationship.

The Chinese leadership view of South Korea is also likely to focus on continuity. Many of China's fourth generation leadership have been to Korea on extended visits and South Korea remains a fascinating model – with both positive and negative lessons to be drawn upon and applied – for China's own development and political liberalization. Given the size of China's own bad debt problem in the banking sector, the Korean Asset Management Company may see attractive opportunities to work with Chinese counterparts now and in the future. It will take time to see how the adjustments of the fourth generation leadership and the vibrancy of political reforms being pursued in the context of Roh Moo-hyun's election in Korea, as well as the broader political and economic adjustments underway in the region, will influence the next stage in the development of the China-South Korea relations.

Chronology of China-Korea Relations October-December 2002

Oct. 3, 2002: South Korea arrests 162 people on charges of smuggling Chinese-made narcotics into Korea and selling them to domestic drug users in the country's biggest-ever drug bust.

Oct. 4, 2002: The South Korean Ministry of Commerce, Industry, and Energy announces that the Korea Industrial Complex Corp. (KICC) signed an agreement with Dandong City to build an industrial complex by 2003 exclusively for Korean manufacturing companies.

Oct. 4, 2002: Yang Bin, chosen by North Korea (DPRK) to administer North Korea's special administrative region, is detained by Chinese authorities on suspicion of tax evasion.

Oct. 8, 2002: In a protest letter to the presidential office of Cheong Wa Dae, Chinese democracy activist Wei Jingsheng expresses regret over the ROK Justice Ministry's alleged threat that Xu Bo would face deportation unless he stops actively promoting democracy in China.

Oct. 10, 2002: A North Korean delegation holds discussions with Chinese counterparts in Beijing regarding the fate of Sinuiju Special Administrative Region head Yang Bin.

Oct. 12, 2002: Twenty North Korean refugees who had sought refuge in the South Korean consulate in Beijing since mid-September arrive in Seoul.

Oct. 29, 2002: The Cabinet approves a regulation allowing ethnic Koreans from China to work in service industries, under F-1 visas for "visiting and joining families," even if they have no kin in Korea. The visa will allow ethnic Koreans from China to stay for up to two years, with unlimited extensions.

Nov. 2, 2002: Korea and China reach an accord on the fishing quota for 2003, giving Korean vessels an extension of the same 60,000 ton limit inside China's exclusive economic zone (EEZ) while the quota for Chinese vessels fishing in the Korean EEZ is reduced from 109,600 tons to 93,000 in 2003.

Nov. 13, 2002: The South Korean prosecutor's office announces that it is tracing the assets of two former consular officials stationed in China after they had been indicted along with other government employees and brokers in a bribes-for-visas scandal.

Nov. 20, 2002: China imposes punitive duties against five categories of Korean steel products, including hot-rolled plates, cold-rolled plates, color plates, electric plates, and stainless cold-rolled sheets through May 23, 2005.

Nov. 25, 2002: Shinsegae Co. establishes a joint venture with Shanghai Join Bui Co. to open the Shanghai E-mart Super Center Company, a discount consumer goods chain of stores. On the same day, Ahnlab Inc. (www.ahnlab.com), a leading computer virus vaccine developer in Korea, announces a contract valued at \$2.38 million with SUNV, a Chinese software provider, to export anti-virus engine and vaccine software programs.

Dec. 4, 2002: A fishing vessel carrying 55 ethnic Koreans and other people from China is caught by maritime police off the western coast while attempting to smuggle migrants into the country. On the same day, Seoul's Guro Police Station arrests eight ethnic Koreans from China for blackmailing and assaulting fellow Korean Chinese in the Seoul metropolitan area.

Dec. 5, 2002: Police in South Gyeongsang Province, South Korea said yesterday they broke up a 20-member human smuggling ring suspected of sneaking Chinese and ethnic Koreans from China into the country.

Dec. 12, 2002: Representatives from Korea, Japan, and China gather in Tokyo to discuss details of the proposed professional soccer championships involving the three Northeast Asian countries.

Dec. 17, 2002: ROK Ministry of Construction and Transportation announces that Korean Air will resume direct flights to Taipei after a decade following the rupture of diplomatic relations with Taipei.

Dec. 19, 2002: Roh Moo-hyun elected next president of the Republic of Korea.

Dec. 23, 2002: Hyundai Motors China and Beijing Automotive Holding Company Limited launch sales of the EF Sonata in China, with expectations to sell over 80,000 units in 2003.

