

China-Korea Relations:

Mr. Kim Goes to Beijing . . . and More Six-Party Talks

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The wheels of dialogue continue to spin between China and the Korean Peninsula, thanks to Beijing's generous quarterly hospitality to participants in the six-party talks. China's efforts kindly assure that we at *Comparative Connections* always have something to write. The talks occurred on schedule following assurances of North Korea's top leader himself during his visit to Beijing that the talks could be a desirable vehicle for addressing the dispute over North Korea's nuclear weapons program. Kim Jong-il's third visit in four years to Beijing breathed new life into the dialogue (combined with his consultations with Prime Minister Koizumi Junichiro in Pyongyang) and provided at least some impetus for another round of talks – and an actual U.S. proposal to settle the crisis – during the last week in June. Beijing's shuttle diplomacy with Pyongyang and Washington has yielded enough progress to say that diplomacy has not failed yet. Meanwhile, the protracted nuclear crisis remains the primary focal point of China's diplomacy toward the Korean Peninsula.

Aside from six-party talks, the stellar growth of the China-South Korean economic relationship has slowed as Beijing tries to rein in its own economy, inducing the first “China shock” in the Korean equity market and underscoring Korea's dependence on exports to China as the primary driver for the country's current economic growth. The usual negative aspects of the relationship – refugees, spoiled food imports, cross-Strait tensions – were also on display this quarter. There are an increasing number of regional economic and other consultations between China, Japan, and South Korea in various forums – from the Asian Development Bank, to energy security cooperation, to a gathering of foreign ministers. These contacts – quite aside from South Korea's own vision of itself as a regional hub in Northeast Asia – suggest potentially significant changes are in the works that may open up new forms of regional cooperation in Northeast Asia.

Beijing's Five-Star Hospitality

Any international visit by Kim Jong-il draws great curiosity from North Korea watchers. This visit drew particular interest, coming as it did in the midst of the protracted North Korean nuclear crisis. Coincidentally, Kim's visit to Beijing followed that of U.S. Vice President Dick Cheney by a week, adding to prospects that Kim could receive a clear understanding of U.S. intentions and level of commitment to resolving the North Korean nuclear issue. Despite the usual secrecy surrounding the visit, it has become increasingly

difficult for Beijing to keep the wraps on such visits; Kim was filmed in Beijing from a distance by South Korean TV cameras and the government officially announced the visit as soon as Kim left Beijing. In fact, the biggest surprise of the visit came on the day of Kim's return to Pyongyang in the form of a major explosion at the town of Ryongchon on the train route to Pyongyang, a humanitarian disaster that occasioned a flood of international humanitarian aid – and a flood of thus far unsubstantiated speculation as to whether the blast was accidental or intended for Kim Jong-il.

Kim's visit to Beijing provided his Chinese hosts with another opportunity to affirm their commitment as host of the six-party talks to the objective of maintaining a nuclear-free Korean Peninsula. There was no official announcement of additional aid from the PRC to the DPRK during this meeting, but Kim Jong-il's attention to official relations with the PRC over the past year shows that he is well aware of the DPRK's dependence on China's largesse for the survival and prosperity of his regime.

In meetings with PRC President Hu Jintao and other top Chinese leaders, Kim affirmed that he has strong interest and confidence in the six-party process as a mechanism for resolving the crisis and considers settlement of the nuclear issue as a high priority, pushing a "freeze for compensation" formula as the basis for further discussions. Although this formula falls far short of U.S. demands, it provided new momentum to the six-party talks. Kim maintained that he wants to have contacts with the U.S. side in order to reach a mutually satisfactory understanding, but that he still has concerns about the lack of mutual trust in the U.S.-DPRK relationship.

In combination with Kim's May meeting in Pyongyang with Japan's Prime Minister Koizumi (see "Engagement from Strength," Victor Cha's chapter on Japan-Korea relations in this issue), Kim Jong-il's talks in Beijing provided concrete data points for directly assessing Kim's intentions. One result of these data points is that it influenced the U.S. to provide a more concrete offer to North Korea as part of the third round of six-party talks held at the end of June. The U.S. presented a seven-page, three-stage offer to North Korea detailing some benefits that North Korea could expect from its good behavior. The process would begin with a three-month period during which North Korea would freeze its nuclear program and allow IAEA inspectors to return to the country, followed by provision of conventional energy assistance to North Korea, the removal of North Korea from the terrorist list, and other steps toward improved relations, ending with the "comprehensive dismantlement" of North Korea's nuclear weapons program. While making demands for energy supplies sufficient to fuel 2 million KW of energy production in North Korea, Pyongyang cooled its rhetorical blasts toward the U.S. and took the offer back to Pyongyang for further study. The term "CVID" was nowhere in evidence at this round, but U.S. expectations regarding the scope of dismantlement and accompanying verification measures remain "comprehensive."

No deal will go forward without Kim Jong-il's personal involvement behind the scenes, but the Bush administration abhors the prospect of direct contact with North Korea's key decision maker. Thus, the practical effect on the six-party talks is that progress can only be made to the extent that other parties find ways to secure Kim Jong-il's cooperation

behind the scenes. In the absence of a channel for direct contact with Kim, either Beijing enhances its leverage on Kim sufficiently to bring him completely under control and serves as a U.S. proxy to lay down the law on North Korea's nuclear weapons development (a potential tangible demonstration of a new level of trust between Washington and Beijing), or it will be necessary to hear Kim's thinking indirectly through multiple channels. Kim's meeting with Koizumi was useful in this regard, but he will need to step up his diplomacy with other countries if progress is to be made toward easing the North Korean nuclear crisis.

Conversations held with Kim in Beijing have resulted in a slightly revised Chinese assessment of North Korea's commitment to economic reforms. Close observers in Beijing now believe that Kim Jong-il has accepted the necessity of economic opening, including allowing some Chinese-style economic reforms to move forward. However, there is also awareness that the direct applicability of the Chinese reform model may have limited applicability to a smaller country like North Korea. Nonetheless, Kim's apparent acceptance of expanded marketization, including the establishment of scores of new markets even in Pyongyang, is regarded by some in Beijing as a turning point in North Korea's economic development. Kim appears to be seeking a model that would mix elements of a market economy with facets of North Korea's planned economy and is interested in pursuing economic reforms, starting with agriculture. Kim Jong-il's personal recognition of the positive effects of PRC reform and opening up are taken in Beijing as a sign that Kim is listening and interested in focusing on economic reform and that such reforms require a more positive relationship with other countries such as the U.S. and Japan, further necessitating the resolution of the nuclear crisis.

During the past year, Beijing has pursued an enhanced diplomatic role vis-à-vis North Korea as part of its mediation and hosting role for six-party talks. Beijing has mobilized its long-standing party-to-party and military ties with North Korea to assure regular direct contact with Kim Jong-il and the Chinese leadership through mutual visits in Beijing and Pyongyang, thereby enhancing China's influence in Pyongyang. Analysts in Beijing hope that a strengthened fraternal relationship at the party and military level may yield success in the six-party talks, but such ties may also be instrumental in assuring that China has sufficient understanding and influence to manage its relationship with North Korea even if the six-party talks fail. These ties also enhance China's ability to make its views known to North Korean counterparts through a wide variety of channels rather than depending only on strong personal ties with Kim Jong-il.

China Shock in the Korean Market

China's rapid growth has been a shot in the arm for Korean exports, which in recent months have grown by over 30 percent per year and are nearing all-time highs. However, Chinese concerns about economic overheating, and the announcement in Beijing of measures to curb China's economic growth in late April, had an immediate impact on the Korean equity market. The Korea Composite Stock Price Index (KOSPI) dropped by 8.4 percent during the week following China's announcement of "forceful measures" to rein in its economy as overseas investors sold over \$600 million in Korean stocks. The pace

of growth of Korean exports to China has dropped since the announcement from a 40-50 percent range to only around 20-25 percent year-on-year, with the steel, automobile, and petrochemical sectors facing the biggest losses. Restrictions on business loans imposed by the Chinese government in April are having an immediate impact on sales of such Korean export items as industrial equipment and automobiles. The pressing of the economic brakes in Beijing has served to underscore two key points in Korea: 1) while China's economic growth has been a major economic opportunity in South Korea, the South Korean economy is now more dependent on China's economic growth than ever before, and 2) in the absence of a recovery of domestic consumption, exports to China continue to be responsible for virtually all of Korea's growth in GDP.

Some interesting strategic developments in the automobile sector have occurred this quarter, all of which are focused on how best to enter the China market. On the one hand, DaimlerChrysler has decided to end its financial relationship as a significant stakeholder in Hyundai, preferring instead to invest directly in the manufacture of a Mercedes-Benz plant in China. Hyundai itself has already entered the China market in a big way, with expectations that its 50,000 annual unit production rate could increase to 150,000 by next year. However, the "China shock" has tempered these expectations as the steady growth of Hyundai's sales in China has temporarily gone flat this quarter due to new restrictions on personal loans for automobiles that have been imposed by the Chinese government. An alternative angle on the Chinese consumer market is being pursued by GM-Daewoo, which has found good success in producing knockdown units in Korea for assembly in China. Last year, GM-Daewoo exported over 46,000 knockdown units and has already attained the same level of exports in only five months this year, a good illustration of how China's demand continues to outstrip supply even despite the considerable investment in industrial production taking place there.

Longer-term Korean investments in China are continuing in industrial plant and factory production, but are now extending to the retail sector with the entry and expansion of E-mart, a low-cost competitor to Costco, Walmart, and Carrefours in Korea that has already opened one store in Shanghai. E-mart's expansion plans include 50 new stores by 2012, and there are desires to dramatically increase the ratio of Chinese goods available in E-mart stores. This expansion may indirectly help sustain Korean inroads with Chinese customers in the areas of cosmetics and pop culture, where substantial gains have also been made in the information technology sector as Korean online game products have captured over half the Chinese gaming market.

Refugees, Spoiled Food, Cross-Strait Headaches: More of the Same

This quarter saw the return of many of the negative issues in China-South Korean relations, including a warning to Korean football fans in May not to attend matches in China in view of violence by Chinese fans and Chinese failures to protect visiting fans. Most of these issues are still overshadowed by a focus on the China-South Korean economic relationship, but they also complete the public picture of China, adding a note of caution to an otherwise positive image.

First, China continues its dual-track policy on handling North Korean refugees, quietly transferring those refugees who successfully enter South Korean consulates or other diplomatic compounds to South Korea, while ruthlessly enforcing border controls and repatriation policies for refugees who are caught in the border areas, away from the public spotlight. In one case this quarter, Chinese border authorities are alleged to have shot and killed a North Korean refugee seeking to cross the Chinese border with Mongolia. There have been reports of hunger strikes by North Korean refugees awaiting repatriation in Chinese detention facilities on the border with North Korea. North Korean refugees once again entered the premises of a German school in Beijing seeking asylum, but this time some refugees were armed with knives as they approached Chinese guards, forcibly securing entrance to the compound. These new twists, along with continuing reports of North Korean refugee treks across China to seek refuge at Korean consulates in Southeast Asia and Indochina, demonstrate the continuing high risks that North Korean refugees are willing to take to avoid being returned to North Korea. China continues to deny the United Nations High Commissioner for Refugees (UNHCR) access to border areas or suspected North Korean refugees and to violate the UN international conventions on refugees that it has signed by allowing *refoulement*, the return of refugees to North Korea despite risks of persecution or death in North Korean detention camps.

Second, a new series of stories involving tainted food products from China have hit the Korean public, as some Korean dumpling manufacturers have been found using bad radishes from China. Increasingly, even Korean kimchi is made in China to lower costs, putting the Korean public at greater risk from poor Chinese food safety standards. The scandal led to the suicide of the CEO of one Korean company and evoked strong criticism among the Korean public. Stories of fake baby formula and other shocking failures by Chinese food manufacturers within China have also received significant play on Korean news broadcasts. There are continuing problems with imports to Korea of Chinese fish products laced with lead or other metal products to increase the weight – and value – of the shipments.

Third, Chinese officials have taken very strong measures against South Korean national assemblymen and other figures who traveled to Taipei for the May 20 inauguration of President Chen Shui-bian, announcing that they would be denied entry into the PRC. These measures have extended to include former President Kim Young-sam, and the application of this restriction to a former president has created consternation and some negative feelings among the South Korean public. PRC expectations for South Korea's adherence to limits on official contact with Taiwan are stricter than with many other countries, including Japan and the U.S., giving the impression that Beijing's expectation is for South Korea to return in its diplomacy with Beijing to a more traditional tributary relationship.

'Experts Discuss Power Sharing in Northeast Asia'

Indeed. *The Korea Herald* headline above draws attention to one among many new forms of regional cooperation that accompany intensified economic exchange in the region. In this case, "power sharing" is being discussed at a symposium on "Northeast Asian

Region Electrical System Ties,” designed to promote sharing of electricity and connection of power grids across national lines. The development of shared power grids would improve electricity access from Russia. The symposium even involved the rare participation of a North Korean representative in Seoul, who revealed that Russia and North Korea have already started to build a “power sharing system.” The Federation of Korean Industries has also proposed joint purchasing of oil with China as a means of enhancing leverage in negotiations with energy producing countries, and such cooperation has also been discussed through a meeting of energy ministers sponsored through the ASEAN Plus Three.

Aside from power sharing, new forms of regional cooperation including China, South Korea, and Japan are gaining impressive new momentum. The foreign ministers of Japan, China, and South Korea met in Qingdao for discussions in late June. At the Asian Development Bank meetings held in Jeju, South Korea, ASEAN Plus Three finance ministers met to discuss regional financing arrangements, including the progress of bilateral swap agreements (the Chang Mai Initiative) and the Asian Bond Market Initiative. The Northeast Asia Development Financing Council was also formed among the development banks from China, Japan, and South Korea. Government authorities from the three countries have agreed to cooperate to develop open source computer operating systems such as Linux. Korea Trade-Investment Promotion Agency has suggested the eventual adoption of a unified visa system for Japan, China, and Korea, similar to that adopted in Europe. The ROK Ministry of Information and Communications has even taken the lead in discussing standards for “home networking technologies” so that consumer electronics might be built to the same standards. If all these developments actually come to fruition, political power sharing may also be just around the corner.

Chronology of Events in China-Korea Relations April-June 2004

April 3, 2004: ROK Ministry of Information and Communications announces an agreement with Chinese and Japanese counterparts to work together to promote the development of open-source computer operating systems such as Linux.

April 6, 2004: The ROK Ministry of Foreign Affairs and Trade announces that China has promised to simplify handling of North Korean defectors and South Korean POWs who want to come to South Korea.

April 6, 2004: Samsung Electronics Company announces that it has moved all domestic microwave oven production facilities overseas, due to price competition from China.

April 8, 2004: The Korea Cosmetic Industry Association announces 31.5 percent growth in exports to China to over \$17 million, to make China Korea’s largest overseas export market in cosmetic products.

April 9, 2004: Internet game portal group NHN Corp. (ROK) and SeaRainbow Holding Corp. (PRC) sign a cooperative agreement whereby NHN would invest \$100 million to develop new game content for the global market, targeting China's over 80 million online subscribers.

April 19-21, 2004: DPRK Chairman Kim Jong-il makes unannounced visit to Beijing to discuss the nuclear issue and other matters with PRC President Hu Jintao and other Chinese leaders.

April 24, 2004: Sinochem Corporation, China's largest petrochemicals trader, selected as the preferred bidder for bankrupt Incheon Oil Refinery Company on a \$561 million offer to acquire the Korean oil refiner.

April 30, 2004: The Korea Composite Stock Price Index (KOSPI) falls 5.75 percent in response to "China shock," a PRC government announcement that it will take "forceful" measures to rein in excessive economic growth. ROK acting President Goh Kun convenes a meeting to monitor and prepare for other possible adverse measures connected with China's economic slowdown.

May 3, 2004: DaimlerChrysler AG decides to sell its \$940 million stake in Hyundai Motor Company and to open production of Mercedes-Benz luxury cars in the PRC.

May 4, 2004: Korean Football Association warns fans not to attend matches in China following incident in which "Red Devils" supporters were injured by debris thrown by Chinese fans.

May 12, 2004: ROK and PRC begin bilateral negotiations on South Korea's opening of its rice market as required under the WTO's Uruguay Round.

May 12-15, 2004: First round of working-level consultations for six-party talks held in Beijing.

May 15, 2004: Korean, Japanese, and China development banks sign a memorandum of understanding to establish a cooperative body to finance infrastructure projects in Northeast Asia.

May 15, 2004: Finance ministers of Japan, China, and South Korea meet on the sidelines of the Asian Development Bank meeting in Seoul to discuss enhanced regional financial cooperation measures, including establishment of currency swaps.

May 18, 2004: The International Symposium on Northeast Asian Region Electrical System Ties is held to discuss ways of connecting the power grids of six countries in Northeast Asia.

May 28-29, 2004: The Annual Congress of Korean History Societies discusses “historical disputes in an era of globalization,” featuring the confrontation between China and Korea over historical origins of the Goguryeo Kingdom (34 B.C.-A.D. 668).

June 7, 2004: Korea Trade and Investment Promotion Agency announces that mergers and acquisitions are emerging as a preferred vehicle for entering into the China market.

June 11, 2004: Korea Food and Drug Administration reveals that Chinese subcontracting factories for Korean dumpling manufacturers provided spoiled chopped radishes to Korean “*mandu*” manufacturers, creating a public uproar and backlash.

June 17, 2004: Sinsegae Co. unveils its plan to open 50 E-mart stores by 2012. One store has already opened in Shanghai, with a second planned to open next month.

June 17, 2004: ROK Ministry of Foreign Affairs and Trade reveals that seven North Korean defectors detained in PRC jails who had initiated a hunger strike were deported to the DPRK.

June 18, 2004: PRC, Japan, and Korea reach agreement to jointly develop home networking technology, promoting standards for interoperability among home-electronic devices, according to the South Korean Ministry of Information and Communication.

June 21-22, 2004: Second round of working-level consultations for six-party talks is held in Beijing.

June 23-26, 2004: Third round of six-party talks is held in Beijing.