

**China-Korea Relations:
Happy Tenth for PRC-ROK Relations!
Celebrate While You Can, Because Tough Times are Ahead**

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The People's Republic of China (PRC) and Republic of Korea (ROK) celebrated a decade of normal relations on Aug. 24, with mutual commemorative events and academic workshops to mark the event. There is much to celebrate. With a bilateral trade relationship that has grown from \$3 billion in 1991 to over \$30 billion per year in 2001 and social, cultural, and political ties that have grown robustly in only a decade, this burgeoning relationship is dramatic evidence of how the end of the Cold War has allowed the development of new relationships in Northeast Asia. China has become South Korea's largest destination for foreign investment and for outward-bound South Korean tourists and has surpassed Japan as South Korea's number-two trading partner. The "Korean wave" in China marks South Korea's capacity to make a notable contribution to China's consumer culture and South Korea remains a model – and benchmark – for managing China's own economic development and political liberalization process.

However, the gathering dark clouds posed by the North Korean refugee issue, illegal drug imports, migrant workers, "yellow dust," and occasional squalls driven by China's direct challenge to Korea's global economic competitiveness are now being directly felt. It is time to post a warning to South Korea of impending damage from a Chinese economic typhoon that could be at least as unsettling to the economic and political landscape in Northeast Asia as Typhoon Rusa, the worst typhoon to hit the Korean Peninsula in four decades, leaving considerable damage in its wake.

Celebrating a Decade of Remarkable Economic Growth

Mutual economic opportunity and complementarity between a newly industrialized economy (South Korea) and a developing economy (China) have catalyzed a relationship that has grown at a double-digit pace over the past decade. Chinese leaders and technocrats have carefully studied South Korea's development experience through site visits to automobile, shipbuilding, and steel-making factories – sectors in which South Korea has established itself as a global leader. Even the financial crisis and South Korea's response have created opportunities both for learning and for new exchanges, such as the recently-announced cooperation between the Korean Asset Management Company (KAMCO), created to dispose of bad loans in the aftermath of the financial crisis, and the China Construction Bank.

When Korean businessmen seek economic opportunities in China, they must have a feeling of *déjà vu*. The bustling feel and particular needs of the PRC as a late-developing modernizer, the role of the state in ordering, brokering, and channeling economic opportunities, the lack of regulatory infrastructure, and the risks (corruption) and opportunities (entrepreneurship) that such an atmosphere provides, the combination of constraint on political expression and economic opportunism that permeates Chinese society – all these aspects of the business atmosphere in China are immediately recognizable to South Korean entrepreneurs, who almost instinctively understand how to work in an environment reminiscent of South Korea two decades ago.

South Korean companies have introduced new business and marketing techniques and have developed a variety of strategies for localizing their presence in China so as to take advantage of the China market. South Korean companies have introduced innovative after-sales service guarantees and financing arrangements into the Chinese market as a way of establishing themselves and gaining market share. The *chaebol* (industrial conglomerates) have adopted varying corporate strategies for entry into the China market, including viewing China as a “second internal market” for sales of its goods. These strategies have accelerated to take advantage of new business opportunities as China has entered the World Trade Organization (WTO) and lowered obstacles to market entry for foreign companies in certain sectors. Samsung has made the China market central to its own corporate development strategy, especially as it takes advantage of a rapidly expanding Chinese mobile phone market. LG is implementing an extensive localization strategy to carry out its distribution and marketing of consumer goods. SK Telecom claims to regard its affiliates as Chinese companies rather than as branches of a South Korean conglomerate. POSCO has sought to develop a partnership with Chinese steel producers rather than regarding them solely as competitors. (For further discussion of Korean corporate strategies in China, see Jeanyoung Lee, “Korea’s East Asian Cultural Diplomacy and the Korean Wave in China,” Korea Advanced Institute of Science conference, Aug. 23-24, 2002.)

With the growing popularity of South Korean TV dramas, movies, and popular music in China (known as the “Korean wave”), some South Korean companies have effectively used Korean TV stars to market their products and to expand the image of ROK products in China, have sponsored South Korean concert tours, and have built promotions around the positive image of South Korean pop stars and pop culture. The appeal of South Korean pop culture appears to be derived at least in part from its ability to “Asianize” Western pop influences in ways that are recognizable and appealing to audiences across Asia, and especially in China and Vietnam. Korean Trade Promotion Corporation (KOTRA) closely monitors Chinese consumer attitudes toward South Korean products, noting that South Korean consumer product images improved slightly following the World Cup, but are still regarded as expensive but good quality in the Chinese market.

The Chinese Challenge to Korea's Economic Competitiveness

Coinciding with the 10th anniversary of China-ROK relations has been the first concrete impact of China's increasing competitiveness as a low-cost producer in key third-country markets and industrial sectors in which South Korea has developed a reputation as a sectoral leader or carved out a significant market share. Due to China's low labor costs, the PRC has become a magnet for a flood of foreign direct investment (FDI) and has made China the global hub for low-cost production of consumer goods. Many South Korean companies in labor-intensive industries such as textiles and parts assembly for electronic goods have joined with the global trend. This year, China has surpassed the United States as South Korea's leading destination for foreign investment, as lower-end factory production functions in many labor-intensive South Korean industries are transferred to China.

Sector by sector, the impact of China's emerging competitiveness resulting from a steady flow of FDI from all over the world is beginning to make itself felt as China challenges the ROK's market share in third-country markets. The Federation of Korean Industries and the Ministry of Commerce, Industry, and Energy released a report in July that empirically demonstrated the impact of increasing Chinese competitiveness on South Korean exports in key industries, including electronics, steel, automobiles, textiles, petrochemicals, and shipbuilding. The PRC enjoyed double-digit growth in exports to the United States and Japan in these sectors (23.6 percent and 13.1 percent, respectively), while South Korea managed only single-digit growth (7.4 percent and 2.7 percent, respectively). The study projected that China would surpass Korea in the competitiveness of its auto parts and semiconductor industries by 2010, and that China was already competitive with South Korea in production of ordinary household appliances and electronics technology. Until recently, POSCO was the lowest-cost producer of cold-rolled steel sheets, but Chinese labor costs now undercut POSCO's efficiency advantages in the other areas of production, according to a report by World Steel Dynamics.

In the short term, the strong *won* has also hurt South Korean price competitiveness in international markets compared to their Chinese rivals, since the Chinese *yuan* remains fixed at a constant rate compared with the U.S. dollar. The Korea International Trade Association reports that South Korea for the first time has a trade deficit with China in the electrical goods sector and that Chinese home appliance and communications goods producers are seriously undercutting South Korea's position as a low-cost supplier in key global markets. This fact reflects China's labor price competitiveness and is inducing more South Korean firms to invest in China in order to competitively produce goods for sale in the local Chinese market.

Likewise, South Korean construction firms are losing business to Chinese firms in the international construction market on the basis of low labor costs and have not effectively developed higher-technology methods that might help make them competitive overseas or in China. According to the Korea Institute of Economics and Trade (KIET), from the beginning of this year the textile sector has also suffered a trade deficit with China. As multinational companies continue to use China as the world's low-cost production

platform across industrial sectors, South Korea will find itself pressed by China in an increasing number of sectors, and can only rely on advances in product quality rather than price if South Korean companies are to be able to hold on to market share. Although ROK companies have worked harder than most to get a share of China's rising consumer market, the costs in terms of lost exports to more efficient, lower-cost Chinese competitors in mature, third-country markets may in the end outweigh the gains of getting into the Chinese market.

The other costs of China's increased price competitiveness and over-production are being felt in the context of China's competitiveness at home in South Korea. There is no better example of this phenomenon than the notorious "garlic war" fiasco (see "Beijing at Center Stage or Upstaged by the Two Kims?" in *Comparative Connections*, Vol. 2, No. 2, July 2000 and "The Insatiable Sino-Korean Economic Relationship: Too Much for Seoul to Swallow?" in *Comparative Connections*, Vol. 2, No. 3, October 2000), through which South Korea agreed to buy large amounts of garlic at fixed rates to protect South Korean garlic producers from being outpriced by their Chinese competitors in exchange for the lifting of a Chinese retaliatory tariff on South Korean mobile phone and chemical exports to China. This past July, it was revealed that such import controls could not be extended beyond 2002 under a secret clause in the July 2000 agreement, subjecting South Korean garlic growers, a significant domestic constituency that represents over one-third of the Korean agricultural sector, to new international competition from next year. The revelation resulted in the firing of responsible economic advisors in the Blue House and the Ministry of Agriculture.

North Korean Refugees: an Ongoing Problem with No End in Sight

Despite an apparent understanding at the end of June between the Chinese and South Korean governments on how to manage passage of North Korean asylum-seekers in Beijing in a humanitarian way – in addition to newly-installed, ugly barbed wire fences in Beijing's diplomatic district and considerably increased police surveillance and repatriation efforts by Chinese security in provinces adjacent to the China-North Korea border – the stream of refugees through foreign diplomatic compounds and related facilities in Beijing has continued apace. Dozens of refugees continued to flow through the South Korean consulate and a German school this quarter, although there is now considerably less media information available regarding refugees until their arrival in Seoul. Chinese border guards and provincial security forces in Yanji and surrounding areas have been beefed up, with house-to-house searches yielding daily busloads of North Korean refugees who are repatriated to the North.

South Korean nongovernmental organization (NGO) workers who provide assistance to North Korean asylum-seekers are increasingly targets of the Chinese security crackdown on North Korean refugees. Rewards for tips leading to the discovery of North Korean refugees have been increased, as have fines levied on local Chinese Koreans for being caught assisting or providing shelter to North Korean refugees. South Korean Reverend Cheon Ki-won and other South Koreans active in organizing routes and accompanying North Korean refugees to safety in China have been detained for extended periods and

finally released upon payment of large fines, since South Korean diplomatic missions in Beijing are either so well-guarded or unreceptive to the pleas of North Korean refugee requests for assistance and/or passage to South Korea. South Korean aid workers have been detained while in transit from Jilin Province to Beijing with North Korean refugees, and North Korean refugees – with South Korean NGO support – have grown increasingly bold and/or desperate, organizing a demonstration outside the front door of the PRC Ministry of Foreign Affairs timed to coincide with the visit of U.S. Deputy Secretary of State Richard Armitage last August. The Chinese crackdown has dramatically tightened border controls, putting thousands of North Koreans at risk. At the same time, North Korean refugee issues have become a political concern in Washington, and Sen. Sam Brownback is now leading efforts to pass legislation that would allow North Korean refugees in China to request and receive political asylum in the United States.

South Korean Timidity and China-South Korea Political Cooperation

Perhaps one of the biggest dividends Beijing has reaped from a decade of normalization with South Korea has been Seoul's unswerving loyalty to the principle of avoiding any action that will make political ripples with China (*sadaejui*, modern style) – this despite a murky but gradually improving record of Chinese reciprocity when it comes to choices that affect North Korea. Yes, Beijing has cooperated to allow refugees to come to South Korea – if their cases become public – but the Chinese authorities continue to repatriate thousands of North Koreans who have sought refuge from privation in northeastern China. At the time of normalization a decade ago, Seoul unceremoniously dumped Taipei in a fashion from which neither side has been able to recover fully, as evidenced by Seoul's recent rebuff to Taiwan's First Lady, who was subsequently feted in Washington, D.C., on Capitol Hill in September. The Dalai Lama not only has never received permission to visit Seoul, but could not even buy a ticket on an Asiana flight to Ulan Bator, Mongolia.

The latest and deepest kowtow to Beijing occurred not at the national level, but at the municipal level, in the form of a canceled awards ceremony sponsored by the Seoul Metropolitan Government. The ceremony had been scheduled for Sept. 5 to honor the winner of an August cyber-essay contest to promote ways of improving urban development and quality of life in the city of Seoul. The winner of the contest turned out to be Xu Bo, a former Chinese dissident who was prominent in the Tiananmen democracy movement in 1989. He had come to Seoul in the year 2000 and petitioned for political asylum as a refugee to the ROK government, which has, for fear of offending China, not acted to grant him refugee status, despite the fact that he is recognized as such by the UN High Commission for Refugees. After canceling the ceremony, the Seoul city government officials wired the awards to the winners, but required Xu to come in and receive his award in cash to avoid leaving a paper trail! On the political front, a decade-long honeymoon between Beijing and Seoul is not yet over. With friends like these, who needs allies?

Multilateralism and U.S.-ROK Tensions: China's Political Prize on a Platter?

After initial resistance to joining multilateral institutions in Asia, China has successfully adopted and used multilateral institutions as a tool for supporting the types of regional cooperation that are supportive of its own interests in stability and prosperity, while steadfastly refusing to give consent to the consensus necessary to move forward in areas not clearly in China's interest. Interestingly enough, one of the by-products of the initial establishment of the Asia Pacific Economic Cooperation (APEC) was the development of diplomatic contacts between the PRC and South Korea that eventually led to diplomatic normalization. Likewise, the ASEAN Plus Three process has provided the nucleus for a sub-regional dialogue in Northeast Asia through regular trilateral meetings brokered by Seoul including the Chinese, South Korean, and Japanese heads of state. A similar annual process has been inaugurated this year at the foreign minister-level among China, South Korea, and Japan.

The Bush administration has shown relatively little public interest in multilateral dialogue or institution-building in Northeast Asia, and has also not offered opposition to the development of sub-regional dialogues that inevitably must develop as common transnational challenges make themselves felt in the region. The major exception to that rule, however, remains North Korea and the Korean Peninsula. During the surprising Koizumi-Kim meeting, Japanese Prime Minister Koizumi Junichiro called for a six-party dialogue including North Korea. This is an idea to which opposition South Korean presidential candidate Lee Hoi-chang has also lent his support. China certainly appears much more accepting than in the past of multilateral dialogue as a useful tool for pursuing regional interests, but there is still a resounding silence on these matters from a Bush administration that continues to struggle with public diplomacy on many issues globally and regionally, including its failure to combat the perception that it is not interested in supporting multilateral approaches to regional problems.

The newly-established Bush doctrine of preemption reinforces existing perceptions abroad that U.S. unilateralism disregards the opinions of allies in favor of an exclusive vision of U.S. security interests at the expense of the security of others. The Korean perception that the United States is capable of and willing to consider actions unilaterally that might actually diminish Korean stability and security is the primary factor that has engendered disappointment and frustration in Seoul. This perception is precisely the type of South Korean public view that may well unleash the healthy dose of Korean nationalism that Chinese analysts have privately counted on for several years as the easiest way to remove U.S. troops from the Korean Peninsula without having to lift a finger. How could they have known – and how could Americans with their decades of experience in South Korea fail to know – that America's greatest risk and China's greatest potential boon would be that South Korean public perceptions of U.S. heavy-handedness might help drive our allies right into the arms of Beijing?

Chronology of China-Korea Relations July-September 2002

July 9, 2002: Korea Asset Management Corp. (KAMCO) signs a memorandum of understanding with the Chinese Construction Bank to help it to dispose of bad loans.

July 17, 2002: The Office of Government Policy Coordination announces that ethnic Koreans from China may be hired to work in the service industry.

July 19, 2002: Senior Presidential Secretary for Economic Affairs Han Duck-soo and Vice Agriculture and Forestry Minister So Kyu-ryung resign to take responsibility for the government's alleged concealment of an agreement with China to open the Korean market to Chinese garlic imports from Jan. 1, 2003.

July 23-28, 2002: An eight-member delegation of the People's Liberation Army led by Lt. Gen. Zhang Wengtai visits South Korea to discuss bilateral military exchanges.

July 25, 2002: The ROK Ministry of Agriculture and Forestry announces that it will invest 1.8 trillion *won* into the local garlic farming sector over the next five years following a firestorm of criticism that the Korean government failed to act transparently during garlic negotiations with China, under which South Korea will be open to Chinese garlic imports from Jan. 1, 2003.

July 30, 2002: Korean Trade Commission Chairman Junn Sung-chull resigns to take responsibility for South Korean failures in negotiations over garlic imports.

July 30, 2002: ASEAN Plus Three meeting in Brunei. On the sidelines, PRC, ROK and Japanese foreign ministers agree to meet annually and to expand economic and human exchanges.

July 30, 2002: ROK Foreign Minister Choi Sung-hong attends ASEAN Regional Forum meeting in Brunei along with his Chinese and other East Asia counterparts.

Aug. 2, 2002: PRC Foreign Minister Tang Jiaxuan visits Seoul for meetings with ROK Foreign Minister Choi, to discuss how to enhance bilateral ties. The PRC approves the ROK's request to open a consular office in Shenyang.

Aug. 3, 2002: Eleven North Korean refugees who had claimed asylum at the South Korean Embassy in Beijing over the previous month arrive in Seoul.

Aug. 9, 2002: ROK National Fisheries Products Inspection Service announces that excess amounts of mercury were found in freshwater eels imported from China.

Aug. 24, 2002: PRC President Jiang Zemin and ROK President Kim Dae-jung exchange congratulations on the 10th anniversary of the normalization of China-ROK relations.

Aug. 25, 2002: Incheon International Airport announces that China surpassed Japan as the destination with the most flights from Korea during the peak summer season.

Aug. 26-31, 2002: ROK Vice Defense Minister Kwon Young-hyo visits China to discuss bilateral military cooperation and regional security.

Aug. 27, 2002: Two men are arrested at Incheon International Airport on charges of smuggling into Korea two kilograms of methamphetamine worth over \$5 million.

Aug. 27, 2002: ROK Ministry of Foreign Affairs and Trade opposes repatriation of seven North Korean defectors arrested for demonstrating in front of Chinese Foreign Ministry regarding their circumstances in China.

Sept. 2, 2002: Chinese security police ransack the home office of a *Chosun Ilbo* reporter for clues regarding South Korean NGOs that are assisting North Korean asylum-seekers.

Sept. 2-5, 2002: Opposition GNP presidential candidate Lee Hoi-chang visits China and meets with top leaders including PRC President Jiang, who pledges to solve the North Korean defector issue from a “humanitarian perspective.”

Sept. 3, 2002: Fifteen North Korean asylum-seekers take refuge at a German school. Negotiations ensue to determine whether the school qualifies as diplomatic property.

Sept. 5, 2000: Seoul Metropolitan Government award ceremony to honor winners of cyber-debate contest on how to solve city traffic and environmental problems is cancelled because it was discovered that the winner, Xu Bo, was a leader of the Tiananmen movement and applicant for refugee status in South Korea.

Sept. 6, 2002: Taegu District Public Prosecutors detain eight people on charges of smuggling 223,140 counterfeit Viagra tablets from China during a six-month period from February to August.

Sept. 10, 2002: PRC Ambassador Li Bin delivers a \$20,000 donation from the Chinese Red Cross to provide relief for Korean victims of Typhoon Rusa.

Sept. 12, 2002: Thirty-six asylum-seekers, including 15 who sought asylum at a German school and 21 who sought asylum at the South Korean consulate, arrive in Seoul.

Sept. 30, 2002: Chief of the General Staff of the PRC People’s Liberation Army Gen. Fu Zuanyou arrives in Seoul for a five-day bilateral exchange visit.