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Korean Economic Trend and Economic Partnership between Korea and China

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Good evening ladies and gentlemen. It is a great honor to be a part of this interesting and meaningful conference. Thank you ○○○, ○○○ for inviting me and all participants for your warm welcome.

In starting this conference, I would like to talk to you little bit about Korea's current economic situation and its economic partnership with China. These two topics, which may seem irrelevant from one another, actually come together as a single issue: the significant influence that economic partnership between Korea and China has on the Korean economy overall.

It was in 1992, only 20 years ago, when Korea established diplomatic relations with China, which also initiated economic interaction. It took only two decades for China to become Korea's biggest trade partner. Moreover, the growth rate of trade volume between Korea and China is higher than that for Korea's total trade volume, suggesting a much greater impact from the economic partnership with China on the Korean Economy in the future. As such, economic partnership between the two countries is one of the most important factors in forecasting the future of the Korean economy. It is from this perspective that I would like to share my thoughts on the current trends in the Korean economy and the topic of economic partnership between Korea and China. I will also touch upon the direction of the economic partnership between the two countries.

Recent Trend and outlook of Korean Economy

As you may all know quite well, the Korean economy is heavily dependent on trade. This makes Korea very sensitive to global economic trends. The recent slowdown of Korea's economic recovery is undoubtedly a reflection of the eurozone financial crisis.

Among the OECD countries, Korea showed the most rapid economic recovery from the Global Financial Crisis of 2008-2009. The mostly gloomy forecasts of negative growth for Korea were proven wrong, as Korean GDP showed a positive growth rate of 0.2% in 2009 and a quite remarkable 6.2% in 2010. However, following the second quarter of 2011, renewed global economic slump slowed Korea's apparently rapid recovery. According to the government's Quick Estimation, the economic growth rate in 2011 was only about 3.6%. This represents a rather low economic performance for the Korean economy, as the rate is far less than the long-term growth rate that was expected to be more than 4% on average.

Considering the negative outlook of the global economy, Korea's economic performance in 2012 will be similar to that of 2011, maintaining a growth rate slightly over 3%. For Korea, low global economic performance will mean, more than anything, a significant slowdown in the growth rate of total exports in 2012. In 2011, Korea's total export growth rate was close to 20% while in 2012, it is forecasted to increase by less than 10%. In January 2012, Korea's export decreased by 7% compared to the same period in the previous year, with the possibility of a first trade deficit in 24 months.

On one hand, we are optimistic about exports increasing, as seasonal variation suggests trade usually declines in January, and trade balance will bounce back later in the year to a surplus as long as oil prices does not rise significantly. On the other hand, we must bear in mind that things may not be so hopeful this year. According to IMF and many other prominent research agencies, global economic downturn may continue into 2013, which would suggest a more difficult path for Korea in 2012.

However, from a long-term perspective, the outlook for the Korean economy is quite optimistic. There are many reasons for this, but I would like to talk about two of them.

The first reason is the increasing competitiveness of Korea's industries that survived through rapid changes in the global economy. The Global Financial Crisis hit many leading companies in highly advanced countries very hard, providing opportunities for large Korean firms in automobile, machinery, and IT industries to increase their global market share. However, their achievements are not a simple reflection of weakened competition. Korean companies maintained increased global market share even as most leading companies in advanced countries recovered, based on a high level of customer trust and satisfaction as well as product quality. Their rapid progress is the result of recognition by the customers of the competitiveness of Korean companies, based on the continuous and hardworking efforts made over time. Korean economy will benefit from such achievement for a while in the future.

The second reason is Korea's capacity to effect a strong recovery, as we have witnessed after the Global Financial Crisis. As I have mentioned before, despite an economic structure that is highly sensitive to external shocks, Korea achieved the most rapid recovery among the OECD countries. This is based on two factors. First, Korea's industrial and export structure has become more diversified, which increased Korea's flexibility in response to external changes. Recently, Korea is showing high competitiveness in diverse industries including semiconductor, telecommunication equipments, IT, automobile, machinery, steel, and petrochemical industries. Diversification of its portfolio of industries has contributed to reducing vulnerability to external shocks and enhancing adaptability to the volatile global environment. Second, the weight of Korea's trade shifted from a few advanced countries to relatively dynamic and more numerous emerging countries. Currently, approximately 70% of Korea's total export is sent to emerging countries, and the rate is increasing. This suggests that the Korean economy leveraged itself successfully on dynamic markets in emerging countries through expanded trade relations. In

particular, Korea's strong trade relations with China is making a significant contribution to Korea's economic recovery and growth.

Korea's Economic Growth and its Economic Relations with China

As I have mentioned in the beginning of my speech, China has been Korea's most important trading partner since 2004. Total trade volume between Korea and China is USD 2.2 trillion. Trade with China makes up 24.1% of Korea's total exports and 16.5% of total imports. If we include export to Hong Kong, aggregated exports to these two countries represent 30% of Korea's total exports.

China is also an important FDI destination for Korean companies. Korean companies began investing in China since the mid 1990s and after the mid 2000s, the scale of Korean investment reached many billions of dollars. According to statistical studies in Korea, total FDI by Korean companies into China up to 2011 is approximately USD 360 billion, and there are now more than twenty thousand local subsidiaries established by Korean companies. In the beginning, Korean companies venturing into China were mostly small and medium sized enterprises (SMEs) producing labor intensive industrial products. However, it did not take long for big companies in capital and technology intensive industries to undertake overseas expansion into China, working closely with the SMEs. As a result, we can now find huge production sites established by Korean companies in many regions of China.

We need to pay attention not only to the scale and weight of the trade between China and Korea, and FDI in China by Korean companies, but also to the growth rate of these activities. For example, following the establishment of diplomatic relations between China and Korea in 1992, average annual growth rate of trade volume between China and Korea was approximately 20% for 19 consecutive years. This was, of course, enabled by China's rapid economic growth.

(For Korea, it has been very beneficial economically to have a neighbor with such a massive market as China. For instance, trading with China played a significant role in Korea's fast recovery after the Global Financial Crisis.)

We all know that China played an important role in the recovery of the overall global economy. However, China was particularly important for Korea. For instance, if we compare the growth rate of exports to China in the first quarter of 2010 to that of 2008 of major OECD countries, Korea shows the fastest growth rate (Japan 6.3%, Germany 11.0%, U.S.A. 17.3%, Korea 19.2%). Furthermore, in the immediate recovery period after the Global Financial Crisis, Korea's exports to China grew faster than any other country. Trading with China, needless to say, played a dominant role in Korea's economic recovery process. Analysis of our research institute suggests that 54% of Korea's total GDP growth from the first quarter of 2008 to the first quarter of 2010 is basically a reflection of the China effect. In other words, since most of the recovery took place during the first half of 2010, China contributed to more than half of Korea's economic recovery process.

Trends and Outlook of the Economic Partnership between Korea and China

As the Chinese economy matures, it is coming to face problems associated with an aging society and labor shortage. However, China can still expect a long future with high economic growth rates. And as long as that trend continues, the scale of economic partnership between China and Korea will continue its fast growth as well. In the meantime, as both countries grow economically and undergo a series of related economic restructuring, the contents of economic partnership will also change.

As it is well known, the main element of trading and FDI between Korea and China coincide with the triangular 'Asian Production Network.' On one point of the triangle, Asian countries with advanced technologies such as Korea, Japan, and Taiwan export

a variety of raw materials and parts to China, positioned on the second point of the triangle. These materials and parts become final goods in China and are shipped to the third point of the triangle, the global markets. Currently, about two thirds of the export to China are not for final consumption in China but for re-packaging and re-exporting to other markets around the world.

However, as the Chinese economy matures and grows further, its domestic market will become increasingly important. Accordingly, it is expected that the Asian Production Network will develop in close relationship with the domestic market in China. In the case of Korea, only one third of the goods currently exported to China are targeting the domestic market. Yet, the total volume of exports to China is so large that a mere third of it nearly matches Korea's total volume of exports to the United States. It is certain that the economic partnership between China and Korea will further expand around the Chinese domestic market.

Being aware of the importance of the Chinese domestic market in the future, Korean companies have undertaken collaboration strategies that targets the Chinese domestic market. We can find a good example in the automobile industry. The number of cars sold in China jumped from 20 million in 2000 to 180 million in 2010. Hyundai and KIA did not fail to miss the opportunity and built a series of assembly plants since the early 2000s which made them the main automobile suppliers in China. They now occupy close to 10% of China's domestic automobile market.

Korean TV and LCD panels are two other representative goods which are exported for consumption in China's domestic market. In the late 2000s, there was an explosive increase in demand for LCDs and TVs which brought these products to the forefront as Korea's most important exports to China. In addition, Korean refining companies made significant R&D and capital investment in advance to increase efficiency in the production of petroleum products, predicting that expansion of automobile and airline industries would increase China's domestic demand for petroleum products.

It is not only big companies but also SMEs that are venturing into China. Furthermore, these companies are not limited to manufacturing industries but consist of a wide spectrum of industries including distribution, game, and various service industries.

Meanwhile, China's importance as Korea's importing partner will also increase significantly in the future. Currently, Korea is importing various IT parts, steel products, chemical products, and apparels from China. The list of import items will become even more diversified. Since China's industrial structure is becoming more advanced and sophisticated, we can also expect the volume of Korea's imports from China to increase steadily.

Efforts for Strengthening the Economic Partnership between China and Korea

Recently, the Chinese and Korean governments have started discussions on a future FTA between Korea and China. Over the past ten years, Korean government actively pursued FTA policy to achieve FTA with ASEAN and EU. And in 2012, FTA with the United States will also go into effect. Since China is Korea's biggest trade partner, an FTA with China will be one of the most important policy agendas for Korean government.

However, since the effect of the FTA between China and Korea is likely to be as massive as the scale of trade volume between the two countries, we must pay very close attention to the contents of the FTA. Getting political agreement and support in Korea may be difficult due to the resistance from particularly vulnerable sectors such as agriculture and SMEs. Policymakers in both countries will have to take significant amount of time to share and gather wisdom.

In the mean time, Korea and China are collaborating to develop partnerships in the area of R&D, standardization and certification systems, and environment and energy

issues. Up until now, Korean companies have focused on developing networks between their Korean headquarters and production subsidiaries in China. However, the trend will change, with a shift in focus from vertical networks to horizontal partnerships with multinational companies within China as well as Chinese companies. In addition, human resource development is an important issue and of common interest to both countries. A significant and increasing number of students from the two countries are studying abroad in China and Korea. In 2011, 66% of foreign students in Korea were of Chinese nationality while China is the second most popular destination for Korean students studying abroad, after the United States. Case in point, 22% of Korean students studying abroad went to China. Such a strong human network will become an invaluable foundation for a more solid economic partnership between the two countries in the future.

Economic partnership between China and Korea in the past has progressed favorably and will continue to be so. This is a case that proves that international unity and exchange based on collaboration brings mutual benefits to participating countries. In order to successfully navigate through the aftermath of the Global Financial Crisis and achieve stable prosperity, collaboration between the two countries would need to become closer and strengthened further.

Thank you for your attention.