

Russia-Korea trade and investment cooperation: current tendencies and perspectives

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Abstract

Russia and Korea have been developing bilateral economic relations for over 10 years. Since 1988, when the first trade agreement was concluded, Korea has become one of the largest trading and investment partners of the Russian Far East. Korea annually increases trade and investment flows to the Russian Far East, a region with a high potential for growth. It should be noted that Korea has become the third largest trading partner of the Russian Far East in the 2000s. In this paper, we are going to consider trade and investment flows from the 1990's to the present and focus on the analysis of achieved goals and the problems of developing further bilateral cooperation between Russia and Korea. We will compare the approaches of Russia and Korea toward the development of bilateral trade and investment agreements. To deepen our understanding of the development in trade and investment cooperation between the two countries, we consider the commodity structure of exports and imports as well as the investment structure of Korean capital that has been flowing into the Russian economy for the last 10 years. The implication is that bilateral economic relations between Russia and Korea are developing slowly. It is necessary to intensify these relations by developing the legislative measures of Russia-Korea trade and investment cooperation and creating a basis for integration of two economies by means of widening the activity of Korean companies in the local trade and financial markets.

At present, Korea imports natural resources from Russia. It is obvious that Russia is a competitive producer of gas and oil which makes it very attractive to those countries that lack natural resources. But Russia also produces skill-intensive goods, which could be of interest to Korean companies (e.g. aircraft, machinery equipment, etc.). Moreover, Russian scientific organizations as well as large-scale enterprises have gained plenty of experience in applying the results of fundamental research to the production process. Recently, a number of Korean and Russian companies set up joint-ventures to conduct research in different spheres. Specifically, some Russian-Korean joint ventures are focused on producing home electrical equipment. In other words, this type of cooperation is based on the unity of Russian scientific skills and Korean capital resources. This illustrates that Russia and Korea may engage in different forms of economic cooperation based on the use of resources each of the countries lacks. So, different forms and ways of further Russia-Korea economic cooperation are considered in the paper in order to analyze its possible outcomes for both countries.

Keywords: trade and investment flows, Korea, Russia and the Russian Far East.

1. Introduction

The development of Russia-Korea trade and investment relations has a comparatively short history. The development went through two stages. The first stage is characterized as a period of political confrontation (from 1970 until 1989). During the existence of the Soviet Union direct trade and investment contacts between the two countries did not exist at all. This was mostly due to the fact that the Soviet Union did not recognize South Korea as an independent state. However, there were cases when Korean companies bought Soviet resources via other countries. Subsequently, the North Korean government forced Soviet leaders to cease any relations with South Korea, including trade through other countries.

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The political situation in North and South Korea had a negative influence on relations between the Soviet Union and South Korea. After the collapse of the Soviet Union, Russia changed its policy with respect to South Korea. For example, trade and investment cooperation developed intensively since the late 1980s, when Russia started to liberalize its trade and capital flows with other countries. This period is considered the second stage of Russia-Korea cooperation.

2. The dynamics of Russia's foreign trade

In 1990, Russia established diplomatic relations with the South Korean government. Trade representatives were set up in both countries. Korean companies established joint ventures with Russian companies in different spheres of the economy. At first, joint ventures started to do business in the fur and timber industries.

However, trade and investment relations grew slowly as a result of Russia's primary interest in developing trade and investment cooperation with Western European countries. These countries' proximity to the western boundary of the Russian Federation made it easier and more profitable for Russian companies to exchange goods with them. Western European countries established their trade branches in Western Russia (e.g. Moscow, St. Petersburg and their counties), because this region comprises up to 80 % of all financial resources in the country. Thus, the opportunity of gaining a large profit propelled European companies to develop trade and investment relations primarily in Western Russia. The amount of Russia's foreign trade with European countries was always much greater than that with Asian countries.

Table 1. Russia's foreign trade by country, 1995-2001 (millions of US dollars)

Country	Exports							Imports						
	1995	1996	1997	1998	1999	2000	2001	1995	1996	1997	1998	1999	2000	2001
Total, including:	63,687	69,294	68,472	57,614	62,179	89,269	84,719	33,117	31,909	38,889	32,266	21,935	22,275	30,394
Germany	6,208	6,735	6,531	5,719	6,205	9,232	9,188	6,483	5,192	6,643	5,486	4,202	3,898	5,755
China	3,371	4,722	3,981	3,169	3,527	5,248	5,509	865	1,003	1,261	1,160	894	949	1,617
USA	4,315	4,889	4,482	5,100	4,709	4,644	4,159	2,648	2,901	4,058	4,114	2,388	2,694	3,203
United Kingdom	3,066	3,209	2,848	2,960	2,886	4,670	4,271	1,100	1,130	1,481	1,220	676	861	984
Poland	1,688	2,132	2,515	2,180	2,608	4,452	4,198	1,321	926	1,354	1,046	603	716	952
Netherlands	3,192	3,324	4,553	3,953	3,673	4,349	4,691	1,646	1,010	1,206	914	689	740	847
Italy	3,376	2,828	3,564	3,219	3,755	7,254	7,395	1,851	2,339	2,641	1,819	1,160	1,212	1,693
France	1,519	1,597	1,626	1,456	1,211	1,903	2,191	1,074	1,269	1,594	1,595	1,233	1,187	1,520
Finland	2,386	2,636	2,774	2,071	2,414	3,104	3,098	2,041	1,675	1,874	1,440	947	958	1,274
Republic of Korea	747	1,185	835	521	826	972	804	502	799	837	1,010	317	359	789

Source: Based on Goskomstat. *Statistics Yearbook 2002*.

As we can see from table 1, Russia's foreign trade reached US \$ 115.1 billion in 2001. The amount of trade was constantly growing in the period from 1995 to 2001, though there was some slump in trade. Exports always exceeded imports during the analyzed period. Moreover, the annual rate of growth in exports was higher than that in imports growth which led to a trade surplus.

The main trading partners of Russia in the period from 1995 to 2001 were Germany, the United Kingdom, Italy and France. Russia focused on exports to the markets of advanced European countries. Germany continued to be the top destination of Russian products, accounting for 10 % of Russia's total exports and 18 % of Russia's total imports, on average, from 1995 to 2001.

Asian countries did not play a major role in Russia's foreign trade in the 1990s. The situation dramatically changed at the beginning of the 2000s when China became the second largest export partner of Russia, accounting for 6.5 % of its total exports. This was due to the Russian

government's change in strategy with respect to the development of trade relations with the countries of the Asia-Pacific region. Korea was ranked as the 10th trading partner of Russia, and the share of Russia-Korea bilateral trade was about 10 % of Russia's total foreign trade. Korea's share in the Russian market has slightly increased since 2001 and has reached 2.6 % of Russia's total imports. Meanwhile, Russia's exports to Korea shrank to 1 % of its total amount in 2001.

At the same time, the Russian Far East was lagging in trade with European countries. The long distance that separates this region from Europe made goods more expensive and, therefore, less competitive in the European markets. In these terms, the Russian Far East could not develop its economy successfully and depended a lot more on cooperation with neighboring countries such as China, Japan and Korea. These countries have become the main trading and investment partners of the Russian Far East. The share of Japan accounted for 12 % of the Russian Far East total trade in 2001. The share of China and Korea was 30 % and 14 %, respectively, of its total trade in 2001..

3. The dynamics of the Russian Far East foreign trade

Despite the fact that Japan and China were historically and still are the main trading partners of the Russian Far East, Korea reached the rank of the third largest partner among the countries with which the region develops trade and investment relations. Indeed, when we talk about cooperation between Russia and Korea, we mostly consider economic relations between Korea and the Russian Far East rather than other regions of Russia.

Table 2. The Russian Far East exports and imports by country, 1996-2001 (millions of US dollars)

Country	Exports						Imports					
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
Japan	734	1021	712	486	522	560	146	252	238	127	116	186
China	746	649	1023	414	1047	1716	208	297	175	132	139	171
Republic of Korea	333	334	336	314	578	644	275	583	578	144	153	207
United States	45	45	66	82	76	47	424	532	345	212	115	126

Source: Based on Goskomstat. *Statistics Yearbook 2002*.

During the period from 1996 to 2001, Korea was one of the major trading partners of the Russian Far East. At the beginning of the 1990s, Korea was just the third major trading partner of the region. Upon the development of diplomatic relations, however, Korea has become a leader in trade with the Russian Far East. Korea was the largest importer and the second largest exporter of goods to the Russian Far East at the beginning of the 2000s. This growth in trade is attributed to an increase in the supply of consumer and food products as well as investment products in the Russian market.

There are a few territories in the Russian Far East that have intensively developed trade relations with Korea -- Sakhalinskaya oblast, Primorsky kray, and Khabarovskiy kray. These territories account for the largest share of the Russian Far East's foreign trade.

Table 3. The share of the Russian Far East territories in its exports and imports, 1998-2003 (percentage)

Territory	Exports						Imports					
	1998	1999	2000	2001	2002	2003	1998	1999	2000	2001	2002	2003
Amurskaya oblast	4.2	10.7	2	1.7	2.3	2.2	5.5	3.5	2.3	2.3	1.8	2
Kamtchatskaya oblast	1.1	0.2	4.4	4.1	4.5	3.8	1.8	0.4	4.1	5.6	1.8	2.7
Magadanskaya oblast	0.2	0.1	0.1	0.1	0.2	0.2	0.1	0.1	6.8	6.7	4	3.2
Primorsky kray	80.7	79.4	20.8	25.5	25.4	22.2	70.3	59.9	46.6	48.7	55.3	52
Sakha Republic	0.1	0.1	5	1.3	3.4	5.7	0.8	0.03	5.1	2.5	2.6	2.5
Sakhalinskaya oblast	0.4	0.4	25	15.5	20.9	18.9	0.7	16.2	17.2	16.2	17	20.2

Khabarovskiy kray	12.8	8.6	42.1	51.5	43.1	46.7	20.2	19.3	17	16.1	16.2	15.1
Evreiskaya oblast	0.5	0.5	0.4	0.2	0.3	0.2	0.4	0.4	0.6	0.4	0.3	0.2
Chukotskiy okrug	---	---	0.01	0.001	0.004	0.004	---	0.2	0.2	1.5	1	2

Source: Based on Goskomstat. *Statistics Yearbook 2002*.

As we can see from table 3, Primorsky kray is one of the largest importing territories in the Russian Far East. Its share was 52 % of the Russian Far East's total imports in 2003. Primorsky kray's proximity to Japan, China and Korea makes it a favorable location to import goods than other territories of the Russian Far East.

If we consider the foreign trade of Primorsky kray by country, we can conclude that Korea is its second largest trading partner. In particular, the share of Korea accounted for 25 % of Primorsky kray's foreign trade in 2002.

Table 4. Primorsky kray's foreign trade by country, 1998-2002

(millions of US dollars and percentage)

Country	1998		1999		2000		2001		2002	
	USD	%	USD	%	USD	%	USD	%	USD	%
China	250.5	17.3	244.2	20	376.8	27.5	311.4	17.5	607.5	33.6
Republic of Korea	208.9	14.4	234.4	19	278.3	20.3	372.5	21	445.3	24.7
Singapore	41.9	2.9	19.9	1.6	24.6	1.8	344.6	19.3	156	8.6
Japan	321.1	22	198.7	16	227.1	16.6	305.8	17.2	280.6	15.6
Total	1450	100	1233	100	1371	100	1781	100	1804	100

Source: Based on Goskomstat. *Statistics Yearbook 2002*.

In general, the Russian Far East is attractive for Korean companies, because it has large reserves of timber, metal ores, coal, oil and other natural resources. Natural resources are one of the factors that make Russia, and especially its Far East, competitive in the Asia-Pacific region. The Russian Far East also has a large market with a high potential for growth. It is obvious that companies that are gaining access to this market now will have spent fewer investment resources than those entering the market after it is already saturated by producers not only from Korea, but from other Asian countries. However, the demand in the market is not stable and, more importantly, the local population has a comparatively low income which precludes many producers from entering the market.

Nowadays, foreign producers prefer to earn a high profit during a short period of time. This explains the reason why Russian-Korean joint ventures mainly do business in mining industries. Korea, on the other hand, is considered a supplier of high-tech and consumer products to Russia.

The commodity structure of Russia's exports to Korea consists of a large number of raw materials. In particular, the Russian Far East exports steel (43 % of the total amount), timber and fish products (13 %), chemical products (10 %), coal and other energy resources (33 %) to Korea. However, its imports from Korea are mostly home and office electrical equipment, plastic, automobiles and buses. The share of these goods accounts for 80 % of the region's imports.

Table 5. The commodity structure of Russia's exports to Korea, 1992-2002 (percentage)

Year	Steel and ore products	Chemical products (oil, cellulose, etc.)	Coal, nickel, aluminum	Timber, fish products
1992	67	7.7	0.2	22.7
1993	46.4	10.6	11	28.6
1994	49.6	12.3	9.9	22.6
1995	51.6	15.4	7.6	19.6
1996	45.7	19.5	4.4	21.9
1997	10.9	20.5	5.6	16.9
1998	37.8	19.6	13.6	20.2
1999	40	16.2	16.4	19.8
2000	44.6	20.1	19.3	11.6
2001	40.8	9	32.9	13.4
2002	42.8	10.1	33.2	12.5

Source: Based on Goskomstat. *Statistics Yearbook* 2002.

The commodity structure of Russia's exports to Korea is not suitable for the former, because Russia has a relatively developed manufacturing industry (e.g. air and space industry), and it is in a position to supply products from this industry. There is little demand for such Russian high-tech products in Korea. Nevertheless, Korea is interested in getting some products from the Russian defense industry. For example, in 1996 Russia supplied 26 tanks, antiaircraft emplacements "Igla" and antitank complexes to Korea (Souslina, 2001).

As a result of the ineffective commodity structure of exports, Russia loses profits by trading labor-intensive products which cost less than skill-intensive ones. To be sure, such a commodity structure of exports will not make Russia better off in the long run. However, it is also true that it is impossible to change the existing structure of the Russian exports within a short period of time.

4. Differences in trade policies of Russia and Korea

In this situation we need to take into account differences in the economic basis of two countries. If we take a look at the share of industry, agriculture and services in the economy, there won't be any big differences between the countries. For example, both countries have a larger share of service sector in the economy (more than 50 % of GDP), and a large share of production sector (more than 30 % of GDP) (UNCTAD, 2003). Yet if we consider the manufacturing industry structure, we can conclude that the heavy engineering industry accounts for the largest share of the Russian industrial production, while the electronic industry represents the largest share of the manufacturing industry in Korea.

In this case, both countries may trade goods in production for those resources which they lack. For Korea, such lacking resources are land and fossil fuels. It has a comparatively high-qualified labor force and large capital resources. Russia, conversely, has a lack of financial resources which prevents the development of its manufacturing industry and, consequently, does not allow it to reap the benefits from trade by exporting finished products. In spite of this, Russia is highly endowed in labor resources, making the production of labor-intensive goods cheaper.

It is understandable that Korea is not interested in supporting the economic development of Russia for the sake of getting a new global competitor in the high-tech products market. At the same time, the bilateral trade and investment cooperation between the countries might focus on developing different forms of cooperation.

Korea has an export-oriented model of economic development, specializing in supplying high-tech products, vessels, petrochemical and textile products, automobiles and home electronic equipment to the world market. The exports of goods and services were 40 % of Korea's GDP in 2002 (UNCTAD, 2003). The country is successful in the development of its economy due to its strong orientation toward international markets. The development of foreign trade relations made Korea one of the largest trading countries in the world.

Russia has an export-oriented model specializing in supplying petroleum products to the world market. Its exports to GDP ratio accounted for 35 % in 2002, compared with 30 % in 1998. However, Russia is not developing its foreign trade relations with other countries as intensively as Korea. The ratio of Russia's exports to its GDP was growing over the last years not because it broadened foreign trade cooperation, but prices for its traded products in the foreign markets were rising. In particular, prices for oil products sharply increased in 2004 which has almost doubled the amount of Russian oil exports.

One of the reasons for Russia's slow development in foreign trade cooperation concerns the competitiveness of its economy. According to the 2003 World Economic Report, Russia has been ranked 65th among the 102 countries surveyed (World Economic Forum, 2003). Its exports are insufficiently competitive in the world market. Even Russia's oil is less competitive, because it is not refined and contains a lot of paraffin. By comparison, Korea, being far ahead of Russia, ranked 18th among competitive economies.

If we compare the level of macroeconomic development in the countries, Russia is ranked 61st, while Korea is 23rd. This means that economic conditions are not as suitable in Russia as they are in Korea, and, consequently, the rate of Russia's economic growth is lower. By comparison, in 2002 the rate of GDP growth in Russia was 4 %, whereas it was about 7 % in Korea. Russia is also less competitive, because of its level of technology application to production. Based on comparison of technology, Russia and Korea have been ranked as the 65th and 6th competitive economies, respectively, among the 102 countries surveyed in 2003 (World Economic Forum, 2003).

It is logical that innovation activity is developing slowly in Russia; after all, it is far behind an industrialized economy such as Korea's. Obviously, this situation can be traced to the problems of application of scientific achievement to the production process. Surprisingly, it takes about 5 to 10 years to apply a new technology to the industrial production in Russia. Yet it is well-known that this period has been shortened in newly industrialized countries by up to 3 years since the beginning of the 21st century. However, it would be a mistake to think that Russia has lost all its power. Russia has the world's second largest highly-qualified labor force and ranks 7th in the number of scientists per capita – twice as many as in Korea! (World Economic Forum, 2003).

The competitiveness of the Russian economy is affected by its internal economic problems that influence Russian companies' trade and investment activity. Russia is considered a less competitive country not only by international organizations, but also by Russian companies. Most of Russian businessmen think that Russian products, as well as companies, are not competitive in the world market. Though, there are some Russian companies whose products are highly competitive in the foreign markets. They are Gazprom, Lukoil, RAO UES, Yukos, Surgutneft, Norilskii Nikel and Severstal, which mine natural resources (gas, oil, ores, etc.) and export raw materials. These companies have been included in the International Institute for Management Development's list of 2000 competitive companies in the world. Some of them are even more profitable than Korean companies, like SK Corporation and S-Oil which conduct business in the same industry as Russian's (IMD, 2004). For example, the Russian companies mentioned above get 9 cents per unit by selling petrochemical products, while the Korean companies get 7 cents per unit or even less. However, Russian manufacturing companies are as profitable as Korean companies. The manufacturing products produced in Russia are much less competitive than those produced in Korea.

Russian products are less competitive not because their quality is bad, though this should also be taken into account, but as a result of high production expenses. Despite the tax privileges that Korean companies get in Korea's industrial and export processing zones, Russian companies pay comparatively high taxes on profits and value added taxes (VAT) even if they invest profits in the development of their production facilities. As a result, Russian companies prefer to invest in the trade sphere rather than in production in order to gain enough profits under the current economic conditions in the country.

5. The dynamics of Korea's foreign trade

To develop trade relations with Korean companies, Russian enterprises set up joint ventures in Korea. However, the size of the companies established by Russian individuals in Korea and the amount of their sales are far less than those of the companies established by businessmen from other countries.

It is important to note that Korea does not consider Russia a main or strategic trading partner. Korea is mainly focused on the North American and South Asian markets. By comparison, the share of Korean exports to the US market was about 21 % of its total amount in 2001, but the share of its exports to Russia was a mere 0.6 % (OECD, 2004). The share of Korea's imports from Russia was 1.4 % of its total imports in 2001. In general, Russia is ranked as the 32nd export and 15th import partner of Korea.

Table 6. Korea's exports and imports by country, 1996-2001 (billions of US dollars)

Country	Exports					Imports						
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
Total	124.5	136.2	132.3	143.7	172.3	150.4	144.1	144.6	93.3	119.8	160.5	141.1
United States	16.6	21.6	22.8	29.5	37.6	31.2	30.9	30.1	20.4	24.9	29.2	22.4
Japan	15.8	14.8	12.2	15.9	20.5	16.5	31.4	27.9	16.8	24.1	31.8	26.6
China	11.4	13.6	11.9	13.7	18.5	18.2	8.5	10.1	6.5	8.9	12.8	13.3
Europe	19.3	22.8	27.4	25.3	27.1	22.8	24.3	21.98	13.08	14.7	17.6	16.7
Russia	1.97	1.77	1.11	0.64	0.79	0.94	1.81	1.53	1	1.59	2.06	1.93

Source: based on OECD *Countries Economic Surveys: Korea*. June 2004

As we can see from table 6, Korea had a trade surplus with Russia from 1996 to 1998, though it has started to export less and import more products from Russia since 1999 which led to a trade deficit. In 2001, the trade deficit still remained.

Russia, on the contrary, has accumulated a trade surplus with Korea recently. However, it had a trade deficit from 1996 to 1998, because prices of its major exports were low until the year 1999. During the period from 1996 to 1998, Russia was faced with economic problems that led to a crash of its financial system in 1998.

The rate of the countries' bilateral trade growth fluctuated throughout the 1990s. There was some increase and decline in trade turnover between the countries from 1995 to 2003. The average rate of trade growth was about 10 %. The bilateral trade significantly increased and reached its annual rate of 20 % in only the last few years. The increase was due to a growing demand for traditional exported goods in both countries. In particular, Korea increased exports of mobile phones, radio and TV sets, computing, plastic, clothing, and other goods to Russia. Russia increased exports of steel, ores, fish products, coal, timber, aluminum, and nickel.

Korea exports heavy industry products (electric equipment, electronic machines, vessels, iron, steel, and machinery equipment) and light industry products (woven and textile fabric, tubes). These products accounted for 80 % and 14 % of Korean exports, respectively, in 2003.

Table 7. Korea's exports by commodity, 1993-2003 (percentage)

Commodity	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Heavy industry products	62.9	65.8	69.6	67.7	67.3	67.8	71.8	74.1	74.1	77.5	79.8
Light industry products	30.3	27.8	24.3	25.2	24.8	24.6	20.7	17.6	17.5	15.7	14.1
Crude materials and fuels	4	3.7	3.7	4.7	5.7	5.6	5.5	6.7	6.6	5.2	4.7
Food and direct consumer goods	2.8	2.7	2.4	2.4	2.2	2.1	2.1	1.6	1.8	1.6	1.4

Source: Korea National Statistical Office. Statistical Database (KOSIS) online.

Russia has a high demand for such heavy industry products as electronic equipment and industrial machinery. It had highly developed machinery and shipbuilding industries, but their development has so far been sluggish. Now, most Russian fishing companies prefer to buy vessels from Japan and Korea rather than at home, because those countries offer reasonable prices and suitable quality. It is obvious that such demand for the products is temporary, and it can easily change in terms of a new economic policy implemented by the Russian government that would be focused on the restoration of the manufacturing industry.

Korea's imports consist of three main groups of goods such as consumer and capital goods, crude materials and fuels. The share of crude materials and fuels, being the largest one, accounted for 48.3 % of its total imports in 2003.

Table 8. Korea's imports by commodity, 1993-2003 (percentage)

Commodity	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Capital goods	37.8	40.8	40.6	40.2	37.6	37.6	40.5	40.8	37.2	38.1	38.5
Crude materials and fuels	52.5	49	47.8	45.6	48	48.9	47.8	49.2	51	48.6	48.3
Consumer goods	9.7	10.2	11.6	14.2	14.5	13.6	11.7	10	11.8	13.3	13.2

Source: Korea National Statistical Office. Statistical Database (KOSIS) online.

It is true that Korea might import any of these goods from Russia. Yet the question is not what Korea is interested in importing from Russia, but what Russia is in a position to export to Korea, considering transportation costs, prices and the quality of its products. Despite the diversified commodity structure of Russian exports consisting of raw materials and finished products, as mentioned above, it can supply mainly oil and gas products of good quality and at relevant prices to the Korean market. The import of Russian capital goods in Korea is not profitable for both Russian and Korean companies because of high transportation charges. As a rule, the goods are supplied by ships and factories, which are producing capital-intensive products and are located in Western Russian -- a long distance from Korea.

This is probably one of the reasons why South Korea would like to develop a railroad line between Russia and its territory through North Korea. Another reason includes the interest of Korean companies to expand the scale of their sales worldwide and to gain access to the markets of advanced European countries. For example, in 2001, the share of the European Union countries reached 13 % of Korea's total exports, and it increased by 16 % over the preceding year (Korea National Statistical Office, 2002).

6. The reasons of slow development of Russia-Korea bilateral trade

There are a lot of reasons for the slow development of Russia-Korea trade relations. Apart from economic reasons, such as a slightly different structure in their economies, it is possible to stress political problems. One of them is the undeveloped legislative measures of bilateral trade and investment cooperation.

Russia-Korea economic relations have started developing quite recently; therefore, the number of trade agreements concluded is very small. The first one was concluded in December 1990. Later, the two countries signed an agreement on their trade mission cooperation. After the economic liberalization in Russia and the implementation of a policy of developing some free economic zones by the Russian government, Korea signed an agreement with Russia on participation in the construction of a Russian-Korean industrial complex in the free economic zone "Nakhodka". The agreement was signed in September 1997. Despite the interest of both countries in the development of this project, it has not succeeded because investment expenses appeared to be very high. One of the latest agreements was signed by the two countries in October 2000. It was related to the supply of some strategic petroleum products to Korea.

Last year, Korea implemented a new policy towards its trading partners. The policy shows an interest of the Korean government in intensifying its economic relations with Russia. South Korea is very interested in developing a trilateral cooperation with North Korea and Russia. The latter is considered a partner in persuading the North Korean government to stop its political confrontation with South Korea.

7. The dynamics of Russia-Korea investment flows

The existing political problems don't allow Russia and South Korea to use the whole potential of their trade cooperation. The same is true for investment relations. The investment cooperation is developing very slowly. The amount of Korean investment in the Russian economy is very small. Specifically, in 2000, Korean investment inflows amounted to US \$ 15,217 million. The share of Russia was about 0.007 % of Korea's total FDI by country in 2000.

Table 9. Korea's foreign direct investment from abroad by country, 1991-2000

(millions of US dollars)

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Japan	204	174	157	345	337	277	275	423	836	1100
France	42	50	44	54	33	90	501	356	365	414
Germany	102	67	35	49	46	47	397	644	766	1117
Netherlands	426	71	58	91	124	252	316	1227	3080	1246
United Kingdom	58	13	44	22	50	48	94	53	485	58
United States	262	268	303	223	342	393	391	1479	1973	1696
Russia	---	---	---	---	---	---	---	1	1	1

Source: OECD *International Direct Investment. Statistics Yearbook 1989-2000*.

Russia is ranked as Korea's 14th investment partner -- far behind the US, the United Kingdom, and Japan, the largest investors in Korea. In particular, the share of the US accounted for 21.9 % of Korea's total investment in 2003, the shares of the UK and Japan was about 16.2 % and 13.8 %, respectively.

Russia as well as Korea gets the largest share of investment inflows from developed countries such as Germany, the United States, the United Kingdom, Switzerland, and others. In particular, the share from Germany was 20.2 % of the total capital invested in the economy of Russia in 2002, the share from the UK and Switzerland was 11.8 % and 6.8 % in 2002, respectively. The share from the US shrank to 5.7 % in 2002 from 14.5 % in 2000, when it was the largest foreign investor in Russia. The amount of Korean investment does not exceed 1 % of Russia's total foreign investment from abroad.

Table 10. Russia's foreign investment by country, 1995-2002 (percentage)

Country	1995	1997	1998	1999	2000	2001	2002
United States	27.9	24.1	19	30.6	14.6	11.2	5.7
Germany	10.3	13.4	24.2	17.7	13.4	8.7	20.2
Cyprus	1.4	8.1	7.8	9.7	13.2	16.3	11.8
Netherlands	2.9	4.4	7.5	5.7	11.2	8.8	5.9
Switzerland	14.6	14.3	3.5	4.2	7.2	9.4	6.8
France	3.6	1.7	13.1	3.3	6.8	8.4	6
United Kingdom	6.1	19.6	13.5	7.7	5.4	10.9	11.5
Sweden	2.1	0.6	1.2	0.7	2.8	0.5	---
Japan	2.5	1.1	0.5	0.4	1.1	2.9	---
Korea	0.8	0.06	0.14	0.01	0.02	0.04	---

Source: Based on Goskomstat. *Statistics Yearbook 2002*.

The structure of foreign investment from abroad by industry significantly differs in both countries. In Russia, foreign companies mainly invest their capital in the petroleum industry. The competition among foreign investors interested in the development of gas and oil fields in the territory of Russia is quite strong. As a rule, there are three main groups of investors from the US, the Netherlands and Japan who exploit natural resources in Siberia, Sakhalin and other territories. Recently, Korean companies have also started to invest money in the development of oil resources in the Russian Far East, making the competition among foreign investors much stronger. Apart from the petroleum industry, foreign investors consider service and trade sectors attractive for investment. The service industry gives investors opportunities to earn higher incomes in a short-term period. This industry looks more attractive for Korean companies that prefer to make a short-term and small investment in Russia.

Russia and Korea also have different amounts of inward FDI. For example, inward foreign direct investment to the Korean economy amounted to US \$ 43.7 billion in 2002, while inward FDI was only US \$ 22.6 billion in Russia. Indeed, the amount of foreign investment allocated in the countries every year will be different as well. In particular, in 2002, Russia received about US \$ 3.98 billion of FDI. Korea received US \$ 2.8 billion in 2001, though it got about US \$ 10 billion the preceding year. It is noted that Russia could receive about US \$ 30 billion of FDI annually without any threat of becoming economically dependant on foreign capital (Chistov, 2003).

At the same time, the structure of foreign capital allocated in the Russian economy is unsatisfactory. Russia receives much more commercial bank loans and trade credits as opposed to foreign direct investment. For example, in 2002, foreign direct investment accounted for 20.2 % of Russia's total foreign investment, while the share of loans and other types of investment attracted was 77.4 %.

Table 11. Russia's foreign investment from abroad by type, 1997-2002

(millions of US dollars and percentage)

Type of investment	1997		1998		1999		2000		2001		2002	
	USD ml.	% of total	USD ml.	% of total	USD ml.	% of total	USD ml.	% of total	USD ml.	% of total	USD ml.	% of total
FDI	5,333	43.4	3,361	28.6	4,260	44.6	4,429	40.4	3,980	27.9	4,000	20.2
Portfolio investment	681	5.5	191	1.6	31	0.3	145	1.3	451	3.2	470	2.4
Other investment	6,281	51.1	8,221	69.8	5,269	55.1	6,384	58.3	9,827	69.9	15,310	77.4

"Other investment" includes trade credits, loans and other financial borrowings.

Source: Based on Goskomstat. *Statistics Yearbook 2002*

In 2002, Russia attracted 0.6 % of the world's total FDI, while Korea's share of the world's FDI inflows was 0.3 %. However, Korea's FDI inward position looked better. Korea's share of inward FDI totaled about 0.6 % of the world's FDI inward stock, while Russia's share was 0.3 % (UNCTAD, 2003).

FDI inflows to Korea have significantly increased since 2003. In Russia, FDI inflows have increased slightly from year to year. Clearly, the growth of foreign investment in the Korean economy was due to the improvement of investment climate in the economy. One of the most important features of this improvement was the establishment of a state agency for foreign investment that provided valuable information to foreign investors interested in the allocation of capital in the Korean economy. Russia had such an agency too -- however, it was closed down after functioning for just three years. Now, there is no longer a unified investment agency in Russia like the one in Korea. This has a negative impact on foreign capital inflows, the amount of which, as mentioned earlier, decreased over the 1990s due to the opacity of the Russian economy.

8. The role of the Russian Far East in the development of Russia-Korea investment cooperation

Korea is a large investor in the Asia-Pacific region. It mostly invests capital in the economies of advanced countries such as the US, Japan, Taiwan, and others. Korea invested much more capital in Asia and North America than in Europe over the last 14 years. By comparison, the average share of Korea's overseas direct investment in Asia was 42.2 % of the total amount invested during the period from 1990 to 2003, while its share of direct investment in North America and Europe was 30 % and 15 % respectively. Russia's share, on the other hand, did not exceed 0.6 % of the total amount of Korea's overseas investment.

In Russia, Korea invests the largest share of its capital in the Russian Far East. Among the territories of the Russian Far East, Primorsky kray has actively developed investment cooperation with Korea. As a result, Korea has become the largest investor in the economy of Primorsky kray.

Table 12. Foreign investment in the economy of Primorsky kray by country, 1998-2002 (millions of US dollars and percentage)

Country	1998		1999		2000		2001		2002	
	USD ml.	%	USD ml.	%	USD ml.	%	USD ml.	%	USD ml.	%
Total	56.3	100	53.9	100	78.1	100	108.6	100	57.3	100
Republic of Korea	23.3	41.4	20.6	38.2	43.4	55.6	30.6	28.2	21.3	37.2
Japan	13.2	23.4	15.9	29.5	11.8	15.1	29.7	27.3	19.8	34.6
China	0	0	0.7	1.3	1.8	2.3	0.4	0.4	0.6	1.05
United States	3.4	6	4.4	8.2	11.9	15.2	38.9	35.8	8	14

Source: Based on Goskomstat. *Statistics Yearbook 2002*

Primorsky kray's favorable location plays a major role in the amount of investment it receives from Korea. Further, Korean companies prefer to work out their investment projects in the Russian East, because its market is not monopolized by large Russian companies, and the region has a high demand for high-tech products specialized in Korea and used in production processes. At the same time, Korean companies prefer to invest capital in spheres where they can earn a high profit within a short period of time (clothing industry, tourism, telecommunication, and service sectors, such as hotels). For the most part, they allocate a medium-term capital in the economy of the Russian Far East, contributing to the region's unstable economic and political situation.

9. The difficulty of developing the bilateral investment cooperation between Russia and Korea

The development of Russia-Korea investment cooperation has stopped because of the debt the former Soviet Union accumulated in loans from Korea. Russia must repay about US \$ 1.58 billion, plus interest, to Korean banks for its loans. Though it is peculiar that this amount of debt might be a serious barrier to future Korean investment in the Russian economy, the Korean government has in fact been paying careful attention to how the Russian government will fulfill its financial obligations. This concern paved the way to an intergovernmental debt rescheduling agreement that was signed by the Ministers of both countries in September 2003. This debt problem, however, will have an impact on how Korea decides to develop economic ties with Russia.

Currently, what the countries have achieved as a result of bilateral economic relations has fallen short of their expectations. Korean companies are still faced with an unsatisfactory investment climate while doing business in Russia. The Korean government insists that the host government offer Korean companies some privileges in Russia. Some of these claims have been met. In particular, Russia and Korea signed an agreement on avoiding a double tax obligation.

It is noteworthy that these measures are not enough to change the current situation in the investment sphere and to persuade Korean companies to invest in the Russian economy. A new approach to the government investment policy should focus on attracting investment from Korea in order to stimulate Korean companies into making long-term and large investment in Russia.

The obstacle to such a stimulus is due to economic and political instability that exists in Russia. As long as this instability persists, Korean companies will continue to make only short-term and small investments in the Russian economy by focusing on the development of small-sized joint business ventures in services sector. This negatively affects the development of long-term bilateral investment cooperation between Russia and Korea.

10. The prospects of the investment and trade cooperation development

The prospects of developing the Russia-Korea investment cooperation are multifaceted. They may concern the development of cooperation in the services sector that seems real. They may also include the development of joint ventures for mining natural resources in the Russian Far East, though this can be doubtful due to high investment expenses which Korean companies will need to provide in order to gain high profits later on.

Russian companies will keep developing trade operations with Korean firms in the near future, buying mostly consumer goods that are in great demand in Russia. There will still be a high demand for home electronic equipment in Russia, because its national electronic industry is less developed. The only goods Russian companies are in a position to offer Korean companies in exchange for high-tech products are raw materials (wood, metal ores, and petroleum). The commodity structure of the Russian exports can vary in some Russian regions, but energy sources will account for its largest share.

It should be known that Russia's exports by commodity will continue in this fashion because there are no prerequisites for change that could be implemented during a short period of time that would significantly change the country's export specialization. Moreover, the commodity structure of any country's exports depends on its domestic production base that is created over the course of many years.

What Russia may rely on now is some long-term trade and investment cooperation with Korean companies which might help strengthen the former's commodity structure and improve the competitiveness of its products by means of developing some joint research projects. Russian scientific organizations conduct applied research in different spheres of natural science which are of interest to Korean companies (e.g. physics). These organizations lack finances to develop their

research, and the government is currently unable to provide enough financial resources to all scientific organizations in the country, though many of them are still state-owned.

The government spending on science in Russia decreases from year to year. In 2003, the share of government expenses was 18.4 % of total expenses on science and technology development. The ratio of expenses on science and technology development to Russia's GDP equaled 0.28 % in 2002 and 0.3 % in 2003, far less in comparison with advanced nations (2 to 3 %). In Korea, the government spending accounted for 15 % of total R&D expenses in 2002 (OECD, 2003).

In Russia, the current economic situation is not conducive to the investment of private capital in the development of applied science. As a rule, government investment accounts for the largest share of capital attracted in the science sphere. In contrast, private capital in Korea finances about 80 % of all R&D expenses.

Despite the financial problems, Russian scientific organizations managed to achieve results and even gain some scientific potential for growth. Russia still has a great number of well-known scientists in the world. In general, the number of scientists working in Russia composes about 11 % of the total number worldwide. This proves the fact that Russia has real potential for achieving higher results in science.

In terms of lacking financial resources, the cooperation between Russian scientific organizations and Korean companies will be mutually profitable: Korean companies may acquire the latest achievements in Russian science and apply them to production, allowing Russian scientific organizations to reduce the deficit in financial resources needed for research. There are some examples of such cooperation. In particular, Samsung provides financial aid to Russian scientific organizations to create new types of semiconductors. The results of their research are applied to the company's production of TV sets. Samsung has also concluded an agreement with the Russian Academy of Science to buy the results of its research (Souslina, 2001). Moreover, large-size Korean companies regularly attract Russian scientists to develop research projects in Korea.

It would be naive to suppose that Korean companies might be interested in developing the manufacturing industries in Russia, except for those that would produce raw materials. While there are some Korean companies doing business in this sphere in Russia, they have entered into the Russian territory merely to be closer to the sources of raw materials.

It seems Russian defense enterprises might attract some Korean investment, because most of them have been obtaining advanced technology and large production facilities for the last 40 years. However, the government controls and regulates this sphere strictly, and investing foreign capital is limited. The development of any project in this industry requires a lot of financial resources that Korean companies could provide, getting some guarantees from the Russian government on the capital invested or sharing investment expenses with Russian partners. This seems unlikely, though, because the defense industry is not a priority sphere where the Russian government provides guarantees on foreign capital invested, and Russian investors prefer to invest money in short-term projects or in projects concerned with the supply of natural resources.

The perspectives of Russia-Korea trade and investment cooperation also depend on the possibility of expanding the commodity structure of their exports and imports. This refers to the export potential of both countries. Russia can easily increase its exports of raw materials by intensifying production processes in the Russian Far East, a region rich in natural resources. Korean companies becoming familiar with the Russian market can surely increase the supply of their goods to the country in order to enlarge their own niche markets. Obviously, Korean companies will be willing to supply their goods to the Russian market without intermediaries in the future to maximize their profits.

It is noted that Russia may gain considerable benefit from its participation in the projects of North and South Korea. In particular, South Korean investors have an interest to connect to the Russian railroad (TRANSSIB) via the territory of North Korea in order to supply their goods to the European market. The project seems realistic, though the North Korean government changes its policy from time to time.

All the parties of the project will be better off upon its development. Russia and North Korea will earn extra revenue for their budgets due to an increase of cargo flow through their territories. Moreover, this project may intensify the development of their transportation infrastructure. South Korean companies will be able to reduce their transportation expenses as a result of moving cargo by trains rather than by ship.

The other project, which also may bring some benefits to all three countries, is the construction of gas and oil pipelines from Russia to South Korea. The pipelines are supposed to go through the territory of North Korea which would make it involved in the project too. This project is optimistic due to a projected increase in demand in South Korea for natural resources in 2005 and in 2007.

However, the realization of this project will enable Russia to supply natural resources, as opposed to finished goods. Such a commodity structure of exports makes the country worse off in the long run, as mentioned earlier. Therefore, it is necessary for Russia to develop projects that would involve it in becoming an equal partner in trade and investment relations.

There are at least two well-known projects relating to the development of infrastructure in Russia. One of them is TUMANGAN. This project is supposed to develop port infrastructure at the mouth of the Tuman River. Russia would gain benefits from developing this project because it would attract more foreign investment to its economy, especially the regional economies of Khabarovsk and Primorsky krais. There are foreign investors, including Korean companies, who have an interest in financing the development of port facilities in the territory along the Russian side of the Tuman River. It is obvious that such Russian regions as Khabarovsk and Primorsky krais located next to this territory will be developing as well. However, this project is developing very slowly, impacting the benefits and losses Russia may endure. It is difficult to measure the effect of this project development on the Russian economy. Yet it is obvious that the railroad system and seaport infrastructure in the Russian Far East will be useless, because the main trade flows will travel via the Tuman River. As a result, this may lead to a decline in the development of the Russian Far East economy.

Another project concerns the development of the Nakhodka free economic zone in Primorsky kray. This project has been focused on forming an export processing zone. It was supposed to attract investment from Korean companies to develop the project, however unfavorable economic conditions forced investors to postpone the development of this project. Now this project remains on paper.

Russia and Korea have some opportunities for trade and investment cooperation in the sphere of marine and wooden goods production. Korea depends heavily on imports of wood and wood products. It imports up to 95 % of wood from abroad. Having large reserves of timber, Russia is considered a main supplier of wood to Korea. It is reasonable to develop Russian-Korean joint ventures in this sphere that would produce finished goods. Moreover, there is a great demand for fishing vessels in Russia, and Korea, being a large producer of vessels, is in a position to supply them to the Russian market. The cooperation based on leasing the Korean vessels to Russian fishing companies should be very promising in the future.

Tourism is one of the directions of Russia-Korea investment cooperation. Korean companies have a great interest in developing tourism between Korea and Russia. This interest is related to different types of tourism including ecological and business tourism. Nowadays, Russian companies are

actively developing ecological tourism. On the one hand, the industry will be focused on providing services aimed at sightseeing and organizing camping trips in the Russia Far East (e.g. Primorsky kray, Khabarovskiy kray, Sakhalin, Amurskaya oblast, and others). On the other hand, it will satisfy a growing demand for trips to Korean ski resorts and amusement parks from the Russian side. Korean ski resorts attract Russian tourists with their well-organized facility structure (e.g. ski slopes), which are still undeveloped in Russia.

Business tourism is supposed to provide opportunities for Korean and Russian businessmen to become familiar with the economic situation in each others' countries, to participate in business seminars, to meet with potential partners and to receive all necessary information on conducting business in Korea and Russia.

There were a lot of projects offered by Korean companies related to the development of business services in the Russia Far East. But only one project has appeared successful. This project was developed by the Hyundai Company. The company constructed a business center in Vladivostok, the capital of Primorsky kray.

11. Conclusion

Russia-Korea trade and investment cooperation is developing very slowly. The analysis of the tendency of this cooperation over the last 10 years has proved it to be unstable. There were years when trade turnover increased between countries, and years when it significantly declined. Unlike the tendency of trade relations, investment cooperation has been developing in a quite stable manner, but the amount of investment flows between the two countries has been extremely small.

The trade and investment cooperation between the countries is developing through joint ventures. Other forms of cooperation, namely research and production ties, remain stagnant due to economic and political problems.

Having concluded diplomatic relations, Russia and Korea have established a basis for their further trade and investment cooperation. However, there is still a need for the improvement of legislative documents on trade and investment cooperation between the two countries. It is clear that the development of research and production cooperation, as well as other forms, requires both governments' support. The joint projects will not be effective unless the countries create more favorable conditions for the joint ventures doing business in their territories.

Russia and Korea have a high potential for developing their trade and investment cooperation. It will be to their advantage to intensify this cooperation. But this intensification will depend on the policy implemented by both countries.

Russia has a great interest in the development of projects with Korea because they will provide Russia a chance to increase its export potential. The growth of exports will be possible due to the development of Russia's manufacturing industry by means of foreign investment inflows. The amount of foreign invest will definitely increase after the economic situation in Russia starts changing for the better. Korean investors are in a position to bring new technologies into the Russian industries.

Korea will also be at an advantage when cooperating with Russia. It will gain access to the Russian market and will be able to expand its exports to Europe. The strategy of further cooperation with Russia may make Korean goods more competitive in the European market by decreasing the transportation costs of Korean companies.

To conclude, it is obvious that Russia and Korea have a stable basis of trade and investment cooperation. Since the two countries started to develop their relations just one decade ago, it would be unreasonable to expect large export/import operations among Russian and Korean companies

during such a short period of time. Yet there is a potential for growth of trade and investment flows between these countries. The governments of both countries continue to successfully work on achieving an agreement concerning different issues of their economic relations development. The tendency of further trade and investment cooperation will depend a lot on the economic policy which Russia and Korea will implement to create favorable conditions for increasing trade and investment flows between their economies.

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