

Korea's Dynamic Economic Partnership with a Rising China: Time for Change

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During the last 20 years, Korea and China have rebuilt their economic relations. Korea has benefited from China's rise through vertical cooperation in the East Asian manufacturing network. The complementary nature of vertical cooperation has reduced direct competition or "threats" from China. However, after the global financial crisis of 2008, the foundation of Korea-China cooperation itself started to change. China now needs a new model of development, one that is less dependent on external markets and leads to a quicker industrial upgradation. China's strategic shift will dismantle the current Korea-China bilateral economic relations. As China's industrial supply chains become more value added, the former vertical cooperation between Korea and China will be transformed into a parallel competition.

Keywords: *Korea, China, Bilateral Economic Relations, Trade, Investment, East Asia*

1. INTRODUCTION

Two decades have passed since Korea resumed formal diplomatic ties with China in 1992. Bilateral economic relations between Korea and China have grown rapidly in terms of trade and investment volumes. In 2011, bilateral trade reached US\$ 220.6 billion, while the accumulated total Korean Foreign Direct Investment (FDI) in China exceeded US\$ 49 billion. Each country has become a major economic partner for the other during these 20 years. Currently, China is Korea's largest trade and investment partner, and Korea is China's 3rd largest trade partner, following the U.S. and Japan.

This impressive development in bilateral economic relation can be regarded as quite natural in some sense. Firstly, it has been a process of "compensating" for or "catching up" of economic relations, which had stalled for almost 100 years because of political reasons.

During the latter half of this political separation, Korea transformed itself successfully into a major industrialized country and an active trader in the global economy. China also introduced "reform and opening" strategy in the late 1970s and gradually participated in international trade and investment. Thus, once the political barriers vanished between the two neighboring economies, the long-suppressed bilateral economic relations recovered very quickly, exactly as indicated by the gravity model.¹

Though the rapidly growing economic strength and geographic proximity can account for this growth in trade and investment between Korea and China, clearly these are not providing enough explanations for these developments (Sohn and Yoon, 2001). Notably, in today's globalized economy, bilateral economic relations would have to be built on the basis of international division of labor and firm-level production network activities. As a result, these two aspects should be properly addressed while focusing on bilateral economic relations. The

¹ The gravity model of trade predicts bilateral trade flows between two units based on their economic sizes and geographic proximity. The model was first used by Tinbergen in 1962.

broader contexts of the global shifts in manufacturing activities, the development of the Global Production Network (GPN), and the industrial division of labor in East Asia, —all of which have been stimulated by the integration of China into the global market—should be considered in order to understand the real nature of the development of bilateral economic relations. Indeed, in this context of globalized activities, Korea and China have been two of the most active players.

At the same time, during these two decades, both Korea and China have experienced some of the most dynamic economic developments. In 1992, Korea had just completed establishing heavy industries with its “government-led” investment approach. The East Asian economic crisis in the late 90s challenged the effectiveness of this model. Korea experienced a severe and painful process of economic restructuring during the crisis. However, owing to its drastic and painful restructuring in 2000, today, Korea is regarded one of the world’s highly advanced, knowledge-based economies. Korea has successfully established several global leading industries such as semiconductor and display manufacturing, information technology, steel, shipbuilding, and automobiles.

In that same year (1992), China resumed its reforms in the aftermath of the Tiananmen incident. In January 1992, Deng Xiaoping made the famous “southern tour” and the Communist Party of China officially declared the “Socialist Market Economy” as the country’s new national strategy. Since then, China has transformed herself into an active market economy, eventually becoming the biggest exporter and the second largest economy in the world. The economic emergence of China makes her one of the world’s major growth engines. In fact, after the 2008 economic crisis, China is widely regarded as having stepped into the shoes of the old growth engines, the U.S. and the EU. Currently, China seems to be a serious contender in the “G2” for the leadership of the global economy in the post-crisis economic terrain² (Garrett, 2009:3).

Thus, the dynamic economic developments of these two countries should also be taken into consideration while studying the evolution of bilateral economic relations between them.

2. ASSESSMENT OF OPPORTUNITIES AND THREATS

Bilateral economic relations can be portrayed with quantitative terms like trade volume, investment flow, personnel exchange, etc. However, to understand the relationship from the Korean perspective, the terms “opportunity” and “threat” are quite useful. In this context, let us consider the economic rise of China and its implications for the rest of world, as has been widely accepted (Huang, 2012; Jee et al., 2005:26-33).³ We therefore use this “opportunity and threat” approach as a starting point of our description of the bilateral relations between Korea and China.⁴

In this regard, for instance, the rapid growth of the Chinese import market and the

² A typical response of one Chinese scholar on China’s role in the world economy can be seen in Yu (2004), although the study was published long before the crisis.

³ The title of a seminar held by a Korean institute (Research Institute of International Issues; Kukjemunjezhosayeonguso) was “Rising China’s Economy: opportunity or threat?” in 2001.

⁴ This approach is also very realistic as bilateral relations between the two countries are asymmetric. The economic influences, or the weightage of the relation for each economy, are different; while China is Korea’s biggest economic partner, Korea is not so for China.

continuing Korean trade surplus could be regarded as a huge economic opportunity, which Korea enjoys in this bilateral economic relationship. On the contrary, the industrial catch up of China's enterprises has often been interpreted as an economic threat for Korean industries. Furthermore, as many Korean companies invest in China, the Korean public has been concerned about the "hollowing out" of Korean manufacturing and lost domestic job opportunities.

However, this prevailing "opportunity and threat" approach easily deteriorates into an excessively simple mercantilist perception of bilateral economic relations between these countries. Surely, today's mainstream economist recognizes this perception as being far from reality. Consequently, we can try to enrich our understanding within the wider context of globalization and dynamic economic development of both countries, by considering trade balance and industrial competition.

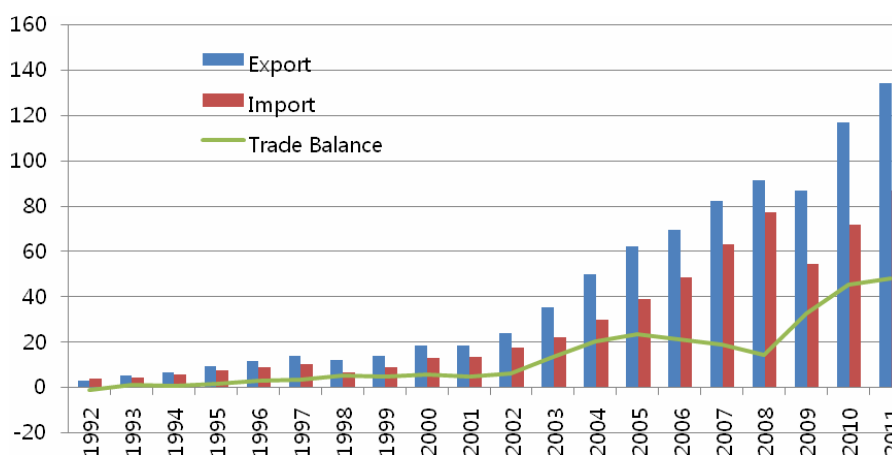
2.1. Trade Opportunities

Trade and the investment are the two arms of any bilateral economic cooperation. There are two apparent features in the Korea-China trade: the rapid growth of overall trade volume, and the continuing and expanding trade imbalance.

Compared to a mere US\$ 6.4 billion in 1992, the Korea-China mutual trade volume rocketed by 34.6 times to reach US\$ 220.6 billion in 2011. Korea's overall foreign trade increased by 6.8 times for the same period. During this time, Korea's export to China increased 50.6 times from US\$ 2.6 billion to US\$ 134.1 billion. With this bilateral trade, Korea has enjoyed a trade surplus since 1993, for 19 years in a row. In 2011, the trade surplus touched US\$ 47.7 billion or 21.6% of bilateral trade (see figure 1).

For Korea, the trade surplus with China contributed significantly towards maintaining its overall trade surplus and helped Korea to cope in the aftermath of the financial crisis in 1997-1998. This is quite clear when we compare the accumulated total of Korea's trade surplus with China (US\$ 272 billion) with that of all over the world (US\$ 239 billion) for the period of 1992-2011. It means, if the trade with China is excluded, that Korea actually

Figure 1. Korea-China Bilateral Trade (billion, US\$)



Source: kita.net

records a trade deficit with the rest of the world during the two decades in question. For this reason, many Koreans regard the Korea-China bilateral trade as a real blessing for the Korean economy. The widely accepted notion of “Chinese opportunity” or “Chinese boom” might well come from this background in trade.

The question arises as to how this has come to be. How can we explain these huge benefits from Korea’s trade with China? The factors of the gravity theory, the geographic proximity, and the sizes of the economies reveal only a superficial part of the whole story.

The unique historical paths of Korea’s economic development and Chinese reform can provide deeper explanations. The globalized nature of bilateral relations also gives us an opportunity to sketch the real story.

Let us return to 1992, the year when diplomatic ties were established between Korea and China. It was an ideal “match” at the outset. At that point, Korea had just completed industrial upgradation, which had started in the late 70s under the-then President Park’s initiative. By then, capital-intensive, heavy, chemical industries like steel, petrochemical, automobiles, electronics, and semiconductors, had become the mainstays of Korean industry. The ratio of heavy industry in the Korea’s manufacturing exports rose dramatically from 38.3% in 1977 to 65.6% in 1992, and to 93.7% in 2011 (Byeon, 1990:535; www.stat.kita.net).

Given the fact that heavy industries require heavy input of capital in order to mass produce, Korean industries were desperately looking for new export markets for their products after the end of the “three-low boom” in late 80s.⁵ The normalizing of diplomatic ties between the countries and the opening up of the Chinese market in 1992 provided a golden opportunity.

As mentioned earlier, 1992 was a turning point for China as well. Under Deng’s initiative of the Socialist Market Economy, China toned down her ideological reservations and started to open up her economy. With this breakthrough, China’s cheap labor power and abundant land absorbed foreign investors. FDI inflow more than doubled from US\$ 4.4 billion in 1991 to US\$ 11.0 billion in 1992. It reached US\$ 37.5 billion just after 3 years (1995). Thus, during 1990-1995, FDI inflow increased more than 10 times (see table 1).

It was the emergence of the East Asian production network that transformed Chinese coastal areas into the final assembling platforms for global companies. After 1992, foreign joint ventures (JVs) from all over the world poured into these areas. They utilized China’s cheap labor and land, and produced labor-intensive products like garments, toys, shoes, computer sets, among others for global export. Since then, China’s export has almost doubled every five years.⁶

Table 1. China’s FDI Inflow during 1990-1995

Year	1990	1991	1992	1993	1994	1995
FDI inflow (billion, US\$)	3.5	4.4	11.0	27.5	33.7	37.5

Source: *China Statistical Yearbook 1996*

⁵ During 1986-1988, a combination of low oil prices, low interest rates, and a low currency value helped Korean industries experience an unprecedented rate of growth in exports and this led to an economic boom. The excessive industrial capacity built in the late 70s under the-then President Park’s strong “guidance” finally found its market.

⁶ China’s recorded exports were worth US\$ 71.9 billion in 1991, US\$ 266.1 billion in 2001, and US\$ 1,898.6 billion in 2011. *China Statistical Yearbook*.

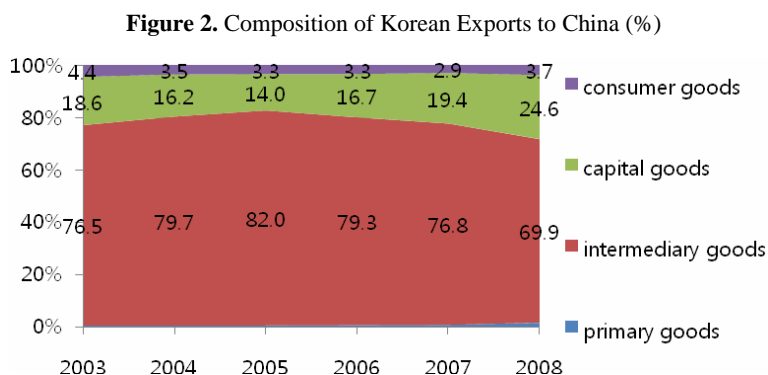
These foreign exporters with labor-intensive assembling needed equipment, machinery, materials, parts, and components for their production in China. However, China's upstream industries could not meet the demands of the foreign JVs. At the time, China's upstream industries consisted of "State-Owned" Enterprises focusing on the conventional domestic market. Their poor governance seldom responded adequately to the dramatic shifts in the GPN activity of the multinationals located in China.

Thus, the fast-growing export industries driven by FDI and the GPN activity of multinationals needed other sources to procure the capital and intermediary goods needed for production. At the time, highly industrialized Korea, Japan, and Taiwan were the obvious ideal partners for them. They were ready and capable to provide any goods that China needed. Most of all, they were located very close, just across the sea.

As a result, along with its fast-growing exports to the world market, China's imports have also increased very rapidly since 1992. The annual growth rate of 8.6% during 1986-1991 accelerated to 12.0% during 1992-1997, and 17.0% during 1992-2011. The majority of imports consisted of capital and intermediary goods from its industrialized East Asian partners, Korea, Japan, and Taiwan. This completed the East Asian production network.

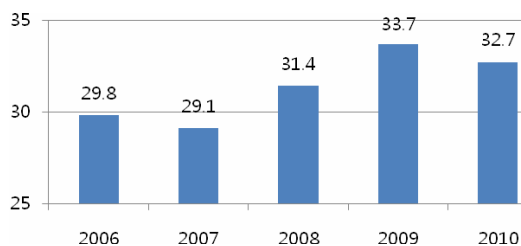
When we look at the composition of Korean exports to China, the structure is quite evident: 95% of Korean exports consist of capital goods (24.6%, 2008) including equipment and machinery, and intermediary goods including parts and components (69.9%, 2008) (See Figure 2).

A major proportion of Korean exports are to China. The Chinese Customs Office categorizes around 70% of Korean exports as "processing and bonded trade," which is



Source: Institute for International Trade, 2009; stat.kita.net

Figure 3. Share of General Trade in Korean Exports to China (%)



Source: Lee et al.(2011:47).

finally employed in China's export sectors. Only 30% is categorized as "general trade," which attracts custom duties (See Figure 3).

2.2. Threats: Competition and Hollowing out

As China became the workshop of the world, its global market share expanded rapidly from 1.8% in 1990 to 9.6% in 2011. Today, China exports more high tech items. According to OECD standards, only 27.4% of China's export was classified as "high or middle tech" in 1992. However, the number grew to 56.3% in 2006 (Bank of Korea 2007:15). This means that Korean exporters face more competition with China in the international market as time goes.

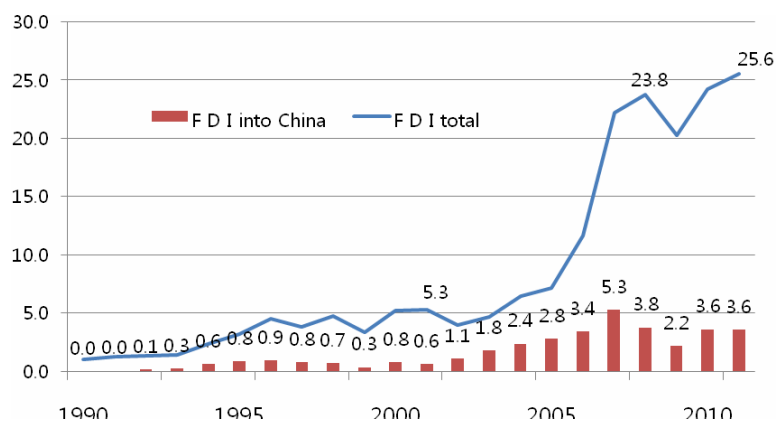
Being an export-oriented economy, it seems natural for Korean industry and businesses to feel threatened by the unprecedented scale and scope of China's rising presence in the global market. Moreover, this concern has been quite prevalent in Korea from the late 1990s. At times, the situation has been depicted with terms like "sandwich" or "nut cracker" to show how the Korean economy is pressurized on the one hand by China and on the other by the prevailing advanced knowledge-based economies like Japan, the U.S., and Europe. The traditional economic nationalism of Korea also drives this concern.

However, if we take into account the transfer of certain GPN activities by multinationals (namely, their export platform) to China, we discover an alternative story about the nature of competition and "threat" faced by Korean industries and companies in international market. Most of all, foreign JVs in China are responsible for more than half of China's exports, which peaked at 58.3% in 2005. The ratio continued to remain higher than 50% in 2011. Among the foreign JVs, Korean JVs played a significant role. For example, in 2005, 10 Korean JVs were listed among the top 100 exporters of China. In this regard, around half of the competition with Chinese products in the global market actually came from those multinationals, including Korean companies, which have already invested in China and built an export platform there. Of course, this should not lead us to underestimate the growth of Chinese local exporters who claim another half of China's exports and the importance of competition comes from those local players. However, the role of foreign JVs are still more crucial and dominant in the more high-tech export industries like IT and computers, where Korean and Chinese products are competing more strongly and directly in the global market.

This alternative story thus provides a different perception of the competition faced by Korean companies. In some sense, China has not been competing against Korean industries. Rather, China has been a playing field or an industrial park where multinationals have invested and competed against each other. Thus, the major competition for Korean industries is not with its Chinese counterparts in the global output market. On the contrary, the competition exists in the input market among the multinationals that hope to make the most of China's low-cost inputs like labor, land, and networks within China.

There is another concern, too. As many Korean manufacturers offshored their production to China following the global shift of production networks, the worry of "hollowing out" rose among the Korean public. Increasing offshoring could undermine the basis of Korean manufacturing and reduce jobs in Korea.

After the restoration of diplomatic ties in 1992, Korean FDI in China increased rapidly. By the end of 2011, a total of 21,743 Korean JVs were established in China, with investments of US\$ 35.9 billion. At its peak in 2007, 2,116 investments amounting to US\$ 5.3 billion had been made in China (See Figure 4).

Figure 4. Korean FDI Outflows since 1990 (billion, US\$)

Source: www.koreaexim.go.kr

It has been estimated that the number of Korean manufacturing jobs declined by 880 thousand during 1990-2003, while Korean JVs in China hired 1 million Chinese workers (The Korea Economic Daily, 2004). A more solid econometric estimation reveals that Korea lost 134 thousand jobs during 1993-2003, with a loss of 44.6 thousand in 2003 alone. Korean domestic investment also decreased owing to rising Korean FDI in China (Park, 2005:75-76).

However, several assessments disprove the hollowing out hypothesis. First, outward investment from a fast-growing economy like Korea can be regarded a quite usual response for a country coping with rising domestic costs and in need of industrial upgrading. Such countries tend to offshore labor-intensive export industries to other developing countries (in this case, China). Their more capital-intensive industries also seek offshoring to advanced countries, in order to secure the market (Lee, 1994). In line with this explanation, not only Korean FDI in China, but also the overall Korean FDI started to rise since the early 90s. FDI in China was just part of the overall trend for Korean industries at that time (Jee et al., 2004: 129-142). also pointed out that FDI in China had provided gradual and graceful exits for some Korean companies whose business life cycles had run out of steam or in the declining stage. These events actually helped Korean industry as a whole by forcing inevitable restructuring and upgrading.

The other point concerns job creation. With 21,743 Korean FDI projects in China by 2011, Korean companies have actually created more than 100 thousand job opportunities for Korean staff working in China as well as for unskilled Chinese labor.⁷ Moreover, the jobs created for Korean staffs are non-menial, for example, managers and technical consultants. Currently, the Korean population in China numbers 700 thousand, with the majority working for Korean JVs or running their own business in China (Korean Embassy in Beijing, 2012).

To summarize, contrary to public perception, the “threats” of competition in the products market or the loss of jobs owing to Korean FDI in China have not really threatened the Korean economy. When we consider the transfer of certain GPN activities by multinationals

⁷ A survey done by Korea Institute for International Economic Policy (KIEP) in 2007 revealed that the average number of Korean staff employed per project was about 5.

to what is now known as the “workshop of the world” and the development of the Korean economy by the 1990s, we begin to appreciate other aspects. The competitions among multinationals to utilize China’s low-cost inputs were real competitions we have faced. The offshoring of Korean capital as it matured, actually created new jobs for Koreans inside China.

3. FROM THE WORKSHOP TO A MARKET: NEW CHALLENGES

However, after the global financial crisis of 2008, the foundation of Korea-China cooperation itself started to change. Market demand from the U.S. and the EU decreased after the crisis and is likely to take quite a while to recover. This has seriously shrunk the final market for Chinese exports. The U.S. and the EU with their lingering economies can no longer provide a large enough market for the East Asian workshop. Under this new post-crisis climate, China needs to transform itself from a workshop for the GPN activities of multinationals to a market for huge domestic consumers. The foundation of China’s export-oriented development strategy needs a thorough reexamination, as does the Korea-China bilateral economic relations model, both of which have largely depended on the “workshop of the world.”

As many economists have pointed out, China now needs a new model of development, which is less dependent on external markets. Decades of China’s “export-led growth formula must give way to the internal impetus consumer-led growth” (Roach, 2009:247). In China’s 11th and 12th five-year plans started in 2006 and 2011, respectively, the Chinese government declared its intention to embark on a new road to secure China’s long-term growth, with the 12th five-year plan outlining how this goal will be implemented. The plan identifies structural problems in the Chinese economy such as 1) the unsustainability of export-led growth, and 2) the fact that consumption as a share of the GDP is too low on account of the low income-to-GDP ratio, weak demand, and an unsustainably high savings rate (Casey and Koleski, 2011:3). Once this transformation is implemented, China will become more domestic-market-oriented rather than export-oriented. Additionally, labor income will take precedence over corporate profits, and consumption will rise while investments are likely to decrease.

China’s strategic shift will dismantle the current Korea-China bilateral economic relations, as they were established on the basis of the GPN activities of multinationals and China’s export-led growth strategy. Just as China transforms her development pattern, Korea-China bilateral economic relations will face serious challenges to adapt to it. In that sense, the implications of this shift on Korea-China bilateral economic relations should be addressed carefully.

As the opportunity-threat structures between Korea and China for the last 20 years have come about as a result of developments in East Asia’s manufacturing workshop, the nature of opportunities and threats posed by China will also change fundamentally.

On the demand side, future opportunities exist for Korean industries in China’s domestic market rather than the provision of intermediary goods for export industries. Thus, in order to maximize the economic benefit from China’s transformation, Korea needs to penetrate directly into China’s domestic market. However, it is not doing well in this regard, as indicated by China’s imports.

Table 2. The Ratio of General Trade within Imports from Various Countries

	2006	2007	2008	2009	2010	Change from 2006-2010
Korea	29.8	29.1	31.4	33.7	32.7	2.9
Germany	65.7	68.4	67.8	74.5	77.9	12.2
U.S.	47.8	51.8	57.7	64.8	62.5	14.7
Japan	36.5	37.7	41.3	47.9	50.6	14.1

Source: Calculated from (Lee et al., 2011:47)

In 2010, the ratio of “general trade”⁸ in Korea was very low (at around 30%), while the corresponding figure for advanced economies like Germany (77.9%), the U.S. (62.5%), and Japan (50.6%) were much higher. It means that unlike Korea, they are better equipped to cope with China’s coming transformation and will thus be the biggest beneficiaries of China’s strategic shift (See Table 2).

The changes in general trade during 2006-2010 show quite different performances between Korea and other competitors in China’s domestic market. The ratios of Germany, the U.S., and Japan rose by 12-14% while that of Korea rose only by 2.9% throughout the period (the crisis and the transformation). Korea’s advanced rivals are doing much better at adapting to the changes in the business climate of China’s domestic market.

While much attention has been paid to the changes and challenges on the demand side, more fundamental changes will occur on the supply side. The changes on the demand side are correlated with those on the supply side. For instance, as the 12th five-year plan depicts, increased domestic consumption will require more disposable income. Higher incomes imply the need for higher wages, and higher wages will require larger business margins. Larger margins demand more mature value chains in Chinese industries. To meet the transformation on the demand side, China’s manufacturing needs to be upgraded to allow her to move up the value chain in light of rising labor costs. This interaction between the demand and the supply sides has been duly recognized and addressed in China’s 12th five-year plan (Casey and Koleski, 2011:3).

Owing to the changes on the supply side, Korean JVs operating within China will first experience a direct shock in terms of rising costs. Small and medium size enterprises (SMEs) in labor-intensive industries would be hit first.⁹ Because they operate on very thin margins, many would be forced to shut shop in China or move to another country where the wages are still low.

However, more fundamental threats will come from China’s industrial upgrade. While Chinese industries performed low value-added activities like processing and assembling, China depended on imported machinery, equipment, materials, parts, and components. This was a blessing rather than a threat for the other industrialized East Asian countries, including Korea.

⁸ It is the ratio of import with the final destination being the Chinese domestic market. This kind of import pays the tariff.

⁹ In 2007, such a “shock” caused numerous cases of “flight by night” or “illegal” bankruptcy among the Korean JVs in Shandong province. They closed the factory leaving the wages and taxes unpaid. Most of the affected companies were SMEs in labor-intensive industries like simple processing or assembling (KIEP, 2008:22-27).

However, once China establishes high value-added and more capital-intensive industries, and builds a value chain inside the country itself, Chinese industries will start producing the capital as well as intermediary goods needed by China's export sector. This will result in rapid import substitution and export upgradation.

For any developing economy, including China, industrial upgradation is a natural process of economic development. Industrial upgradation has been an aspiration of the Chinese government since the early 1990s. Earlier, China's 8th five-year plan (1991-1995) outlined various versions of government-led industrial policies to upgrade its capital-intensive heavy industries (or the so-called "pillar industries" such as automobiles, petrochemicals, machinery, electronics, etc. (Hong et al., 2002:85-87).

However, this time, it is quite different, because for the first time, industrial upgradation has been integrated with China's overall development strategy. Before the 12th five-year plan was devised, it was just a direction that any ambitious government with development aspirations would have taken. Now, it has become a precondition for future development. Under the new framework of economic development, which puts more emphasis on domestic consumption and the rapid rise of disposable income, Chinese companies would be pressurized to provide higher payrolls.¹⁰ To enable higher payments, they will have to accelerate product upgradation and improve production processes. They would thus need to transform themselves into more capital-intensive, value-added, and high-tech companies. Moreover, this push no longer comes from the government's policy but from the market environment itself.

These changes are already underway. Chinese companies are getting bigger,¹¹ and more capital- and technology-intensive.¹² The R&D expenditure of the government and industries has been rising sharply.¹³ Chinese companies are acquiring reputed brands and technology through aggressive M&As.¹⁴

These recent developments on the supply side triggered by the transformation of China's development strategy mean two things. First, China's industrial progress is bound to accelerate as the overall market environment encourages upgrading. Second, there will be strong competition between Korean and Chinese industries in the domestic Chinese and global markets. As China's industrial supply chains become more value added, the former vertical cooperation between Korea and China will be transformed into a parallel competition.

¹⁰ Since 2010, the minimum wage levels have been rising by more than 10% every year in the almost every region in China. In reality, these levels are regarded as the wage guideline for companies in the respective regions.

¹¹ There were only 3 Chinese companies included in the "Fortune Global 500" list in 1995. The number climbed to 61 in 2011. For Korean companies, the corresponding numbers are 8 and 14, respectively. <http://money.cnn.com/magazines/fortune/>

¹² The growth rate of heavy industries has continuously exceeded that of light industries.

¹³ The key indicators of China's 12th five-year plan include raising R&D spending from 1.75% to 2.2% of GDP (Proposal for Formulating the 12th five-year plan, 28 October 2010).

¹⁴ The ODI of Chinese companies has increased rapidly. While China's ODI was a mere US\$ 2.7 billion in 2002, it jumped to US\$ 68 billion in 2010. In fact, China climbed up the world rankings to become the fifth-largest ODI investor in 2010. (UNCTAD, 2011:9; Ministry of Commerce of PRC, "Statistical Bulletin of China's Outward Foreign Direct Investment.")

4. BUILDING A NEW FORM OF COOPERATION

During the last 20 years, Korea and China have rebuilt their political and economic relations. Korea has benefited from China's rising through vertical cooperation between the GPN and the East Asian manufacturing network. So far, the complementary nature of vertical cooperation has dominated this relationship, where globalization enabled the conditions for economic co-development, and reduced direct competition or "threats" from China. At the same time, vigorous dynamics of both economies made the Korea-China bilateral economic relations a win-win situation.

After 20 years of this "honeymoon," the transformation of a rising China poses a serious challenge to these relations. Now, Korea finds itself losing out on China's fast growing domestic market compared with other countries like Germany, the U.S., and Japan. On the supply side, the competition from China's industrial upgradation has materialized at last.

Being neighbors with a rising China, Korea should accommodate these new changes, just as it has done over the past 20 years. As to the changes on the demand side of the bilateral relations, the ongoing Korea-China FTA negotiation¹⁵ can help improve Korea's accessibility to China's domestic market. Moreover, capitalizing on the large bilingual population in both countries would present numerous business opportunities in China's growing service sector, which is the mainstay of its domestic market.

On the supply side, Korea needs to adopt the double strategy of participation and differentiation. On the one hand, Korean companies should be players and partners in China's industrial upgradation, just like they were during China's export-led industrialization. At that time, Korean SMEs and *chaebols* became one of the major stakeholders in China's export industries through active FDI in those sectors. In the new phase of China's industrial transformation, a similar strategy can help Korea maintain economic links with China's "2nd" rising. If Korean companies can participate in the next phase of China's industrial upgradation and become one of the major players of that phase, the risk of "Chinese threats" can be minimized.

On the other hand, Korea's domestic industries should also differentiate themselves from Chinese industries undergoing upgradation. Korean industries could do this effectively by dissecting their business activities more deeply. Even within an industry, the modern value chain approach provides a lot of spheres like R&D, design, craftsmanship, marketing, branding, financing, procurement, etc., where a company can find its niche by devising its own competitive edge and differentiating itself.

The development of Korea-China bilateral economic relations demands more creativity from each party. After 20 years of successful cooperation, the future of their partnership depends on this creativity.

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¹⁵ In May 2012, Korea and China announced the start of bilateral FTA negotiations. The 3rd round of negotiations was held in August 2012.

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