



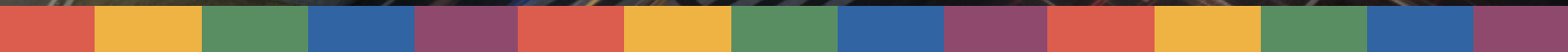
KOREA'S ECONOMY

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ECONOMIC IMPLICATIONS FOR SOUTH KOREA OF THE CURRENT TRANSFORMATION IN THE MIDDLE EAST

By Han Baran

We are witnessing unprecedented civil unrest and political transformation in the Middle East.¹ In Tunisia and Egypt, the protests were against increased poverty caused by rising commodity prices, high rates of youth unemployment, corruption, and lack of democratic processes. In less than 30 days since the beginning of contention, the Tunisian president of 24 years, Zine El-Abidine Ben Ali, and the Egyptian president of 30 years, Hosni Mubarak, were ousted. Hoping for similar results, Libyans followed suit and began protesting against the country's autocratic regime; there is now ongoing a full-fledged civil war with NATO involved. In Bahrain, the majority Shia population has stood up against the ruling minority Sunnis, demanding more political freedom and an end to absolute monarchy. Clashes that first broke out in Yemen over poverty and unemployment have now turned into demands that Ali Abdullah Saleh, president for 33 years, step down. There are continuing mass demonstrations in Syria demanding political reforms, and the regime there is suppressing them with violent crackdowns.

With more than 60 percent of the world's oil reserves and 45 percent of the world's natural gas reserves, the region and its political uncertainty inevitably have had a global economic impact. The price of Brent crude broke through the \$100 per barrel level amid the fear that the operations of the Suez Canal and the Sumed pipeline that in 2010 carried 1.8 million barrels of crude every day would be affected as protests in Egypt escalated.² When the civil war in Libya escalated in late February 2011, disturbing its sweet crude production, the price went over \$110 per barrel. As protests in Bahrain—located at the doorstep of Saudi Arabia, the biggest supplier of oil in the world—intensified in

early March, the price of Brent crude reached a new peak, going beyond \$115 per barrel. The current high oil prices in June 2011 are not just the doings of the political unrest in the Middle East, but there is no doubt that it is one of the main driving forces. Given that the civil unrest will not spread further to the oil-exporting countries such as Saudi Arabia, Qatar, Kuwait, and the United Arab Emirates (UAE), the International Monetary Fund forecast the price of oil to average \$107.16 a barrel in 2011 and world real GDP growth to be at 4.5 percent.³

Despite Korea's slowly increasing diplomatic role and the involvement of its military in the Middle East, the relationship between Korea and the region is still highly economic. In 2010, Korea exported goods worth \$28.3 billion to the region and imported goods worth \$80.8 billion.

In this article, I focus on the impacts on South Korea of the current transformation in the Middle East. South Korea is the world's fifth-largest importer of oil, importing 98 percent of its oil for domestic use, 80 percent of which comes from the Middle East. Korea is a major exporter of automobiles, automobile parts, and consumer electronics to the Middle East and North Africa region, and the amount of exports has been steadily rising for the past 20 years. The Middle East is also Korea's largest engineering, procurement, and construction (EPC) market overseas, and, in turn, Korea is one of the top contractors there. Given such economic ties, how is the "Arab Spring" affecting the

1. By Middle East, I refer to the 22 countries in the Middle East and North Africa region.

2. "Suez Canal/SUMED Pipeline," U.S. Energy Information Administration, February 2011, http://ei-01.eia.doe.gov/emeu/cabs/World_Oil_Transit_Chokepoints/Suez.html.

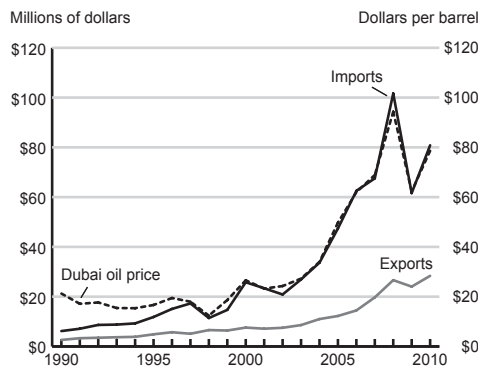
3. *World Economic Outlook: Tensions from the Two-Speed Recovery: Unemployment, Commodities, and Capital Flows* (Washington, D.C.: International Monetary Fund, April 2011), www.imf.org/external/pubs/ft/weo/2011/01/index.htm.

Korean economy? I first examine the close relationship between Korea and the Middle East and then analyze the short-term influences since January 2011. Then I attempt to forecast the longer-term consequences.

Economic Relationship between South Korea and the Middle East

Despite Korea's slowly increasing diplomatic role and the involvement of its military in the Middle East, the relationship between Korea and the region is still highly economic.⁴ In 2010, Korea exported goods worth \$28.3 billion to the region and imported goods worth \$80.8 billion. As seen in **Figure 1**, exports have been steadily rising for the past 20 years: Korean products have gained a positive reputation for their price and quality competitiveness. The main exports were automobiles (27.69 percent); ships, offshore structures, and parts (6.72 percent); auto parts (4.01 percent); and synthetic resin (4.00 percent). The major export markets were UAE, Iran, Saudi Arabia, and Egypt. Exports to Iraq, Libya, and Jordan have shown a significant increase from 2008 to 2010.

Figure 1: Korea's Trade with the Middle East Compared with Dubai Oil Prices, 1990–2010 (exports and imports in millions of dollars; oil price in dollars per barrel)



Sources: Korea International Trade Association, various years; International Monetary Fund, primary commodity prices, various years.

Of total imports from the Middle East to Korea, 98 percent were mineral fuels: crude oil (69.53 percent), petrochemicals (11.05 percent), natural gas (10.80 percent), and liquefied petroleum gas (4.02 percent). Korea satisfies more than 80 percent of its crude oil demand by importing from the Middle East, its major partners being Saudi Arabia (33.3 percent), UAE (12.79 percent), Kuwait (12.35 percent), and Iran (8.13 percent); see **Table 1**. The large proportion of petroleum and petroleum products explains the similarity of the import trends and the Dubai oil price trends as well as the continuously recorded trade deficit since the start of the trade relations (as shown in Figure 1). In 2010, 19 percent of all imports to Korea were from the Middle East while only 6.1 percent of total Korean exports were directed to the region.

Unlike trade, the number of investments between the two parties has been relatively insignificant. In 2010, investment from Korea into the Middle East was only \$330 million, a mere 1.42 percent of total Korean investment abroad. Approximately 39.1 percent of investments were made in the petroleum and petroleum product industries, and countries such as Iraq (27.22 percent), Oman (21.62 percent), UAE (19.37 percent), and Bahrain (18.5 percent) were the major destinations. Investment from the Middle East to Korea was even smaller, adding up to only \$171 million (1.31 percent of the total inward foreign investment into Korea), 90 percent of which came from Saudi Arabia.

One of the main drivers behind exports and investment to the Middle East is EPC contracting. Korean contractors first entered the region's heavy civil engineering industry in the 1970s during the oil boom. Now, the Middle East is Korea's largest EPC market overseas, and in turn Korea is one of the top contractors in the region active in areas such as oil, gas, renewable energy, construction, chemical engineering, and desalination. South Korea's market share in EPC contracts in the Gulf Cooperation Council countries (GCC; Saudi Arabia, UAE, Kuwait, Oman, Bahrain, Qatar) that host

4. Alon Levkowitz, "The Republic of Korea and the Middle East: Economics, Diplomacy, and Security," *Academic Paper Series: On Korea* (Korea Economic Institute) 5, no. 6 (August 2010).

5. "A Region Divided: Middle East Market Risk Report," No. 10, 11–17 March 2011, www.meed.com/sectors/economy/government/a-region-divided-middle-east-market-risk-report/3090047.article.

Table 1: South Korea's Top 10 Trading Partners in the Middle East, 2010

Imports			Exports		
Countries	Value (\$m)	Share (%)	Countries	Value (\$m)	Share (%)
Saudi Arabia	26,820	33.19	United Arab Emirates	5487.047	19.34
United Arab Emirates	12,170	15.06	Iran	4596.721	16.20
Qatar	11,915	14.74	Saudi Arabia	4556.673	16.06
Kuwait	10,850	13.43	Egypt	2240.439	7.90
Iran	6,940	8.59	Algeria	1495.609	5.27
Iraq	4,428	5.48	Libya	1410.549	4.97
Oman	4,096	5.07	Jordan	1266.220	4.46
Egypt	938	1.16	Syria	1256.003	4.43
Israel	769	0.95	Iraq	1200.771	4.23
Bahrain	589	0.73	Israel	1059.432	3.73

Source: Korea International Trade Association, 2010.

more than 50 percent of the contracts in the Middle East,⁵ was recorded at 47 percent in 2009. In 2010, the total value of Korean EPC contracts in the Middle East was \$47.2 billion, which was more than 66 percent of the value of Korea's total foreign EPC contracts. The top three partner countries were UAE, Saudi Arabia, and Kuwait (*Table 2*); and energy, chemical engineering, and desalination were the main areas.

Market Contraction from Regional Security Risk

With heightened regional security risks, we have seen a short-term slowdown of economic activities—for example, contraction in local demand and freezing of EPC projects—in countries that have been severely affected by civil unrest. Recent data on Korea's trade with Libya and Egypt, two of three countries that are ranked as top 10 export destinations in the Middle East and have experienced significant political uprising, reflect this. Another country is Syria, but the data were unavailable for the period (May 2011) when its protests intensified.

Egypt is the fourth-largest export destination for South Korean goods in the Middle East, the major exported goods being automobiles, petrochemicals, auto parts, and synthetic resin. Exports to Egypt have been increasing annually by 25 percent on average since 2005.

The protests in Egypt escalated at the end of January 2011 and eventually led to the stepping down of the president in mid-February. Such political change is reflected in the trade data: for February and March, Korean exports to Egypt decreased significantly each month, from \$215 million in January to \$145 million in February, and to \$87.9 million in March. In April, Korea's exports to Egypt recovered somewhat to \$163 million. Imports from Egypt were not very different from the previous years' figures. The value of goods that came to Korea from Egypt in January was recorded at \$31 million; February, \$147 million; March, \$79 million; and April, \$30 million. The peak in February is seasonal.

Peaceful protests that started in western Libya on 15 February 2011 soon turned into a civil war as the Gaddafi regime responded with military force. Based on a UN Security Council resolution, the coalition forces began military intervention on 17 March, and NATO took over on 25 March. The Korea International Trade Association (KITA) reports that for the first two weeks of the turmoil, the loss in exports was approximately \$79 million, amounting to almost 5 percent of Korea's total exports in 2010. From February to April 2011, exports to Libya showed a 90.8 percent decrease compared with the same period in 2010, from \$349 million to \$31 million. KITA predicts that if the civil

Table 2: Top 10 Countries for Korea's Engineering, Procurement, and Construction Services, 2010

Rank	Country	Amount (\$)	Share (%)
1	United Arab Emirates	25,602,121	35.77
2	Saudi Arabia	10,531,994	14.71
3	Kuwait	4,893,025	6.84
4	Vietnam	3,298,707	4.61
5	Australia	3,246,427	4.54
6	India	3,159,366	4.41
7	Libya	1,959,690	2.74
8	Singapore	1,623,594	2.27
9	Ghana	1,526,363	2.13
10	Myanmar	1,387,983	1.94
	World total	71,578,807	

Source: International Construction Association of Korea, 2010.

war continues until the end of 2011, the loss to Korea in exports could amount to \$1.6 billion in construction equipment and raw materials, machinery, electronics, and petrochemicals. In terms of imports from Libya, in February and March of 2011 the total value was \$0.6 million and \$3.6 million, respectively, a decrease of more than 98 percent compared with the same period the year before. In April, however, trade picked up again, and \$35 million of goods have been imported, 88 percent of which were heater parts.

While Korea's exports to Egypt and Libya have suffered significantly, Korea's overall exports to the Middle East have increased by 31.7 percent and imports by 36.3 percent for the first four months of 2011. Most of the export increase came from business with Saudi

Arabia, UAE, Jordan, and Israel, and the increase in imports came from dealings with Saudi Arabia, Qatar, Kuwait, and Iraq. These are countries that have been relatively insulated from the uprisings. Since at this stage it is quite unlikely that the unrest will spread to Korea's major trading partners such as Saudi Arabia and UAE, in the longer run it is likely that exports to and imports from the region will continue to grow, hinging on high oil prices. Korea imports more than 80 percent of its oil from the Middle East. With higher oil prices, the total value of imports from the Middle East will increase, and there will be an opportunity for export increases as well because of the growth in oil wealth in the region.

Increase in Exports and Investment to the Middle East

The governments of Saudi Arabia, UAE, and Kuwait have barely been scathed by the political turmoil in the region but are nonetheless shaken. For domestic and regional stability, such countries with oil are generating and dispensing funds, making use of increased oil wealth achieved through higher oil prices. They are attempting to tackle economic problems such as unemployment and weak infrastructure that are understood to be the underlying causes for the civil unrest. According to the *World Development Report 2007*, unemployment rates in the Middle East are the highest in the world: around 12 percent of the total workforce and 25 percent of youth (ages 15–24) are unemployed.⁶ Moreover, with the population having grown rapidly in recent years, more than 60 percent of the unemployed are the youth in countries such as Syria, Qatar, Kuwait, and Egypt.⁷ Weak infrastructure in water and electricity is also a serious problem. The World Bank estimates that almost a half the region's population to have inadequate access to water, many more without access than the world average; world-

6. *World Development Report 2007: Development and the Next Generation* (Washington, D.C.: World Bank, 2006).

7. Nader Kabbani and Ekta Kothari, *Youth Employment in the MENA Region: A Situational Assessment*, Social Protection Discussion Paper no. 0534 (Washington, D.C.: World Bank, September 2005), <http://siteresources.worldbank.org/SOCIALPROTECTION/Resources/SP-Discussion-papers/Labor-Market-DP/0534web.pdf>.

8. "Water Sector Brief" (Washington, D.C.: World Bank, September 2010), http://siteresources.worldbank.org/INTMNAREGTOPWATRES/Resources/Water_Sector_Brief--Fall2010.pdf.

9. *World Energy Outlook 2009* (Paris: International Energy Agency, 2009), table 2.4 on 132, "Electricity Access in the Reference Scenario," www.iea.org/textbase/nppdf/free/2009/weo2009.pdf.

wide, the average water availability per capita is close to 7,000 cubic meters per year, but only 1,200 cubic meters per year are available in the Middle East.⁸ For electricity, in 2008, 21 million people in the region were without access to electricity, including approximately 30 percent of the rural population.⁹

To preemptively tame domestic uprisings, Saudi Arabia in February 2011 announced an aid plan in the amount of \$35 billion, which includes raising the minimum wages and providing housing loans, investing in health projects, and expanding unemployment benefits. Oman has decided to give out unemployment benefits of \$390 per month, promised 50,000 new jobs, and pledged to monitor compliance with minimum wages. UAE has decided to spend \$1.6 billion on better water pipelines and electricity networks in poorer parts of the country,¹⁰ and the Kuwaiti government has distributed to each citizen \$3,550 in grants and has also guaranteed free food staples for 13 months for every citizen.¹¹

For the poorer countries in the region that have been most affected by the political uprisings, funds are flowing in from within and outside the region. The oil-producing countries in the Middle East historically have used their oil wealth in aiding their non-oil-producing counterparts to maintain regional stability and form strategic partnerships. The GCC not only has sent troops to Bahrain to counter the continuing protests but has also launched a \$20 billion aid package for Bahrain and Oman, funds that are expected to

be invested in housing and infrastructure in the next 10 years.¹² There have been bilateral efforts as well. Saudi Arabia is reported to have lent Egypt \$4 billion in emergency funding in the form of soft loans, deposits, and grants.¹³ Qatar has announced that it will invest \$10 billion in Egyptian projects, and the Kuwait Investment Authority launched a company with capital of \$168 million to invest in Egypt.¹⁴

Internationally, the World Bank, the International Finance Corporation, and the Islamic Development Bank have formed a partnership called the Arab Financing Facility for Infrastructure, which aims at raising \$1 billion for regional infrastructure development. It will focus on cross-border projects on water, electricity, rail, and road networks through private investment.¹⁵ The Group of Eight also has pledged to support the democratic transitions in Egypt and Tunisia with \$20 billion of international aid through multilateral development banks during the period 2011–13; this aid would be separate from bilateral aid flowing in from the United States and the European Union.¹⁶

Such economic stimulus packages distributed across the region with a focus on enhancing social infrastructure are expected to invigorate the EPC market and the consumption goods market, thus providing more business opportunities for countries like South Korea to invest and export. Korean firms will be able to participate in the bidding on the contracts, and, once won, they will be able to export raw materials, machinery, and equipment used in the projects.

10. "UAE Ruler Orders \$1.6B Water, Power Investments In N Emirates," *Zawya*, 2 March 2011, www.zawya.com/story.cfm/sidZW20110302000129/?relcontent=ZAWYA20110523104919.

11. "Arab Rulers Use Handouts to Ward Off Unrest," *Financial Times*, 19 January 2011, www.ft.com/intl/cms/s/0/938dbe0c-23e1-11e0-8bb1-00144feab49a,s01=1.html#axzz1OTRh5wnJ.

12. "Update 3—Gulf States Launch \$20 Bln Fund for Oman and Bahrain," *Reuters*, 10 March 2011, www.reuters.com/article/2011/03/10/gulf-fund-idUSLDE7292D620110310.

13. "Saudi Arabia Lends Egypt \$4bn," *Financial Times*, 22 May 2011, www.ft.com/intl/cms/s/0/c3fa0976-8465-11e0-afcb-00144feabdc0.html#axzz1OTRh5wnJ.

14. "Qatar to Invest up to \$10bn in Egypt," *ArabNews.com*, 24 May 2011, <http://arabnews.com/economy/article427155.ece>; "Saudi Plans \$7 Bln Egypt Housing Project Agency," *Reuters Africa*, 18 April 2011, <http://af.reuters.com/article/egyptNews/idAFLDE73H1R120110418>.

15. "Arab Financing Facility for Infrastructure," World Bank, Arab World Initiative, n.d., http://arabworld.worldbank.org/content/awi/en/home/initiatives/financing_infrastructure.html.

16. "G8 Offers \$20bn to Aid Arab Democracies," *Financial Times*, 27 May 2011, www.ft.com/intl/cms/s/0/aa9e92ca-884e-11e0-a1c3-00144feabdc0.html#axzz1OTRh5wnJ.

Moreover, the expansionary government spending coupled with industrial diversification efforts of oil-rich countries to prepare for the post-oil times will lead to more opportunities for Korean firms in sectors beyond infrastructure—specifically, education, finance, medicine, and tourism. With more jobs created through projects and increased minimum wages and unemployment benefits, the disposable income of the low- and middle-income classes is likely to increase, resulting in an expanded market for consumption goods such as automobiles and electronics.

Increase in Trade Deficit and Reduction in Purchasing Power through High Oil Prices

Even though it is likely that both imports from and exports to the Middle East will increase for Korea, the high price of oil—as much as \$107.16 a barrel that the IMF forecast for the year 2011—is inevitably going to raise the amount of the overall trade deficit. Moreover, the high price of oil will be transmitted to the domestic economy through prices of goods, thus affecting inflation, purchasing power, and private spending. In May 2011, the Korea Development Institute, quoting the oil price as the main reason, projected Korea's inflation rate to be at 4.1 percent in 2011, which is 0.9 percent higher than previous estimates. In Korea, an increase in oil prices means a decrease the purchasing power more significantly than in countries like France, China, and Japan; a 10 percent increase in oil price is estimated to decrease the ratio of purchasing power to GDP by 0.6 percent.¹⁷ In 2011, with reduced purchasing power, private spending is expected to increase only by 3.5 percent, a lower rate than the expected GDP growth.

Long-Term Effects of Change in Decision-Making Processes

The fall of the long-reigning Tunisian and Egyptian regimes and various attempts for regime change in other countries seem to indicate a shift in authoritarian and patriarchal systems widespread in the Middle East to more democratic ones. In the long run, with waning political authoritarianism, a decline of economic authoritarianism is expected even in absolute monarchies. More specifically, state-led economies

are likely to be transformed to more pluralistic private sector-led ones, with more employment opportunities. This implies a shift from oil and gas industries to more labor-intensive manufacturing or service industries. If until now the wealth has been created and redistributed among a specific group of the population, the economy is likely to be transformed to one where the majority of the population will be participating in wealth creation and can benefit from it.

There is a possibility that such a pluralistic economy could mean a major shift in strategy for Korea in dealing with the Middle East. Up until now, Korean firms and the government of Korea could negotiate directly with the states in the Middle East in business matters because the decision-making power has been centralized. It is well known that President Lee Myung-bak played an important role in negotiating with the UAE government for the \$20.4 billion nuclear power plant deal in 2009 as well as the oil deal with the Abu Dhabi National Oil Company in 2011. If these countries become more democratic and pluralistic, with more interest groups at play, Korean firms and the government will have to diversify their channels of communication to conduct business.

Conclusion

The protest that started in Tunisia triggered by the self-immolation of a street vendor has spread rapidly to other countries in the Middle East, eventually resulting in the crumbling of two regimes, one ongoing civil war, and many violent clashes between governments and protesters. Oil prices have risen, reflecting the political turmoil. Imports and exports between Middle East and Korea have both increased. Because the Middle East is Korea's major source of oil, with high oil prices the value of Korea's total imports has grown. With expanding oil wealth, the Middle East region is importing more goods and starting up infrastructure projects to tackle the problems of poverty and high unemployment that are believed to be one of the main reasons for the present contention.

If the current political uprisings spread to oil-producing countries such as Saudi Arabia and UAE that are

17. Kim D., "Economic Impacts and Trends with High Oil Prices [in Korean]," *Current Economy Analysis* (Seoul: Korea Development Institute, 2011), http://210.114.108.30/data/download/attach/9209_cu20110518.pdf.

also Korea's major trading partners, Korea is likely to face an energy crisis as it will have to deal with even higher oil prices and securing Korea's oil supply from other countries. Exports to the Middle East would be severely affected as well owing to a contraction in consumer demand and a slowing of infrastructure projects, as we have seen in the Libyan and Egyptian cases. For now, however, the possibility of protests spreading to the oil-producing countries is low.

In the long run, there is an expectation that the state-led economies will eventually be transformed to more pluralistic economies led by the private sector, thus creating employment in areas beyond petroleum and gas. This implies that Korea will have to prepare itself with new strategies to do business with the region, with the state playing a less significant role.

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