KOREA'S ECONOMY

2011

a publication of the Korea Economic Institute and the Korea Institute for International Economic Policy

Volume 27

The Korea Economic Institute is registered under the Foreign Agents Registration Act as an agent of the Korea Institute for International Economic Policy, a public corporation established by the Government of the Republic of Korea. This material is filed with the Department of Justice, where the required registration statement is available for public inspection. Registration does not indicate U.S. Government approval of the contents of this document.

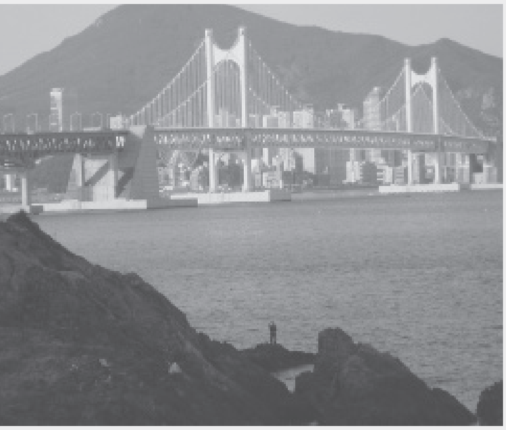
KEI is not engaged in the practice of law, does not render legal services, and is not a lobbying organization.

The views expressed in this publication are those of the authors. While this monograph is part of the overall program of the Korea Economic Institute endorsed by its Officers, Board of Directors, and Advisory Council, its contents do not necessarily reflect the views of individual members of the Board or of the Advisory Council.

All images are from Getty Images, iStock, or were taken by KEI staff.

Printed in the United States of America.

ISSN 1054-6944



Volume 27

KOREA'S ECONOMY

2011

Part I: Overview and Macroeconomic Issues

Part II: Financial Institutions and Markets - Focus on Green Growth

Part III: The Seoul G-20

Part III: The Seoul G-20 (Continued)

Part IV: External Relations

Part V: Korea-China Economic Relations

Part VI: North Korea's Economic Development and External Relations

KOREA-AFRICA: EMERGING OPPORTUNITIES

By Philippe de Pontet and James Clinton Francis

Just a few decades ago, South Korea had much in common with many African states as they were emerging from colonialism. At the time of Ghana's independence in 1957, for example, the country's income per capita was practically equivalent to South Korea's at just under $500. Fifty-four years later, the economic trajectories of the two countries could not be more divergent. According to World Bank estimates of purchasing power parity income per capita, at the end of 2009 Ghana's income per head stands at $1,530 while South Korea's sits at $27,240. Despite Ghana's natural resources—gold, cocoa, and now oil—and robust democratic institutions, without credible investment partners that can help develop the economy, it would take Ghana five centuries to catch up to South Korea at the current rate. Fortunately, countries like Ghana are finally poised for economic takeoff, and Korean firms are well positioned to both assist in, and benefit from, the boom.

A Changing Africa Ready for Investment

Following several "lost decades" of stagnant growth and bad governance after independence in the 1960s, African countries are now resurgent. Whether one looks at GDP growth, investment flows, trade, or the process of economic reform, there has been a sea change across much of the continent since 2000, mostly for the better. In the last five years, only southeastern Asia has outpaced Africa's 5 percent aggregate growth rate; looking ahead, the International Monetary Fund (IMF) expects acceleration of the trend, with a 5.5 percent forecast for 2011 and 6 percent in 2012—although with 53 separate countries, of course there can be wide variation from country to country. Nevertheless, the overall trend is unmistakable and has been sustained for about a decade. Foreign direct investment (FDI) is also on a rising trajectory in most sectors, including oil, mining, infrastructure, telecommunications, and agriculture, where opportunities still abound despite the remarkable penetration of Chinese and other emerging-market firms alongside the traditional Western multinationals.

A big part of this story is the rise in commodity prices, but this is not the entire story. Equally important is the improved macroeconomic policy climate and stabilization of many countries once wracked by civil war or rebel threats. Moreover, at a time when North Africa and the Middle East are roiled by protest, there are few signs that sub-Saharan Africa will face a similarly destabilizing "African spring."

While the competitive climate has become a bit more saturated in recent years, the window of opportunity remains very much open for incoming Korean firms; major new investments by the Korean National Oil Company (KNOC) among others show the way forward.

This essay examines and analyzes the African opportunity for Korean firms, drawing partly on the Chinese experience and partly on trends within Africa itself. While the opportunities are vast and many obvious synergies exist between Korean interests and African assets, challenges and risks must also be carefully weighed in a country-by-country fashion. Not all countries are on a reform trajectory, after all, and many resource-rich countries, recognizing the leverage granted by high commodity prices, are demanding more than ever from their investment suitors on fiscal and other terms. Daewoo's unfortunate experience in Madagascar, where the 2009 coup scuttled a major land deal negotiated with the former government, serves as a stark reminder that investing in Africa still carries risk. On balance, though, the timing is ripe and the opportunities are vast for Korean firms in Africa.

Current Status of China-Africa Relations

A convergence of interests between Beijing's diplomatic goals, its companies' strategies, and the needs of host countries has allowed China to develop a seemingly coherent investment model in Africa in the past few years. The pace and scope of Chinese commercial engagement in Africa since 2000 have been breathtaking. Trade has exploded from from about $15 billion a decade ago to nearly $120 billion in 2010, according to the IMF. FDI flows are also rising sharply, centered on both infrastructure and natural resources. Chinese FDI increased from $1.6 billion in 2005 to $8.3 billion in 2009, according to the Chinese National Bureau of Statistics. China's most prominent trade partners are also, unsurprisingly, its biggest suppliers of natural resources. Oil-rich Angola and Sudan top the bill, with South Africa (the biggest African supplier of manganese and iron ore to China) in the third spot. The Democratic Republic of Congo (DRC) and Zambia are also key mining partners, as two of the world's fastest-growing copper producers. Investments in oil and infrastructure in Nigeria remain relatively modest despite heavy courtship, but we expect this relationship to grow exponentially as part of China's efforts to secure up to 6 billion barrels of oil reserves.

Diplomatic overtures and multilateral venues, such as the Forum for China and Africa Cooperation—at which Chinese leaders offer aid packages, debt relief, and preferential trade access to the Chinese market—pave the way for investment contracts. Aid remains, however, a vague and all-encompassing term, including grants, interest-free loans, and preferential buyers' credit.

Cheap loans—provided by the Export-Import Bank of China (China Eximbank) for industrial and infrastructure projects—have been the most important financial tool Beijing deploys in Africa. The terms of the loans vary widely, and in some cases, when countries cannot provide adequate financial guarantees to back their commitments, loans are secured with commodities as collateral. This type of arrangement can also entail awarding rights to a Chinese company to extract resources that are then used to repay the loan. In fact, with many China Eximbank loans, the recipient government may never actually receive the funding because the loan operates like a current account held in China, and contract fees are paid directly to the implementing company.

The essential bargain, at least in resource-rich countries, has been to link infrastructure development in exchange for resource deals and exports, often structured through resource-backed loans. This strategy is also paying off for China's energy security as Africa now provides one-third of its imports, a major hedge against Middle Eastern instability. Other strategic resources actively sought by Chinese firms for future supply security include iron ore, copper, cobalt, coal, uranium, and even fertile land for agriculture.

China's government-supported investments in Africa are spurring economic growth across the continent and creating new investment opportunities for others; Chinese infrastructure in a country such as the DRC, for example, opens up entire regions long neglected by foreign investors, including Korean mining companies. While Chinese oil and mining companies have made inroads in many countries, they are far from dominating the extractive industries, where Western multinationals remain the biggest players and opportunities are still ripe for new entrants.

Chinese resources-for-infrastructure projects will remain a useful model in Africa's least-developed (and often unstable) countries, such as the DRC, Guinea, and Niger, and in pariah states such as Sudan. A similar model can—and already has—worked for Korean firms, albeit on a smaller scale. In other markets, promises of spending on infrastructure may not be sufficient as host governments are increasingly demanding value-addition through refining and processing facilities (and downstream investment). Korean consortiums that can offer a broad package, including not only expertise in exploration and production but also supporting infrastructure and value-addition, will be well placed to succeed in Africa.

That said, it is difficult to overstate the importance of infrastructure in the engagement strategy. The perceived political and economic payoff from such spending is enormous. Roads, rail, ports, and perhaps above all power are all very tangible deliverables that African leaders can point to as signs of progress and an improving quality of life for constituents. Congolese president Joseph Kabila trumpets new infrastructure development, much of it Chinese built, as the core of his reelection campaign.

Chinese commercial engagement has also included African parastatals in joint ventures in a way that makes host governments feel like real partners in projects. The typical parastatal has 15–30 percent equity in the joint ventures (above the norm with Western multinationals), though often the resource-backed infrastructure loan must be paid back to China first, which can cause tensions over time, as in Angola. Chinese firms allay these tensions in part by offering generous up front bonus payments, such as the $350 million bonus that underpinned the $6 billion agreement with the DRC in 2008.

The engagement strategy does not always rely heavily on spending commitments. Chinese officials have helped their companies make inroads by offering preferential trade access, “preferred destination” status for Chinese tourists, timely diplomatic support, technical assistance, agricultural machinery, technology transfers, debt relief, large trade delegations led by senior officials (including the premier), and the like. The incentives vary some from country to country and generally tap into key priorities of the host government.

Limits to the Chinese Model

But there are limits to the successes of this model, which are also instructive. By far the biggest drawback, at least from the African perspective, has been the reliance on imported Chinese workers in labor-intensive projects. This has created backlashes toward Chinese firms in countries such as Zambia and Angola, while putting host governments in a difficult political position with their own constituents. Because of the double-digit unemployment in most of these countries (in some cases the formal sector employs only about 20 percent of the population), the presence of thousands of Chinese workers, many of them doing manual labor, is highly unpopular. Korean firms would do well to avoid this approach and instead hire locally whenever possible, including for executive positions. This is especially the case because many African governments are following Nigeria’s lead in implementing strict local content requirements that insist on local hires and domestic sourcing for critical inputs.

Another common complaint has to do with poor labor conditions and environmental safeguards. Chinese firms have a reputation for paying poorly, fostering inhumane working conditions, and even mistreating employees. This has raised strong opposition from labor unions, which are fairly powerful in certain countries such as South Africa, Zambia, Guinea, Nigeria, and Ghana, all priority destinations for resource-based investment. Chinese mining companies are also seen as poor corporate citizens with regard to the environment, which puts them on a potential collision course with local communities and powerful industries such as tourism.

Chinese firms and diplomats focus on elite-level relationships in the capital to the exclusion of civil society institutions, including opposition parties. Direct ties to heads of state, ministers, and their domestic business allies can be essential to market entry, but engagement needs to be broadened to other stakeholders. Otherwise this dynamic can expose them to high levels of political risk when there is a change in regime, an ascendant opposition movement, or major political protests. This strategy can also come at a high cost when the host government lacks legitimacy or faces a rebel threat, since Chinese firms can be seen as tempting targets and as proxies for the hated government. In 2007, Ethiopian rebels in the restive Ogaden region bombed a Sinopec oil installation, killing nine Chinese workers, as a proxy target allied with the host government.

Chinese firms have not managed expectations properly in some cases, which has led to disillusionment. A notable example is Sinopec’s decision to walk away from a commitment to refurbish the Lobito refinery in Angola, a major priority of the government. This incident caused relations to cool (despite an estimated $11 billion in resource-backed loans since 2005) and probably contributed to the government’s decision to block Sinopec’s planned $1.4 billion acquisition of a Marathon offshore divestment in 2010.

Heavy competition from Chinese imports has alienated the local business community, which finds it difficult to compete. This can cause headwinds for China’s firms on the ground. Perceptions run deep that cheap Chinese goods, sometimes bolstered by predatory business practices, are flooding the local market. This can turn the local business community against China and force host governments (as in South Africa) to erect targeted trade barriers that can complicate the bilateral relationship.

There is widespread suspicion, and a fair amount of evidence, that Chinese firms use big bonus payments to secure deals, thereby blocking rivals. Some of this is legitimate but some crosses the border into bribery, essentially reinforcing official corruption in the process. In one recent example, Wuhan Steel paid the pariah government of Madagascar $100 million to stave off competitors for the Soalala iron ore concession. Even if such tactics are technically legal, they practically ensure that host governments will continue to expect or demand special payments and perquisites over the course of the investment cycle.

Current Status of Korea-Africa Commercial Engagement

After witnessing the success that China and India have had in Africa, officials in Seoul are seeking to acquire oil acreage and cargoes in return for soft loans to construct infrastructure.

Beginning in March 2011, South Korean foreign minister Kim Sung-hwan and deputy economy minister Kim Jung-gwan visited five countries across the region. KNOC, which is one of the preeminent South Korean commercial players in sub-Saharan Africa, has committed to develop the region's downstream resources through the potential construction of a gas liquefaction plant in Mozambique (partnering with Anadarko) and at Soyo in Angola (partnering with Sonangol and Chevron).

South Korea appears to be assuming a less aggressive version of a Chinese resource-for-infrastructure model in Africa. KNOC has been in Africa since 2005—with its largest presence in Congo-Brazzaville, Libya, and Nigeria—although it has yet to pump any oil out of the ground. To take advantage of its position as a public company, KNOC has tried to forge high-profile partnerships with state-owned companies. Although Gabon has delayed the auction of 40 blocks in its presalt, KNOC wants to win some of this acreage in return for South Korea constructing an airport in Ntoum as well as providing hospitals in the run-up to the 2012 Africa Cup soccer tournament. South Korea's offer to help Libreville hone its exploration skills and geological data collection has enabled it to cut into China's position in Gabon. In the DRC, South Korea has signed memorandums promising to build hydropower infrastructure in exchange for minerals.

Ghana remains South Korea's main target, as the executives of SK Energy, Daewoo International, and Samsung C&T signed a memorandum of understanding on 28 March 2011 to help develop the country's gas infrastructure and construct a new oil refinery. In Accra, South Korea has agreed to finance a $20 billion housing construction project with the hopes of importing oil from Jubilee and other offshore fields. This project, which expects to construct approximately 200,000 homes, is not without its controversy; critics have pointed out that Ghana cannot afford the debt that will accrue as a result of the deal, nor does the proposal do enough to address the country's low-income-housing deficit. It remains likely that if the government, while working with Korean investors, fails to address popular concerns and manage expectations over this deal, Ghana—which narrowly elected John Atta Mills with 50.23 percent of the vote—could see a shift in political power in 2012.

If South Korea has achieved quiet success in engaging the African energy and mining sector, arguably its biggest failure has been in Madagascar, where, in 2008 at the height of the food crisis, Daewoo Logistics attempted to lease 3.2 million acres of highly arable farmland for about $6 billion. Daewoo's deal has branded South Korea persona non grata in Madagascar, as many viewed the deal as not doing enough for the Malagasy people, many of whom saw little direct benefit accruing from the investment. Former Antananarivo mayor and popular disc jockey, Andry Rajoelina, capitalized on Daewoo's proposed investment along with former president Marc Ravalomanana's purchase of a $60 million presidential jet by organizing a coup, which at the time was widely supported by the Malagasy population. The intensity of the street protests, in turn, emboldened political elites and key members of the armed services to back the mayor, culminating in a show of force on 16 March to occupy the president's office and other government institutions.

Investment Trends in Africa

Sub-Saharan Africa is, economically speaking, forecast to be the second-fastest-growing region in the world in 2011, after Asia. The IMF projects 5.6 percent annual GDP growth for the region, outpacing global growth of 4.2 percent. Economic expansion will continue to hinge on oil and other commodity exports, but rising domestic consumption will also help. The rapid growth of Nigeria's nonoil sector, which expanded by 11.4 percent in the first half of 2010, is a case in point, but consumption-driven growth has been notable across the region. This will continue to boost nontraditional investment sectors such as retail, wholesale, and telecommunications.

Strategies for Korean Companies

- *Examine the Chinese model.*
- *Broaden consortia to include infrastructure firms.*
- *Invest in comprehensive training, including for jobs in associated industries.*
- *Highlight technological advantages over competitors.*
- *Understand government's priorities beyond the immediate sector.*
- *Consider strategic acquisitions.*

Better economic policies are partly responsible for sub-Saharan Africa's upgraded outlook. Macroeconomic management has broadly improved in recent years. Fiscal performance is also improving, with better management of budget deficits and debt levels. While the downturn justified a degree of countercyclical spending, pressure for fiscal tightening will increase in 2011 and test governments' discipline.

Even countries that have been historically mismanaged, such as Nigeria and the DRC, have improving prospects for economic policy. Nigeria will reform its oil and power sectors and take steps toward bolstering fiscal stability by replacing its oil revenue fund with a proper sovereign wealth fund. This move could someday provide a better financial cushion. In the DRC, economic management is improving incrementally, especially at the central bank, the finance ministry, and donor coordination bodies, while world-class mining companies such as Freeport show that big profits can be made despite the risks.

Timing is of course important to business success, especially in volatile regions. There are significant upside risks to proper investment timing in Africa. One example is ExxonMobil's decision to enter Angola in a big way around 2001, just as the country's decades-long civil war was winding down. Ten years later, ExxonMobil now produces about 700,000 barrels per day in offshore Angola, and the peace process is consolidated.

Korean firms that are uneasy about greenfield investment in certain countries can enter these markets as minority partners with more established investors. Risk-averse Japanese firms have taken this approach in countries such as the DRC and Equatorial Guinea. South Africa is a natural candidate for this type of collaboration, given its large and developed private sector that has already made aggressive forays across the continent. Today, South Africa is one of the largest foreign investors in sub-Saharan Africa. Not surprisingly, South African companies see mutual advantages in teaming up with foreign firms that can provide the capital to complement their regional footprint and expertise. Banking sector tie-ups can be an innovative way to expand exposure to Africa. This was highlighted by the landmark $5.5 billion acquisition by the Industrial and Commercial Bank of China (ICBC) of a 20 percent stake in South Africa's Standard Bank in February 2008, in large part designed to finance projects across the continent.

South African firms like to position themselves in such deals as the African face of foreign capital with the ability to provide deep and specific market knowledge. South African multinationals in sectors ranging from telecom to agribusiness to mining and retail have built strong footholds in many regional markets, suggesting that the Standard Bank deal could provide a future model for other sectors.

Strategies for Sectoral Engagement

Oil and Gas

Sub-Saharan Africa supplies about 12 percent of global oil production, led by OPEC members Nigeria and Angola, which produce about 2.1 million barrels per day (bpd) and 1.8 million bpd, respectively. Then there is a subset of marginal oil producers such as Gabon, the Republic of Congo, Cameroon, Equatorial Guinea, Chad, and Sudan that supply between 80,000 bpd (Cameroon) and 500,000 bpd (Sudan). Africa's newest oil producer, Ghana, and its next producer, Uganda, will be among the marginal producers in this range—and both offer fresh opportunities for incoming investors. Last, another dozen or so countries are seeing a major rise in exploration owing to high oil prices, nearby commercial finds, and investment incentives. Of these, the most promising include Sierra Leone, Tanzania, Mozambique, Madagascar, Liberia, and Namibia.

While investment terms are generally attractive among the new frontiers, there are signs that the established producers, led by Nigeria, are considering modest fiscal reforms that will shift more revenues to the state.

In Nigeria, pending legislation likely to pass this year would enshrine higher royalties, stringent local content requirements, additional demands on oil companies for social spending and supporting infrastructure, domestic gas supply mandates, and a new joint venture model that could compromise operational flexibility for international oil companies.

From a political perspective, the reforms outlined in the controversial Petroleum Investment Bill (PIB) are highly popular across a Nigerian populace that has grown weary of industry megaprofits amid widespread poverty. The newly elected Jonathan administration, flush with political capital, includes the PIB among its top priorities for 2011—and this could send a signal to peer governments to follow suit with similar reforms.

If oil prices remain high, Angola will attract ultradeep offshore exploration by companies that think the country could have Brazil-like presalt plays. That would be a potential game changer for Angola and the region. Interested Korean firms may wish to partner with well-regarded firms in Angola, including Brazil's Petrobras.

In early 2011, Ghana became Africa's newest oil producer, with generally positive prospects. Ugandan oil exports will have to await construction of the Mombasa pipeline, however, which will likely take a couple of years to complete. In the meantime, new exploration licenses will be issued and the Tullow-CNOOC-Total consortium will move ahead aggressively on production and downstream work.

Luanda has increasingly taken measures to diversify its core diplomatic and commercial partnerships beyond China and the West. It has deepened relations with countries such as Brazil and Portugal, cemented by lines of credit to support commercial engagement. Korea and its companies can follow suit.

Mining

Most of Africa's mining-rich countries are located in the southern and western subregion. South Africa, with its large reserves of coal, gold, platinum iron ore, uranium, and manganese among other strategic metals and minerals, remains the biggest prize. Other important coal producers include Botswana and Mozambique; significant iron ore reserves are also found in Liberia, Sierra Leone, Republic of Congo, Cameroon, and Guinea; DRC and Zambia are rich in copper and cobalt; Niger and Namibia are top-five global uranium exporters; Guinea is the world's top exporter of bauxite; and Ghana, Mali, and Tanzania produce gold on a large scale.

The investment climate in most of these countries is relatively stable and on an upward trajectory (exceptions might include Guinea and DRC), but similar fiscal pressures are at play here as in Africa's oil-rich nations, for similar reasons. Countries such as Ghana and Tanzania have already implemented higher royalties, while some others such as Guinea are considering doing the same. In South Africa, the combination of union demands, black economic empowerment mandates, and nationalization rhetoric (which does not pose a real threat in our view) clouds the investment picture to some extent.

Mining firms are under pressure to build smelters and copper refining facilities in countries such as the DRC. The DRC government has slapped high export taxes and fines on raw ore exports in an effort to force companies to do at least some processing in country. The Chinese mining consortium Sicomines may face similar pressures over time even though the Sino-Congolese memorandum of understanding waives most tax and royalty requirements under the mining code.

Many of Africa's mining-rich countries have implemented or are considering reforms to capture a greater share of mining revenues. The most radical policy options (including calls for nationalization in South Africa) will be avoided, but taxes on windfall profits are possible in countries such as Zambia, where Michael Sata, the opposition candidate, is expected to propose a windfall profits tax on copper. This would be popular and would materially affect miners there. Elsewhere, governments are likely to follow in the footsteps of countries such as gold-rich Tanzania and Ghana and introduce modest royalty or tax increases, with greater emphasis on the careful auditing of mining company revenues.

If mining prices stay buoyant and Asian growth remains robust, exploration and production of commodities such as gold, uranium, nickel, iron ore, copper and cobalt, and coal are all likely to rise.

Agriculture

Land is a contentious issue in most African nations, with the stakes especially high where food security is tenuous, as in the Horn of Africa. In such cases, governments will likely insist on local employment mandates and that firms set aside some portion of the resources, such as food, for domestic use. With land exceedingly cheap in Africa, such ventures may still pose attractive returns over time, which is why private equity interest continues to grow. Moreover, foreign donors, led by the Barack Obama administration, are encouraging rural investment and supporting public-private partnerships across the continent.

"South Korean financiers, drawing from their own involvement in agricultural reform that underpinned Asia's economic transformation in the 20th century, could offer much to sub-Saharan Africa."

Rising agricultural prices can be destabilizing, even though farm work remains the continent's dominant source of employment, including in dynamic countries such as Nigeria, Kenya, and Ghana. The specter of another round of agflation is a big worry among African governments, which remember the riots sparked by the spike in food prices in 2008. Indeed, a relatively modest increase in staple prices earlier this year touched off bloody protests in Maputo, Mozambique. This could prove to be a harbinger for other countries if prices of staples such as corn, cassava, rice, and sorghum rise sharply again.

Investors are starting to access the largely untapped potential of agriculture and other land-intensive activities on the continent. European, Arab, and Asian investors—with and without support from their governments—are making major land lease deals in pursuit of food security, biofuels development, and resource extraction. South Africa remains the continent's top agricultural producer despite uncertainty over land reform. The Zuma administration has signaled that it will defer the redistribution target of commercial farmland to black farmers by a decade, to 2024, but political pressure could force the government to act sooner.

The primary challenge of unearthing Africa's potential in agriculture is securing access to credit for the highly productive, smallholding and mediumholding farmers. South Korean financiers, drawing from their own involvement in agricultural reform that underpinned Asia's economic transformation in the 20th century, could offer much to sub-Saharan Africa. Already, South Africa's Standard Bank has committed $100 million to help smallholder South African farmers grow export crops, and a number of other private equity funds have pledged to invest $2 billion over the next three to five years primarily in eastern and southern African countries. Yet the funding gap remains wide across the region. The customary land tenure system—which boosts the governing power of chiefs—presents an obstacle for many agri-entrepreneurs in securing credit. For example, agriculture accounts for 40 percent of Nigerian GDP, yet the sector receives only 1 percent of commercial bank loans.

Second, South Korean businesspeople should share technical expertise with farmers who own small- and medium-sized tracts of land to encourage farmers to operate on a larger scale (about four-fifths of African farms operate on a scale smaller than 2 hectares) and ultimately increase food production in sub-Saharan Africa. If these farmers have access to agricultural technologies like fertilizers and seeds similar to farmers with large tracts of land and can operate under similar agricultural conditions, small- and medium-sized farmers have the strongest incentive to get the most out of their land and labor. These farmers also have lower management costs, whereas larger farmers are heavily dependent on mechanical inputs—which offer few job opportunities—or have high costs organizing and managing their workforces.

Manufacturing

Reaching the one-billion population mark for the first time in the continent's history in 2009, Africa is witnessing a period of unprecedented urban growth that is fueling the expansive growth of its population, especially an emergent middle class. Approximately 40 percent—a figure that surpasses India's and comes close to China's—of sub-Saharan Africa's population lives in urban centers that are host to the region's middle classes. According to the United Nations, it took 27 years for the continent to double from 500 million to one billion people, whereas the next 500 million will take only 17 years. In approximately 2027, Africa's demographic growth will start to slow, and it will take 24 years to add the next 500 million, reaching the two-billion mark around 2050, of which about 60 percent will be living in cities. Nevertheless, despite population growth—which expands both the labor pool and the consumer base—the continent has yet to develop a robust industrial sector.

Industrialization requires more than cheap labor; it also requires reliable infrastructure and favorable trade and investment policies. Africa's 53 separate nations and limited cross-border infrastructure make figuring out how to penetrate the diverse African market—outside of perhaps South Africa and Nigeria, where achieving economies of scale is possible—the first challenge facing those who wish to strengthen their manufacturing presence in the region. A viable middle ground is beginning to emerge, though at the sub-regional level, driven by the process of economic integration that is reducing trade and investment barriers across borders. From a business perspective, this process has the potential to, for example, turn East Africa's atomized economies into a combined market of more than 130 million people with a combined GDP of $75 billion, with both figures growing fast. Multinationals are also seeking to set up operations in urban regional hubs—such as Nairobi and Accra—where the emergence of export processing zones has made doing business easier.

Second, South Korean investors could play a role in helping Africa move up the value chain by employing the growing number of educated and urban, middle-class people. Although there is some truth to the perception that Africa's manufacturing sector has been decimated by a flood of Chinese goods, many Chinese manufacturers have responded to government pressures to move up the value chain by increasing domestic investment in capital-intensive industry while exporting labor-intensive industry to regions like sub-Saharan Africa. Even though wage pressures among South Korean workers are not as strong as they are in China, South Korean infant industries may find African cities to be viable destinations for centering their operations. Many African governments with leaders and political parties that have been in power for decades would welcome South Korean businesses looking to move part of their supply chain to urban areas, especially if it would provide employment for a politically active, educated youth population that has been at the forefront of recent protests over the failure of government to provide more jobs.

Conclusion

The level of South Korean investment in sub-Saharan Africa lags behind China's and is nowhere near the level of the United States or Western European nations like France or the United Kingdom. South Korean investors and businesses are well positioned to enter the African market now though, as many African governments look to connect with nontraditional partners such as India, Brazil, and Turkey. A more crowded investment space suggests that Western firms will have to be more flexible and devise new strategies to compete with the growing number of Southern investors, including South Korea, that can cheaply align their priorities and capabilities with host country governments.

South Korea's role in sub-Saharan Africa's commercial development is set to rise in the coming years. Like China's resource-for-infrastructure model, Korea's resource-for-development model—with a focus on agricultural, information and communication technology, and social projects—offers much needed and greatly valued services to underdeveloped African countries.

Philippe de Pontet is the head of the Eurasia Group's Africa Practice. James Clinton Francis is a researcher in the Eurasia Group's Africa practice.

Selected Commentary

Korea and the World Economy
C. Fred Bergsten, Peterson Institute for International Economics

Korea's Challenges and Opportunities in 2011
Chae Wook, Korea Institute for International Economic Policy

A Reflection on the Seoul Summit
Paul Volcker, Former Chairman of the Federal Reserve

The G-20: Achievements and Challenges
SaKong Il, Korea International Trade Association

Korean Green Growth in a Global Context
Han Seung-soo, Global Green Growth Institute

Korea's Green Energy Policies and Prospects
Whang Jooho, Korea Institute of Energy Research

Additional Commentary and Analysis

Korea: Economic Prospects and Challenges after the Global Recession

Achievements in Seoul and Korea's Role in the G-20

Africa and South Korea's Leadership of the G-20

Korea's Green Growth Strategy: A Washington Perspective

An Ocean in Trouble, An Ocean of Opportunity

System Architecture for Effective Green Finance in Korea

Economic Implications for South Korea of the Current Transformation in the Middle East

Korea-Africa: Emerging Opportunities

U.S.-Korea Economic Relations: A View from Seoul

A New Phase in China–North Korea Relations

Increasing Dependency: North Korea's Economic Relations with China

The Economics of Reunification

Human Resources and Korean Reunification

Korea-China Economic Partnership: The Third China Rush

Korea Economic Institute

1800 K Street, N.W
Suite 1010
Washington D.C., 20006