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130TH ANNIVERSARY OF KOREA'S ECONOMIC RELATIONS WITH RUSSIA

By Jeong Yeo-cheon

Abstract

The beginning of Korea-Russia economic relations go back 130 years, however, for most of the last century, the relationship between Korea and Russia has been curtailed due to historical events. It was not until the early 1990s that South Korea and Russia established new diplomatic ties and resumed normal economic interaction.

Over the last 20 years, South Korean and Russian economic relations have vitalized rapidly. Russia is currently South Korea's tenth trading partner, and is becoming increasingly important as an importer of automobiles and an exporter of energy resources. As large-scale direct investments of Korean companies into Russia have increased since the mid-2000s, the fields of economic cooperation between the two nations have become more diverse.

There is a strong synergy between South Korea, with its powerful manufacturing industry, and Russia, which has abundant natural resources. Another possible factor accelerating economic relations between the two nations is the Russian government's pursuit to develop the Far East, and the Korean government's goal of a tighter connection with the Eurasian continent. If North Korea's peaceful participation is made possible, the economic relations of Korea and Russia will progress even more rapidly.

Introduction

Today, many people regard the ‘Friendship and Trade Agreement’ between the Joseon Dynasty and the Russian Empire contracted in 1884 as the starting point of official diplomatic relations between Korea and Russia. It is not a simple task to summarize the 130-year relationship between the two nations, especially because of the enormous changes in national systems and territories that occurred in each nation during this time.

In this chapter, the author will focus on the economic relations between Korea and Russia from South Korea’s current point of view. The author will first summarize a century of events, from the establishment of diplomatic ties between the Joseon Dynasty and the Russian Empire in 1884, to the early 1990s when new diplomatic relations were established. The new relations between South Korea and Russia (Russian Federation) were based on a diplomatic treaty agreed to by the Soviet Union and South Korea in 1990, which was a complete departure from the 19th century ‘Friendship and Trade Agreement.’ Thus, the new era of economic relations is impossible to compare with the former one. The author will then focus on the development of economic relations between South Korea and Russia from 1990 to present; the distinctions of Russia as a partner of economic relations with Korea; and the prospect of future economic relations between the two nations. Relations between North Korea and Russia will also be mentioned.

Historical Background of Korea-Russia Economic Relations

Being the only nation on the Korean Peninsula in 1884, the Joseon Dynasty’s first diplomatic relationship with the Russian Empire occurred in the context of the competitive entries of Europe’s imperial powers¹ into Northeast Asia. The Joseon Dynasty had few international exchanges except with China (the Ming and the Qing Dynasties) and Japan since its foundation in the late 14th century.² In the late 19th century, however, the Joseon Dynasty established modern diplomatic relations with Europe’s imperial powers, including the Russian Empire. As shown in the title of the first diplomatic treaty, the ‘Friendship and Trade Agreement,’ economics were an important issue within the amity between the Joseon Dynasty and Europe’s imperial powers. Core issues included obtaining the right to exploit goldmines, construct railroads, and open harbors for international trade. However, in 1910, 20 years after establishing diplomatic ties with the West, the Joseon Dynasty was forcefully annexed by Japan and remained as a colony until Japan was defeated in World War II. During this period, it was impossible for Korea to establish any independent relations with foreign countries, including Russia.

With the end of World War II, the Cold War structure began to form and in 1948, Korea became divided into South Korea and North Korea. South Korea belonged to the so-called Western bloc, led by the United States, and pursued anti-Communism policies which disapproved of diplomatic relations and private contacts with the Communist bloc, including the Soviet Union. This status continued until the mid-1980s when the Cold War structure collapsed with the USSR operating policy of reformation internally and open-door policy externally. Therefore, South Korean-Russian economic relations essentially did not exist between 1910-1980s. In contrast, for North Korea, Russia (the Soviet Union at that time) was not only their most important partner country, but also their strongest patron and socialist advocate. The primary industrial facilities of North Korea were constructed through technical, material, and financial support from the Soviet Union. Almost half of North Korea’s foreign trade in the early 1990s was with the Soviet Union,³ which illustrates the economic importance of the Soviet Union to North Korea.

South Korea sought to improve relations with the Soviet Union from the mid-1980s, during the Soviet Union’s reform and open-policy era, and established official diplomatic relations in 1990. During this time, trade between South Korea and the Soviet Union grew, culminating in a trade volume exceeding \$1 billion in 1991, the last year of the Soviet Union. South Korea extended an Economic Cooperation Loan to the Soviet Union to support the expansion of trade and, as a political bonus, to form the beginning of an amiable relationship between the two nations. After a discharge of \$1.47 billion, however, the loan was suspended due to the extinction of the USSR.⁴

The Progression and Present Conditions of South Korea-Russia Economic Relations

The Progression of South Korea-Russia Economic Relations during and after the 1990s

Near the end of 1991, after the extinction of the Soviet Union, all official South Korea-USSR relations became South Korea-Russia (the Russian Federation) ones. Almost 70 years of complete severance in diplomatic relations had ended and new ties were established, making it possible for people to travel freely. In the first stage, trade between South Korea and Russia expanded to \$3 billion in the mid-1990s. During the first decade of Korea-Russia economic relations, trade mainly settled into Korean exports of electric home appliances (color TVs and refrigerators), and Korean imports of raw materials (steel, metal goods, and wood) from Russia. At that time, Russia had just begun opening its market, so awareness of Western products was limited, making entry of South Korean consumer goods easy. In addition, abundant and cheap Russian natural resources and raw materials found Korean sales channels relatively

rapidly. As South Korea-Russia trade grew quickly in the 1990s, the early stage of their interaction, other economic relations stalled in the investigation phase. For example, even though Korean companies had made various attempts at direct investment in Russia before the treaty of amity with the USSR, it only resulted in a few small investments. This was partly caused by post-Soviet Russia's unstable social circumstances and institutional chaos after its implementation of radical reform. However, the main reason was the lack of information and knowledge that South Korean companies had about Russia's domestic market and the Russian people, which made it difficult to carry out bold investments. After the establishment of formal diplomatic ties, the governments of the two countries signed an agreement related to customs and reciprocal protection of investments to prepare a systematic ground for activating interactive economic relations, and directly led discussions about economic cooperation projects in terms of national policy. Plans for building exclusive industrial complexes for South Korean companies in the Russian Far East, and setting a joint project on the development of natural gas field in East Siberia's Sakha Republic,⁵ were discussed, but none of them came to fruition at that time.

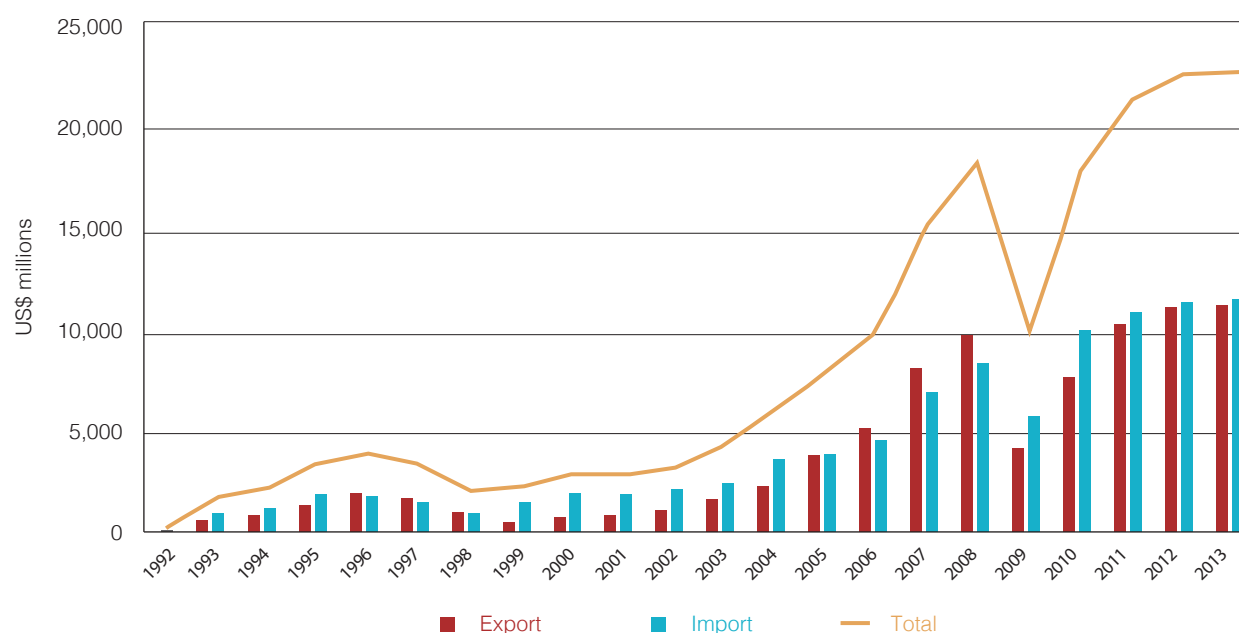
Economic exchanges between South Korea and Russia grew constantly from the early 1990s, apart from sharp dips due to the economic crises originating in Korea (1997) and Russia

(1998). However, in the 2000s, economic relations between the two countries started to enter a full-blown growth stage, as Russia's economic situation took a favorable turn and entered a long-term booming stage. The trade volume between South Korea and Russia exceeded \$10 billion in 2007 and \$20 billion in 2011.

During the 2000s, traded products between the two countries also changed significantly. Korean automobile machinery exports to Russia increased drastically to over 60 percent of entire exports in the late 2000s.⁶ Russia's export items to Korea also changed. In the late 1990s, Sakhalin Island began exporting crude oil and crude oil processed products, which became Russia's principal trade items. In the stabilization of society and economic prosperity during the Putin administration (2000), direct investments of South Korean companies in Russia also started to increase. In particular, after the mid-2000s, South Korean companies carried out investments that built large-scale hotels and manufacturing plants for automobiles and electronic products, so that Korean direct investments to Russia exceeded \$2 billion.

Entering the 2000s, South Korea-Russia interaction increased and economic relations diversified. The combination of Korea's capital, technology, and business know-how with Russia's production achieved remarkable successes in several fields. In this period, the Korean and Russian governments discussed linking the Trans-Siberian Railroad (TSR) and the

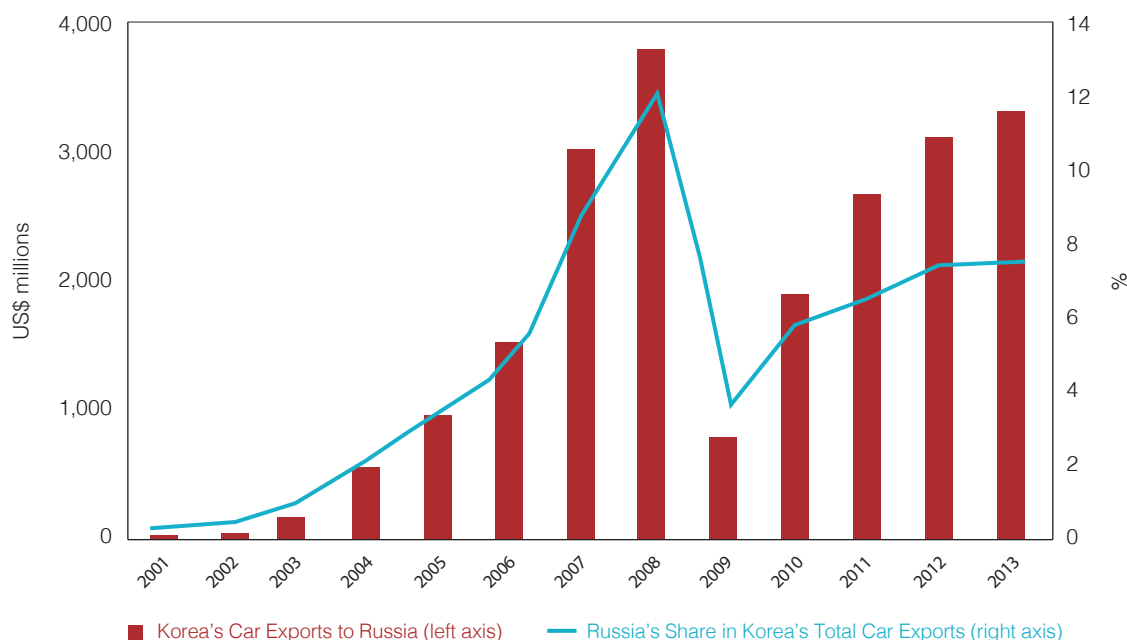
Figure 1 Annual Changes of Korea's Export to and Import from Russia (1992-2013)



Source: Korea International Trade Association, Trade Statistics, <http://stat.kita.net/stat/kts/ctr/CtrTotalImpExpDetailPopup.screen>.

Figure 2

Growth of Korea's Car Exports to Russia in 2000s



Source: Korea International Trade Association, Trade Statistics: <http://stat.kita.net/stat/kts/pum/PumCtrlImpExpList.screen>.

Trans-Korean Railroad (TKR), making natural gas pipelines traversing from the Russian Far East to the Korean Peninsula. Although both projects failed due to lack of cooperation with North Korea, they still hold an important position in the current list of South Korea-Russia economic cooperation. Farming was a new form of investment in Russia tried by South Korean private enterprises during this time. In the mid-2000s, when crop prices throughout the world were on the rise, several South Korean companies leased and managed large-scale farms in the Russian Far East. In addition, the Russians collaborated with the South Koreans to develop a satellite rocket for the first time in South Korea, demonstrating the diversity of their economic relations. This project, started in 2004 from the agreement between the two governments and processed by South Korean and Russian research institutes, paid off in early 2013 with a successful satellite launch in South Korea.

The Position and Distinctions of Russia as a Partner of Economic Relations with South Korea

Economic relations between South Korea and Russia have expanded enormously in many fields during the 20 years following the establishment of diplomatic ties after their 70-year hiatus. Consequently, Russia's status as a partner of economic relations with South Korea has risen significantly.

Today, Russia is ranked tenth of South Korea's trading partners, contributing 2.3 percent of the entire trade volume of South Korea. As South Korea's automobile business rapidly grew in the Russian market during the 2000s, Russia became the second import destination of South Korean cars, just behind the United States.

Today, crude oil makes up 40 percent of South Korea's imports from Russia. As a result, Russian crude oil's portion of total crude oil imports in South Korea expanded to approximately five percent. As South Korea began importing liquefied natural gas (LNG) from Russia in 2009, South Korean dependency on Russian energy resources became even higher. For the last 20 years, the trade volume between South Korea and Russia has been balanced in general, and recently, imports of Russian products to South Korea have been marginally higher than exports from South Korea to Russia.

Until recently, the accumulated amount of direct investment of South Korean companies in Russia, over \$2 billion, had been less than one percent of South Korea's entire overseas direct investment. Considering this figure, investment relations had not been as active as trade relations during this same time period. It was after the mid-2000s when direct investments of South Korean companies in Russia rapidly increased, although this was not strictly a Korean phenomenon since

Russia was becoming a global host country.⁸ While other countries concentrated on investing in material resources in Russia, South Korean companies invested in local production and the sale of processed goods, including automobiles. The fact that investment relations between the two countries still consist mainly of South Korea's investments in Russia,⁹ but not Russia's in Korea, confirms that South Korea-Russia investment relations are not yet active. Even though Russia has become one of the most primary overseas direct investment candidates in the world, its investments are still biased mainly in the former Soviet countries and regions of Europe. Only recently has Russia begun investing in Asian countries such as China and Vietnam, and is expected to increase direct investments in Korea in the future.

Today, there are various discussions underway about economic cooperation projects between South Korea and Russia which are not yet developed enough to be specific investment projects. For instance, the two countries have discussed plans to jointly develop and utilize underground resources such as oil, natural gas, and coal; develop agriculture in the Russian Far East; acquire fishery resources; and process forest products. Along with discussions about railway cooperation centered on the Trans-Korean Railway-Trans-Siberian Railway (TKR-TSR) linkage project, the construction of harbors, expressways, powerhouses, and massive mining facilities are also on the South Korea-Russia collaborative business plan. In addition, there has long been discussion about joint construction of a transmission network for exchanging mutual surplus electricity. There are already successful cases of businesses that produce new products which combine Russia's advanced scientific technology and Korea's commercialization techniques. Although the financial costs and benefits of these mutual projects in process are difficult to assess, their very existence highlights the diversity, distinctiveness, and significance of economic relations between South Korea and Russia.

Prospect of Korea-Russia Economic Relations

Considering that South Korea and Russia's current interactive history is only about two decades, it is not hard to forecast that the future will bring more contact between the two countries.¹⁰ Most scholars and commentators agree that their current economic relationship has barely reached its potential. For example, a recent study evaluated that South Korea-Russia trade in the 2000s was only 40-50 percent of a generally expected size based on the economic conditions of the two countries. Since economic relations occur primarily through the interaction of people, economic relations will escalate as experience and knowledge of

not only the economy, but also of culture, language, and customs, intensify between both countries. In this regard, the visa-waiver agreement of short-term visitors between South Korea and Russia, which went into effect in early 2014, seems to boost the visit and interaction of citizens and, therefore, the economic relations of the two nations.¹¹

South Korea's manufacturing-centered economic structure with absolute scarcity in natural resources and Russia's abundance in natural resources together with her big market provide the basic rationale for a positive forecast of economic relations between the two countries. Another positive element leading to a more profound relationship is the friendliness between the two governments' external economic policies. The South Korean government has been taking a huge interest in Russia's rich natural resources, large market size, and the potential of developing railways and marine transportation networks through the Russian Far East, which is directly connected to the Korean Peninsula and regarded as a crucial platform for Korea to establish a new international transportation system for future imports and exports. That is why the Eurasia Initiative policy of the present South Korean government includes cooperation with Russia. The Putin administration started long before to modify Europe-leaning economic relations and began expanding economic relations with the Asia-Pacific region. The 2012 foundation of the Federal Ministry of the Development of the Far East shows the Putin administration's interest in the economic developments of the Russian Far East and East Siberia as its national project. It appears that the basic aim of international economic policies between South Korea and Russia will remain into the future, and will serve as a key engine for intensifying these economic relations.

To forecast future economic relations between South Korea and Russia, North Korea should be mentioned as an important element and special consideration. For the past 20 years, North Korea has not put any substantial influence on the economic relations between South Korea and Russia. Nonetheless, there have continuously been suggestions of economic cooperation projects between South Korea and Russia which involve—or utilize—North Korea. Quite a few of them were actually attempted, although they did not result in any projects. The chief arguments were to use North Korea's geographical location in the middle of South Korea and the Russian Far East, to apply the long-standing friendly political and diplomatic relationship between North Korea and Russia, or to make use of the special relationship between South Korea and North Korea. Connecting TSR-TKR railroads or constructing pipelines between the Russian Far East and South Korea, as mentioned, are the representative examples of suggested cooperation projects of this kind. Other suggestions included business plans

(such as building a transmission network from Russia to the Korean Peninsula), using North Korean workers for South Korea-Russia common development projects in the Russian Far East, and South Korea and Russia's collaborative project for regional development in North Korea. These plans, the so-called 'trilateral economic cooperation between South and North Korea and Russia,' would not only establish infrastructure to propel long-term economic progression using beneficial geographical conditions, but also bolster communication and cooperation between South Korea and North Korea which would have political and security significance by stabilizing the Korean Peninsula. Whichever meaning it takes, the realization of trilateral cooperation is expected to strengthen economic relations between Korea—the whole peninsula including the South and North in this case—and Russia.

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- ³ On the other hand, the share of China rarely went beyond 20 percent in North Korea's foreign trade until early 1990s, right before the collapse of the Soviet Union. See Jeong, Yeo-cheon, *Changes and Prospects of Russia's Economic Cooperation with North Korea*, Northern Economic Studies, Vol. 7, pp. 135-152, published by Association of Northern Economic Studies, Seoul, 1996, p. 145. (in Korean)
- ⁴ 'Economic Cooperation Loan' was contracted in early 1991 through an agreement between Seoul and Moscow. It was originally planned as \$3 billion.
- ⁵ Sakha Republic is one of the states of the Russian Federation, formerly called Yakutsiya during the USSR days and is famous for its coal and diamond fields.
- ⁶ Visual equipment such as color TVs occupied 30-40 percent of Korea's export products to Russia during the 1990s, but it declined to around 2 percent in the late 2000s.
- ⁷ According to official statistics, the trade volume between South Korea and Russia in 2013 is recorded as about \$22.6 billion, which is equivalent to about 22 percent of trade volume between South Korea and the U.S. (about \$103.5 billion).
- ⁸ In 2006, Russia overtook China as the inflow volume of foreign direct investment (FDI) per capita. D. Tarr/N. Vlochkova, *Russian Trade and Foreign Direct Investment Policy at the Crossroads*, Policy Research Working Paper 5255, The World Bank, p.15.
- ⁹ The accumulated amount of direct investments carried out by Russia in South Korea until recent is not even \$100 million.
- ¹⁰ Jeong, Yeo-cheon, et. al., *Korea-Russia Economic Cooperation in the Era of Strategic Partnership*, Korea Institute for International Economic Policy, 2010 (Mimeo., in Korean).
- ¹¹ See Jeong, Yeo-cheon, Park, Sun-chan, Kang, Bu-gyun, *Economic Impact and Application Plan of the Visa-Free Regime between South Korea and Russian*, Korea Institute for International Economic Policy, Policy References 2013-09 (in Korean).

¹ The United States also can be regarded as one of them.

² Historical records show that the Joseon Dynasty had official foreign relations with other countries besides China or Japan, such as some tribal countries of Manchuria and the Ryukyu Kingdom (today's Okinawa, a part of Japanese territory). However, this kind of exchange occurred rarely, and even so, was terminated when they were incorporated as parts of China and Japan.

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