KOREA INSIGHT

KOREA ECONOMIC INSTITUTE OF AMERICA
Volume 2, Number 7
July 2000

U.S. Opens Door to Trade with North Korea

by R. Ben Weber (rbw@keia.org)

On June 19th, the United States finalized the regulations allowing the easing of sanctions on North Korea. By easing sanctions, the United States has placed the "ball" back in North Korea's court and fostered engagement with North Korea on nuclear and missile proliferation, as well as maintenance of regional stability. However, it is reasonable to ask whether the easing of sanctions will lead to significant economic benefits for either North Korea or the United States, or is merely an element of the continued engagement that the Perry Report recommends.

Since 1953, the United States has maintained a virtually complete embargo on all trade in goods and services with North Korea. In the early nineties, discussions among the two countries and South Korea led to the 1994 Agreed Framework, which established an organization, led by the United States, South Korea and Japan, to develop two light water reactors, and provide heavy fuel (HFO) oil to North Korea. In addition, the U.S. government offered the possibility of the easing of sanctions. North Korea, for its part, agreed to close its single working 5-Megawatt nuclear reactor, the canning of its fuel rods, and the halting of any further construction and proliferation of nuclear technology. Despite a number of setbacks on both sides, most of these issues have been addressed. The reactors are currently being built, the HFO continues to be delivered, and North Korea has closed its reactor and has completed the canning of all its old fuel rods. The easing of sanctions was also designed to further encourage North Korea to continue to support the Agreed Framework and to refrain from any further long-range missile tests.

Exporting Made Easy

The Bureau of Export Administration (BXA) in the U.S. Commerce Department has been charged with the task of regulating and monitoring all U.S. exports to North Korea under the new federal regulations. With the easing of sanctions on North Korea, export of most consumer goods—such as dishwashers, TVs, and foodstuffs—are no longer restricted and do not require government approval or licensing. Restrictions on items which may pose a threat to national security and which are on the Commerce Control List (CCL)—such as computers with a rating of 6MTOPS (25Mhz) or faster, diesel engines and tractors that are over 400 horsepower, and aircraft and aircraft parts—are handled on a case-by-case basis. However, BXA has placed a heavy burden on potential U.S. exporters. It is the responsibility of the exporters to know with whom they are trading in North Korea. If it is determined that an exporter is trading with a North Korean entity which is connected to North Korea's nuclear or missile programs, the U.S. government will take immediate action against that exporter. BXA contends that determining the real motive of the North Korean partner will be difficult and suggests that, if the U.S. exporter is unsure of the intentions of its North Korean counterpart, it would be wise to contact BXA and seek their assistance and insight. Currently, the State Department has designated only the North Korean Mining Company as a restricted trading partner.

Importing...Not So Easy!

The U.S. Treasury and its Office of Foreign Assets Control (OFAC) is responsible for monitoring all U.S. payments to North Korea for imports and other purposes. In order to import North Korean goods, a letter of approval will be required in all cases, for imports either directly to the United States or through third countries, regardless of the product. Importers are required to inform OFAC if the items produced were from "a) a foreign person having engaged in missile technology proliferation activities; b) an activity of the North Korean Government related to the development or production of any missile equipment or technology; or c) an activity of the North Korean Government affecting the development or production of electronics, space systems or equipment and military aircraft." If importers are found to have violated any of the above listed requirements, the penalty ranges up to 10 years in prison and $1 million in fines for corporations and $250,000 for individuals, along with civil penalties of up to $55,000 per violation.

As part of the sanctions-easing process, restrictions on travel to North Korea by U.S. residents have been lifted. However, this does not guarantee entry. Travelers will need to obtain the permission of the North Korea government in order to gain admittance. Currently, there are no U.S. based flights or ships that visit North Korea.

ECONOMIC TRENDS

by Florence Lowe-Lee (fll@keia.org)

Korea Missing Out on Opportunity to Reform Economy: According to a report by the Milken Institute, "Korea's Recovery: Don't Count on the Government," the nation's rapid recovery from the crisis in late 1997 may have caused the opportunity to reform its economy to be lost, as interest groups are focused on their own well-being. The report said that the parliamentary elections in April resulted in no agreed agenda to dramatically restructure the economy. However, it pointed out that market forces may change Korea anyway, as the banks are unlikely to play the central role they once played as the principal source of investment capital. The weakness of the banking system may end the cozy relationship between firms and politicians, who used to provide privileged access to cheap credit in exchange for contributions. The report noted that, while Korea has made significant progress over the past two years in restructuring its financial sector, little has been done on corporate reform. The institute said continuing links between nonbank financial institutions and the corporate sector are the most problematic area and are obstacles to true institutional reform.

Private Consumption Rises to Pre-Crisis Level: The Central Bank said that private spending as a percentage of gross national income advanced 56% in the first quarter of this year, as the nation continued its economic recovery. The figure is close to the pre-crisis level of 56.3%. The gain was mainly attributed to a surge in private spending on durable goods. Consumer spending on durable goods, such as cars and personal computers, jumped 44% in the first quarter from the same period last year. Spending on telecommunications and internet services rose 34.8% year-on-year in the first quarter, while spending on apparel increased 19.5%. Although household income was the major factor in private spending, the Central Bank said, stock price levels had a considerable impact on consumer spending between 1997 and 1999. Stock prices rose 132% in 1999 from the end of 1998, and the impact of stock prices on the level of private spending almost doubled in the 1990s from previous decade.

Reunification Cost Manageable: A report released by Barclays Capital brought optimistic news to most South Koreans about reunification costs. It said that unification costs will remain manageable as long as wages in the North are not brought up to the levels in the South until North Korean workers are as productive as their southern counterparts. Under the least expensive model, North Koreans would have wage levels equal to 25% of those of workers in the South by 20 years after reunification. The report said that the South should slow down annual growth by a percentage point to further afford the burden of the transfer of resources to the North. Furthermore, it stated that reunification need not entail massive migration of poverty-stricken North Koreans to the South as long as the rapid privatization of land and a massive upgrade of infrastructure take place in the North. The report also said that the prospects for foreign direct investment in the North after reunification is bright because of its untapped market, strategic location, mineral resources, and cheap labor.

Foreign Investment Surges: Foreign investment in Korea increased in June, totaling $1.18 billion, highlighted by major investment in Hyundai Group affiliates. Last month, Hyundai Investment Trust & Securities Co. received $900 million from six foreign financial institutions, while Hyundai Motor Co. formed a strategic alliance with DaimlerChrysler AG of Germany, the Ministry of Commerce, Industry, and Energy said. In the months ahead, foreign investment is expected to increase if creditors manage to sell Daewoo Motor Co. to foreign buyers. Investment by Japanese companies in Korea more than tripled in the last six months, totalling $1.01 billion, while investments by U.S. companies declined 6.9% from a year earlier to $1.04 billion.

Corruption Hurts Korean Economic Growth: The Korean Economic Research Institute reported that corruption in Korea is eroding the nation's economic growth. The study estimated that, if corruption is reduced to the level of Japan's, the annual economic growth rate can be pushed up by 1.4 to 1.5 percentage points. According to Transparency International, Korea obtained 3.8 points out of 10 points in terms of transparency, ranking 50th among 99 countries worlwide, while Japan received 6 points. The study suggested that, to reduce corruption, public officials' pay should be raised sharply.

U.S. POLICY PERSPECTIVE

by Caroline G. Cooper (cgc@keia.org)

U.S. Trade Deficit with Korea Increases in May: After declining by nearly 30% from February to April, the U.S. trade deficit with Korea increased by 38% from April, to $747 million in May. Imports from Korea increased by 7% from April to May, while U.S. exports to Korea decreased by 4%. Imports from Korea increased substantially in the areas of mineral fuels/lubricants, manufactured goods, and machinery and transport equipment. The total trade deficit with Korea this year to date is estimated to be $3.7 billion.

Congress Exerts Muscle on Foreign Policy in Asia: U.S. foreign policy continues to be a divisive issue for the U.S. Congress and the Clinton Administration. This is particularly true when it comes to using economic sanctions to safeguard national security interests.

In the past two months, this division over foreign policy has been evident. In the House of Representatives, for example, Representatives Ben Gilman (R-NY), Ed Markey (D-MA), Joe Knollenberg (R-MI), and Frank Pallone (D-NJ) introduced H.R. 4868 to reimpose economic sanctions on North Korea should the North fail to comply with the missile moratorium. This is particularly notable because the legislation was introduced very soon after the formal announcement by the Administration on June 19 to fully implement the removal of certain economic sanctions on North Korea. In a similar move, Senator Fred Thompson (D-NJ) introduced S. 2645 in the Senate to impose sanctions on China if it were to sell, transfer, or develop weapons of mass destruction. This legislation was introduced as debate in the Senate over granting China permanent normal trade relations began. Like the North Korea legislation in the

House, S. 2645 has received considerable support from several high-ranking Democrats in the Senate, such as Senator Robert Torricelli of New Jersey.

It is unclear at this point what, if any, effect the two pieces of legislation will have on future foreign policy objectives of the United States in Asia. However, it is clear that the U.S. Congress will continue to exert its oversight authority over foreign policy unless a new Congress and new President can come to agreement after the November election.

NEWS HIGHLIGHTS

by Emily T. Bryant (etb@keia.org)

Chosun Ilbo *"S & P Expresses Gloom on Financial Restructuring"* (July 20): In its report, "The Problems With The World Financial System," Standard and Poors (S & P) noted that the reduction of their debt/equity ratio by Korea's four top *chaebol* last year to 174% was cosmetic and their absolute burden has been reduced only marginally, with interest payments also virtually unchanged. In commenting on the same report, Thompson Financial Bank Watch (TFBW) stated that non-performing loans at Korea banks have reached 110% of loan loss provisions, proving that the country's financial sector is far from healthy. TFBW also stated that, in an attempt to boost profits, most banks have lowered their loan loss provisions to below what is actually needed.

Chosun Ilbo "*Garlic Wars" Finally Over as Deal Is Initialled"* (July 16): The Ministry of Foreign Affairs and Trade (MOFAT) announced that it initialled an agreement with its Chinese counterpart on July 14, ending the so-called "garlic wars" trade dispute. The issues raised by the "garlic war" were said to reveal the ineptitude of the Korean government's handling of negotiations, due to a lack of communication between related ministries. Another dispute between the ministries was over beef. The Ministry of Agriculture and Forestry (MOAF) wanted to label beef products from the countries of origin; MOFAT had to point out publicly that this breached WTO regulations. Prior to this, MOFAT had to tell the Ministry of Finance and Economy (MOFE) that requiring car salesmen to inform the tax service of the names of people buying cars with engines bigger than 2,400cc also did not follow WTO rules. The latter issue made the MOFE the laughing stock in international circles. MOFAT said that the debacle was due to other ministries' ignorance of international regulations, attempts to appeal to national sentiment, catering to special interest groups and their failure to communicate and coordinate with each other.

BUSINESS UPDATE

by R. Ben Weber (rbw@keia.org)

Korea's Internet Industry Lagging: A recent study by the Korea Development Bank (KDB) on Korea's internet industry, concluded that, despite its great strides, Korea's internet industry is about three to five years behind advanced countries such as the United States. Although overall access to the internet is equal to that of advanced countries, access in the banking and education sectors is lagging. The KBD contends that, if the banking and education sectors do not institute drastic changes, it will be difficult for them to adapt to the new marketplace. Korea's E-commerce is currently behind other international E-commerce standards in areas such as privacy and usage. However, it is expected to thrive in the coming years. The KDB went on to say that the installation of high speed networks and other related infrastructure projects will greatly enhance Korea's competitiveness in the coming years.

Top Three Electronic Firms Account for 20% of Korea's Total Export: In the first half of 2000, Korea's leading electronic firms —Samsung Electronics, LG Electronics, and Hyundai Electronics — accounted for a combined $17.3 billion (20%) of Korea's total exports of $82.98 billion. Analysts atttribute the increase to the growing demand for semiconductors, which are essential for the information and telecommunications sectors. However, unlike Samsung and Hyundai, LG's dramatic sales figures were led by digital products such as the flat panel display units (FPD) that are gaining popularity amongst home computer users. The IT sector accounted for about 10% of Korea's GDP in 1999.

Korea Auto Makers Projected to Hit the 3.16 Million Mark: The Korea Auto Industry Research Institute projected recently that this year the Korean auto industry for the first time will produce over 3 million units. The 1997 crisis caused a dramatic drop in demand in both the domestic and international markets. Nevertheless, 1998 saw a turnaround resulting in 2.84 million units produced, marking a return in consumer demand. Domestic and international demand for Korean cars is expected to increase 14.1% and 12.6%, respectively, this year. According to Daehan Investment Trust, growth in Korea's auto industry is expected to average 10% in 2001 and 2002. Daehan also stated that Hyundai's share of the domestic market will likely decrease from 73.2% to 50-60% in the coming years. However, Renault's Samsung Motors should see an increase of its share to over 10%. If Ford is successful in purchasing Daewoo, Daewoo's local market share is predicted to increase from 18.3% to around 30% in the long term.

Italy Improves Relations with North Korea: Since Italy and North Korea renewed relations earlier this year, both sides have been discussing areas of continued engagement. Italian Minister of Industry and Trade Enrico Letta stated recently that Italian companies have "prepared themselves to enter North Korea immediately," in areas such as textile and automobile manufacturing, when the North is ready. The Italian Trade Commissioner, who has visited North Korea three times between 1998-1999 as a member of the European Union Chamber of Commerce in Korea, indicated that Italy is prepared to discuss various economic exchange projects with North Korea. This statement comes after the Minister's recent visit to Pyongyang to discuss a joint agreement to prevent double taxation, investment guarantees and bilateral cultural exchanges between the two countries. Minister Letta also said that "given the economic condition of North Korea, it is desirable for Korean and Italian companies to join hands in bids to enter the North."

***Korea Insight* is published monthly by the Korea Economic Institute. Vice President James M. Lister is the editor.**

ECONOMIC INDICATORS

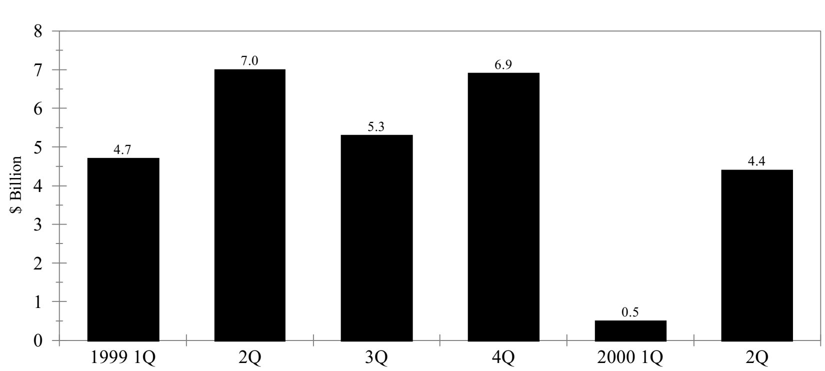
by Florence Lowe-Lee (fll@keia.org)

	1997	1998		1999			2000					
	Dec	Jun	Dec	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	June
FX Reserves ($ billion)	8.9	37.0	48.5	60.4	65.5	74.0	76.8	79.7	83.6	84.6	86.8	90.2
Exchange Rate won/$ (end of month)	1415	1385	1208	1156	1219	1145	1122	1132	1108	1110	1129	1115
Stock Price Index (1980=100)	390	313	525	841	927	985	953	903	878	780	721	795
Interest Rate (3 year Bonds)	24.3	16.6	8.3	8.1	10.4	9.9	10.3	10.0	10.0	10.0	9.9	9.8
Industrial Production (1995=100)	116	99	122	132	135	152	147	134	151	148	155	n.a.
Unemployment Rate (%)	3.1	7.0	7.9	6.2	4.8	4.8	5.3	5.3	4.7	4.1	3.7	3.5

Source: Bank of Korea

				1998				1999				2000	
	1997	1998	1999	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Jan-May
GDP Growth (%)	5.0	-6.7	10.7	-4.6	-8.0	-8.1	-5.9	5.4	10.8	12.8	13.0	12.8	n.a.
Consumption Growth (%)	3.2	-9.8	8.5	-9.9	-11.3	-10.5	-7.6	5.3	8.4	10.1	10.1	9.7	n.a.
Domestic Investment Growth (%)	-2.2	-21.2	4.1	-19.9	-23.9	-22.4	-18.3	-4.2	4.9	7.0	7.6	22.4	n.a.
Trade Account ($billions)	-8.5	39.0	23.9	8.6	11.3	9.0	10.1	4.7	7.0	5.3	6.9	0.5	4.4*
Current Account ($billions)	-8.2	40.6	25.0	10.9	10.9	9.8	8.7	6.2	6.4	6.7	5.7	1.3	2.4
FDI Inflows ($billions)	7.0	8.9	15.5	0.6	1.9	2.2	4.2	2.0	2.5	4.0	7.1	2.7	4.6

Source: Bank of Korea, Ministry of Finance, and Economy and Ministry of Commerce, Industry and Energy; percentage changes are over corresponding period of previous year.
** Jan-Jun*



Source: Bank of Korea

ISSN 1061-3803

Korea Economic Institute
1101 Vermont Avenue, NW, Suite 401
Washington, DC 20005

Please visit our Website for more information. WWW.KEIA.ORG