

## Five Keys to Korean Prosperity in the “Chinese Century”

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Since 1992, I’ve spoken at tradeshows and in academic settings throughout Asia and the United States about South Korea’s technological leadership in the areas of information technology and wireless communication. Until about 2000, the question I was asked most often was, “How did Korea do it?” How and why did Korea succeed when so many other countries that emerged after World War II are still so underdeveloped? More recently, the question I am asked most often is, “Given everything that is going on with the Chinese economy, does Korea still matter?” These are good questions, and the answer to the first may help underscore my positive answer to the second.

Korea today is on track to hit US\$20,000 in per capita GDP by 2010, is the world leader in broadband access, and has a wireless telecommunications infrastructure that is one of the best in the world (and is 3–5 years ahead of that of the United States). It hosted the 1988 Summer Olympic Games and cohosted the 2002 World Cup. Korean women dominate the Ladies Professional Golf Association, and Korean men are striking out hitters in Major League Baseball. South Korean firms have built the three tallest skyscrapers in the world, and Korea can boast of 41 companies in the *Forbes 2000*. Among the almost 100 countries that became independent following World War II, none of them can come close to this list of achievements. It’s not called the “Korean economic miracle” for nothing.

But for all Korea’s economic success and the democratic system that it now enjoys, there remains a shadow on the horizon: China.

China is the most important country in Asia, and that is unlikely to change anytime soon. The United States knows this. Korea knows this. The Chinese certainly know this. But also unlikely to change anytime soon is Korea’s position as the fourth largest economy in Asia (after China, Japan, and India on a purchasing power parity basis). The threat to Korea is not solely from these goliaths, however, but from the David-like eastern Europe and still-emerging Asian countries, such as Vietnam. The Korean government can promote the country’s “talented human resources,” but, ultimately, cost will drive manufacturing venues, and Korea’s unions have made the country just as uncompetitive as U.S. and western European unions have made their manufacturing sectors.

Again, the question is not how Korea can defeat China—it can’t. The question is how Korea can stay relevant in the Chinese century and protect itself from faster growing economies. I offer here five keys to continued economic prosperity for Korea.

1. Look north, south and east—not just west.

An old expression observes that, “Just because you are paranoid doesn’t mean no one is out to get you.” Korea must be a little paranoid about China, but that can be a healthy thing. In addition to improving quality and reducing prices, competition can drive innovation and sharpen focus. Certainly Korean companies are already using Chinese

manufacturing to lower costs. And China has replaced the United States as Korea's largest foreign market. The challenge for Korea is not to lose sight of the other compass points.

Looking north, peaceful reunification with North Korea will obviously help South Korea by allowing for reduced defense expenditures, increasing investor confidence, and, in general, allocating resources (especially men aged 18–22 now faced with mandatory conscription) in areas that offer greater economic return. But North Korea can be South Korea's China—a center for low-cost manufacturing, a market for almost everything South Korea produces, and a place in desperate need of South Korean expertise.

The Kaesong Industrial Park in North Korea has been a successful merger of South Korea's capital and technology and the North's land and non-unionized labor in a classic example of interdependence. A February 2006 *International Herald Tribune* article reports that, "Over the next year, the number of South Korean factories and North Korean workers will nearly quadruple to 39 factories and 15,000 employees." According to the 20 March 2006 *Business Week*, "North Korean workers at Kaesong earn about US\$50 per month, around half the average wage for unskilled workers in China and less than 10% of what South Koreans earn." It is hard not to smile at the irony of North Korea being one of the economic saviors of South Korea.

Looking south offers Korea the chance to export knowledge to a hemisphere desperately in need of mentoring. Think of what Korean companies in the fields of banking, construction, energy, manufacturing, and telecommunications could teach people in lesser developed countries. And this is not about charity—though that could be a component. This is a for-profit business in which Korean companies promote their expertise by saying: We don't have some theoretical approach to sustainable growth. We know what works and can train your people and companies.

Finally, looking east cannot be overlooked. The U.S. market is one of the largest in the world for Korean goods and will remain so for the foreseeable future. The U.S. security umbrella will help Korea remain competitive, even after peaceful reunification. The unique relationship the two countries share—never having been at war with each other and often fighting together in times of war (WWII, Vietnam, and Iraq), is a foundation to be maintained and could serve Korea well as a deterrent to the ever-present potential for Chinese militarism and economic bullying.

2. Accept and embrace the best global practices for financial transparency at all levels, including banking, regulations, corporate governance, and contract enforcement, including intellectual property rights (IPR). Nothing—nothing—Korea can do will give investors more confidence and provide a clearer differentiator vis-à-vis China and Vietnam.

What China cannot offer today—and shows few signs of offering any time soon—is financial transparency and IPR protection. Huawei, one of China's largest domestic companies and quickly becoming a global brand, has faced accusations of reverse

engineering and corporate espionage since the company was started in 1988. More recently, Huawei came under fire in 2004, when an employee was caught taking photographs of a rival's circuit boards after hours at a trade show in Chicago. A Huawei official called the incidents "misunderstandings" and added that they are "all about how Westerners and Americans view China."

Whether China's transgressions are perception or reality, Korea is far ahead of China in terms of IPR and has significantly improved financial transparency following the 1997–1998 Asian financial crisis. Even the largest foreign firms in China enter the market with their fingers crossed. Vietnam still must climb the same learning curve that China started 10 years ago. Korea can differentiate itself by continued promotion and enforcement of proactive public and private initiatives to strengthen Korea's laws in these areas.

3. Deal with the domestic political issues with the unions and farmers and sign a Free Trade Agreement (FTA) with the United States.

As a strong Korean currency and increased labor costs eat away at profitability and ultimately harm competitiveness vis-à-vis China, there is nothing better Korea can do to lower the landed cost of their exports to the U.S. than to sign the FTA. Vocal special interests in Korea will make this obvious step harder than it should be. But just like the rice protests prior to Korea joining the World Trade Organization, those opposition voices will be drowned out by the tangible economic gains Korea will enjoy.

Two recent examples of the success of a bilateral trade agreement with the United States are Vietnam and Chile. Since the 2001 U.S.-Vietnam Bilateral Trade Agreement, Vietnam's exports to the United States have increased more than sixfold under the deal. In terms of foreign direct investment (FDI), according to *BusinessWeek*, Vietnam's jumped 41%, while China's total actually fell slightly. China still saw commitments of \$60 billion, but as a percentage of GDP, Vietnam's total was more than twice what China received last year.

Chile's numbers are even more impressive and serve as a useful counter to Korea's antitrade farmers. In the two-year period immediately following the start of the Chile-U.S. FTA, Chile's exports to the United States almost doubled, according to the Central Bank of Chile. And some of the biggest export industries were fish, agriculture (grapes, avocados), and wine.

Equally important is the signal that an FTA with the United States sends to other potential Korean partners about what differentiates Korea from China and many other countries. It tells the world that Korea has addressed successfully such issues as transparency, the rule of law, corruption, and IPR.

4. Forget about competing with China and Vietnam and even eastern Europe in terms of low-cost manufacturing. Focus instead on quality using the Japanese model from the 1970s and 1980s.

Low-cost manufacturing is a race to the bottom as one emerging country after another tries to undercut each other, much like Korea did to Japan 20 years ago. It is a race that Korea can't win and wouldn't want to.

When I lived in Seoul from 1992 to 1996, the standard joke among the expat community was that Korea was “the land of almost right.” A beautifully hand-tailored suit would have one sleeve just a little longer than the other. Certainly the country has made tremendous strides since then, but “Made in Korea” as a brand still does not evoke a feeling of quality.

The answer is to focus on quality. Korean firms will continue to migrate their manufacturing to low-wage countries. So the products built in Korea must be world class. People will pay more for quality. Americans saw the 10- to 20-year shift in perceptions of Japanese cars such that now the Lexus is arguably the best built car in the world. Hyundai seems on that path to quality, but it is a steep mountain to climb, and it gets much steeper as you get closer to the top. Quality is an attitude not yet common in most Korean companies—and it needs to be.

5. Reduce the percentage of GDP produced by the chaebol without being punitive. Small and medium-sized enterprises (SME) can be a growth engine and offset job losses as manufacturing migrates to China.

Anyone who has done business in Korea quickly sees the spirit of entrepreneurialism that permeates Korean culture. With a higher tolerance for risk and less fear (and fewer consequences) of failure than Japan, Korea should see tremendous wealth creation in the SME sector. And the Korean government sponsors or otherwise supports such organizations as the Small Business Corporation (<http://www.sbc.or.kr/eng/>), Small and Medium Business Administration (<http://www.smba.go.kr/main/english/index.jsp>), and Korean Marketplace (<http://eng.best sme.com/main/aboutus/aboutus.jsp>) to help Korean firms.

As with quality, however, Korea still talks a better a SME promotion game than it plays. The Korean economy arguably has never been more dependent on chaebol than it is today. In 2003, according to the *Korea Times*, the four largest chaebol (Samsung, LG, Hyundai Automotive, and SK) accounted for almost a half of the nation's total exports and 40% of the GNP. But the big four are not creating many new jobs in Korea. According to same *Korea Times* article, “A bigger issue is that the chaebol are focusing more on expanding operations offshore and reducing the number of local subsidiaries, which has raised concerns about reduction in employment.”

According to the 18 March 2006 issue of *The Economist*, “By one account, 40% of Korean SME make no operating profits, among them many “zombie” firms kept alive with government credit guarantees.” Weak firms must be allowed to fail, and direct and indirect government subsidies must focus on sectors (i.e., rather than particular companies) where Korea has a competitive advantage in the global marketplace. Korea

has the intellectual muscle—both from its own universities and the students that go abroad and return—to enter and compete in many emerging technology and service sectors.

## Conclusion

“The Mayans lost to the Aztecs, the Romans lost to the Barbarians, and the French lost to the Vietnamese. In each case the losers had superior technology, but the victors had more troops.”

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I believe the 21<sup>st</sup> century may in fact be remembered as the Chinese century, just as the British dominated the 1800s and the United States dominated the 1900s. Britain and the United States aren't going away anytime soon, and neither is Japan, Vietnam or eastern Europe. There are five provinces in China that have a larger population than Korea. Even a unified Korea will not overtake China, Japan, or India in economic terms. So, what's a country to do?

Korea must focus on evolution not revolution. It must make its government, institutions, companies, entrepreneurs—and therefore its country—just a little bit better. Then it must start the process over and make the new and improved Korea just a little bit better. Korea will matter in the Chinese century only if takes the steps necessary to differentiate and then redifferentiate itself so as to stand out in the shadow cast by its neighbors. Financial transparency, IPR protection, quality, and SME promotion is Korea's path to relevancy.

## About the Author



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