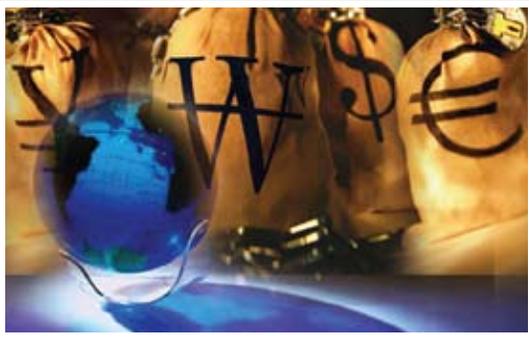


# KIEP

## ANNUAL REPORT

### 2009



KIEP  
ANNUAL  
REPORT  
2009

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ANNUAL  
REPORT  
2009





KOREA INSTITUTE FOR INTERNATIONAL  
ECONOMIC POLICY

**KIEP...**

**Making international economic policies  
turning Korea into a world power.**

*We study International Macroeconomics/Finance.*

*We examine Trade & Investment Policies.*

*We observe the International Regional Environment.*

*We analyze International Economic Relations.*

*We engage in research for Economic Cooperation in APEC and Northeast Asia.*

*We explore issues in International Cooperation for Korean Unification.*

## ON PUBLISHING THE 2009 KIEP ANNUAL REPORT



2009 was a busy year for the Korea Institute for International Economic Policy (KIEP). It was a year spent trying to safely navigate through the domestic economic crisis caused by the global financial crisis, and suggesting global-level economic policies as part of efforts to ensure that Korea play a leading role within the global economy amidst the rapidly changing international economic environment.

Korea's status as the organizer of the G20 Summit spurred KIEP to play an active role in reorganizing the international financial order and in resolving outstanding issues pertaining to international economic policies that have emerged in the aftermath of the subprime crisis. As part of its attempts to foster the development of in-depth multilateral/bilateral trade policies, KIEP focused its energies on research activities related to Korea's international economic policies. Examples included the development of responses to the changes in the international macroeconomic environment, preliminary studies on Korea's international economic strategy given the changes in its status within the global economy, studies on the measures needed to develop the service industry and improve FDI/ODI, studies on the subject of how to meet the in-depth research demands as pertains to regions abroad, and the development of various policies and strategies related to economic cooperation in East Asia.

KIEP is proud to publish this 2009 KIEP Annual Report which not only looks back of the research achievements of the past year, but also paves the way for new research activities by summarizing the major results and contents of research projects implemented in 2009. More to the point, the 2009 KIEP Annual Report seeks to spread awareness of

the results of the research conducted within KIEP throughout society at large. This is to be carried out by introducing the main contents of the research reports and materials created through the tireless efforts of our researchers, and highlighting the contributions made by KIEP's research activities to government policy.

KIEP will continuously strive to contribute to transforming Korea into an advanced country. This shall be achieved through active participation in the establishment of Korea's international economic policies via the development of the cutting-edge theories and vantage points needed to cope with the changes in the domestic and international economic & trade environment. We hope to receive continued support and inspiration from all levels of society.

Thank you.

Wook Chae  
President, Korea Institute for International Economic Policy



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## MISSION AND BRIEF HISTORY

### ● FOUNDING OBJECTIVES

- KIEP seeks to contribute to the establishment of international economic policy through the investigation, study, and analysis of issues related to the global economy.

### ● SCOPE OF RESEARCH ACTIVITIES

- Investigation, research, and analysis of trade policy, international financial markets and investment, and other issues related to international economic policy, as well as development of policy tools
- Research and analysis of matters pertaining to the global economy, as well as of economic trends and policies put in place in major regional economic zones
- Conducting of joint research projects with scholars and research institutes at home and abroad
- Commission and consignment of research services relating to the global economy and major regional economic zones
- Education, training, and public relations activities pertaining to the global economy and major regional economic zones
- Other activities associated with the achievement of KIEP's goals

### ● HISTORY

- August 1989 Establishment of KIEP research foundation
- December 1989 Passage of a special law authorizing the establishment of KIEP (dissolution of the foundation)
- January 1990 Establishment of KIEP as a government funded economic research institute  
Assumed responsibility for the supervision of the Korea National Committee for Pacific Economic Cooperation from the Korea Development Institute
- October 1992 The KIEP Center for Northern Area Studies is renamed the KIEP Center for Area Studies
- March 1995 Founding of the KIEP Beijing Office
- April 2000 Reorganization of the Center for Regional Information as the Center for Regional Economic Studies
- March 2002 Establishment of the DDA Research Center
- December 2005 Establishment of the SNU-KIEP EU Center
- May 2005 Inauguration of the 7th President, Wook Chae
- June 2008 Reorganization of the Center for Northeast Asian Economic Cooperation as the Center for International Development Cooperation

I  
OVERVIEW OF  
KIEP PROJECTS  
AND ACTIVITIES

*KIEP  
Annual Report  
2009*

# 1 OVERVIEW OF PROJECTS

## Outline and Current State of Research Projects

Through a wide range of activities that include in-depth analyses of core issues, the formulation and assessment of relevant policies, development of international negotiation strategies, drafting of summit and ministerial meeting proclamations, participation in diplomatic delegations, and the public promotion of policies, KIEP seeks to contribute to the establishment of policies and provision of possible mid-to-long-term direction for government policy.

- The contribution made by KIEP reports are assessed based on the extent to which the core suggestions found in a particular report were subsequently reflected in government policy.
  - The contents of our reports have been referred to in conjunction with the legislation of new laws, Presidential Decrees and other forms of legislation, official government documents, and when the government's international trade strategy is being established.
- More to the point, KIEP reports have been used in conjunction with such topics as FTA/DDA policy, regional economic studies and case studies, Northeast Asia and regional economic cooperation, international macroeconomics and finance, green growth/ resources development, FDI/ODI policy, and official development assistance (ODA) etc.

\* Instances in which KIEP reports were employed during the establishment of government policy in 2009

| Field                              | FTA/DDA | Regional economic studies | Northeast Asia/regional economic cooperation | International macroeconomics and finance | Green growth/resources development | FDI/ODI | ODA | Other | Total |
|------------------------------------|---------|---------------------------|--|--|------------------------------------|---------|-----|-------|-------|
| Number of times reports were cited | 29      | 28                        | 13   | 11                                       | 9                                  | 10      | 7   | 6     | 113   |

## International Macroeconomics and Finance

- Introduction of measures to facilitate the internationalization of the Korean Won and the development of the financial industry
- Discerning international macroeconomic trends and analysis of policies adopted in response to the global financial crisis
- Analysis of the exchange rate system and exchange rate predictions
- Analysis of global research trends in the field of macroeconomics and finance
- Strategic response to the G20 Summit and study of the related agenda

## Green growth/ Development of overseas resources

- Analysis of International environmental agreements related to the achievement of low carbon green growth, analysis of the environmental policies of the major countries, and study of Korea's strategic response
- Suggestion of measures to facilitate the development of overseas resources and activation of plant construction projects

## FTA/DDA Policy

- Assessment of Korea-China and Korea-Japan FTAs and introduction of potential negotiation strategies
- Analysis of DDA/WTO trends and the development of possible government response strategies
- Analysis of the economic influence and spread effect of FTA/DDA agreements
- Preparation of basic plans for negotiations and draft schedules
- Provision of policy support for the FTA negotiations currently being carried out with the EU, India, Canada, Mexico, Australia, New Zealand, and the GCC nations.
- Analysis of the economic impact of Korea-EU and Korea-ASEAN FTA agreements and introduction of potential strategic responses

## FDI/ODI

- Analysis of the economic impact of FDI and introduction of measures to facilitate investment

- Analysis of the results of FDI-related efforts of Korean enterprises and introduction of measures to activate Korean enterprises' access to foreign markets
- Analysis of FDI/ODI in major countries and implications for Korea

### Regional Economic Studies

- Support for the establishment of regional trade strategies in the form of in-depth analyses of regional trends
- Analysis of major bilateral economic issues
- Introduction of foreign case studies pertaining to issues currently affecting the domestic environment
- Provision of in-depth materials on individual countries to be visited by high-level officials such as the President

### International Development and Cooperation

- Formulation of conclusions pertaining to Northeast Asian economic cooperation policies
- Study of the main items on the agendas of APEC, ASEM, and ASEAN+3
- Development of Korea's basic stance toward regional economic cooperation, and its participation and support for related meetings
- Analysis of the major issues affecting North-South economic relations and the establishment of policies based on the outlook for the future
- Assessment of international assistance policies and introduction of measures to strengthen the efficiency thereof
- Analysis of ODA trends based on case studies and examination of the implications of such trends

### Other Policies

- Additional research on issues pertaining to international macroeconomics and economic policies
- Provision of support for the government's international negotiations

## 2 AFFILIATED BODIES AND RESEARCH-RELATED ACTIVITIES

### International Seminars and Policy Councils

Through its international seminars and policy councils, KIEP has sought to facilitate the invigoration of both the domestic and international economy and regional studies. In particular, the "Global Korea" seminar held in 2008 created an opportunity for prestigious scholars from the world over to gather in one place.

#### Notable activities and achievements in 2009

- Making a New Industrial and SME Policy Cooperation between Korea and the EU
- Asian Economic Panel(AEP)
- Seminar to commemorate the 5th anniversary of the signing of the Korea-Chile FTA
- Changes in North Korea and Policy Responses of the International Community toward North Korea
- Roundtable Discussion with KIEP and the Melbourne APEC Finance Center At RIMT University
- International Conference on Foreign Direct Investment in East Asia: Issues, Strategies and Prospects
- The 5th Conference of East Asian Institutes Forum
- Workshop on CAREC Corridors Performance Measurement and Monitoring and Establishment of CAREC Federation of Carriers and Forwarders Associations
- The 13th Korea-Central and South America Business Forum
- AECF(Asia Economic Community Forum) 2009: Session on International finance
- AECF(Asia Economic Community Forum) 2009: Session on the EU session
- International Conference on The Global Financial Crisis & International Trade and Financial Architecture
- The World Economy with the G-20
- Korea-Central Asia International Seminar "Global Financial Crisis, New Order and the Future of Collaboration between Korea and Central Asia"

## **Korea's Official Pool of International Economists (KOPIE)**

As part of its ongoing efforts to organize international economic research teams (panel sessions) and provide support for international conferences whenever petitioned to do so by the government, KIEP has established and made active use of Korea's Official Pool of International Economists (KOPIE) Database. While each research team consists of up to twenty economists, the panel sessions carried out under the auspices of the various regional research groups involve up to fourteen researchers. In order to maintain a certain level of consistency in terms of the work duties, each research group designates one or two secretaries. KIEP seeks to have the Korean position represented by dispatching, through its KOPIE system, specialists to unofficial international meetings in which Korean participation at the government level is deemed essential.

### **Notable activities and achievements in 2009**

- Organization of research projects
  - Organized a total of 52 research projects, namely those conducted by the International Macroeconomics and Finance Team (10 projects), WTO Research Team (3 projects), FTA Team (1 project), FDI Team (1 project), APEC Team (2 projects), Energy/Environment Team (0 project), ODA Team (5 projects), and Regional Studies Team (30 projects)
- Participated in international conferences as part of government delegations (13 occasions)
- Provided support to the Ministry of Strategy and Finance (3 occasions), Ministry of Foreign Affairs and Trade (6 occasions), Korea Communications Commission (1 occasion), Ministry for Food, Agriculture, Forestry and Fisheries (1 occasion), Korean Agency for Technology and Standards under the Ministry of Knowledge Economy (1 occasion), and the Ministry of Knowledge Economy (1 occasion)

## **Asian Economic Panel (AEP) and Publication of Related Academic Journal**

In conjunction with Columbia University's Earth Institute (EI) and Keio University's Global Security Research Center, a number of think tanks and scholars in the Asia region got together to establish the Asian version of North America's Brookings Papers on Economic Activity (BPEA) and Europe's Economic Policy (EP). Known as the Asian Economic Panel (AEP), the body has contributed not only to the conduct of research on major economic issues affecting Asia, but also put forward potential policy options where these issues are concerned.

As part of its mandate, the AEP invites researchers from throughout the Asian region to take part in panel discussions twice a year. It also publishes a series called Asian Economic Papers on a triannual basis (MIT Press).

### **Notable activities and achievements in 2009**

- Organized the Asia Economic Panel (biannually)
- Publication of Asian Economic Paper
  - Published in a triannual manner by the MIT Press in the following order: Winter 2009(Issue 1), Spring 2009(Issue 2), Fall 2009(Issue 3)
  - Revamping of the Asian Economic Paper's domestic subscribers list
  - AEP subscribers can now access the Asian Economic Paper through the homepage of the MIT Press

## **Management of KIEP-Macroeconometric Model and Establishment of DB for International Macroeconomics and Finance**

KIEP has introduced a new Economic Analysis Model that effectively expands the one developed in 2007 by including China and Japan, and also accounts for elements which were not properly addressed under the past model. More to the point, a Korea-U.S.-China-Japan-RW model was formulated, with special attention paid to the upgrade of the assets market. Based on this model, the results of a quantitative analysis involving the economic effects which Korea, China, Japan, and the United States would incur should a macroeconomic shock of global proportion come to pass were calculated.

### **Notable activities and achievements in 2009**

- Improvement of KIEP-Macroeconometric Model
  - Adjustment of trade variables, the industrial structure of major countries, and financial variables; use of simulations to ascertain whether significant result could be produced
  - Adjustment of the input-output table for the trade of specific items between five countries, and completion of the normal values for main variables and adjustment coefficients
  - Input-output table for inter-industry trade between two industries based on data for 2000 and 2007
- Adjustment of the trade coefficients used within the KIEP-International Macroeconomic Model based on the UN BEC Classification

- Adjustment of the macroeconomic coefficients used in the KIEP-Macroeconomic Model based on existing references

## **KIEP-Trade Model and the Establishment of a Trade DB**

By supplementing existing models such as the International Macroeconomic Model, CGE Model, and the International I-O Model through the establishment of a basic trade related DB, KIEP seeks to provide the basic analysis materials needed to facilitate the process of forging government policies, establish customs-related statistics, and make these statistics program-mable so that they can be utilized in future policy research. Furthermore, KIEP also makes use of the CGE Model to measure the effects of the FTAs reached the major powers, and to establish the major political and economic statistics related to research on trade with the United States and the EU.

### **Notable activities and achievements in 2009**

- Consignment of research services and research paper preparation
  - Prospected to be of value in terms of the advancement of FTA and DDA-related policy research
- Participation of one member of the joint research team in the Seventeenth Annual Short Course in Global Trade Analysis program
  - Production of learning contents related to the development of a KIEP-Trade Model and holding of discussions with the GTAP research team on the development of new materials
- Establishment of Trade DB
  - Use of the data contained in the UN-COMTRADE and UN UNCTAD TRAINS databases during the second half of 2009 to facilitate the establishment of data related to the major countries' trade indexes and tariff rates

## **Management of Mid and Long-term Trade Strategy Research Team**

As part of its ongoing efforts to help Korea effectively overcome the financial crisis and economic downturn, KIEP conducts in-depth analyses of the trends towards reform and change in three areas occasioned by the rise of G-20 system, namely macro-financing, micro-financing, and trade, and seeks to draw up measures which can actually be implemented in the financial

market and trade sectors. Furthermore, based on case studies of the trade strategies adopted in various regions in the world, KIEP delves into the implications of Korea's own policies. KIEP also makes efforts to heighten its international utility by implementing the joint research and conferences with members of domestic academia and prestigious international organizations.

### **Notable activities and achievements in 2009**

- Suggestion, in accordance with the rise of the G-20 structure, of the desirable direction for Korea's new role in terms of the governance of international finances as it pertains to emerging markets, and identification of the direction which the establishment of new regulations and changes in global standards within the international financing market should take.
- Based on an examination of how the economic crisis has affected individual countries and the responses of the relevant governments, an analysis of the possibility of recovering from the global economic recession is conducted, and a desirable route for Korea in terms of its foreign economic policy given the anticipated changes within the global economy in the aftermath of the global economic crisis is introduced
- Identification of the future implications of the global economic crisis on the real economy, such as the changes in the trade and industrial structure, as well as the labor market, and suggest the implications of the rapidly changing international trade order and trade policies.
- Analysis of trends and impacts in terms of sectors where Korean economy has exhibited a strong foreign dependency, such as the financial and real markets, and introduction of policy alternatives which can be used to decrease the risks of foreign dependency and to contribute to economic growth
- Evaluation of Korea's dynamic path and changes in its international capital transactions as it moves towards, in conjunction with the acceleration of the international integration of financial markets, becoming a small open economy
- Publication of reports and research materials
  - The World Economy with the G-20
  - Analysis of economic trends and of the exit strategies of major countries after the global economic crisis
  - Structural impact of the global financial crisis and the implications of the trade policy
  - Rational coordination of the macroeconomic structure's foreign dependency as part of efforts to bring about stabilized growth
  - External Adjustment under Increasing Financial Integration in Korea Economy

## DDA Research Center

In addition to publishing a research series designed to improve the general level of understanding of the Doha Development Agenda (DDA) and the opening of the economy, the DDA Research Center has also managed the Association for Research on International Trade, and through public relations activities and seminars, helped to not only develop government-level strategies for the DDA negotiations, but also a national perspective on this matter. The DDA Research Center has striven to heighten national awareness vis-à-vis the principles of international economics and the market economy, as well as international norms.

### Notable activities and achievements in 2009

- Publication of reports related to the research projects
  - Nine reports including *Analysis of the Environmental Changes in Korea's commodity trade occasioned by FTAs* (2009).
- Lectures on the Trade Act (6 sessions), organization of seminars (7 sessions)
- DDA and opening related seminars (2 sessions)
- DDA related government-led seminars and conferences (52 sessions), participation in WTO negotiations (5 sessions)
- Public relations activities via the use of media such as TV and newspapers (15 instances)

## National Center for APEC Studies

The National Center for APEC Studies has implemented APEC-related research, provided support for participation in international academic conferences and government involvement in related meetings, and published relevant study materials. In addition, the Center has also kept the public abreast of its activities through its APEC/PECC Korea Newsletter. The Center has stimulated of APEC-related studies through such means as the provision of support for government participation in the ASC International Conference, APEC summit, economic and trade ministers' meetings, as well as senior officials' meetings (SOM).

### Notable activities and achievements in 2009

- Provided support for the implementation of the "Further Analytical Study on the Likely Economic Impact of an FTAAP" presented during the APEC Summit (2 instances)
- Publication of APEC/PECC Korea Newsletter (three issues annually)

- Participation in APEC related international conferences (ASCC) and provision of support for Korean scholars' participation in such conferences
- Participation in APEC related conferences and provision of support to the government
  - Provided support for the APEC ISOM, SOM I, SOM II, CSOM and ministerial conferences
  - Presented the results of the analyses of FTAAP related economic effects during the APEC SOM II and CSOM meetings as part of efforts to contribute to the government's policy goals
- Organized an APEC Consortium Conference ("To overcome the economic crisis and develop a new vision of APEC")

## SNU-KIEP EU Center

Based on the support of the Commission of the European Communities, KIEP has actively managed the SNU-KIEP EU Center since 2006. The SNU-KIEP EU Center has carried out various activities pertaining to EU studies. These have included the organization of seminars, invitation of EU researchers, dispatch of Korean EU researchers, and the publication of an EU study series. In addition, the Center has sought to heighten mutual understanding through such means as the conduct of joint research and academic exchanges with individual European countries and also provided vigorous support for the government's European policy.

### Notable activities and achievements in 2009

- Organization of seminars (2 instances)
  - Holding of international seminar to activate Korea-EU industrial cooperation, Asia Economic Community Forum –EU session
- Publication of the EU Center's research series (5 instances)
  - Prospects for European Foreign Policy
  - Changes in the EU Regional Policy and Implications Thereof
  - The Impact of the EU Cultural Policy on European Integration and Its Implications for East Asia: A Case Study of the European Capital of Cultural Program
  - ODA as a Soft Power Instrument: The EU Experience and its relevance for Asia
  - The Impacts of Enlargement on the Central and Eastern European Countries
- Provision of support for the joint summer seminar hosted by the European Union Studies Association of Korea/ SNU-KEIP EU Center

## Joint KIEP-SAIS Research

KIEP's Joint KIEP-SAIS Research is an educational project designed to produce specialists in Korea-U.S. relations and issues concerning Korean peninsula and to provide support for policy research in the United States on matters pertaining to Korea-U.S. relations as well as political and economic issues that affect the two Koreas. The project also strives to foster the establishment of intellectual/human networks between Korea and the United States. More to the point, this undertaking has contributed to the extension of the foundation for research by expanding the number of Masters Degree programs in Korean Studies, and inviting former/current government officials from the U.S. Department of State as well as Korean specialists in the United States to Korea, where they serve as diplomatic/intellectual assets. In addition, discussions between Korean and American specialists have also been expanded through such venues as the Visiting Scholar Program, High Level Discussion, and the Policy Dialogue Program.

### Notable activities and achievements in 2009

- Increased investment in Master's Degree programs as part of efforts to produce Korean specialists
  - Management of Korean Studies courses, expansion of Korean language education programs, and hosting of North Korea related lectures
  - Provision of scholarships to those majoring in Korean studies
- Provision of support for policy research
  - Publication of Working Paper and Special Report series: new Korea-U.S. partnership, Korea's practical diplomacy, North Korea and unification, Korean Studies
- Establishment and expansion of Korea-U.S. intellectual networks through the holding of discussions and cultural events
  - Based on a consideration of the characteristics of the Washington area and the sensitivity of issues, projects were divided into public and confidential ones
  - Organization of the Northeast Asian Future Forum: held annually on a rotating basis in Washington, Beijing, and Seoul
  - Management of the Sejong Society: Invitation of specialists to take part in lectures

## Korea Economic Institute (KEI) in Washington, D.C.

The Korea Economic Institute (KEI) in Washington D.C. is engaged in activities designed to promote the Korean economy and policies in the United States, as well as the analysis of current

trends in the latter. More to the point, KEI seeks to activate the exchange of opinions through such means as the organization of discussions involving leading opinion makers, Korea-U.S. policy seminars, and Korea-U.S. joint academic conferences. In addition, KEI also implements academic and policy-related projects on behalf of the government as well as the active exchange of human resources.

KIEP's active promotion of the Korean economy in the United States through KEI is designed to contribute not only to the establishment of Korea's international economic policy, but also to the creation of a broader base of support for Korea abroad.

### Notable activities and achievements in 2009

- Collection/provision within the United States of materials related to the analysis of trends in Korea and Asia
  - Publication and dissemination of the "KEI Reports" series featuring in-depth reports on economic matters related to Korea and Asia published in the United States to domestic and international organizations
  - 2009 saw the special publication of analytical reports on the Korea-U.S. FTA and North Korean nuclear problem
- Promotion of Korean economy and economic policy in the United States
  - Publication and dissemination of *Korean Insight* (monthly) and *Korea's Economy* (annual) series, and distribution of essays presented during academic seminars to leading media outlets in the United States as part of efforts to effectively inform U.S. political circles of the state of the Korean economy
- Academic discussions and seminars
  - Organized a U.S.-Korea joint annual academic conference at Hawaii University's East-West Center from October 21-23 entitled, "Navigating Turbulence in Northeast Asia: The future of the US-Korea Alliance"
  - Confidentially hosted the OLS (Opinion Leader Seminar) and 2009 Korea-US media elite seminar
  - Held the KEI Policy Forum: Academic Paper Series (8 instances)
- Engaged in academic and policy-related projects
  - Held an event to celebrate and discuss the publication of "The Global Crisis and Korea's International Financial Policies"
  - Published "Ambassadors' Memoir: US-Korea Relations through the Eyes of the Ambassadors" (a Korean language version is now in the works)

## KIEP Beijing Office

The KIEP Beijing Office analyzes current trends in China and seeks to promote Korea's economy and policies within the latter. The KIEP Beijing Office is able to provide important information in a timely manner through its series known as the Chinese Economy Briefing. The Office also facilitates exchanges of opinions between Korea and China through the Korea-China Economic Forum.

The KIEP Beijing Office's provision of objective and practical information has contributed greatly to the making of China-related policies. Moreover, by strengthening networks between Korea and China, the Office has actively promoted the conduct of China-related research in Korea. It has also carried out activities designed to promote the Korean economy in China and provided support to Korean enterprises desiring to enter the Chinese market.

### Notable activities and achievements in 2009

- Published Chinese Economy Briefing
- Published Chinese Economy Briefing (24 instances)
- Organized Korean Economy Forum (8 instances)
- KIEP World Economy update (2 issues), Regional Economic Focus (2 issues)
- Research networking activities (54 instances in China, 80 in Korea)
- Promotion of the Korean economy
  - Sent out "Korea Economic Bulletin" (10 instances)
  - Received a request to prepare a manuscript entitled "Korea's Economy in 2009" from the Chinese Academy of International Trade and Economic Cooperation (CAITEC)
  - Contributed articles to the monthly magazine <Renmin Huabao (人民画报)> (April, 2009)
  - President Wook Chae carried out an interview with the 21st Business Herald (21世紀經濟報道) (March 22nd)
  - Dissemination of materials such as <Changes in North Korea and Policy Responses of the International Community toward North Korea> amongst North Korean specialists in China

## Training of Regional Specialists Through Joint Ventures Involving KIEP and Graduate Schools of International Studies

As part of its efforts to develop networks with regional economic specialists, specialized research institutions situated abroad, as well as foreign specialists, KIEP offers, in conjunction

with a number of graduate schools of international studies, regional specialist education programs. Two options are offered as part of this program. While the 'Full Package' focuses on the training of specialists in lesser-known regions, the 'Special Package' revolves around the training of specialists in major regions. To date, the graduate schools of international studies of five universities have participated in this specialist education program, namely those from Korea University, Hankuk University of Foreign Studies, Chungang University, Hanyang University, and Seoul National University.

This project is designed to help train specialists who possess comprehensive knowledge of various regions. All in all, this project has sought to meet the demand for regional studies which has emerged at both the national and educational institution levels.

### Notable activities and achievements in 2009

- Divided into the Full Package (joint education of specialists in lesser-known regions) and the Special Package (joint education of specialists in major regions)
- Increased interest and support for students specializing in regional studies
- Education of regional specialists in accordance with the strengthening of the competencies of students enrolled in regional studies
- Expansion of local networks and strengthening of the infrastructure for regional studies

## In-depth Research on Strategic Regions

KIEP has sought to strengthen Korea's foreign economic policy capacity by expanding regional studies on the main industrial fields and economic systems associated with strategic economic countries (regions) in a concrete and practical manner. Moreover, it has attempted to, by implementing strategic regional studies and expanding domestic and international networks in a manner that reflects Korea's actual circumstances, establish a foundation for long-term economic exchanges and cooperative relationship with strategic countries (region). Furthermore, in its capacity as a part of the infrastructure responsible for the implementation of national policies, KIEP has set out to collect and accumulate information, materials, and studies related to strategic regions (countries), as well as establish a network system which makes it possible to share such information amongst researchers.

### Notable activities and achievements in 2009

- Management of the three departments of the Central Asia Research Forum established in Ko-

rea and publication of the strategic reports produced by each of these departments

- General Department: *The political elite and power structure of Kazakhstan*
- Trade and Investment Department: *Korea's strategy for gaining access to Central Asia in the aftermath of the global financial crisis*
- Energy Resources Department: *Analysis of the investment environment as pertains to resources and energy in Central Asia and the policy implications thereof*
- Conclusion of MOUs with national research institutions in Central Asian countries
  - Uzbekistan IFMR (Institute of Forecasting and Macroeconomic Research)
  - Turkmenistan ISPED (Institute of Strategic Planning and Economic Development of Turkmenistan)
- Contribution of Central Asia related research papers and publication of research papers (two volumes, total 21 papers)
- Organization of an international academic conference related to economic cooperation between Korea and Central Asia
  - Invited the directors of research institutes from the major countries in Central Asia to take part in a seminar entitled: Cooperation between Korea and Central Asia in the 21st century and future tasks
  - Joint organization of an international academic conference with the IFMR in Uzbekistan: Global Financial crisis, new order and the future of collaboration between Korea and Central Asia
- Joint organization of Central Asia related academic conferences in Korea
  - In conjunction with the Korean Association of Slavic Studies, Korean Association for Contemporary Chinese Studies and the Asia-Pacific Research Center of Hanyang University, held a joint conference entitled the "Systemization of Central Asian Studies"
- Establishment and management of a Central Asian knowledge and information portal (CAF: Central Asia Forum)
  - Expanded national-level information resources based on the diversification of databases related to the Central Asian region, with the expectation being that such materials will be used as part of national-level knowledge
  - Plans to establish comprehensive DB on such topics as the industries, enterprises, resources, and policies of Central Asian countries

## Reinforcement of Regional Economic Studies Project

KIEP has established 'regional study infrastructure and network' to facilitate the implementation of regional studies the world over. As part of its efforts to unify its regional studies DB

and expand the amount of information that is available on a national scale, KIEP expanded its BRICs Information Center to EMERICs, which features information on 50 newly emerging countries. KIEP also provides systematic information about regions where an interest in research and investment has been displayed, supports the education of human resources specializing in regional studies, and maintains networks between regional specialists in order to facilitate the sharing of new information and studies on individual regions.

## Notable activities and achievements in 2009

- EMERICs (Information for Emerging Countries)
  - Establishment of a knowledge & information DB featuring 45,000 materials related to emerging countries for which the amount of information available has not kept pace with the demand for information. This DB includes regional economic information, information about leading individuals, academic information, and business information
- Cultivation of regional specialists program
  - Central Asian specialist course (Uzbekistan and Turkmenistan) (5 people studying in their respective countries)
  - East European specialist course (Poland, Slovakia, and the Czech Republic) (30 people studying in Korea and 16 people in their respective countries)
  - Issue-specific courses related to Eastern Europe (53 people studying in Seoul and 53 in Busan)
  - Issue-specific courses related to Central Asia (45 people studying in Seoul)
- Management of programs related to the invitation of foreign scholars (9 instances)
- Expansion of cooperation with research institutions abroad based on the conclusion of MOUs
  - Concluded an agreement with Uzbekistan's IFMR (Institute of Forecasting and Macroeconomic Research)

## Support for the Establishment of a Northeast Asian Development Bank

KIEP has carried out theme-based research projects designed to facilitate the activation of the international discussions that have been held since 1990 on the subject of the establishment of a Northeast Asian Development Bank. To this end, efforts have been made to ascertain the desirable direction for the establishment of this Northeast Asian Development Bank, and to form the related international consensus.

## Notable activities and achievements in 2009

- Organization of seminars and international forums
  - Held a Planning Meeting (Hawaii)
  - Held the 18th Annual Northeast Asia Economic Forum (Busan)
  - Held a specialists meeting (China)
- Publication of seminar proceedings
  - Title: Financing for Regional Economic Integration for Northeast Asia
  - Held discussions on the need for financial support for the advent of economic integration in the Northeast Asian region, a matter which has been regarded as being of great importance amidst the current global financial crisis
  - Held discussions about a possible mechanism and measures to actualize a multilateral financial organization
  - Held discussions on the establishment of a Northeast Asian Development Bank, the future direction thereof, and strategies

### Strengthening the Northeast Asian research network

Through such means as the invitation of foreign scholars who majored in the Northeast Asian and East Asian regions, research exchanges, and the formation of human networks, KIEP has been at the forefront of the establishment of a hub for study activities related to Northeast Asia and East Asia. It has also collected and classified information produced by KIEP and other domestic and foreign research institutions related to trends in Northeast (East) Asian economic cooperation, academic materials, and specialized research, and disseminated it through its website.

#### Notable activities and achievements in 2009

- Program to facilitate the invitation of foreign scholars
  - Invited a total of 7 scholars emanating from countries that included China, India, Singapore, the United States and New Zealand
  - Facilitated exchanges of opinions through the organization of domestic and international seminars, as well as policy conferences, on core issues related to research themes previously agreed to with KIEP and East (Northeast) Asian economic cooperation.
- Organization of international conferences and LES (4 instances)
  - Invited individuals from international organizations such as the ADB and IMF, as well as from similar research institutions located abroad such as the East-West Center (University of

- Hawaii) and VASS, to take part in international conferences and LES on the subject of current issues such as regional cooperation and responses to the global financial crisis.
- Management of the English website of the Northeast Asian Network
  - Heightened efficiency in terms of the implementation of domestic and international research projects and the establishment of policies via the dissemination through the English website of various materials that have been collected
  - As of December 2009, there were 8,204 materials found on this page (increase of 54.2% over the previous year)

### Enforcement of cooperation with foreign research institutes

By expanding close collaboration with core regional research institutes located abroad, KIEP has facilitated the establishment of international regional studies networks. KIEP has focused on the collection of high-quality information in a practical and timely manner through the planning of in-country training programs. It has also invested in the establishment of networks involving key personnel from various key countries as part of efforts to forge the infrastructure needed to facilitate Korea's entry to such countries. Furthermore, KIEP has also contributed to improving information capacity and strengthening research cooperation by forging cooperative partnership with major institutions in emerging countries.

#### Notable activities and achievements in 2009

- Planning and implementation of in-country training programs based on cooperation with the government agencies, public organizations, and research institutes of major emerging countries
  - Special programs (4 cases): improvement of the research competency of related organizations and strengthening of human networks
  - Dispatched training programs (3 cases): Strengthened competencies through the holding of training and education programs in Korea and overseas designed to improve the knowledge, skills, and applicability associated with various work duties
  - Training program to improve work performance (1 case): Strengthened competencies through the holding of training and education programs in Korea and overseas designed to improve the knowledge, skills, and applicability associated with various work duties
- Establishment of an overseas specialist DB related to information sites such as EMERICs and CSF, and expansion of overseas cooperation organizations
- Management of foreign scholars invitation programs (annually)

- Increased research cooperation with research institutes in Central Asia, a region for which a lack of information exists, through the establishment of MOUs

## Information Management

As part of its ongoing efforts to strengthen support for research, KIEP operates a Digital Library. The Digital Library offers individual researchers information related to their research topics and provides an online list of the research materials contained in the KIEP library. The Digital Library also offers two webzines (weekly/occasional) that contain summaries of research reports collected from foreign research institutes, economic research centers associated with universities, and international economic organizations. The Digital Library also collects statistical materials, such as those pertaining to major countries, in order to facilitate regional studies projects. KIEP has also expanded its cooperation with domestic and international academic societies and associations, and frequently conducts educational courses related to the practical use of information and its core DB.

### Notable activities and achievements in 2009

- Management of Digital Library
  - Distribution of the list of works related to 21 basic tasks
  - Collection and update of materials related to topics such as recent economic trends, economic information about individual countries, and major economic articles
  - Establishment of DB featuring original copies of housed materials (10,939 materials)
  - Publication of bulletins featuring materials emanating from foreign organizations (52 instances), and of bulletins related to recent issues (7 instances)
- Collection of information materials
  - Collection and registration of information provided by the central banks, statistics offices, and main research institutes of Central Asian countries (140 reports)
  - Renewal of periodical subscriptions for 2009
  - Collection and registration of 13,000 volumes of materials from various information sources
- Management of information
  - Completed the publication of the materials collected in 2008 in 315 volumes
  - Implementation of a review of 35,000 reports: with 204 reports abandoned and another 656 digitalized
  - Information service use and DB education (13 sessions)

- Survey of the degree of user satisfaction with our two webzines

## Computational Management

While the KINIS system has enabled KIEP to combine and disseminate the contents of its various research databases, its information management system has helped to improve overall work efficiency.

In addition, KIEP has made efforts to create a user-oriented website and to strengthen the computation infrastructure environment.

Notable activities and achievements in 2009

- Sharing of DB knowledge through the knowledge information system
  - Collection of information related to topics such as economic trends (26,011 materials)
  - Integration of the DBs featuring the profiles of external researchers and review commissioners
  - Reorganization of the current state of research projects, addition of evaluative items omitted during the evaluation of research performance
  - Establishment of an individually optimized information service (Work List) and informatization of computational equipment rental services
  - Reorganization of KMS screen and addition of management function
  - Establishment of an online club and community
  - Establishment of an integrated search system
- Improvement of work efficiency through enhanced management of the computation system
  - Improvement of system functions and modification of errors such as those related to the search function for the budgetary control conditions, and the time & attendance management program (20 instances)
  - Addition of a data-awareness component linking together the time & attendance management system and personal information groupware data
  - Addition of a data-awareness component linking together the personnel management system and the documents related to the approval of personnel appointments
- Provision of KIEP research achievements via the website and actualization of an user-oriented website
  - Implementation of a homepage monitoring system (received 2 monitoring reports)
  - Reformulation of the main screen for the Korean & English homepages and changing of the menu bars
  - Actualization of a Q&A response system involving the relevant persons in charge

- Establishment of a Korea-India FTA material room and promotion center menu
- Provision of domestic and international statistics in excel file form
- Strengthening of the computational infrastructure environment
  - Expansion of internet connection bandwidth (40M)
  - Establishment of secure USB management and intrusion prevention systems

## Publications

KIEP publishes various theme-based research reports and research materials. It also regularly releases analyses of topical matters related to the economy through web-based magazines such as KIEP World Economy and Focus on Regional Economies. In addition, KIEP also publishes the Journal of International Economic Studies, which includes outstanding papers written by both domestic and foreign researchers, on a semiannual basis. All of KIEP's publications are available online, and active exchanges of such publications take place with domestic as well as foreign institutions.

### Notable activities and achievements in 2009

- Periodicals *Journal of East Asian Economic Integration* publication (twice a year)
- Publication of papers on current economic issues
  - Published *KIEP World Economy update* (42 issues), *Regional Economic Focus* (55 issues)
- Publication of series of research reports and research materials (total 68)
  - 24 research reports (including confidential expenses), 16 research materials (including confidential expenses), 10 working papers, 5 KIEP-KOTRA papers, 4 papers on Northeast Asian studies, 3 works related to trade and investment, 2 on regional studies, 1 policy analysis, 1 report on conference proceedings, 1 foreign study, and 1 reference material
- Establishment of research ethics for KIEP and the *Journal of East Asian Economic Integration* (2008)
  - Brought an end to the external publication of KIEP materials because of increased plagiarism of KIEP publications
- Publication of promotional materials pertaining to KIEP research projects
  - Published *KIEP 20 Years of History*
  - Published 2008 Annual Report (including Research Summaries)
  - Published the Korean/English version of the list of publications (2007-2009)
- Distribution of published materials and management of sale/membership system
  - Dissemination of published materials amongst policy makers, media outlets, and related

- organizations, management of membership system
- Exchange of published materials with organizations at home and abroad
- Management of the overall distribution system as pertains to domestic bookstores and the online sale system

## Public Relations

KIEP has actively conducted public relations work through such means as contributing articles to media outlets and publishing special articles. In addition, the results of studies and the latest news concerning KIEP are available through the KIEP web magazine. It has also increased accessibility to its newsletter the KIEPzine. In addition, KIEP has contributed to the establishment of a human network through such means as the enhancement of information related to the recruitment of new employees and the building of regional DBs for students.

Notable activities and achievements in 2009

- Strengthening of public relations
  - Published 5 webzines, including the *KIEP Newsletter* (19,417 members, 153 issues)
  - Provision of customized information through the PCRM bulk email system
  - Management of web mail membership, development of webzine distribution sources centering on foreign students and public libraries
- Production of promotional materials to create the image of KIEP as the “World’s Leading Think Tank”
  - Production of promotional PPT and videos in both Korean and English
  - Support for the publication of the *KIEP 20 Years of History* and production of related video materials
  - Formulation of a ‘Promotion Center’ menu for the homepage
- Establishment of a planning and promotion system
  - Establishment of a promotional/report cooperation system: established promotion/reporting plans based on consultations between the relevant departments at every stage beginning with planning, carried out discussions based on the notion of a cooperative approval line prior to the implementation of events and projects both inside and outside of KIEP, provided support for the production of overseas promotional materials
  - Contributed articles to the KIEP-Chosun Daily Newspaper Column Series (45 occasions) and to the KIEP-Chungang Daily Newspaper Column Series (10 occasions)
  - Contributed articles to the Korea policy portal site (9 occasions)

- Published a collection of articles related to KIEP that appeared in 2008 (631 articles)
- Promotion of main policy plans: 'GK 2009' and 'Korea-India CEPA'
- Implementation of surveys of the awareness of KIEP's promotional activities and the degree of satisfaction therewith

## II REVIEW OF 2009 PROJECTS

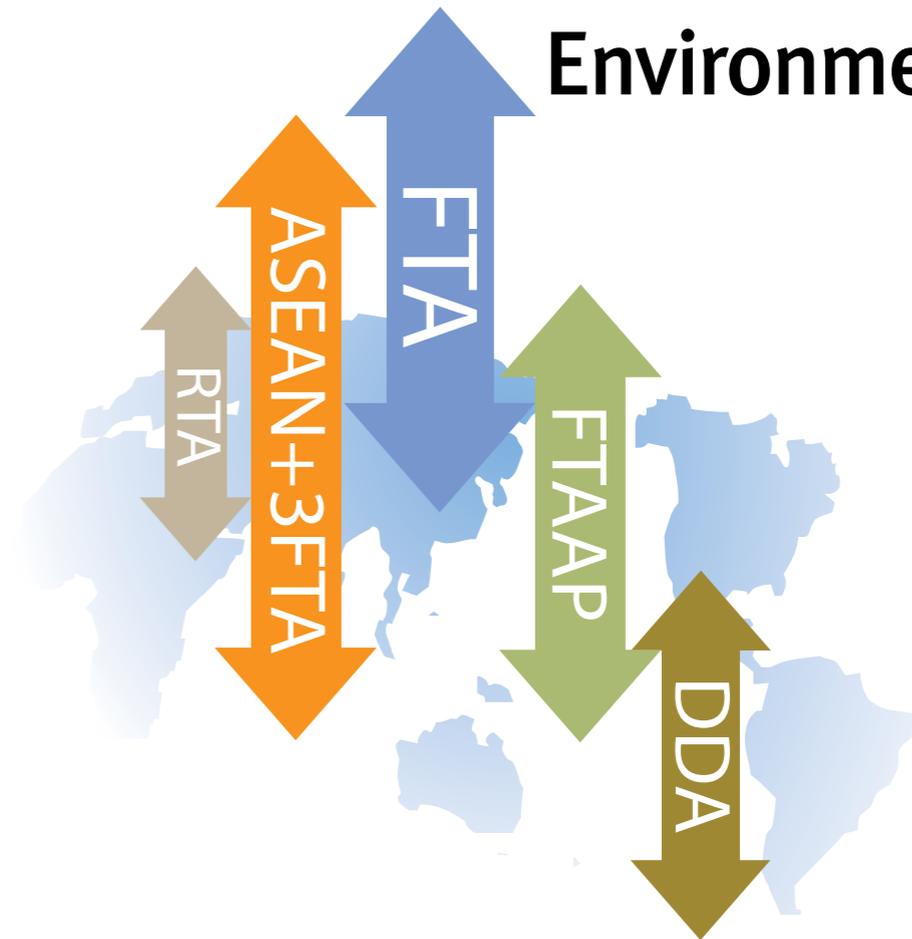
*KIEP  
Annual Report  
2009*

## 1 RESEARCH TRENDS IN 2009

- ❖ KIEP seeks to thoroughly examine the rapidly changing global economic environment characterized by such events as the U.S. financial crisis occasioned by the subprime crisis, the decrease in global liquidity, confusion within international financial markets, the growing supply-demand instability in terms of the supply and demand for the dollar, fluctuation within the key currency system, rapid changes in oil and raw materials prices, and the reorganization of the international financial order. More to the point, KIEP has forecasted the impact of these environmental changes on Korea, and, by analyzing the impact of the inflow of foreign capital within the domestic financial market, sought to introduce proper policies and responses.
- ❖ KIEP has responded to the acceleration of multilateral trade negotiations such as the WTO/DDA, regional/free trade agreements such as FTAs, APEC regional economic cooperation and trade liberalization occasioned by the perceived slowdown in the growth of the global economy in the face of the current global financial crisis by enhancing research in these particular fields. In addition, it has also focused on the changes in the structure and order of trade, commerce, and the investment environment at the multilateral, bilateral and regional levels. As part of efforts to introduce a short and long-term based strategic policy direction and core implementation measures, KIEP has also examined such matters as the development of the Korean service industry and the improvement of FDI/ ODI under the global environment.
- ❖ KIEP analyzes current issues impacting bilateral economic cooperation between Korea and major countries and regions, and seeks to introduce measures to facilitate such cooperation. It also delves into the changes in the environment surrounding the economic cooperation carried out with these countries and regions. KIEP in particular focuses on establishing strategies designed to gain access to emerging markets, FTA conditions around the world, and strengthening the R&D cooperation that is intricately related to regional studies.
- ❖ KIEP seeks to develop measures to facilitate regional economic integration between Northeast Asian and Southeast Asian countries. To this end, it has reviewed the future direction of inter-Korean economic cooperation and the multilateral cooperation measures needed to develop the Northeast Asian region in the aftermath of the inauguration of the new government. It has also introduced aid policies and measures to improve the relevant institutions as part of preparations for Korea's ascension to the OECD/DAC in 2010.

## 2 BASIC RESEARCH TASKS

# Multilateral and Bilateral Trade Policy Amidst Changes in the Global Trade Environment



## The Path to a Successful Doha Conclusion: Impacts of DDA and its Implications for Korea's Stance

Jin Kyo Suh *et al.*  
(In Korean)



The multilateral negotiation engaged in Doha in November 2001 has reached a very crucial point. Draft modalities have been finalized by the chairmen of the agriculture and Non agricultural market access (NAMA) committees. However, the multilateral agreement, and the ultimate fine tuning of the proposals missed target of reaching a consensus. Still negotiations resumed and helped removing some stumbling blocks.

In the stage of political lack of will among the main actors of a possible deal, it is utmost importance of precisely quantify the potential gains associated with the completion of the Round and how these gains are shared among countries.

The study used here to assess the consequences of the negotiations are highly technical and complex, pointing to the imagination of the negotiators to find a politically acceptable deal. The state of the art lies in the measurement of border protection at the most detailed level affordable, and in the computation of actual liberalization resulting from a tariff-cutting formula. Bound and applied duties (whether ad valorem, specific, mixed or compound) have to be measured at the HS-6 digit product level.

Using computable general equilibrium model of the world economy (GTAP), we simulate the impacts of the December 2008 drafts circulated by the WTO. The most important finding at the aggregate, global level is that any of the plausible trade scenarios will produce only modest gains, a one-time increase in world real income of \$58 to \$136 billion. This represents an increase of 0.1~0.3 percent of current global gross domestic product (GDP). The limited nature of the gains from the Doha Round goes far in explaining the lack of urgency demonstrated by WTO negotiators.

Given relatively low gains, the adjustment costs to which countries expose themselves when



they change trade policies may loom larger than in the past. The modest overall gains would have quite different economic effects on different countries and regions. The biggest gainer is both China and Korea with gains ranging from 1.1 to 1.4 percent of GDP under different scenarios. More than half of these gains would be reaped within 5 years of implementation only.

In conclusion the crunch has come: 2011 is a real dead line. If Doha fails, it seems inevitable that the WTO's slow decline will accelerate. If it succeeds, then victory will have been snatched from the jaws of defeat. Either way, serious thought needs to be given to future methods of negotiation. In these process, Korea needs to participate actively in the negotiation, particularly with a possible compromise on essential issues such as SSM and sectorals.

## Economic Impact of an FTAAP: Implication and Significance for Korean Economy

Sangkyom Kim *et al.*  
(In Korean)

Since its inception in 1989, Asia-Pacific Economic Cooperation (APEC) has long been striving to evolve the vision of building the Asia-Pacific economic community into the stage of maturity under the principle of 'open regionalism.' However, with its 20th anniversary, APEC appears to be adrift in the middle of formidable challenges demanding major changes and reforms. Among others, challenges posed by its unique feature, represented by dynamism and diversity, is worth to note for further deliberation. While the growing interdependence in our region by economic dynamism heightened the need for the APEC to strengthen regional economic integration its diversity which in effect produces the heterogeneity of economic interests and political stances makes it very difficult to construct a proper architecture for the region as a whole.

Currently proliferating regional trade agreements (RTAs) around the world, especially, in the East Asian region, have made APEC consider the preferential liberalization approach to be an attractive policy alternative. Moreover, slow progress of the WTO's (World Trade Organization) DDA (Doha Development Agenda) round of free and open trade negotiations in Geneva shall force the world economy including APEC member economies to rush to bilateral and plurilateral cooperation for preferential trade and investment liberalization. Quite a few economists suggest that this multi-track approach will be more desirable to reinvigorate APEC's vision of one community. More specifically, considering (i) the sluggish and stalled progress of negotiating multilateral trade and investment liberalization under the WTO's DDA round, (ii) the failure of the APEC's EVSL (Early Voluntary Sectoral Liberalization), (iii) the slow progress of the Bogor Goals, (iv) the loss of vitality of APEC economic activities after the East Asian financial crisis occurred in 1997, (v) the spaghetti bowls phenomenon expected from a complicated web of overlapping RTAs in the Asia-Pacific region, (vi) deepening interdependence among APEC

member economies, and (vii) strong positive welfare effects expected from RTAs, a Free Trade Area of the Asia Pacific (FTAAP) has been discussed in APEC as a long-term prospect.

The objective of this paper is to provide an economic implication of an FTAAP as catalyst to promote APEC's vision of creating one economic community. In order to serve this purpose, we endeavor 1) to examine a more concrete rationale for APEC member economies discussing a possible FTAAP by addressing conditions for desirable FTAAP, 2) to analyze the economic impacts of an FTAAP.

To provide policy makers with more realistic and practical forecast, the benefits linked to the core FTA chapters (liberalization for trade in goods and reduction of barriers in service trade) were analyzed in addition to the economic impact of trade facilitation and rules of origin (RoO) standardization either quantitatively or qualitatively. The same methods used in feasibility studies for proposed FTAs between much smaller groupings of economies - the Gravity model and (both static and capital accumulation) computable general equilibrium (CGE) - were adopted with GTAP 7 data set.

Since tariffs have decreased, the focus of FTAs tends to be diversified. If an FTAAP is defined as a comprehensive and high-quality large scale FTA, it is reasonable to assume full tariff elimination in goods. However, since trade barriers in service sector will not be completely eliminated through an FTAAP, only 10% reduction of the trade barriers in services is assumed. Also, trade and investment facilitation, transparency, behind-the-border regulations, and administrative procedures are now acknowledged as important determinants of economic progress, which highlights the significance of business friendly environment. However, since it is not easy to quantify the effects of the changes in all elements, the focus is on the elimination of tariff and non-tariff barriers in agricultural, manufactured goods and services, and the trade facilitation. In this manner, this paper developed 3 sets of policy experiments: a full elimination of tariffs in agricultural and manufactured goods (Scenario I), the elimination of tariff and non-tariff barriers in agricultural and manufactured goods and 10% reduction in trade barriers in services (Scenario II) and the reduction of trade costs by 5% through trade facilitation (Scenario III).

The results of the Scenario I in which tariffs in FTAAP are removed present the economy-wide effects of FTAAP. These involve changes in GDP, welfare and, aggregated exports and imports. Also, GDP increases in developed economies, such as the US, Japan, Canada, Australia, and Singapore, are relatively smaller than those in developing economies. And the welfare of Canada, Indonesia, Chile, and Peru would decrease a little.

The results of the Scenario II present the economic effects of tariff elimination and 10% reduction in tariff equivalents of services. The FTAAP in Scenario II yields higher economic gains for each member economy as well as APEC as a whole in terms of real GDP and welfare than in Scenario I. All participating countries would experience a more positive growth of real GDP and welfare than in Scenario I. In this respect, we may argue that liberalization in services leads to an efficiency increase in service sectors. Since services are basic inputs or interme-

diates for industrial production, the competitiveness of manufacturing sectors also would be improved.

The results of Scenario III that includes Scenario II and 5% reduction in trade cost by trade facilitation shows bigger economic effects of an FTAAP than of Scenario I and II, presenting the magnitude of increase real GDP and welfare of all member economies has been found to expand. This implies that trade facilitation is one of the most important catalysts of economic growth and its impacts on GDP and welfare are significant.

In short, the study shows that medium-run effects of the FTAAP according to Scenario III for the member economies would be larger compared to the effects on GDP and welfare estimated with the static CGE model. Moreover, the results indicate that the overall economic outcome is more favorable than any other Scenarios. More specifically, the outcome reports the highest welfare gains among other scenarios as it estimates welfare gain by 3.08%. In addition, the outcome also yields relatively higher growth gains for some developing economies including Thailand, Viet Nam and Malaysia. Thus, we can find out that 1) as GTAB database initially reports relatively high tariff rates for these economies, the size of the impact will be greater and 2) the unique methodology for estimating capital accumulation CGE model and assumptions used in the scenarios may result in favorable outcome for those economies having a large demand for capital.

In fact, it is expected that real GDP for APEC as a whole would increase by 3.31% (Capital Accumulation under Scenario III), whereas only 0.13% (Static under Scenario I) increase in real GDP in the static CGE model. Also, the gains for Thailand and Viet Nam in terms of real GDP are higher than others. This implies that traditional trade liberalization in market access still has important impacts on real GDP and welfare in those countries.

Economic effects of 3 sub-regional RTAs are also estimated. First of all, it suggests that TPP formation does not produce significant trade diversion effect to non participating members. Thus, non-participating members, except Russia, will also enjoy the benefit of free trade if the medium-run growth bonus effect is taken into account. However, with some minor exceptions, formation of East Asian sub-regional RTAs, ASEAN+3 and ASEAN+6, will produce negative effects on the GDP and welfare of non participating members, while positive economic effects on GDP and welfare are reported for participating members.

In addition to the three Scenarios, the empirical evidence of gains from cumulated RoO for the Scenario IV has been employed. More specifically, the expected positive trade-enhancing effect from the RoO cumulation is estimated to be huge compared to the bilaterally cumulated RTAs. Also, the positive trade creation effect (trade-enhancing effects) of different cumulation schemes ranges from the highest in full cumulation (35.8%) to the smallest in bilateral cumulation (0.9%). The negative trade diversion effect ranges from the highest in diagonal cumulation (16.0%) to the smallest in full cumulation (3.1%). Therefore, a full cumulation scheme to consolidate existing small-scale RTAs in APEC is a desirable FTTAP. Such harmonization will



realize significant welfare gains to members, without causing a serious damage to nonmembers. Likewise, an FTAAP will be able to pave a way to a global free trade area compatible with WTO multilateralism.

The empirical outcomes provide Korea with the following policy implications on APEC's ongoing FTAAP development. While APEC prepares for the completion of the Bogor Goal for the developed economies in 2010, the world has experienced the proliferation of regionalism and two significant financial crises (1997 Asian Financial Crisis and 2008 Global Financial Crisis), and the deadlock of DDA negotiation has not been resolved yet. Accordingly, APEC members have traditionally placed more weight on the small-scale, bilateral or multilateral RTAs than on the comprehensive region-wide trade liberalization arrangements. Thus, APEC has become a spider web of small-scale FTAs in which potential for the negative welfare effects is high. Under these circumstances and the rapidly approaching Bogor Goal target year for the developed economies, the revival and the expansion of the regional economic dynamism became an APEC's top priority. On the reality, however, the sub-regionalism has proliferated despite of continuous efforts to maintain the multilateral trading system as the basic framework for the economic cooperation. Consequently, APEC has recently begun searching for comprehensive and high-level RTAs through a harmonized integration of small-scale regional FTAs. For this purpose, the establishment of FTAAP is now being discussed with a long term perspective. The positive gains from the larger-scale FTAAP are expected to be significant enough to invite all APEC members to join. At the same time, however, the trade and investment liberalization of APEC through the second-best policy may encounter strong obstacles incurred by diversified interests of member economies, lack of political will, and problems of compatibility with multilateralism and APEC's basic principles. Understanding these difficulties for the FTAAP formation, this study considers following 4 policy options: 1) comprehensive application of tariff

elimination in trade in goods with all sectors, 2) enhancing trade facilitation, 3) liberalization of services trade, and 4) simplifying RoO by adopting a full cumulation scheme. Believing these policy options as scenario for the FTAAP shall create significant gains from the deeper integration. The scenarios were designed to best reflect current APEC initiatives: trade liberalization through tariff reduction, trade facilitation through trade cost reduction, liberalization of trade in services, and standardization of RoO. According to the analysis of each scenario, the overall welfare gain for all economies range from US\$55 billion to US\$ 284 billion and from US\$ 149 billion to US\$ 636 billion under static and capital accumulation models, respectively. The standardization of RoO would provide additional 32% net positive trade creation effects under full cumulation scheme. Based on the results so far, APEC should target a high quality and comprehensive agreement for a maximum economic output. Particularly, trade facilitation and liberalization of service trade is found to contribute largely towards increase in real GDP and trade volume. Therefore, if an FTAAP could be linked to current initiatives on trade facilitation and service trade liberalization in APEC, the member economies may enjoy significant economic gains from creation of free trade area in APEC without making extra efforts. In this light, APEC's activities, such as continued commitment to development of model measures, study on identifying convergences and divergences of existing RTAs/FTAs, trade facilitation schemes, and structural reforms, should remain as top priority regardless of the FTAAP progress. As to avoid enormous negative effects, FTAAP becomes critical to integrate the region. And TPPA including P4 and TPP is believed to become a stepping-stone to promote high quality and comprehensive RTAs at global scale. Moreover, the establishment of FTAAP is expected to promote a China-Japan-Korea FTA, an ASEAN+3 FTA, an ASEAN+6 FTA, and a TPP, which are also expected to become a stepping stone to create global free trade environment. In addition, the standardization of RoO within APEC needs to be continually considered. RoO is critical in determining the overall economic gains of trade liberalization arrangements that an early implementation of the standardized RoO in the region will enable each economy to realize full gains from the existing FTAs.

## Effective Implementation of Korea-ASEAN FTA: Trade in Goods

HanSung Kim, Mee Jin Cho, Jae-Wan Cheong, and Min-Sung Kim  
(In Korean)

● Interest of government, the media, and the academic world for concluding FTA tends to focus on how broad the openness of markets would be, or how fast tariff elimination or reduction could be achieved. It is a clear fact that the breadth and depth of market opening is a staple issue for each participant, yet to recognize how to utilize a concluded FTA efficiently is a question as significant as to concluding FTA.

Korea has agreed on bilateral FTAs liberalizing the commodity and service markets with 10 countries of ASEAN (Association of South-East Asian Nations), and FTA on the commodity market has been in effect since June 1st 2007; In nine countries, except Thailand, FTAs have come into effect in order of ratification.

Among Korea's FTA partners, ASEAN countries presented insufficient capability to lead and implement bilateral FTAs unlike EFTA, Singapore and Chile; which have accumulated much experience through closing a number of FTAs. Hence, in order to efficiently conclude a Korea-ASEAN FTA, a positive and active endeavor is required. This study, is a reflection of such a need, examining the current status of Korea-ASEAN FTA on the commodity, which has been in effect for two years, and proposes measures to implement it resourcefully.

First of all, it is apparent that export volume to ASEAN countries has increased more than that to other major exporting countries and regions, judging from the change on the amount of goods traded between Korea and ASEAN members for two years before and after the implementation of Korea-ASEAN FTA. Although the export growth to ASEAN countries has usually exceeded the total export growth, considering the fact that Korea-ASEAN FTAs have taken effect in one country after another successively and that FTA has yet to be effectuated in Thailand, significant augmentation in export through FTA is anticipated. In the case of Korea-ASEAN FTA, two years after effectuation, export growth to ASEAN members has decreased to minus

2.7%, which is better than that of China's -6%, and Japan's -9.2%, and EU's -14.7%, indicating that ASEAN countries were relatively less influenced by the global financial crisis that started at the end of 2008.

A similar situation is unfolding concerning import. On the basis of the implementation of Korea-ASEAN FTA, from two years before the implementation to one year after, even though import growth to ASEAN members is lesser than that to China, Korea's largest importing partner, or total import volume of Korea; it is still higher than that to Japan, the EU, and the US (second, fourth, and fifth biggest trading partners, respectively). In the two years following the implementation, import growth to ASEAN countries has been accelerating, which can signify that the economies of ASEAN members were less impacted by the global economic recession and that concluding the Korea-ASEAN FTA played a positive role.

It seems premature to evaluate the influence of FTA on bilateral trade at this point, but it is reasonable to acknowledge that Korea-ASEAN FTA were conducive to the increase in the amount of trade between ASEAN members. Besides, reflecting the fact that tariffs will be eliminated on general goods, accounting for more than 90% of total trading goods, by 2012; and the implementation of the Korea-ASEAN FTA will be accomplished respectively in each of 10 countries, the influence of the Korea-ASEAN FTA on the increasing trade with ASEAN members is expected to grow.

If the change in trade volume with ASEAN members represents the quantitative aspect of Korea-ASEAN FTA, as the qualitative measure, a utilization rate of preferential tariffs can be used to examine the conditions of practical implementation of the Korea-ASEAN FTA. The utilization rate of preferential tariff denotes the actual proportion of trade —among trade volume qualified for preferences between contracting parties—that benefited from the preferential tariff of FTA. The rate of deployment of preferential tariff on import in one country is defined as FTA

utilization rate of preferential tariff on import; the record of deployment of preferential tariffs on exports is defined as FTA utilization rate of preferential tariff on export. These rates display how efficient a certain FTA or trade agreement is utilized. For example, 0% indicates the FTA or trade agreement does not employ preferential tariffs at all and 100% means a perfect utilization of preferential tariffs.

The utilization rate of preferential tariffs on import and export of the Korea-ASEAN FTA demonstrates apparent differences between import and export; analyzed with data from Customs Service, the Korean Chamber of Commerce and Industry, and Korea Customs and Trade Development Institute. The utilization rate of preferential tariff on imports is 38.0% on the first year of implementation and 49.0% on the second year, which are not impressive figures, though showing significant improvement. Contributing to the growth in the utilization rate from year one to year two is the condition that, due to the increase in the public attention and domestic promotion regarding Korea-ASEAN FTA, small-scale imports in the fields as textile and



clothing along with small/medium importers gradually benefitted from the preferential tariffs, which used to benefit only large scale imports or certain importers.

Therefore, the utilization rate of preferential tariff on import has thus inevitably entered a stable phase. The rise in imports of general manufacturing goods, aside from large-scale import such as processed minerals, between the first year and the second year indicate that domestic importers have improved awareness of the Korea-ASEAN FTA and an ability to utilize it.

On the other hand, to investigate a current state of utilization of preferential tariff on exports, the utilization rate of preferential tariff on export needs to be estimated. Due to limits in accessible data, however, this study chose to estimate a utility rate of preferential tariffs on exports, instead of the utilization rate. The utility rate of preferential tariffs on exports implies the portion of export volume that benefits from preferential tariffs among total export sales from a certain country in a certain period. To apply the benefit of Korea-ASEAN FTA preferential tariffs, a certificate for the origin of products is required, issued by the customs or government of an exporting country. In the case of Korea, Customs Service and the Korean Chamber of Commerce are responsible for issuing the certificate. With the aid of the Customs Service, and the Korean Chamber of Commerce, the utility rate of preferential tariff on export could be calculated based on the number of certificates issued between the first and the second year of the implementation. The utility rate in the second year for eight countries of ASEAN is 2.6%, which is lower than that of the first year. In the first year, Malaysia recorded a rate of 22.9% which is the highest, and 1.28% for Indonesia, 1.89% for Vietnam, and 0.02% for Myanmar. The figure presented for the Philippine is 0.03%, analyzed for 5 months from January 1st 2008.

In the second year, export rates to Indonesia and Vietnam were 4.2% and 3.2% respectively, signifying rapid growth. The rate for Malaysia is 1.5%. Cambodia, Laos, Myanmar, which joined ASEAN later; along with the Philippines, and Brunei; show a figure of less than one percent.

Referring to the utility rate and utilization rate for each import and export, the most distinct characteristic is that utilization of Korea-ASEAN FTA is becoming stable and established concerning imports, whereas, it is inactive in terms of export. Although the utility rate was used (not the utilization rate due to the lack or insufficient data), 2.6% in the second year is a very disappointing figure. Moreover, when the utility rate is converted into the utilization rate, it would only be 14%, which is not impressive number as well. The utilization rate represents how Korean importers have utilize FTA efficiently, which was in turn the result of importers' active demand to obtain certificates for the origin of products to benefit from preferential tariff. On the other hand, low utilization rate or utility rate for exports indicates indifference on the part of exporters in Korea, and insufficient understanding among local corporations in ASEAN countries regarding the Korea-ASEAN FTA.

To understand why the utilization rate is low, it is necessary to investigate the current state of utilization of Korea-ASEAN FTA for local corporations that import Korean products. In the study, a survey on Korea-ASEAN FTA was conducted in Indonesia, Malaysia, the Philippines, and Vietnam—all members of ASEAN and Korea's primary trading partners in the region—by the Korea Research Center. Regarding the question why local corporations do not utilize preferential tariffs, most of them responded that they have never heard about it or do not fully understand it. About 68.0 percent of the total 309 companies, or around 210 companies responded that they did not know Korea-ASEAN FTA has already been concluded or even if they knew, they do not know how to utilize it. Furthermore, 53 companies (17.2%) stated there was no need for the Korea-ASEAN FTA because importing goods are already tariff-exempt, tariff-refunded products or imported from areas of tariff evasion. 46 companies (14.9%) replied, even though they would benefit from it, they did not apply for it since there are no special advantages given incidental inconveniences.

The result of the survey confirms the present state of the utilization of the Korea-ASEAN FTA and difficulties of utilization for local companies in ASEAN countries. The survey has shown that even companies trading with Korea still display insufficient understanding regarding the Korea-ASEAN FTA, and also experience difficulties in taking advantage of it. Thus, ASEAN should promote the understanding of Korea-ASEAN FTA to local companies to remedy the current state of affairs.

By resolving the problems stated above, there is a chance that utilization rate would increase, but still, active involvement by governments and companies is critical. This study proposes that domestic companies provide the motivation for utilizing the Korea-ASEAN FTA and governments to enforce intergovernmental measures in the ASEAN or among ASEAN members

for efficient implementation. First, convenience that would be derived from the FTA should be offered to companies; especially by providing accurate data about preferential tariff of the Korea-ASEAN FTA. Tariff information on exporting products is fundamental, in terms of Korean exporters' utilization of the Korea-ASEAN FTA, for anticipating benefits from employing preferential tariff or to negotiate with importers. It should be developed further to offer easier accessibility for companies; to provide and build an impeccable information system for future variation through requesting the information from ASEAN countries which do not consider complete tariff reduction or elimination. In addition, the voluntary participation of company should be elicited by emphasizing expected conveniences in issuing the certificate for the origin of products. Customs Service and the Korean Chamber of Commerce are in charge of issuing it as long as the principal of exclusive verification of government agencies is maintained. This certificate can be obtained by submitting required data to the Customs Service or the Korean Chamber of Commerce and there is no service charge. The process of issuing certificate in Korea is conducted fairly efficiently and promptly. Nonetheless, it is true that certification issued exclusively by government agencies can be a burden for companies. Fears of leaking valuable information about the company, or fault issuance are some of the main reasons for not obtaining the certificate. Especially if there are raw materials supplied from more than two companies, it is virtually impossible to prove the origin of the product without cooperation of suppliers. To identify the origin of the raw materials, although, concrete documents are required: documents such as a bill of manufacturing process, a bill of invested materials, and a bill of invested materials cost, which are considered confidential by companies, presenting extreme difficulties for raw materials or parts suppliers in Korea to provide them to exporters or final manufacturers—the main cause for exporters in abandoning the benefits of preferential tariff. Complementary rules of origin of exporting goods to aid companies can be an alternative to promote utilization of Korea-ASEAN FTA.

Moreover, as efforts for intergovernmental measures for efficient implementation are made, reinforcing the ability of an exercise committees become significant. In the Korea-ASEAN FTA, the formation of a committee to deal with matters of execution is clearly stipulated. The committee, composed of a director-general level official from Korea and 10 members from ASEAN, operate with three subcommittees: a subcommittee on tariff and origin of products, an economic cooperation subcommittee, and a TBT/SPS subcommittee. The committee can be an effective in solving problems through an official channels, but the absence of a domestic committee to bridge and lead the exercise committee creates another problem. The Ministry of Foreign Affairs and Trade, the Ministry of Strategy and Finance, and the Customs Service have arranged a free trade agreement exercising team to deal with exercising matters, overall management and supervision. In reality, the linkage between one department which performs authentic negotiations and another which proposes solution regarding domestic problems related to exercising matters is not intimate enough, and further, the lack of interest about “exercising”

inhibits the performance of the organization. Consequently, a universal organization responding immediately to exercising matters between committees and departments, and deals with domestic and international matters professionally and simultaneously is required not only for Korea-ASEAN FTA but also for FTAs currently being implemented. Particularly, as there are a number of exercising matters expected in Korea-U.S. FTA, Korea-EU FTA, and Korea-India CEPA, a motivated and authoritative domestic organization is necessary to prepare for them.

Increasing the number of customs officers to ASEAN office is receiving consideration as an efficient option for enhancing the utilization rate on exports in a short term. In the case of ASEAN countries, major trading partners of Korea and staple footholds of Korean companies, there are difficulties in the process of customs clearance due to inconsistent behavior of customs officers and the issue of non-tariff barriers. Especially, after the implementation of Korea-ASEAN FTA, preferential tariff and its related problems, as well as the irrationality of local customs offices present a challenging environment for Korean exporters in utilizing preferential tariffs of the Korea-ASEAN FTA. To resolve these matters, collection of information about local companies, immediate response to problems, and close cooperation between host countries and the customs personnel is desired. Among 10 members of ASEAN, however, Thailand and Indonesia are only countries that customs officers have been dispatched to, and it was in 2009 that the officers were dispatched to Indonesia. Furthermore, local customs offices sometimes mete out arbitrary decisions, and communication between central government and local customs offices is not steady in less developed members of ASEAN. When any disadvantages are observed by Korean exporters, the government does not react to them promptly, accruing problems which cannot be undone in a short period. Thus, services for resolving difficulties involved in preferential tariff and customs clearance should be furnished to Korean companies that are willing to utilize Korea-ASEAN FTA, by stationing customs officers with professional knowledge in ASEAN countries. In the short term, dispatching customs officers would mean convenience for Korean companies and also make local customs offices aware that Korea actively responds to the behavior of irrational tariff administration. In the long term, it will reform unreasonable customs clearance processes in general. Hence, it is very important to send an expert with professional knowledge and experience to deal with issues of customs in host countries. Thus it is urgent to dispatch customs officers to major ASEAN countries presenting difficulties to implement Korea-ASEAN FTA.

In addition, there are other measures for enhancing efficiency and to resolve insufficiencies, such as monitoring application of mutual tariff, offering guidelines, or considering bilateral FTA between members of ASEAN. All in all, consistent interest and effort from government, companies, and the academia is regarded as the most imperative in maximizing the FTA effect.

## Analysis of Challenge of FTAs and Its Implications for Trade and Structural Adjustment

Nakgyoon Choi *et al.*  
(In Korean)



Since the conclusion of its first FTA with Chile in 2003, Korea concluded FTAs with Singapore, the EFTA and ASEAN. FTAs with the U.S., India, and EU were signed in April 2007, August and October 2009, respectively; and are currently awaiting approval for ratification. The Korean government is currently negotiating FTAs with Canada, Mexico, the GCC, Australia, New Zealand and Peru. Korea's robust FTA policy is mainly due to expectations of benefits from bilateral/regional economic integration; including efficient resource allocation, economy of scale, and enhanced productivity, among others.

Trade statistics during recent years reveal that trade with FTA members such as Chile, Singapore, and the ASEAN has increased dramatically. In addition, the Korean experience shows that the FTAs provided Korea with opportunities to upgrade economic infrastructure and adapt itself to global standards.

This study aims to study the mid- and long-term policy directions to take maximum advantage of current FTAs. It focuses on national policies to tackle the challenge of FTAs rather than external negotiation strategies. Specifically, this study examines the effects of FTAs such as the EU, the NAFTA, and the CER on production, employment, and industrial structure in the OECD.

This study implements the following two-stage approach. First, it will apply an unbalanced nested error components model to the pooled data for the full 30 countries, 16 industries, and 24 years sample. Second, it implements both one-way and two-way error component regression models to take care of fixed effects and random effects along with country-specific and time-specific characteristics.

This study demonstrates that the coefficient on FTAs is statistically significant and positive, when we apply the nested error components model to the pooled data on the full 16 industries

in the OECD, meaning that FTAs tend to enhance the production and employment structures. When we analyze country-specific and time-specific effects using the fixed effects model as well as the random effects model for the six industries, the coefficient on FTAs turned out to have different signs depending on the industry. The FTAs tend to increase the production share of the metal industry but decrease textile and business services industries, which are statistically significant. The effects of FTAs on production shares in agriculture, food, and transport industries turned out to be statistically insignificant. On the other hand, the FTAs tend to decrease employment shares of agriculture, food, and business services industries, but increase those of metals and transport industries.

This study also conducts case studies in the agricultural industry, the manufacturing industry and the services industry, which shows how countries have implemented structural adjustment policies in order to cope with the economic shocks that an FTA brought about. For the case of the agricultural industry, this study selected the avocado and corn industries of Mexico, the dairy industry of Australia, and the fishery industry of Denmark. In addition, reviewed among the manufacturing industry were the textile and apparel industry of the U.S., the automobile industry of Poland, the steel industry of the EU, and the shipbuilding industry of Australia. The services industries examined here include the health services industries of Thailand and Japan, and the finance industry of Mexico. As a result of FTA or market opening in general, one expects that trade and investment would increase, resources will be distributed effectively, and scale economies realized. However, these fruits of FTAs require considerable effort. Results of the case studies brings forward the important policy implication that countries should invest more effort into domestic industrial adjustment and institutional improvement, since FTA policy itself does not automatically give rise to economic benefits for the signatory state.



This study analyzes the effects of FTAs through quantitative as well as qualitative approaches, thereby providing the policy implications from experiences of the OECD countries. When we reviewed Korea's national policies for handling the challenge of FTAs, it turned out that they were not fully effective in spite of notable achievements. In this respect, Korea's trade and structural adjustment policies should be implemented in the following direction.

First, Korea will have to strengthen competitiveness in the newly growing and high-value-

added industries where most benefits of FTAs are expected. The structural adjustment policies should be time-bound with a clear exit strategy, and their transparency should be enhanced to make sure that government budgets are executed effectively and negative consequences from FTAs addressed properly.

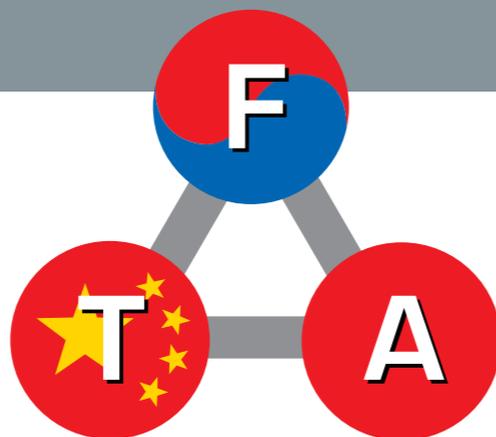
Second, trade and foreign direct investment (FDI) policies should be upgraded to the level of advanced countries, especially in terms of service liberalization and legal institutions related to FDIs. In addition, the utilization rate of FTA preferential tariffs should be enhanced in order to maximize profits without any additional costs. Korea should take follow-up measures to address obstacles to the utilization of FTAs by businesses.

Third, Korea can address the consequences from FTAs only when such effort is accompanied by trade adjustment policies. Especially, a simple scheme of injury compensation is not enough. The trade adjustment assistance program, a useful policy tool to minimize injuries of market opening, should be effectively developed and managed; inclusion of regional support scheme can be a part of the future progress.

Fourth, the Korean government must also improve economic infrastructures as well as legal bases for economic activities; such as factor market regulations, competition law, etc.

## From ASEAN+1 FTAs to an East Asia FTA

Chang Jae Lee *et al.*  
(In Korean)



Although East Asian Countries belatedly joined the worldwide regionalism, they concluded many bilateral and plurilateral FTAs within a relatively short period of time. A number of FTAs were concluded among East Asian countries.

In addition to the “Spaghetti bowl phenomenon” that resulted from the proliferation of FTAs among East Asian countries, recently, the global financial and economic crisis prompted East Asian countries to consider seriously an East Asia FTA (EAFTA). In fact, since the United States and the European Union are not expected to continue absorbing exports from East Asian countries in the coming years, there is a growing need for expanding the intra-regional market, and an EAFTA.

On the other hand, it would be quite burdensome politically and administratively for East Asian countries to launch negotiations for an EAFTA, just after concluding quite a few FTAs and with a number of FTA negotiations still in progress.

In our view, the most important task for an EAFTA at this juncture is to come up with a model of an EAFTA which could produce real benefits, increasing intra-regional trade and being achievable at the same time; demanding a minimum of political and administrative burden to countries in East Asia, and to ASEAN countries, in particular.

This study aims first to suggest such a model for EAFTA. Given that the ASEAN-China FTA, the ASEAN-Korea FTA, and the ASEAN-Japan FTA (the three ASEAN+1 FTAs) have already been concluded, a consolidation of these ASEAN+1 FTAs will be most important and necessary.

Thus, the study examined and compared the three ASEAN+1 FTAs in terms of trade in goods, trade in services, investment, trade and investment facilitation, economic cooperation and rules of origin (ROOs). On the basis of comparison of these ASEAN+1 FTAs, we propose

a model containing the following elements.

First, the creation of the unified ROOs will be the first step. We propose a simple and liberal ROOs and not to use it as a means of protection. Having a unified ROOs alone will produce substantial benefits to East Asian countries by overcoming the “Spaghetti bowl effect” and reducing transaction costs for intra-regional trade.

Second, in order to minimize the political and administrative burdens, we propose utilization of the concession structure of existing FTAs. In addition, some efforts at harmonization will be necessary. We note that the process of harmonization will be easier after 2012, because about 90 percent of all tariffs will have been eliminated by that time for many countries.

Third, as for services and investment, given that the Japan-ASEAN FTA lacks these agreements and that even those agreements that were concluded are not high quality in terms of level of liberalization, and considering the increasing importance of services and investment for East Asian economies, we propose that further efforts will be needed to liberalize both services and investment.

Fourth, with respect to facilitation and cooperation, we propose to focus on those facilitation measures that are closely related to the EAFTA, such as ROOs or customs-related issues. Additionally, we suggest that cooperation measures with appropriate funding mechanisms and adequate resources should be directly linked to these facilitation measures in order to ensure their implementation.

In order to achieve an EAFTA, however, the consolidation of the ASEAN+1 FTAs will not suffice. Any kind of FTA(s) will be necessary between China, Japan and Korea; namely, a trilateral FTA, a series of bilateral FTAs, or de facto FTA between China, Japan and Korea; in addition to the consolidation of ASEAN+1 FTAs. In fact, without an FTA between the three countries, the consolidation of the existing FTAs will be meaningless.

The process of forming any kind of FTA(s) between China, Japan and Korea lags behind that of consolidating ASEAN+1 FTAs. The official tripartite joint study for a China-Japan-Korea FTA (CJK FTA) has yet to start. Thus, the study highlights the importance of speeding up the CJK FTA process. In order to achieve an EAFTA, these two processes should advance simultaneously. Furthermore, to shorten the duration for realizing an EAFTA and to avoid unnecessary and superfluous administrative activity, each process should proceed while closely considering the other, especially as far as the rules of origin and the tariff nomenclature are concerned.

Even though the ASEAN countries are often said to be in the driver’s seat in pursuing an EAFTA, the study underscores the importance of the three Northeast Asian countries in advancing the process for an EAFTA at this critical juncture in its formation. Additionally, it admits that the formation of an EAFTA is a complex process depending on both economic and geopolitical variables. Thus, the study recommends that the Korean government should play the role of facilitator in realizing an EAFTA expecting that it may take a long time to achieve it.

## International Trends in Post-2012 Climate Change Negotiations and their Implications

Sung-chun Jung, Hyong-kun Lee, Ki-su Kwon, Cheol-won Lee,  
Tae-hyun Oh, Jino Kim, and Soon-cheul Lee  
(In Korean)



International negotiation on Climate Change is now under way through the UN negotiation process. In 2007, the parties agreed to devise an ambitious and effective international response to climate change. 2009 is a crucial year in international efforts to address climate change. International society is now trying to form a new climate regime through the United Nations Climate Change Conference in Copenhagen, to be held from December 7th to the 18th of this year.

Developed countries and major developing countries will play an important role in addressing climate change. Developed countries have no choice but to take action, because of their impending mitigation targets under the Kyoto Protocol. Major developing countries also need to introduce mitigation measures as soon as possible, as early actions would contribute to enhancing their international competitiveness. In these respects, many countries, including developing countries, have introduced various policies and measures to address internal mitigation targets and climate change.

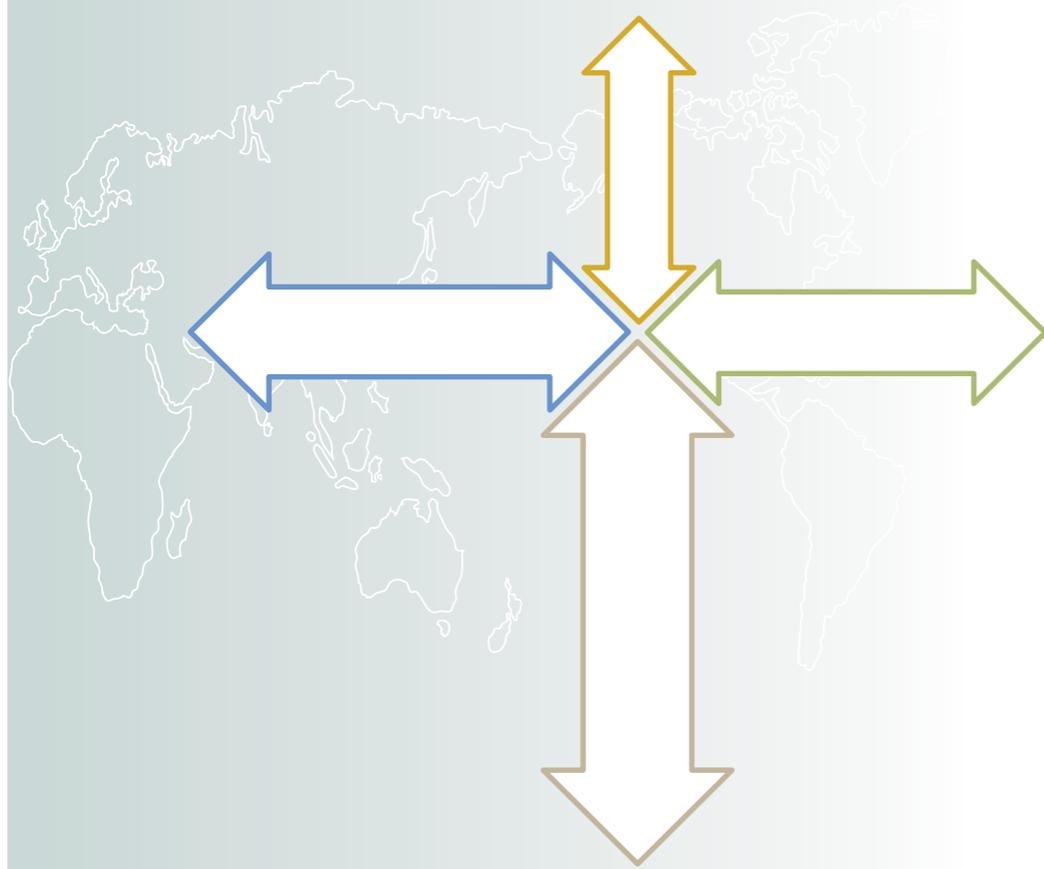
Korea will likely be required to make comparable contribution to global mitigation efforts. The Korean government has recently announced the Green Growth National Strategy, which will be an important guideline for Korea's economic and social policies. Under these domestic and international circumstances, Korean government must prepare its own action plan for mitigation along with negotiation strategies concerning post-2012 climate regime.

This paper has three main purposes. The first is to survey and collect information on international climate change negotiations. COP13 and COP14 are especially important, and the Major Economies Meeting and G8 Summit are also crucial consultation processes when we understand and try to forecast what will happen in the future. Second, to provide information on domestic policies and measures in eight major countries, which include US, EU, Japan, Russia,



China, India, Brazil and Mexico. Lastly, we have attempted to propose a policy direction for Korea in addressing climate change negotiations.

# Study on the Policy Measures Necessitated by the Changes in the International Macroeconomic Environment



## Global Financial Crisis and Post-Crisis International Financial Architecture

Yonghyup Oh, Chang-Gyu Choi, Young-Joon Park, and Yeon Sil Kim  
(In Korean)

● This study examines the causes and results of global financial crisis, which was triggered by the subprime mortgage crisis in the U.S. It further suggests policy implications to overcome the crisis. Chapter 2 summarizes the causes of the U.S. financial crisis and explains its effects on the economic recession. Chapter 3 focuses on the international transmission of the financial crisis in two aspects of both financial and foreign exchange crisis. In addition, it summarizes major countries' policy responses to get over the crisis countries being USA, EU, China, Japan and other Asian countries. The empirical analysis accounts for the international transmission of the financial crisis between the U.S. and Korean financial markets. Chapter 4 provides policy suggestions for national authorities and international cooperations, including the G-20 process at a global level and the CMIM (Chiang Mai Initiative Multilateralization) at a regional level. The last chapter is a conclusion that also looks at the G-20 process as a new feature of the post-



crisis international economic order.

The crisis in emerging economies like Korea is distinguished from that in the advanced economies in the sense that financial crisis has manifested as a severe recession through foreign exchange markets, rather than the impact on financial market itself. Accordingly countries react differently to overcome their economic difficulties. The report suggests that post-crisis international financial policies should direct our attention to strengthening international financial regulation and supervision, and reforming international financial monetary institutions. For Korea, government policies should work towards creating transparent and healthy financial markets by strengthening the central bank's function as macro-supervisor. And at the same time, the present decentralized micro-supervisory authorities need to be merged to better monitor domestic financial markets. Lastly, East Asian countries are making progresses towards regional financial cooperation via the CMIM which was developed from the bilateral currency swap agreements under the CMI. The ASEAN+3 countries are currently involved in establishing regional surveillance unit with the CMIM, and Korea should make a significant contribution for regional monetary and financial cooperations.

## Effects of International Economic Shocks and Macroeconomic Policies

Dong-Eun Rhee, Wonho Song, and Seung Hwan Oh  
(In Korean)



Korean Economy has been affected by various international economic shocks, since it is export-dependent small open economy. It has been directly influenced by import countries' business cycle because of its high dependence on export, while it has been also vulnerable to the changes of raw material prices. Moreover, recently as the share of foreign investors increases, the financial sector is exposed to financial risks from the foreign countries. This study aims at explaining the effects of the international economic shocks on Korean economy, and analyzing the effectiveness of macroeconomic policies as countermeasures. This study is different from previous studies in this area in that it reflects recent international economic environment which has been dramatically changed since 2000s, and uses 5-country open economy macroeconomic model.

The coupling of the world economy and the decoupling trends has been a hot issue in open macroeconomic studies. This paper examines this issue in a qualitative way, and concludes that the world economies are related with each other more closely as the international trade volume and international capital mobility are increased. Especially for Korea and US, the decoupling has been debated more seriously, since in the Korean economy relative dependence of export to US has been decreased after 2000. However, the paper pointed out that the coupling in the real sector is still significant considering intermediate trade route. Moreover, considering the increasing share of US capital in the Korean financial market, the financial route of the US economy on Korean becomes stronger than before.

The paper is looking for the empirical evidence of international economic shocks on Korean economy using VAR analyses. The empirical analyses define four different shocks: raw material price shock, US ICT bubble shock, sub-prime financial risk shock, and Chinese rapid growth

shock. The VAR analyses conclude that the raw material price shock most deeply impacts after-2000 Korean economy, and the sub-prime financial risk shock was the second. Chinese rapid growth shock was the smallest among four shocks. US ICT bubble didn't affect Korean growth rate, price level, and trade surplus, but it only affects Korean stock market. Lastly, the effects of international economic shocks on Korean economy have been increased during 2000s due to the



fact that oil price shock and sub-prime shock occur in the late-2000s.

Lastly, the paper adopt 5-country open economy macroeconomic DSGE model to analysis the effects of international economic shocks on Korean economy and the effectiveness of macroeconomic policies. The

model explains the effects of current global financial crisis as a mixture of US slowdown shock and Korean country risk premium shock. The model simulation describes the impacts of the current global financial crisis successfully: US slowdown drops the economic growth rates of Japan and Euro area most severely, while Chinese growth rate is least affected by the shocks among the 5 countries. Also it predicts that Korea and China will recover most rapidly from the crisis, which matches the current situation. Also, the model predicts that the impact of US economy on Korea was decreased between 2000 and 2007, but still it affects Korean economy significantly. However, if the size of the shock is same, the shock from the Chinese slowdown will be greater than that from US. This result implies that policy authority concerned should pay attention to the possible shocks from China. Lastly, the paper evaluates the effectiveness of the macroeconomic policies. Overall, government spending increase policies are more effective to boost the economy than the tax cut policies. Especially, among the government spending policies, increase of the government investment boosts the economy most effectively than the increase of government consumption and transfer. Regarding monetary policy, the model shows that monetary authority should be careful to raise its policy rate preemptively as a part of the exit strategy, since the policy rate increase causes exchange rate appreciation and, in turn, it will hamper exports.

## Effects of Foreign Investment on Korean Bond and Derivatives' Market

Deok Ryong Yoon, In Huh, Seung Hwan Oh, and Ho Jin Lee  
(In Korean)

Foreign investment in Korea's financial market attracted attention mainly due to its impact on price and volatility. This study analyzes the impact of foreign investment in bonds and derivatives market in Korea, even though foreigners do not have strong impact on these markets.

Korea's bond market was opened in December 1997 excluding nearly all types of barriers. Foreign investment reached just 4.3% of total bond market volume by the end of 2008. In stark contrast with the stock market, foreign investment increased very slowly in the bond market. Foreigners bought mainly public bonds and came to occupy around 10% of its market volume. The main results of the research on the impact of foreign investment in Korea's bond market can be summarized as follows:

First, foreign capital inflow in the bonds market functions as an important channel for providing foreign currency, especially the US dollar. Investment in bonds by foreigners has increased since the global financial crisis in 2007 and is still showing a high growth rate in 2009. The possible interest arbitrage using their financing capacity for the US dollar seems to have prompted their growing investment in the bond market. The foreigners' net investment was concentrated on currency-stabilizing bonds with short maturity, which implies that foreign investors seek riskless profit from the high interest of currency-stabilizing bonds.

Second, the study could not find any evidence that foreign investment caused the volatility of bond prices. This may be due to the relatively small weight carried by foreign capital on the bond market. However, the high volatility of Korea's financial market at the time of expiration of bonds held by foreign investors signals that the foreign bond investment may have great influence on dollar flows.

Third, the weight carried by foreigner's in the bond market may increase at any time be-

cause securing the channel for financing the dollar will be a continuous concern in Korea. The possibility of interest arbitrage may probably continue to attract the dollar in the event of a dollar shortage.

The study on foreign investors' impact on the bond market emphasizes the importance of stable foreign investment in the bond market not to stabilize the bond market itself, but the foreign exchange market.

Empirical analyses on KOSPI200 index futures market show that foreign investment increases the volatility of the market. Foreigners have stronger impact on volatility than domestic institutional or individual investors.



This conclusion supports the hypothesis that foreign investors trade with better information than domestic investors.

Second, foreign investors lead price changes. The foreigners' buy-position has a positive correlation with the profitability of futures while the sell-position depresses the price level of futures.

Third, net purchase volume of foreign investors only have statistically significant positive correlation with the profitability of stock index futures market. Institutional or individual investors do not show any statistically significant correlation with its profitability. These results imply that foreign investors dominate the KOSPI index future's market.

Contrary to the impact of foreign capital in the stock market, foreign investors do not have a significant influence on governmental bond futures market. The empirical analysis shows following results.

First, foreign investors behave as a price-taker so that their net purchase varies up to the price level on the market.

Second, the net increase of foreign investment in public bond future market shows significant grandeur causality with the profit on the public bond spot market.

Third, the public bond future market may influence the public bond spot market and foreigners' net purchase on the bond future market. However, this relation is unilateral, as the process cannot work in reverse.

Fourth, the distribution of profit rates on public bond spot and futures market varies from period to period. But the impact on variables persists longer on the futures market.

Putting these results together, we can say that foreign investors in the public bond futures market do not have significant influence on the profit rate of spot and futures. Foreign investment has rather been influenced by market conditions and situations, which determines the participation of foreign capital. This relatively weak influence of foreign capital may increase the change in the future, if the unsettled contract and cohesive dealing are considered.

Summing everything up, the study comes to the conclusion that foreign capital increases its influence on the bond market as well as the futures market in general. Foreign investors dominate a part of financial markets where they have better information and they can access liquidity easily. In other markets, foreigners behave as adaptive market participants.

## Portfolio Investment of Foreign Capital and its Impact on Stock and FX Market

Deok Ryong Yoon, Seung Hwan Oh, and Ho Jin Lee  
(In Korean)



Korea has lifted all the barriers against foreign capital in the 1990s, especially after the currency crisis in 1997. As a small open economy, the Korean economy became more volatile due to the movement of foreign capital after the capital liberalization. This study focuses on the volatility caused by foreign portfolio investment in the stock market as well as in the foreign exchange market to find a way to stabilize the market.

At first, the authors provide an overview of the Korean stock market and describe the impacts of foreign investment in the stock and FX market. The next chapter analyzes how the capital inflow on the stock market influences the volatility of stock prices and the stability of financial markets. In the following chapter, empirical studies verify the relation between foreign capital and the volatility of financial markets. Last chapter seeks possible policy implications from all the analyses.

The inflow of foreign capital increased very rapidly after the deregulation measures for foreign investment. Foreign capital possessed over 40% of the total stock value until the global crisis 2007. Foreign investment on the portfolio market increased rapidly since 2002. The inflow of portfolio investment exceeded its outflow until 2004. The outflow, however, began to increase over the inflow since 2005. The subprime mortgage crisis that broke out in the US in 2007 accelerated capital outflows and led to high volatility of the financial market.

Our empirical studies confirmed that the capital market liberalization reduced capital costs, and also shows the impact of cost reduction would be very small, staying under 1%. The study on the volatility of stock prices caused by foreign portfolio investment shows that the abrupt change of foreign investors' position between net short and net long caused the volatility regardless of the investment volume. This result implies that the stock market can maintain its stability

only if the short-term capital is brought under some degree of control. The result highlights also the importance of the quality of inflow capital in managing market volatility.

High proportion of foreign portfolio investment contains the risk of exchange rate volatility as well. Especially, the excessive volume of in- and outflow determines exchange rate volatility while the net volume of inflow does not have decisive impact. For instance, net inflow of foreign capital in 2004 reached only US\$9.42 billion whereas the total volume of in and outflow amounted to US\$222.92 billion. The shocks from excessive capital movement can be absorbed only by institutional investors. Participation of pension funds should be welcomed as a market stabilizer, because pension funds usually engage in long-term investment.

This research confirmed the negative correlation between the profitability of KOSPI and exchange rate fluctuation.

The regression analysis showed that the 1% increase of exchange rate decreases profitability of stock index by 0.6952% and the relation was statistically significant.

The pattern of foreign investment varied according to the investment period and the level of stock index. Foreign investors increased their investment until 2004 when the stock market remained under

KOSPI index 1000. During this period, foreign investors lead changes in the stock index. Since 2005, foreign investors started to sell because Korean institutional investors including pension funds and insurance companies participated in the stock market and took over the role of leading the stock index. Foreign investors have shown adaptive attitudes in dealing stocks according to the stock index especially around KOSPI index 1500.

In sum, net investment of foreign investors has shown great influence on the level and the volatility of the stock index. The reason is as follows; First, foreign investors can mobilize higher capital volume than domestic investors. Second, foreign investors have access to more accurate information, thereby able to lead market prices.

This research work provides some policy implications for stabilizing financial markets in Korea.

First, the quality of foreign capital plays a decisive role in eliciting positive effects from foreign investment. Long-term investment can contribute to the stability of the financial market while short-term investment increases the market's volatility. However, conditions in the



domestic market have a strong influence on whether the foreign investment would stay long or leave early, which emphasizes the importance of economic fundamentals in determining the quality of foreign capital.

Second, the research underlines again the role of domestic institutional investors as stabilizers in financial market.

Third, the empirical analysis shows a strong correlation between stability of the stock market and the stability of the FX market. The research result highlights the importance of stability in the stock market for stabilizing the FX market, because higher the profitability of the stock market, the more stable will be the exchange rate.

Fourth, every market has short-term noise, even if long-term changes depend on changes in economic fundamentals. Therefore, policymakers should try to minimize market-disturbing factors caused by foreign investment.

## Analysis of North Korea's International Economic Activities and Policy Implications

Myung-Chul CHO, Jiyeon KIM, Ihk Pyo HONG, and Jong-Woon LEE  
(In Korean)

North Korea is in the midst of an economic crisis that began back in the 1990s. Though statistics indicate a cycle of fluctuation between growth and downturns not unlike other economies, the North Korean economy remains in a dismal state.

The crisis that befell North Korea's economy stems from a number of reasons, but it was necessarily brought on by the combination of international conflict arising from the nuclear issue and inefficiencies associated with planned economy operating in a closed environment. Therefore, a fundamental solution lay in the simultaneous establishment of peaceful diplomatic relations and opening of the hitherto self-contained economy. This would make possible massive influx of international aid, which could be coupled with increased efficiency from reform and opening, leading to potentially rapid growth.

This report seeks to investigate present conditions of North Korea's international trade, analyze those factors that impede active development of its international economic cooperation, and identify some of the measures for removing those impediments and policy that can be undertaken in support of those efforts. The following is a summary of the six sections comprising this report.

Section One outlines the purpose and significance of this research, prior research on the subject, the scope of the research and methodologies employed, and potential impact. In order to extricate itself from its chronic economic crisis, it is critical that North Korea improve its political/economic relations with other countries, in addition to pursuing policies of reform and openness. Such would necessitate efforts that include an investigation of the present state of the North Korean economy, an assessment of impediments inherent in the present framework of North Korea's international economic cooperation, and finally coming up with alternatives for

stimulating economic exchange and cooperation for North Korea. This would represent an effort with great importance not only for the governments of the two Koreas, but for the international society as a whole. This report was based on a thorough review of prior research concerning the connection between North Korea's trade/investment and economic growth; in order to estimate the effects of removal of above impediments, to economic openness and international economic activity, upon the North Korean economy. The present treatise can be divided into five parts: Assessment of the present state of the North Korean economy, Analysis of major impediments interfering with North Korea's international economic activity, Examination of examples from other countries of successful negotiation of factors impeding international economic activities following regime change, Suggestions of measures for elimination of roadblocks to international economic activity in North Korea, and Policy proposals for implementation of above measures. Combining textual analysis with on-site visits and in-depth interviews, and conferencing with relevant experts, there are several positive benefits that may result from this report including: Proposals for implementation of the Non-nuclear 3000 Plan, indirect provision of advice for the North Korean government, and provision of suggestions for the international community in inducing policies of openness in North Korea.

Section two involves an assessment of the current status of North Korea's international economic activity, based on evaluation of foreign corporate investment into North Korea, North Korean efforts to reach out overseas, and trends in international aid directed towards North Korea. While trends indicate that North Korea's overseas trade has grown overall since 2000, it was accompanied by several side effects, including overdependence on China and increased trade balance deficits. The exact figure for foreign investment into North Korea is difficult to ascertain due to limitations in the data collected; the major investors were China, Russia, and EU; investing mainly in such areas as resource development, manufacturing, and creation of services/social infrastructure. International aid, in the meanwhile, is taking place in an extremely limited form as a result of controversy and diplomatic friction between North Korea and the international community over the issue of nuclear weapons development. Economic sanctions against North Korea that followed in the wake of missile launches and nuclear weapons testing have caused massive interruption of trade and foreign investment into the communist state, with sharp reduction in the amount of international aid.

Section Three involves the analysis of factors impeding North Korean efforts at international economic cooperation. The factors, which form the main criteria for analysis, can be divided into two categories: external and internal. Internal factors include those in policy, institutions, productive capacity, and administrative systems; the external factors stem from bilateral and multilateral sanctions. Some of the reasons discussed as factors in the policy arena were limitations posed by North Korea's policy line emphasizing the creation of a self-sufficient, 'national' economy; as well as focus on heavy industry and military/security. As for institutional factors, laws and systems concerning trade and foreign investment were the major limiting factors.

Analysis in terms of productive capacity will revolve around North Korea's low productive capacity in acting as impediments to the country's industrial development and economic cooperation with the rest of the world. On the administrative side, limitations were cited as inherent in North Korea's highly centralized administrative system. Analysis of the types and content of sanctions imposed by the US and Japan as well as their effects were the main focus in the discussion of bilateral sanctions, a major external impediment to the North Korean economy. The same analysis on the type and content were also performed for multilateral sanctions levied by the international community.



Section Four features cases where former socialist countries including China, Vietnam, Poland, Hungary, Romania succeeded in surmounting limitations to their own international economic activity after regime change. China began removing those limitations with normalization of relations with western industrialized nations and concomitant improvement in its external environment; followed by implementation of specific measures such as trade liberalization, reform of its foreign exchange system, creation of special economic zones, active efforts to attract foreign investment, and nurturing export industries. After the adoption of "doi moi" reforms in 1986, Vietnam has been engaged in efforts to eliminate impediments to its international economic activities through improvement of its relations with the US and its external environment. The Vietnamese government also initiated trade liberalization, foreign exchange controls, reformation of its foreign system, and efforts to attract foreign investment along with creation of export industrial complexes – all aimed at maintaining the process of reform and change. Elimination of impediments to international economic activity in Poland, Hungary, and Romania was much more rapid; involving drastic regime change and economic liberalization measures. Countries in Eastern Europe liberalized trade, attracted foreign investment, and enacted foreign exchange controls to keep pace with rapid change in their economic regime.

Section Five concerns elimination of factors limiting North Korea's international economic activities. In accordance with the two categories of factors outlined in Section Three (external/internal), there are measures for elimination of internal and external impediments. Measures for elimination of internal impediments can be subdivided into more detailed measures concerning policy, institutions, productive capacity, and administrative systems. Elimination measures for external factors consist of two parts, those for multilateral sanctions and bilateral sanctions. Removing impediments in policy would involve revision and suspension of drive to create a 'self-sufficient national economy', strategies for creation of an export-oriented economy driven by light industry, transferring the focus from the military/security sector to development of the

civilian economy, and consistency in CSBMs (confidence and security building measures) to regain the trust of the international community. In neutralizing the barriers in the realm of policy, the measures being discussed include trade liberalization, establishment of a stable foreign exchange market, reorganization and improvement of laws on international economic activity, and expansion of special economic zones. Impediments concerning productive capacity will be neutralized by addressing the inadequate electricity and energy supplies, along with bolstering infrastructure related to industrial production. Administrative limitations will be remedied through abolition of customary usurpation of administrative authority by the KWP, decentralization of international economics apparatus, and firm establishment of regimes to support trade. Improvement of relations between North Korea and the US, and North Korea and Japan, were discussed as measures for negating limitations posed by bilateral sanctions. As for impediments created by multilateral sanctions, they would be dealt with through efforts to convince the UN and the international community to lift those sanctions; and giving North Korea membership in international financial institutions.

Section Six concerns policy proposals for stimulating international economic activity in North Korea. Discussions for those proposals included the significance of revitalizing North Korea's international economy and preconditions for its realization, rational approaches, basic aims and methods of execution, and proposals in support of revitalizing international economic activity in North Korea. As far as discussions on the significance of revitalizing North Korea's international economic activity and its preconditions was concerned, North Korea was a country fully capable of normal economic cooperation with other countries. The necessary preconditions for North Korea being accepted as a responsible member of the international community included resolution of the nuclear issue, reform and openness, and lifting of international sanctions against North Korea.

Concerning other proposals, strengthening of bilateral and multilateral economic cooperation was identified as the most 'rational path' for stimulating North Korea's international economic activity. The some of the major objectives of the revitalizing North Korea's international economic activity include resolution of the economic crisis and establishment of an 'advanced' economic structure, making contributions to economic growth in South Korea and countries in the vicinity, and eliciting openness in North Korea. Measures that stand out in support of these objectives consist of bolstering Inter-Korean economic cooperation, improvement of its relations with advanced nations of the West, and receipt of international ODA. The last of the policy proposals for supporting revitalization of North Korea's international economic activity can be summarized as: active utilization of available means of Inter-Korean economic cooperation; support for establishment of an Inter-Korean trading system, joint utilization of South Korea's trading infrastructure, creation of a system for training trade professionals, establishment of a special trust fund for providing assistance to North Korea, and founding of an overall system for revitalizing international economic activity in North Korea.

## Macroeconomic Structure for the Stable Economic Growth in Korea

Deok Ryong Yoon, Woosik Moon, Chi-Young Song,  
Jai-Won Ryou, Hee-Yul Chai, and Yeongseop Rhee  
(In Korean)

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Korea is an example of a country that has maintained a policy of export-oriented growth. Due to the small domestic market size and relative low level of GDP per capita, Korea cannot still reduce its reliance on exports. The financial sector has also become increasingly dependent on foreign capital since the currency crisis in 1997, because the country has removed almost all barriers against external investment. A relatively high level of trade dependency as well as the growing weight of foreign capital in the domestic financial markets caused a concern that the external sector would become more important than the domestic sector. Global financial and economic crisis last year reignited discussions on the appropriate level of Korea's external dependency. In this book, we examine issues and problems related to high external dependency or linkage in various ways. Based on the results of our empirical and analytical observations, we also suggest policy recommendations which may bolster stable economic growth in Korea.

Chapter II analyzes whether Korea's high trade dependency is the main reason impeding stable economic growth. Korea's export-GDP ratio is higher than Japan's, but it is similar to China's, and smaller than those of Asian NICs (Newly Industrializing Countries). Moreover, Korea's trade dependency ratio, the average ratio of exports and imports to GDP, is smaller than those of smaller EU economies, even if higher than the OECD average. While the negative impact from the global financial crisis was greater for countries with higher trade dependency, at the same time, recovery is expected to be much faster for those countries. Therefore, the argument that Korea should lower its trade dependency is untenable.

Meanwhile, the downturn in the world export market, particularly that of the US, is surely a serious challenge to the Korean economy. The global balancing of current accounts will require

depreciation of the US dollar, and appreciation of the Korean won. In order to secure growth potential, the Korean government needs to increase domestic demand through stimulation of investment. At the same time, Korea should increase trade with East Asian countries through promotion of free trade agreements with China and India, and strategic use of official development assistance (ODA) towards developing countries in the region. On the financial side, the financial and monetary cooperation in East Asia should be strengthened to stabilize exchange rates of East Asian currencies against the U.S. dollar, as well as against each other.

Chapter III tests the hypothesis of decoupling and re-coupling of Korean and Asian economies. As economic linkages between Asian economies increase and accelerate, there is an increasing business cycle synchronization among Asian economies, which led many people to argue for a unique Asian business cycle independent of US and EU economies. In the case



of the Korean economy, for example, China has emerged as the most important trading partner, far ahead of the US which was for a long time Korea's dominant trade partner. As a consequence, Korean business cycle became more and more closely linked with the Chinese business cycle. According to this analysis, despite increasing synchronization of Asian economies among themselves, it also turns out to be true that Asian economies still maintain a high degree of business cycle synchronization with the US and EU economies. That is,

for Asian economies, re-coupling is taking place alongside the decoupling process.

This analysis yields two important policy implications. First, to sustain their economic growth, it will be very important for Asian economies to continue to maintain closer economic policy coordination with the US as well as other Asian economies, in particular China. Second, reflecting the increasing economic linkages among Asian economies and the shift of the world economy to multi-polar system and away from US dominance, Asian economies should continue to strengthen their regional economic cooperation.

In Chapter IV, we examine why Korea's financial sector is vulnerable to external shocks and derive some policy implications for reducing its vulnerability. External shocks are transmitted to the domestic financial sector through two channels. One is the channel of interest differential and the other of psychological fear. In Korea, the deviation from the covered interest parity tends to be maintained due to financial market inefficiency and foreign exchange market inter-

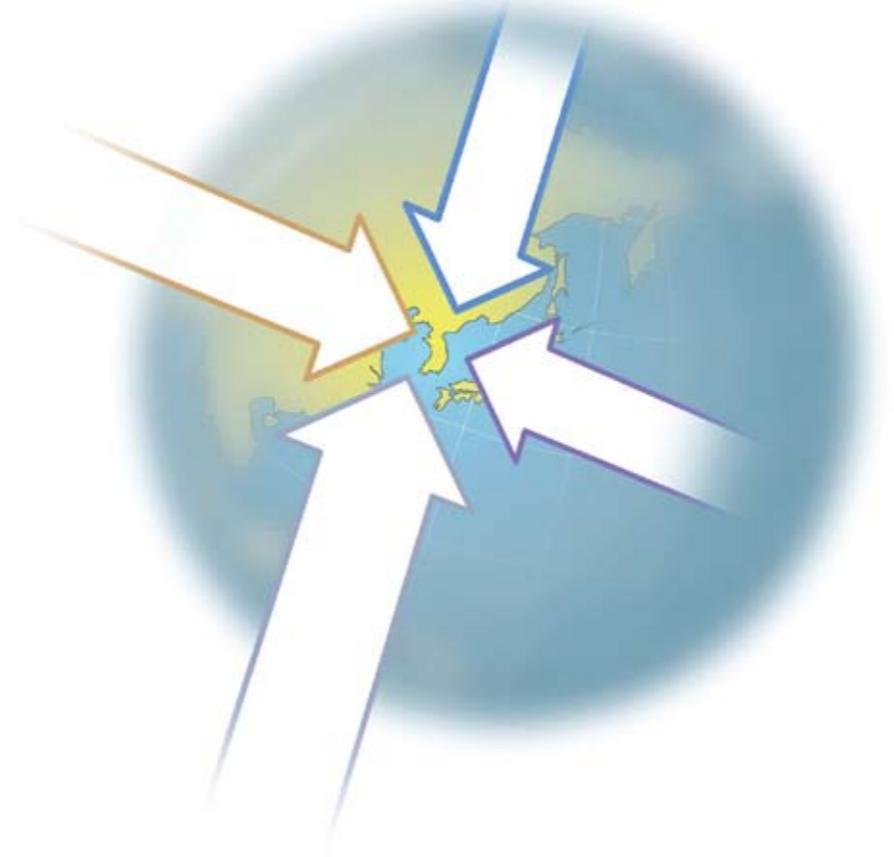
ventions. This attracts huge inflow of short-term capital and increases the vulnerability of the financial sector to external shocks. During crises, the second channel plays a more important role. Our empirical results show that this vulnerability arising from psychological factors is associated not with the openness of the financial markets but the management of external exposure. The concentrated linkage of the Korean financial sector to the US market also increases its vulnerability to external shocks.

To reduce its vulnerability, Korea should improve the efficiency of its financial sector so that the chance of collecting returns without risk is not made available for a long time. Also, a proper management of external exposure is more important than a simple reduction of financial openness to protect against external shocks. The extended diversification of financial linkage to other countries is also desirable so as to harmonize real and financial linkages.

Chapter V empirically investigates the crucial determinants of balance sheet mismatch between foreign assets and liabilities in Korea. The balance sheet mismatch in general includes currency and maturity mismatches. Our empirical results indicate that the balance sheet mismatch gets worse in Korea as the current account balance deteriorates or the arbitrage opportunities reflected in covered interest rate differential become larger. Contrary to our expectation, however, the volatility of the Won/Dollar exchange rate does not have significant impact on the mismatch. In this chapter, we also find that the worsening of the balance sheet mismatch was one of the main causes of the Korean currency crisis in 2008.

We suggest that the retainment of the overseas debt to a reasonable level, a sound current account balance, and the removal of excessive and persistent opportunities for interest arbitrage in the Korean bond markets are important factors for reducing Korea's financial vulnerability. More statistical information, which can help us understand Korea's real situation concerning currency and maturity mismatches more accurately, should be disclosed promptly in order to avoid raising unnecessary concerns about the Korean economy in the international community. The size of foreign reserves needs to be maintained at an optimal level sufficient to mitigate the disturbances in the foreign exchange market in the case of global credit crunches. The regulatory standards for liquidity risk in terms of foreign currencies should be also reinforced. Finally, the equity investment by foreigners may be an important source of balance sheet mismatch, as it is not backed by short term asset, although easily reversible. But capital controls to contain excessive equity inflows are not recommended as they will have negative impacts on Korean economy's international credibility, not to mention other drawbacks.

# Study of Korea's International Economic Strategy in the Face of the Changes in its Status within the Global Economy



## OECD DAC Accession and its Implications for Korea's ODA Policy

Yul Kwon *et al.*  
(In Korean)

● Korea became the 24th newest member of the OECD Development Assistance Committee (DAC) in January 2010. The DAC is a like-minded group where donor governments and multilateral organizations come together to help partner countries reduce poverty and achieve the Millennium Development Goals. As a member of the DAC, Korea needs to upgrade its development assistance system and follow international guidelines on development.

Korea joined the OECD in 1996. However, the ODA/GNI of Korea was just 0.03% and it did not meet the requirements to be a DAC member country. Korea is now one of the major global economies in the world and the volume of the ODA was 803 million dollars in 2008, meeting an annual minimum net ODA volume of either \$100 million or 0.20% of GNI. Korea's ODA as a share of GNI is 0.09%; however, it has committed to increase the ODA spending to 0.25% of GNI by 2015.

In line with the DAC recommendation, Korea plans to untie 75% of its ODA by 2015, prioritizing untying in its support to least developed countries (LDCs) and other heavily indebted poor countries. Meeting the minimum level of grant element for ODA to LDCs, Korea changed the terms of its concessional lending such that the repayment and grace periods are extended by 40 and 15 years, respectively, and the interest rate is reduced to between 0.01% and 0.1%.

This study analyzed the DAC's guidelines on the development areas including environment, trade, gender equality, and poverty reduction. The guidelines provide analysis, guidance and recommendation for the DAC members to coordinate their development efforts based on them. Case studies of other DAC countries were included to reflect good strategies, policies, and practices into Korea's system of development assistance.

Korea needs to work to increase not only the quantity, but also the quality of aid. This study identified the current issues in development such as aid effectiveness, division of labor, and pol-

icy coherence. Based on the survey on monitoring the Paris Declaration, Korea's development assistance and effort on improving aid effectiveness were assessed by each component of the monitoring survey.

This study suggests an establishment of a separate government department

within the authority of prime minister which is responsible for policy-making and coordination among the line ministries. To increase the link between grant and loan projects or programs, an integrated country assistance strategy on the same partner country is necessary and a system of monitoring and evaluation should be set up. An importance of decentralization is emphasized in order to respond effectively to the needs of the partner countries and increase the harmonization with other donors in the field. Finally, the policy of development assistance needs to be coherent with the policy on other foreign affairs including trade, environment, and economic cooperation.



## Korea's Agricultural ODA Policy toward Africa

Young Ho Park, Jisun Jeong, and Yoon Sun HUR  
(In Korean)

Currently over 3 hundred million people suffer from absolute poverty in Africa, which represents 40% of the population of the entire continent. Yet there is a bigger concern: it is highly likely that the population living in absolute poverty will increase to 4 hundred million by the year 2015. In 2001, the international community adopted the UN's Millennium Development Goals (MDGs) to alleviate poverty and spur development in the world's poorest countries by 2015. However, it is predicted that Africa will fail to achieve many of the goals outlined in MDGs by the time given. There is a broad consensus that agricultural and rural development should be the priority in order to address the issue of poverty trap and initiate take-off economic development in African continent. It is because poverty in African is predominantly rural. More than 70 percent of the continent's poor people live in rural areas and depend on agriculture for food and livelihood. Without a developed industrial sector that can contribute to the national growth, agriculture plays a role as a key industry in most of African countries. Yet, subsistence farming remains the main agricultural activity in Africa. In many countries, the rural situation is marked by continuing stagnation, poor production, low incomes and the rising vulnerability of poor people. Furthermore, conditions prevailing in African agriculture are dismal African farmers are vulnerable to increasingly volatile environments, land degradation, and suffer from limited market access and decreases in foreign aid. While Asia and Latin America raised food production dramatically by expanding irrigation facilities, developing new varieties of crops and increasing the use of fertilizers, Africa is still at a standstill due to lack of basic fundamentals and poor natural and socio-economic environment.

Up until now, many African governments have promoted their own agricultural development policies. Yet they were met more by failures than successes due to a host of problems such as the lack of financing and qualified workers, poor governance and outdated public finance

management systems. Decades of government failure and inefficient external assistance are one of the many factors that led to low agricultural productivity and food shortages.

In the short term, the future of African agriculture does not look bright. Current indicators in African agriculture and development make it difficult to expect 'green revolutions' and any other dramatic breakthroughs. However, one should not underestimate the potential of Africa's agricultural development. It is widely believed that with its huge arable land and labor, the continent can achieve a substantial production increase with sufficient funding and the right approach to development. With most of Africa's population living under the poverty line and concentrated in rural areas, increase in food production and improved livelihood of the rural poor could bring out a basis for a long-term economic development and poverty reduction of the continent.

Over the last half century, acknowledging the importance of addressing rural poverty, international donor community has attempted at a wide range of agricultural and rural development approaches. The predominant themes in rural development for each period could be summarized as community development in the 1950s and 60s, integrated rural development in 1970s and community-based rural development in the 80s. Nevertheless, the top-down, donor-oriented blue-print approaches have resulted in a series of failures by overlooking Africa's diversity and complexity, and uncritically recommending imported models from the other continents. Since the late 1990s, along with growing disenchantment among donors and emergence of new issues for development such as education, HIV/AIDS and environment, there was a sharp decline in the overall spending on agriculture by donors and African governments. The agricultural and rural development has been pushed aside from the center of international aid. However, for the past couple of years, the role of agricultural development in addressing food insecurity and poverty in Africa is being re-emphasized in the context of climate change and the food crisis. With various international initiatives to resolve food crises, aid to African agriculture is back on the international policy agenda. In the context of growing importance of aid effectiveness, the agricultural and rural development is being identified as a sector strategy and is being incorporated into Poverty Reduction Strategy Papers (PRSPs) and country assistance strategies (CAS).

Each donor takes different agricultural and rural approach to Africa. For instance, the UK, a leading donor in aid effectiveness agenda and a former colonial power in Africa, focuses on supporting nationally-owned agricultural development strategies and delivering aid through budgets of the partner country. Japan, one of the largest donors in agricultural aid, emphasizes increasing productivity and irrigation development based on their expertise in rice cultivation and crop diversification, actively promoting its community development experiences through the One Village

One Product Movement (OVOP). The United States can be characterized by its focus on market mechanism for agricultural development in Africa. The U.S. puts emphasis on private sector development, strengthening agribusiness, promoting better market access and improving

competitiveness in global markets through a value-chain approach. The UK, U.S. and Japanese approaches strongly feature their own development experiences and competitive advantages. The main aid modalities of Korea, a new DAC member and emerging donor, are project-type assistances and technical cooperation.

Meanwhile, the Millennium Village Project (MVP) has been receiving much attention as a new development path to eliminating rural poverty in Africa. MVP aims to achieve MDGs in rural villages through an integrated community development approach. MVP is the first attempt to combine MDG and rural development, and is different from previous approaches with its scientifically-proven methods, a budget based on the international commitment to expand ODA. Its comprehensive, all-encompassing approach including sectors like agriculture, health, infrastructure and education resembles the integrated rural development approach of Korea's Saemaul (New Community) Movement. Since the project was first launched in Sauri, Kenya in 2004, there are about eighty Millennium Villages with up



to 400,000 beneficiaries in ten countries as of 2009. In 2009, the Millennium Promise and South Korean Government have agreed to launch a Korean Millennium Villages Project to share the experience of Saemaul Movement and demonstrate how extreme poverty can be ended in villages in rural Tanzania and Uganda. Despite a range of widely disputed limitations such as financial sustainability, 'friction' with administrative systems of partner countries, and income disparity between Millennium Villages and other regions, the MVP appears to have strong potential for lifting rural villages out of the poverty trap.

So far, South Korea, as a donor, has not paid much attention to the issue of African agriculture development. In addition to the geographical distance, the lack of understanding concerning rural Africa has hindered Korea's further engagement with African rural development. Under these circumstances, the aid budget for agricultural and rural development in Africa could only remain insignificant, leading to an ad-hoc, case-by case assistance without a long-term development strategy.

However, with its successful community-based rural development model, South Korea has a valuable experiences and expertise that can be customized and adapted in the African context. To many African countries, it is of great interest how Korea, a country with scarce natural resources and small arable land could have achieved self-reliance in food in such a short period of time.

This research proposes agricultural development cooperation between South Korea and

Africa based on South Korea's agricultural development experience. The research emphasizes sharing of development experience, especially development knowhow from the Saemaul Movement, and supporting agricultural infrastructure.

The sharing of development knowledge, especially the Saemaul Movement, will not only meet Africa's development needs, but also constitutes a method for development cooperation that can bring real poverty alleviation at relatively low cost.

Sharing development knowledge from the Saemaul Movement with Africa is an appropriate method for increasing Korea-Africa development cooperation in that it has significant implication for African development. Saemaul Movement can contribute to accumulation of social capital of the partner community in Africa. Currently, what Africa needs the most are social capital such as diligence, self-help, and cooperation - all basic tenets of Saemaul Movement, rather than 'physical capital'. In order to escape rural poverty trap, African communities need to build social capital by enhancing its own capacity and strengthening cooperation among community members. Building social capital will provide a basis for sustainable agricultural and rural development. Considering the implication of the Saemaul Movement for African development, South Korean government has made the sharing of development experience and expertise from the Saemaul Movement a cornerstone of its development policies for Africa. Despite the relatively small aid volume, the knowledge sharing from the Saemaul Movement could serve as valuable means for South Korea to contribute to poverty reduction and MDGs as the first recipient-turned-donor.

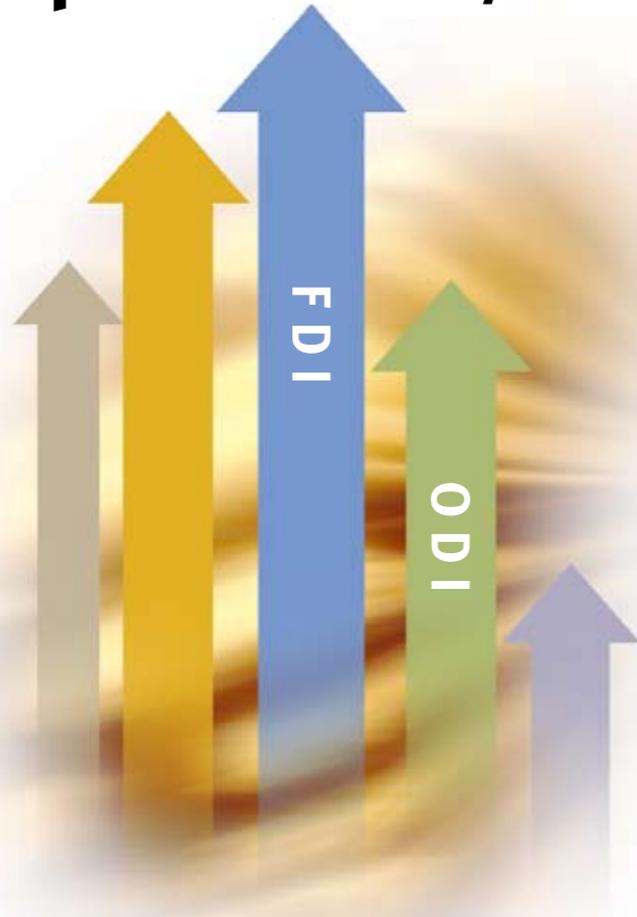
However, since the circumstances of South Korean farms in the 1970's and that in which African farming communities currently face are considerably different, sharing of Saemaul experience should not be overly emphasized in the Korea-Africa development cooperation. For the Saemaul Movement to be effectively adapted to African communities; the complex political, socio-economic and cultural factors in each community must be considered and integrated into a new model.

First of all, the Saemaul Movement should be adapted in a flexible manner to the African continent with careful consideration of conditions prevailing in the African community that are different from that of South Korea in the 1970s. Since the Saemaul Movement is a unique Korean historical experience, it is not only ill-advised but also impossible to transfer it in its 'original' development model. Second, considering the reality of the African rural area, emphasis should be given to development of social 'strategy' in order to create initial conditions of modern rural community. Third, in order to maximize effectiveness, the Saemaul Movement should be adopted to homogeneous social groups at a small scale, not to the entire nation. Recalling that Saemaul Movement's success in South Korea came from strong regional ties and traditional leadership, the homogeneous social groups should be considered as target groups in the implementation of the Saemaul Movement in Africa. Fourth, the Saemaul Movement should be implemented in a way that facilitates voluntary participation of community members in Africa

and thus ensures local ownership and leadership. The participation of community members is a key factor that directly relates to the success of Saemaul Movement. Thus, in order to successfully implement the Saemaul Movement in Africa, active cooperation and participation of community members crucial. Lastly, given the limited aid budget of South Korea, the principle of 'selection and concentration' is key; selecting small number of key countries among 53 African countries and providing intensive support to a selected communities will increase the impact of the Saemaul Movement in Africa

Regarding the method of agricultural development cooperation between South Korea and Africa, this report suggests technology transfer and establishment of agricultural infrastructure. Since Africa lags behind in agricultural technology, providing new yet viable technology could improve productiveness. Some African countries are already drastically improving their agricultural productiveness by learning new agricultural techniques from developed countries. However, since the African continent is enormously diverse in agricultural characteristics depending on climate and soil conditions, it is important to select and plant different crops considering the climate and soil condition of each region. For research cooperation, a pilot-research center should be established in the country's agricultural area, and the research center should conduct joint research with researchers in partner countries. The pilot-research center and joint research will improve possibilities for applying the technology transferred to African countries. During the process of disseminating those technologies, the local farmers or agriculture professionals should be included as participants and agents in all research process, including development of new crops. Furthermore, the problem of excessive reliance on climate must be addressed. As most African farmlands are rain-fed paddy fields that depend solely on rainwater, they are highly vulnerable to droughts and floods. To improve stability and durability of production, a solid agricultural infrastructure needs to be built and enhanced. Without firm agricultural infrastructure, it is difficult to expect significant productivity increase no matter how excellent the techniques and policies implemented. The most urgent task concerning agricultural infrastructure is to enhance irrigation facilities, given that most African farmlands are suffering from water shortages. In fact, only 4% of African farmlands have sustainable access to irrigation facilities, with the rest dependent solely on rainfall for cultivation. Thus, decreasing the dependence on rainwater and building irrigation facilities is crucial issue for increasing African agricultural productiveness. Also, many African agricultural experts point out the expansion of irrigation facilities along with new technologies and usage of fertilizer, as important means for improving local agricultural productivity. The establishment of storage facilities and distribution infrastructure is also an important issue with respect to Korea-Africa agricultural cooperation. The storage and distribution system which collects and gathers products and transports them is necessary to increase the added value of the product and ensure accessibility of food for consumers.

# Development of the Korean Service Industry and Measures to Improve FDI/ODI



## Economic Effects of Foreign Direct Investment into Korea and Some Proposals on Improving the Investment Environment

June Dong Kim *et al.*  
(In Korean)

Foreign direct investment (FDI) has been established as one of the main pillars of growth in the Korean economy since the 1997 financial crisis. However, the growth of FDI has slowed to a virtual halt recently. In particular, global increases in FDI from 2003 to 2007 did not translate into growth in Korea, as FDI into Korea actually decreased during the same period. Even though FDI inflow met the target level in 2009, FDI growth into Korea has become stagnant, standing still between 10 to 12 billion US dollars since 2000.

The main cause for the stagnation seems to be Korea's adverse management environment that act to impede FDI. Various regulations concerning the financial market, foreign exchange transactions, taxation and labor matters are criticized as being inferior to those of other competing countries. Labor disputes involving militant unions and anti-foreign capital sentiments have had a negative impact on the image of the Korean market.

Against this background, this study aims to analyze the investment environment in Korea and present some proposals to improve them in order to increase FDI into Korea well beyond the current 10 billion US dollars. The analysis is preceded by estimates of the effects of FDI into Korea on production and employment, as well as its spillover effects on productivity.

First, analysis of the effects of FDI into Korea on production and employment, resulted in estimates that show FDI into Korea increasing 2.8~3.7% of total GDP and 1.0~1.3% of total employment in 2000. In 2003, due to the dwindling of FDI into Korea, the share of production and employment created in total GDP and total employment decreased to 0.8~1.5% and 0.3~0.6%, respectively. In 2005, FDI into Korea generated 1.1~2.3% of its total GDP and 0.4~0.8% of total employment in the country. In 2007, the share of production and employment created in total GDP and total employment by FDI reached 1.1~1.5% and 0.42~0.56%, respectively.

Results of evaluations on productivity spillover effects by using the Generalized Method



of Moment system showed that the average foreign share had positive spillover effects in both periods of 1990~2003 and 2001~2007, if we include service industries. The coefficients of the average foreign share in forward industries show different results depending on the period being evaluated. For 1990~2003, the results showed negative spillover effects, while spillover effects were positive for 2001~2007. The average foreign share in backward industries was estimated to have significant positive spillover effects except for the period of 2001~2007. This shows that forward spillover effects recently became positive and backward spillover effects turned towards a positive direction overall, if we include service industries. In other words, the cases where we include service industries show higher spillover effects than cases where only manufacturing industries were analyzed. These results imply that the promotion of FDI in service industries should be given greater importance.

Even though FDI in service industries create significant spillover effects in the national economy, the degree of openness in key service industries such as education and health-related services is still low compared to other major industrialized countries. Furthermore, a recent survey done by KOTRA revealed that establishing sound labor relations, internationalization of public sentiments and expanding market openness is critical in order to induce more FDI.

Therefore, this study aims to present some specific proposals with in-depth analysis of the current investment environment. First, concerning further opening of service industries, how quickly the stepwise opening schedules agreed in the KORUS FTA is implemented is crucial in the case of legal services. In the case of health-related services, allowing for-profit health institutions needs to be reviewed in tandem with easing of restrictions on liquidation as a second-best option. Likewise, in the case of education services, easing restrictions on liquidation can be considered for community colleges specializing in technical education as a second-best alternative. Regarding ownership restrictions in broadcasting services, it is necessary to review as a next-best option the elimination of foreign ownership ceiling for system operators (SO) and program providers (PP) for cases of indirect investment in telecommunication services.

In order to facilitate M&A-type FDI, it is necessary to allow leveraged buyout by amending the Commercial Act, as well as improve the taxation system related to M&A. Regarding investment incentives, it is desirable to expand the system of cash grants and enhance the efficiency of tax exemptions in order to raise Korea's negotiating power. Concerning Korea's labor problem, which has become a target of frequent criticism as one of the most severe impediments in the country, it is necessary to publicize the fact that domestic labor relations have been stabilized recently, with concomitant expansion of programs designating professional labor managers to foreign invested firms.

## Comparison of Competitiveness among Korea-China-Japan on Business Service by Analysis of the Determinant for FDI

Hyung-Gon Jeong, Seong-Bong Lee, and Seung Kwon Na  
(In Korean)



Recently, along with the globalization of economic activities and expanded competition, cases where companies are outsourcing nonessential part of their work in order to maximize comparative advantage are increasing. Outsourcing directly related to manufacturing production used to be limited to design and engineering, but it now has expanded into the field of business-related services, such as management consulting and advertising. Under such circumstances, the importance of the business service industry is growing in both quantitative and qualitative aspects. In many of the developed nations including the United States, the business service industry takes up 12~14% of the entire economy. In the case of Korea, the proportion is still low, but it has been showing signs of rapid growth.

The business service industry must be taken far more seriously, because it has the potential to quantitatively expand the industrial sector and it can contribute towards improvement of efficiency in other sectors. Thus, as the business service industry becomes more developed, we can provide high-quality service at low cost through outsourcing, which will improve the efficiency of companies and become a catalyst for economic growth. In addition, as institutional integration like the Korea-China-Japan FTA becomes a visible possibility, each country's demand for business services may rise very high in the future. So, we need to check competitive advantages concerning the business service industry in the Northeast Asia region and map out strategies for strengthening competitiveness of business services.

This study draws determinant variables which decide FDI inducement in business service industry and compares investment conditions in Korea-Japan-China. This study analyzes the comparative advantages of Korea's business service industry over Japan, China, and global market, and suggests policy measures based on the result of the analysis.

Before we compare the conditions for FDI inducement, we first examined the overall status

of the business service industry in Korea, Japan, and China. In general, the business service industry in three countries showed a pattern of steady growth, but in terms of proportion of value added, number of people employed, and trade investment, they were markedly below the level of major developed countries. Korea, Japan, and China are engaged in various projects to actively foster the business service industry, and rapid growth in the future is expected both domestically and internationally.

On the other hand, the outcome of FDI inducement in the Korean business service industry tells that absolute size of inducement is increasing while the business services industry share of total foreign investment is actually decreasing. We therefore drew up a plan to identify such causes and to raise competitiveness.

In this study, we perform an empirical analysis on determinant factors of FDI inducement in 35 countries where data on business service industry is available. First of all, according to the early studies, independent variables are chosen according to element conditions, demand conditions, competitiveness of associated and support industries, and other system-related factors. After four factors were selected and analyzed in an exploratory factor analysis, the result indicated environmental and cost variable (income level) as the important factors. A comparison of each country tells us that if the country's institutional environment is more developed and its cost aspects higher, its FDI also tends to be higher. Among all the factors, institutional factors, such as bribery and corruption, transparency, Intellectual Property Rights, and ease of doing business, is found to be the most important factors of FDI inducement in the business service industry.

When comparing Korea-Japan-China by major determinant factors, Japan's institutional level was below that of Singapore, Hong Kong, and United States; but similar to that of Germany and England and higher than of Korea. Institutional level and income level of Korea is slightly lower than Japan, but they are in more favorable circumstances when compared to China. China carries many more disadvantages than Korea or Japan in FDI inducement for its business service industry.

According to the result of the empirical analysis, Korea's conditions for FDI inducement in the business service industry ranked almost in the middle among the 35 sample countries, while institutional aspect was found to be very weak when compared to Hong Kong and Singapore. Korea's future policy direction must therefore be focused on enhancement of institutional conditions, based on cases of Hong Kong and Singapore.

First, policies for prevention of corruption must be strategic, practical, and gradual. Since controlling corruption is not the matter of the individual but rather about the whole social system and institutional apparatus, it is important to achieve institutional stability through consistency in policy operation.

Second, in terms of effective safeguarding of intellectual property rights, expansion of research capabilities for digital information property rights is needed and international coopera-

tion must take place for its enforcement. In order to achieve this, dispatching staff to overseas agencies for training or creation of a system for continuous exchange of information is necessary.

Third, as can be seen in cases in Hong Kong and Singapore, the most important factor for a company that is investing is absence of discrimination between domestic and foreign corporations and conditions for the supply of manpower. An improvement of Korea's business environment must be preceded by advancement and globalization of overall market management system and creation of an environment conducive to recruitment of skilled personnel from both home and abroad.

Fourth, improving the attitudes toward globalization is a task that takes time. From a long-term perspective, our government should adopt policies that attracts skilled foreign worker just as Singapore and Hong Kong have done. The development of Free Economic Zones, developed under the concept of a globalized future city, is expected to be an important catalyst.

Fifth, labor market flexibility should be improved gradually through introduction of preferential labor deregulation policies in the Free Economic Zone.

In the long-term, improvement of the institutional factor is the most important, but for the short-term, it is important to formulate a strategy for attracting FDI in business service industry also. So we present four strategies for the government decisionmaker below.

First, in order to stimulate M&A and joint ventures, government support measures like building a database of domestic M&A target companies and offering matching services as needed.

Second, to expand FDI inducement in business services, we need to consider expanding the target range for FDI incentives restricted to manufacturing and a few service industries (Logistics, R&D, and Tourism Industry) into the business service industry.

Third, better higher education courses for business services and introduce incentives for attracting quality foreign human resources.

Fourth, select Free Economic Zones with sufficient market demand and human resources (and close to Seoul) as a business service hub, and give preferential financial and institutional incentives.

## Changes in the Pattern of International Capital Movements and Financing of the Current Account Deficit of the United States

Hankyung Sung, Hyeri Park, Hosun Nam, and Joo Young Yang  
(In Korean)

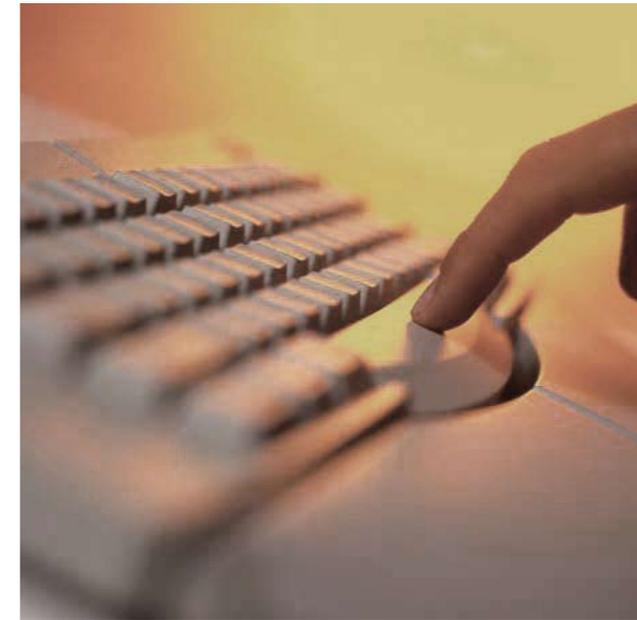
● The purpose of this research is measuring barriers for the service trade on telecommunications, constructions, and professional service sectors in seven OECD countries including Korea and suggesting policy implications by estimating economic effects when those are eliminated.

In the second chapter, we study the characteristics and trade flows of the three service sectors. Telecommunication services, which used to provided by state-owned enterprises (SOEs), is considered regulations would be necessary to keep the market competitive. The construction services may be restricted by several regulations since mostly those need to be provided by commercial presence. Professional services that include legal, accounting, architecture, and engineering was highly regulated but the discussions on its opening and facilitating competition is widely in process.

In the third chapter, we measure Service Market Barriers (SMB) using firm level data related to internal industry trade and construct Service Trade Restrictiveness Index (STRI) using regulatory profile data from OECD. Then we analyze the service trade barriers from the both SMB and STRI, which are complementary each other. The rank in the SMBs and the STRIs for Korea is relatively idiosyncratic in that the SMB on the three service sectors in Korea is mostly higher compared to other countries, but the STRI is relatively lower. It may imply that Korea has accomplished regulatory reform for a few years, but that still service providers have yet internalized the reform.

The fourth chapter reports that in the most cases the eliminations of the service trade barriers result in the increase in real GDP, enhancement of allocative efficiency, the increase in real production of manufacturing sectors.

This paper concludes in emphasizing that we should not overlook the positive side from regulatory profiles, which may hinder the service trade, but we can expect the efficiency and



real GDP growth by removing the service trade barriers. Korea is expected to have the positive economic effects from liberaizing service trade, so it has to pursue lowering service trade barriers. In particular, appropriate competition policy would help not only loweirng SMBs but also preventing monopolistic behaviors by foreign service providers.

The STRI in construction by OECD and this work has some limitations to be used for trade negotiations but it is useful for reference for policy makers as well as negotiators. It still remains as future works that the extension of research by expanding service setors and country profiles and refining data.

## Development Strategies for Korean IT Services in the Era of Globalization

Yeongkwan Song, Jungu Kang, and Hye yoon Keum  
(In Korean)

Creation of many high quality jobs is very important for the domestic economy, in order to secure a new engine of growth and to reduce polarization. Knowledge-based services, and business services in particular, are attracting much attention in this regard. Business services develops as other sectors of the economy, such as manufacturing, progress into a higher level. In developed countries, business services have developed naturally in line with their economic progress. The development of business services in turn raised the efficiency of companies, creating a virtuous circle.

When business services become developed, companies can easily achieve efficiency in managing firms through outsourcing. Due to the characteristics of increasing returns to scale of business services following the creation of demand, outsourcing brings the benefit of low cost to companies paying for those services, and broadens the base of earnings of companies that supply business services. This expansion of the earning base eventually enables service companies to employ a high-quality work force that helps business services develop further, creating another virtuous circle.

Korea has accomplished astonishing economic growth in the 1970s and 1980s thanks to the development of manufacturing dependent on low-cost labor. However, the time has come for Korea to develop more globally competitive companies in spite of the high cost of labor required, and business services are essential for that purpose. The development of business services raises the general level of the economy including manufacturing, and is not just business services. The development of business services leading to stimulation of the outsourcing market in is critical for small and medium enterprises in becoming mid-sized, large, and eventually global firms. Because business services do not usually require much capital to start, it is comparatively easy to enter and withdraw, and has a very flexible labor market. In addition,

because business services need quality manpower, it is possible to create many high-quality jobs. It is expected that potential demand for business services in Korea will be relatively large in the event that quality services begin to be supplied, because manufacturing is already well-developed in Korea

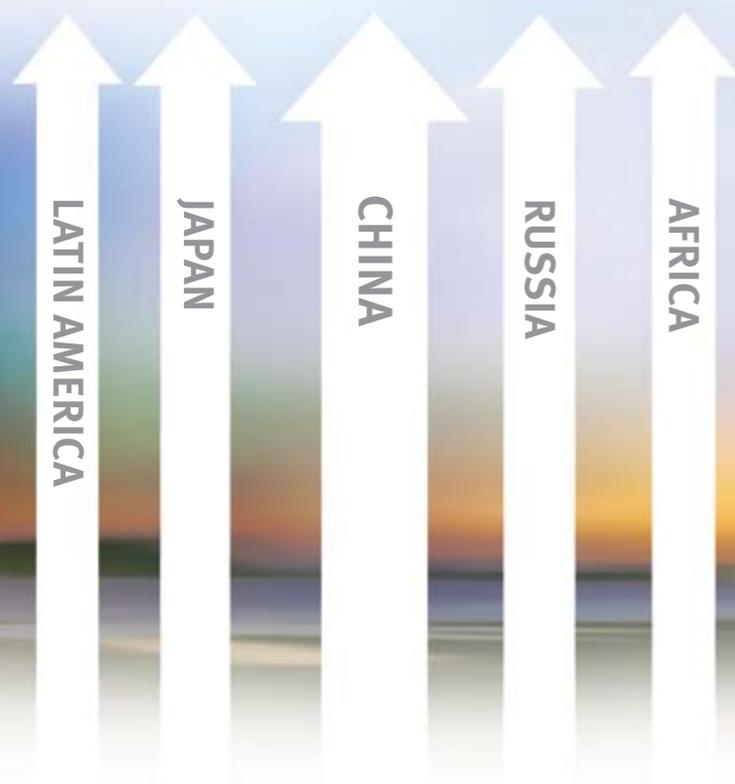
The subject of this study is IT services, as IT services are one of the most active in business transactions and is an industry where Korea is considered to have comparative superiority. The volume of trade in IT services is quite large in terms of business services, and its growth rate is also high. The trade in IT services created a new phenomenon called global outsourcing, which in turn becomes more activate by global outsourcing. Since the global outsourcing in IT services has become active, world-class companies in business services are emerging not only from developed countries like the US, but also from developing countries such as India. It is notable that Brazil, China, India, Indonesia, and Russia combined for a growth rate of 19% in the world IT market from 2003 through 2007, and the market share of the newly developing countries account has increased to about 20%.



The purpose of this study is to deduce conditions and the policies necessary for the development of Korean IT services and the birth of its own world-class companies. Toward that end, this study will examine the current state of some major global IT service companies in the US and India by using a variety of statistical analysis methods related to the IT service industry, such as the size of industrial value added and revenue of the major companies. This study will also review the present state of Korea's IT service industry through inter-industry analysis etc. In this study, the policies for the development of Korean IT services will be presented as active supply policies, active demand policies, and open-to-outside policies, respectively.

The first and most urgent condition for the development of Korean IT services and creation of world-class companies in Korea is the establishment of infrastructure with superior human assets, which is considered to be the most important in IT services. Accordingly, in the active supply policies, expert manpower policies to nurture more creative and highly-skilled workers will be discussed and business policies such as active M&A will be presented. Second, measures for promotion of exports related to government procurement policy and official development assistance will be proposed as active demand policies. Finally, open-to-outside policies, the position Korea should take in the IT service field in multilateral trade negotiation (DDA) currently in progress and in the FTA; policies to attract expert personnel and investment from overseas; and export promotion policies are introduced.

# Coping with the Demand for In-depth Research on Other Regions



## A Study on Japan's Low Carbon Strategy

Sung Chun Jung, Yang-Hee Kim, Gyupan Kim, Hyong-Kun, and Eun-Ji Kim  
(In Korean)

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“Low Carbon Society” is a keyword in the 21st century. Many developed countries are trying to transform their economy into low carbon society, which is defined as a society limiting the emission of green house gases to such a level that there is no artificial harm to the climate system. Japan is one of those leading countries pursuing the value of low carbon society. Several visions and strategies were issued recently by Japanese government. These visions and strategies show that Japanese government has a strong will to change its society into low carbon society and at the same time to make use of climate challenges as a chance to boost economic activity.

This report is aimed at showing Japan's policies and measures related to low carbon strategies. We divided policy entities into four groups. The first is central government. This policy entity is the most important driving force of low carbon policies. We survey central government's midterm reduction target and some policy tools. The second is local government. We explain local government's role and responsibility in accomplishing national reduction target. We also conduct case studies on Yokohama city and Kitakyushu city which were selected as Environmental Model City in 2008.

Industrial group represented by Keidanren is the third policy entity. Keidanren started its voluntary program which aimed at reducing GHG emission from industrial activity to the level of 1990. We analyze its activity and also four main industrial sectors(steel, chemical, automobile and electronics) are surveyed in more detail. Japanese government is trying to foster new industries by low carbon strategy. We focus on four main sectors such as solar cell, wind power generation, green cars and fuel cell. Lastly we surveyed civil society's role and power in changing Japan into low carbon society. We confirmed that Japan's civil society has been playing important role. However, more efforts should be made to strengthen its role and power.

## The Development of Retail Industry in China and its Implications

Seungshin Lee *et al.*  
(In Korean)

China's retail industry has been growing rapidly since the liberalization of the distribution industry after China became a member of WTO. The increase of consumption due to the growth of disposable income affected the liberalization process as well. In addition, the Chinese government's policies and measures that expanded domestic demand and acceleration of urbanization also facilitated the growth of consumption and retail industry.

The regulations and rules regarding the retail industry are being established continuously as the retail industry develops. The various laws and regulations will be introduced henceforth to modify the retail industry by management of distribution channels in urban areas, fostering large commercial enterprises, controlling the relationship between the manufacturer and retail company, and regulation of sales promotion etc.

Most restrictions regarding the entry and operation of wholesale & retail industries have officially been abolished at present, so it can be considered that the distribution industry has been opened up in general. However, some non-tariff barriers still remain which might make it difficult for the foreign distribution businesses to enter the Chinese market.

In this paper, we discussed the retail industries in major centers of consumption such as Beijing, Shanghai, Guangzhou, Shenzhen, Chongqing and Tianjin which are considered "1st tier cities" in China. We also explored major 2nd tier cities like Shenyang and Dalian. We also reviewed the characteristics of major types of retail industry (department stores, discount stores, supermarkets, convenience stores and online shopping etc.) in China.

The retail markets in Shanghai, Beijing, Shenzhen are almost saturated. Therefore, most local and foreign retail companies are expanding their distribution channels to second and third tier cities. Although there are some differences by region, the sales of supermarkets and dis-



count stores are increasing steadily. And sales of department stores have been growing at an annual rate of 23% since 2005. The TV home shopping and online shopping have also shown a pattern of rapid growth since 2000 in certain regions and sectors. The potential for growth of non-store retailing business is supposed to be very high because of the rapidly rising internet penetration rate, the rise in potential spending power in the fast-growing domestic market and the accelerating growth of the wealthy class that form the main customer base of the non-store retailing business.

We undertook this case study on Korean retailing and manufacturing enterprises in China to understand their management conditions, and then evaluated their success factors. The factors for success of retailing enterprises are: joint ventures with Chinese firms, differentiated marketing strategies and localization of the management system. This stands in comparison with factors for the success of manufacturing companies: localization of products, attention paid to management of agents as well as marketing strategies that reflect regional characteristics of China.

Finally, this paper forwards some suggestions for retailing and manufacturing enterprises, respectively; and policy recommendations for the Korean government to help Korean enterprises in China or considering entry into the Chinese market.

## The Rise of China and Korea's Strategy

Chang Kyu Lee *et al.*  
(In Korean)

● The recent full-blown global financial crisis, triggered by the bankruptcy of Lehman Brothers, has been called the worst financial crisis since World War II. Since China's financial institutions have been relatively isolated from the global financial system, the initial impact from the global financial crisis were not so severe. Consumption in most developed countries has, however, shrunk in the aftermath of the global financial crisis. As a result, China's export industries suffered from sluggish overseas demand, meaning that the current global economic crisis clearly caused some serious damage to the Chinese economy.

Amidst an unprecedented and distressing economic situation, China's policymakers quickly came up with stimulus packages of RMB 4 trillion for two years. This stimulus package effectively boosted the Chinese economy, achieving the target growth rate of 8% in 2009. It means that in the midst of a severe global economic recession, only China was able to achieve meaningful economic growth.

On the other hand, the US which was once touted as the world's main growth engine, has stagnated. The unemployment rate has recently hit double digits and the status of dollar has been weakened as trust in the dollar as the key currency has been undermined.

In addition, a rising China is becoming one of the world's most influential buyers at the market for oil and other natural resources. With cash flowing from huge foreign exchange reserves, China is in a comfortable position to buy oil and other strategically important resources in the world. The other example of the rise of China can be seen in the automobile industry. China was expected to produce over 13 million vehicles in 2009, becoming the world's largest automobile producer and consumer. In the automobile industry, some Chinese automakers are eager to acquire brands and technologies from foreign firms as the domestic auto industry struggles to pro-

duce high-end vehicles and break into markets of developed nations.

At this point of time, it seems uncertain what the world's political and economic landscape would look like after the end of the current global economic crisis. It is, however, clearly certain that China would be the only winner in the midst of the

current global economic crisis and that China will join the ranks of the great powers in world politics and economy.

As illustrated above, the main purpose of these books is to analyze the rise of China and to seek out the various implications for Korea-China relations. All 22 topics were selected in order to elicit detailed strategies for Korea facing various circumstances related to the rise of China.

To give some examples, Korean policymakers are recommended to maintain stable relations with China in a consistent and predictable way. Also, it will be critically important to seek a balance between Korea's relations with the US and China in the future. With respect to economic relations, Korea should not be reluctant to explore China's potentially immense domestic market and to expand the exchange between the two countries. However, Korean policymakers must urgently find ways to reverse the current overdependency of the Korean economy upon China.

In conclusion, more efforts should be made to improve bilateral relations between Korea and China, politically and economically because China is fast emerging from the status of a regional power to become one of the world's powerhouses.



## Korea's Overseas Direct Investment in Latin America: Its Performance and Challenges

Kisu Kwon, Jin-O Kim, and Hee-Chae Ko  
(In Korean)

Latin America has recently been receiving attention as a new market for investment as a result of the region's economic growth, and for its importance as the treasure house of natural resources. The multinational corporations of advanced economies including the United States, EU, and Japan, and corporations from emerging economies like China and India are increasing their investment to take advantage of the "Latin America Opportunity." The investments of multinational corporations are diversifying from simple assembly production of electrical and electronic equipments, textile, and automobile to IT services and bio-energy. Also, investment goals are changing from simply securing the market to gaining a firm foothold in the global market, and/or R&D investment.

Considering the strategic importance of the Latin American economy, the pace of investment by Korean companies in the region has been accelerating since 2004. Aside from early entrants to the market like LG and Samsung, noticeable investments are also coming from large firms like POSCO, Hyundai Motors, Dongkuk Steel, and CJ. As a result, Korea recorded \$1.6 billion worth of investment in 2008, the highest figure ever.

Despite the increasing volume of investment, investments from the Korean companies, except for certain major companies, are still marginal compared to the strategic significance of the Latin American market. Especially, the investments from the small and medium-sized enterprises (SMEs) are weak.

Comprehensive surveys and research on the Korean companies' investment in Latin America is nonexistent, due to absence of recognition on the region's economic importance and lack of interest. This paper analyses the operations and achievements of Korean companies in the market and managerial difficulties they encounter. Based on the results of the analysis, this

paper suggests strategies for market entry for companies and strategies for government support. The following is the summary of the results from the survey and review of the literature.

First, Korea's investment into Latin America is mainly led by large corporations. For instance, SMEs have found it easier to enter markets in Mexico and the Central American countries. On the other hand, the investment of SMEs in South America, including Brazil, is nearly nonexistent.

Second, in terms of forms of investment, there is insufficient diversity in the region. Although Korea's investment in Latin America has been increasing since the mid 1990s, the investment style has not yet diverged from early forms of the investments of developed countries. Whereas firms from developed countries are diversifying the market entry through joint ventures, strategic alliances, and cooperation among SMEs, independent investments dominate Korea's investment pattern in the region.

Third, like exports, Korea's investments in Latin America show tipping effect by industry and by country. Industry wise, investments from Korea are concentrated in manufacturing and mining industries. Especially, the investments within manufacturing industry are centered on communication equipments and textile and clothing sector. Also, the investments in manufacturing are limited to Mexico, Central America, and Brazil.

Fourth, the investment strategies of Korea show significant differences by subregion and by country. First, the efficiency-seeking strategy to enter the US market indirectly is noticeable in Mexico and Central America. On the other hand, the market-seeking strategy targeting the region's domestic market is apparent in South America, especially in Brazil.

Fifth, Korean companies use investment information on the region from firms already operating in the region or from their own surveys. On the other hand, the utilization rate for information provided by the government and public institutions is very low.

Sixth, the companies entering the Latin American market suffer from difficulty in raising funds due to underdeveloped financial system and high investment risks of the recipient country. It turns out that about 60% of the entering companies rely on their own capital when funds are needed.

Seventh, most of the competition encountered by Korean companies in the local market are Chinese companies. Competition that was predominantly advanced companies from Europe, the United States and Japan has changed in composition to Chinese firms, and competition with whom is unavoidable.

Eighth, the Korean companies have absolute comparative advantages in technology and quality compared to the local companies; but comparative disadvantages in fund raising, promotion and advertisement, and sales and marketing.

Ninth, the labor management in the local area has been pointed out as one of obstacles in management together with increase in the labor and production costs. Other serious problems include difficulty of hiring skilled workers during the recruiting process, language and communication barrier, and the burden of extra expenses other than salary. In terms of wage

management, excessive social security costs, high rate of wage increase, excessive benefits and subsidies are pointed out as serious obstacles. Also, in terms of labor management, lack of sense of responsibility, lack of loyalty and a sense of belonging to the company, complacent work attitudes are pointed out as problems.

Tenth, the Korean companies face many difficulties when procuring materials on-site. Because many Latin American countries emphasize the local procurement, certain portion of the materials must be purchased locally. However, because the regional manufacturing standard is low, the quality of the materials is low and deadlines are often missed.

Eleventh, the infrastructure in general is poor in Latin America. Even Chile, where political and economic institutions are most advanced among Latin American countries, suffers from severe electricity shortage.

Twelfth, the public security situation is unstable in general and thefts and robberies are frequent during transportation and distribution. Lack of public order and security has been pointed out as the most serious problem.



Thirteenth, Korean companies investing in Latin America use the problem settlement support and consulting services the most among other services provided by the government and public institutions. In particular, Korean companies

operating in Brazil favor consulting services the most.

Fourteenth, Korean companies are generally satisfied with services provided by the government and public institutions. 48% of the respondents in the survey were satisfied with the services. However, the rate of dissatisfaction was very high in Central America, where many Korean SMEs are in operation.

Fifteenth, in order to expand the investment in Latin America Korean companies made a diverse array of demands to the Korean government. The most frequently demanded was the expansion of financial support for investment from financial institutions such as the Korea Export-Import Bank and the Korea Development Bank. The second most frequent were government efforts to enhance the national image in the region concerned. Number three was strengthening government-level support for investor security. Other major demands were sim-

plified and expeditious visa issue, the speedy conclusion of free trade agreements (FTA) with Latin American countries, the establishment of constant consultation channel to settle problems from investment with the local government, the expansion of financial support from international organizations like the Inter-American Development Bank.

Sixteenth, there have been diverse demands to the local governments by the Korean companies. The demand most frequently made was improvement of customs procedures. The second involved the expansion of financial support. Third was improvement of distribution and infrastructure of each Latin American country. Other demands to the local governments include the increase of flight services, the conclusion of free trade agreements with Korea, the offer of investment incentives, the convenience concerning the visa issue and issuance of long-term visa.

### Proposals for strategies

Based on the above analysis, this paper suggests six corporate investment strategies: (1) differentiation strategy based on market characteristics; (2) investment in R&D and expansion of technical partnership; (3) expansion of strategic alliance with the Latin American National Oil Companies(NOCs); (4) the utilization of Latin American FTA networks; (5) strengthening CSR activities by companies (6) large corporation investment accompanied by SMEs or strengthening investments of the SMEs.

Here are more specific investment strategies for companies entering Latin American markets. The most important is to set up an investment strategy based on the understanding of local market characteristics. Based on the survey results from firms operating in the region, this paper identified promising markets for each industry by categorizing the Latin American market into a manufacturing base, a sales channel, a roundabout export base, and a foothold in the region.

Second, enlarging investment in R&D and technical cooperation is needed to respond immediately to a spectrum of demands from customers and to increase diversity of investment in form. This paper suggests investment in R&D and technical partnership expansion strategy based on the case of Brazil, Korea's most representative manufacturing investment base in Latin America.

Third, in order to enter the Latin American energy market, it is important to cooperate with the National Oil Companies (NOCs), which holds absolute status among oil-producing countries. In particular, it is important to grasp the diverse partnership needs before working together with NOCs.

Fourth, establishing an investment strategy utilizing the Latin America FTA network is necessary for effective market targeting. The case of Eagon Industrial is presented for this purpose. Eagon succeeded investing in Chile by employing the said FTA network.

Fifth, it is crucial to expand the firm's corporate social responsibility (CSR) activities to

improve not only the corporate image but also the national image. Joint cooperation with the Inter-American Development Bank (IDB) should actively be sought when conducting CSR.

Sixth, the investment of SMEs should be expanded. The alternatives could be strategic alliance with firms already operating in the market or entering together with contractors.

#### Five plans for government support

This paper suggests five plans to increase the government level support: (1) the systematic management of the investment status of each industry; (2) the establishment of investment infrastructure; (3) the increase of FTA negotiations with Latin American countries; (4) the improvement of Korea's national image and recognition; (5) and the increase in financial support.

First, the Korean government should publish a 'white paper on the status of the investment in Latin America by Korean firms' to prepare for the expansion and intensification of economic integration in the region such as launching of the Union of South American Nations (UNASUR). The white paper should be utilized to make provisions for industries in which Korean firms are expected to be negatively impacted and to use as the preliminary data for finding new business.

Second, investment infrastructure is needed, such as institutional infrastructure (guarantee of investment agreement, double tax avoidance agreement), negotiation channel to settle investment problems with local governments, a special distribution base and an industrial complex, stimulating investment of SMEs by establishing the Korea-Brazil industrial technology cooperation center, creation of a human resource network to engage the second generation of Korean immigrants, and dispatching security agents to alleviate security problems.

Third, the Latin America FTA frontier must be expanded by concluding FTAs with Latin American countries currently in impasse. Most of all, the government should make a breakthrough in FTAs with MERCOSUR and Mexico by pushing through projects such as the trade facilitation agreement and a system of payments in local currencies. Also, the government must conclude FTA negotiations with Peru and Colombia and initiate FTA negotiations with Central American countries in which Korea's SMEs are operating. Especially, the FTA negotiations with the Central American countries where the least developed countries are concentrated demand a new negotiation strategy focusing on development and cooperation.

Fourth, boosting Korea's national image is important in the region. In order to do so, specific programs that should be considered include the 'visit Korea' program for local workers at Korean firms, and connecting Korean firms' CSR activities with the Korean government's official development aid (ODA) programs.

Lastly, the companies operating in the regional markets need to be financially supported by expanding funds, for instance, by utilizing the Inter-American Development Bank loans.

## Natural Resource Potential of New Emerging Regions and Its Implications for Korea: Russia, Central Asia, Latin America, Africa

Young Ho Park *et al.*  
(In Korean)



International commodity prices, including oil prices that experienced a dramatic fall during global recession, are on the rise again. Oil prices have reached their highest for this year while copper and nickel have also rallied strongly compared to the beginning of this year. The rise of commodity prices comes amid speculation that excessive liquidity and increasing demand from China and other countries are driving the commodity market. Although it is difficult to predict the price changes in the commodity market given the complex nature of the factors causing price fluctuations; the dominant view of most analysts, from their comprehensive price forecasts, seems to be that the market is headed upward. Expectations of early recovery from global recession have already prevailed, and it is regarded as a fact that higher oil price will consequently follow.

As a country lack in natural resources, South Korea has repeatedly faced difficulties when commodity prices became unstable. Sole reliance on importing for acquisition of strategic resources provides Korea with no guarantees whatsoever for securing those resources. Therefore, it would be more practical for us to heighten our own level of development via direct investment measures.

This research intends to provide solutions for stable resource acquisition and thus our strategic approaches toward this end have been elicited by studying 4 regions: Russia, Central Asia, Latin America and Africa. There have already been many studies concerning overseas resource development since it has emerged as a major and current issue. But, as previously mentioned, this paper takes on a local perspective, to find strategies tailored to each region, something that was not emphasized in past studies. The region-specific strategy here can also be regarded as 'customized' plans that take account of our capabilities and needs of partner countries for cooperation. I hope this paper can provide useful guidance to those in government, corporate

sectors and others who have interest in the field. The local customization strategy drawn from this paper can be summarized as below.

The following 4 methods of the local customization are suggested for Russian region. First, implement cross investment strategy for utilizing both upper/down streams. This can be carried out in the context of Korean companies purchasing a Russian energy company (or parent company) while the Korean government can allow Russia to acquire stocks from domestic gas energy firms. Also, for the sake of strengthening cooperative ties involving South Korea-North Korea-Russia, South Korea can participate together with Russia in North Korea's energy infrastructure industry, thereby establishing shared rights either for construction and management in the LNG areas of the Far East or for gas fields in the East Siberia. The second is active participation in the energy industry through M&A. There has been a boom recently for domestic and overseas M&A activities as the country is implementing restructuring plans for its energy industry. It is also recommended that Koreans invest in Russian energy companies through equity purchase or strategic alliance because stocks of many Russian energy firms are underpriced due to falling international commodities prices. Third, it is important to examine the political power dynamics in Russia and direction for possible impact on restructuring policies for their energy industry. The key players in Korean-Russian collaboration are the federal government, state-owned companies, and local government and so forth.

Therefore, the first step would be to accurately understand what goes on in the energy industry and its power structure by carefully observing policies laid out by the central government and state-owned firms following, and the local governments that have jurisdiction over legal, institutional permits in the development regions; then seeking ways to take cooperation among those parties to a higher level. Furthermore, detailed analysis on the prospect of the Russian energy industry is necessary. The fourth method is to involve another country's participation in line with our cooperative activities with Russia. As Russia is expanding its resource development efforts in the CIS region as well as in Africa, there is a need to find ways to make joint investments concerning the development plan. For example, a consortium can be set up with Gazprom for developing coal mines in the Central Asia or Korea can secure a shared role in Algeria's LNG technology development project.

With respect to resource development in Central Asia, we have suggested the following four region-tailored strategy plans. First is resource development strategy in accordance with the country's power structure and its petrochemical industry. As Central Asian countries like Kazakhstan have given much focus to industry diversification by fostering non-petroleum industries, we need to ponder upon potential for cooperation in the region to constantly pursue co-investment strategy, together with plans for resource development and entry into energy industries in the region. The range of opportunities include power plant construction, oil field investment, nuclear power plant and uranium coal mine construction, coal processing plants, and petrochemical plants as well as simultaneous entry into resource development projects. Second, building cooperative resource infrastructure by way of financial collaboration can be actively

contemplated. Central Asian countries in the midst of global recession are keenly aware of South Korean capacities in recovering from the foreign exchange crisis and they are actively asking South Korea's advice on improving their own financial systems. From the Korean perspective, there are no major technical difficulties to be negotiated, and this can be an effective way of doing business with regard to transferring our experience and contributing to the development of Central Asian financial industries. In the long run, we can assume that the growing needs for financial cooperation among Central Asian nations can help us lead such financial collaboration and convert it naturally into energy-related collaboration. Third suggestion is a go-around-entry strategy via Turkey. Based on the country's historical relation with other countries in Central Asia, Turkey has been expanding their political/economic influence over the region, and we can form a strategic alliance with Turkish firms to facilitate our entry. Lastly, Koreans can contemplate diplomatic policies with Central Asian countries concerning natural resources. Unlike Latin American nations or African states, the political structure of Central Asian nations is not given to frequent regime change, meaning cooperative relations with them could be sustained for an extensive time period. There is a need to heighten the status of diplomatic meetings, from deputy secretary-level to prime minister-level, which was the case during the "Korea-Central Asia Cooperative Forum". Furthermore, there is a need to improve the degree of exchange/communication with the new leaders in the states, where political prospects of ruling parties have not yet to be confirmed.

In case of Latin America, we have suggested a plan comprising of five region-tailored strategies. First is an entry strategy through specialization in specific role in public and private sectors depending on the investment environment in Latin America. The region contains some countries engaged in "resource nationalism" in which political/economic risks can be very high. In this respect, for entry into less risky countries, private companies should take a role in establishing specialization structures while public companies (or government) that have a comparatively higher capabilities for dealing with the political/economic risk should take the lead in the high-risk countries. Second is by forming a strategic alliance for cooperation with the Ibero-American region. The need to build a strategically cooperative relation with National Oil Company (NOC) that attained an exclusive position among resource-rich countries in the region precedes



any other process. Also, we need to actively devise a way to establish tri-party cooperative systems (South Korea-Iberoamerica-Latin America) by teaming up with firms such as RespolYPF, Galp and other Ibero-American firms beforehand, as they have linguistic/cultural/historical ties with Latin America along with much experience in entering into domestic market. By doing so, Korea can aggressively pursue the regional resource development market and then can think of entering other actively-invested areas like Africa or other alternative regions. Third is through international organizations (IO) in Latin America. Korea should first consider going into Latin American resource development market via the Inter-American Development Bank (IDB), in which South Korea has been a member since 2005.

More specific measures include ΔUsing credit for financing resource development projects, Δpromoting coal mining technology collaboration through the IDB trust fund, Δpartnership with IBD in corporate social responsibility activities. Furthermore, it is necessary to join OLADE, the only organization for energy cooperation in Latin America, which can provide a channel in which to create opportunities for entry and conditions for investment. The fourth can be executed as a combination of industry coordination promotion strategies. Brazil has emerged as one of the world's top 10 petroleum-exporting countries and it has nurtured top-notch technology in ocean-oil field extraction. On the other hand, South Korea is arguably the world's best in both ship-building and marine engineering industries, which can serve Brazil's needs. A win-win cooperative model should be established between the two countries through high-tech coordination between the oil and shipbuilding industries. A fifth suggestion involves developing a resource-development FTA model. When promoting FTA among MERCOSUR, Peru, Columbia and other resource-rich countries in Latin America, a new FTA cooperative model must be developed. We especially need to benchmark the case of China, who included clearly-outlined details for resource development in the FTA agreements.

For Africa, we have also present a plan consisting of five suggestions. First of all, since Africa is divided into 53 nations with different investment potentials and conditions, we need to consider each country's unique characteristics in formulating entry strategy. This research provides suggestions for entry based on African resource-development market characteristics, divided into 3 categories. A second suggestion involves promotion of joint-entry (resource-industry linked). Joint-entry strategy can be deemed a conceptually wise model in terms of increasing resource development investment opportunities by combining together Korea's competitive industries and SOC, and also ease the complicated overseas expansion process for related industries. However, the validity of such a model is questionable since it poses some problems upon close examination. Effective operation of a joint-entry strategies depend on the level of detailed preparation and internal mediation among participant firms, and also on the government's active role as a coordinator. However, limitations found in joint-entry strategies are mostly of a pragmatic nature involved in its implementation, rather than conceptual ones concerning entry strategy itself. Our third suggestion is that there is a need to strengthen dip-

lomatic ties with resource-rich countries. If we take into account of the fact that most African countries are ruled by authoritarian regimes, a more effective method of acquiring resources would rely on diplomatic bargaining power of the Korean government. This research has designated 4 plus 3 nations as a target for top-priority resource diplomacy. The fourth suggestion is an infrastructure-building scheme through resource coordination for development collaboration, such as new village construction. Since general entry methods merely aimed at acquiring resources is both short-lived and is subject to unexpected errors that may result, we need to include official development assistance (ODA) in the resource cooperative efforts between South Korea and Africa. The growth of development collaboration can lead to economic cooperation and partnership and will eventually benefit Korea by stabilizing the acquisition process for energy resources. Fifth, we also need to establish a base for entry by providing assistance for development studies. Also, to overcome entrance difficulties due to variable costs and risks, entering companies will require government subsidies. One of the examples is development studies business. In regard to development studies, government can provide meaningful financial support to private firms launching businesses in the newly developing nations, to supplement the firms' initial costs and risks. In addition, our companies are faced with several problems when trying to launch businesses in the African resource development market, and so, assistance for development studies could perform a kind of leverage to facilitate their business activities. Trust funds from African Development Bank (AfDB) are mainly used for examining business potential (F/S) of its big-scale development plan and technology collaboration projects, and thus, it is urgent that we find ways to utilize trust funds from AfDB to discover new businesses and to link EDCF business plans with the implementation of such activities.

The research above has presented several strategies tailored to each region – from the perspective of a regional studies expert, but there may be other plans that are region-specific and thus customized. And suggestions from this paper are inevitably subject to necessary modifications with respect to changes in environments of the related countries. For instance, joint-entry plan mentioned here has the potential risk of contract breach if there is a regime change like in Nigeria. In this aspect, this research focuses more on regional characteristics to devise customized strategies rather than that of general or comprehensive plans for resource development overseas, and therefore the paper necessarily contains some logical weaknesses in refuting basic assumptions. For example, in the case of region-tailored plans for Russia and Central Asia, it is difficult to evoke a general consensus among experts because both business potentials and problems are inherent within the regions, and furthermore, it is not easy to establish a consistent policy due to an array of preferences and opposing opinions that become mingled into a complex mix. Nevertheless, in order to establish a realistic and pragmatic policy measure, we need to differentiate each plan according to characteristics of the respective regions and environmental factors, since such an approach seems more meaningful. For this reason, we should leave opposing arguments about relevant strategies and problems as major issues to be solved in the future.

### 3 RESEARCH ON CURRENT ISSUES

#### World Economy Update

- 09-01 Evaluation of the 14th Session of the Conference of the Parties to the United Nations Framework Convention on Climate Change and the outlook for the future
- 09-02 The major tasks as pertains to the G-20 structure and the direction of Korea's response
- 09-03 The current state of climate change funds for developing countries and the implications thereof
- 09-04 The current state of Korea's use of special tariff preferences as part of FTAs and the implications thereof
- 09-05 International outlook for the North Korean economy in 2009
- 09-06 The state of industrial commodity agreements contained in Japanese EPAs and the implications thereof
- 09-07 China's attempts to internationalize the Yuan and the implications thereof
- 09-08 The 2009 London G-20 Summit and future tasks
- 09-09 Characteristics of the third term of the Kim Jong-il regime and evaluation of the 2009 budget
- 09-10 Causes of the recent fluctuations in Korea's trade balance and the implications thereof
- 09-11 Trends in Korea's trade with China and the implications thereof
- 09-12 UN sanctions imposed on North Korea and the future outlook thereof
- 09-13 Trends in major countries' FDI regulations vis-à-vis strategic industries and the implications thereof
- 09-14 Strategy for Korea-Central Asia economic cooperation and the future tasks related thereto
- 09-15 The significance of Chiang Mai Initiative Multilateralization (CMIM) and the implications thereof
- 09-16 The sanctions imposed by the international community on North Korea following its 2nd nuclear test and Korea's response strategy
- 09-17 Identifying an appropriate level in terms of the won/dollar exchange rate and the future outlook thereof
- 09-18 The economic countermeasures implemented by the Japanese government in the aftermath of the global economic crisis and the implications thereof
- 09-19 The factors behind the recent increase in oil prices and its impact on the macro-level economy
- 09-20 Korea-EU service trade and the implications of a Korea-EU FTA
- 09-21 Assessment of Japan's mid-term greenhouse gas mitigation policies and measures and the impli-

cations thereof

- 09-22 The outlook for international financial markets in the second half of 2009
- 09-23 The outlook for the international trade environment in the second half of 2009
- 09-24 Economic trends within major countries in the second half of 2009 and outlook therefore
- 09-25 The current state of the Korea-ASEAN FTA commodity agreement two years after its implementation and the implications thereof
- 09-26 The implications of Europe's flexicurity policy in terms of the issue of Korea's irregular workers
- 09-27 Analysis of Chinese enterprises' trade practices with North Korea along the North Korea-China border
- 09-28 U.S.-China strategy, the nature of their economic dialogue and the implications thereof
- 09-29 International comparison of the low birth rate – with a special focus on the labor market
- 09-30 The current state of major countries' monetary policy in the era of low interest rates
- 09-31 Assessment of the economic policy of the new DPJ government in Japan and the future outlook thereof
- 09-32 The main contents and economic effects of the Korea-India CEPA
- 09-33 Results of the 3rd G-20 Summit and the implications thereof
- 09-34 Assessment of the Chinese economy over the last 60 years and outlook for the future
- 09-35 Securing of the financial resources needed to cope with climate change in developing countries: discussions and the implications thereof
- 09-36 Trends in the development of the Duman River area and the policy implications thereof
- 09-37 The significance of North Korea's currency reform and the implications thereof
- 09-38 Deflation within the Japanese economy and the outlook therefore
- 09-39 Trends in terms of WTO discussions as relates to TBT and the implications thereof
- 09-40 Outlook for the global economy in 2010: international financial markets
- 09-41 Outlook for the global economy in 2010: international trade environment
- 09-42 Outlook for the global economy in 2010: global regional economy

#### Regional Economic Focus

- 09-01 The main contents of the China-Peru FTA and the implications thereof
- 09-02 The main contents of China's economic stimulus package and the implications thereof
- 09-03 The current state of the management of the European Globalization Adjustment Fund and the implications thereof
- 09-04 The implications of the Russia-Ukraine gas dispute

09-05 The main contents of China's ten industrial promotion policies and the implications thereof

09-06 The prospect for the spread of the East European financial crisis and the implications thereof

09-07 The acceleration of Japanese enterprises' employment adjustment efforts and changes in its policy responses

09-08 Recent trends in the U.S. housing market and the implications thereof

09-09 The Middle Eastern economy amidst the global crisis: impact and responses

09-10 Contents of the Malaysian economic stimulus package and evaluation thereof

09-11 EU measures adopted in the aftermath of the East European financial crisis and the outlook for the future

09-12 China's decision to prohibit Coca Cola's acquisition of a Chinese beverage company and the implications thereof

09-13 The impact of the global crisis on the South African economy and the outlook for the future

09-14 Political instability in Thailand and its response to the global economic crisis

09-15 The changes in China's foreign investment policy and the implications thereof

09-16 Recent trends within the Indian economy and its response to the global economic crisis

09-17 Analysis of the election of South African President Jacob Zuma and his economic policies

09-18 The UPA's seizure of power in India and future prospects

09-19 Economic trends in Kazakhstan and Uzbekistan during the first quarter and the outlook therefore

09-20 The asset due diligence policies of large-sized U.S. banks: background, results and future prospects

09-21 Recent trends within the Chinese economy and the future outlook therefore

09-22 Economic trends in Russia during the first quarter of the year and outlook for the Russian economy in 2009

09-23 Regional economic growth in China: changing trends

09-24 The background to the inauguration of a new South American bank and future prospects

09-25 The results of the European Parliament election and future outlook therefore

09-26 Economic results in Indonesia during the last five years and the implications thereof

09-27 Korea-Poland economic cooperation: an opportunity to bring about economic recovery in both countries

09-28 The main contents of the China-Hong Kong CEPA and the implications thereof: with a special focus on the service sector negotiations

09-29 The development of the medical tourism industry in Singapore and the implications thereof

09-30 The establishment of a Russia-Kazakhstan-Belorussia Customs Union and the outlook for joining the WTO

09-31 The budgetary proposals of the new government in India and its main policies

09-32 The global economic crisis and the current state of the implementation of the MDG

09-33 The current state of China's anti-dumping policies and the implications thereof

09-34 Assessment of the GCC market as a potential FTA target

09-35 The CO2 emission regulations of the EU and the implications thereof

09-36 The main contents of the "Buy China" campaign and Korean enterprises' strategy to enter the Chinese procurement market

09-37 The problem of European youth unemployment and the implications thereof

09-38 Assessment of Ireland's economic crisis and the implications thereof

09-39 The rapid increase in Indian FDI and the implications thereof

09-40 Main direction of U.S. financial regulation reform and the future outlook thereof

09-41 Evaluation of the Korea-Chile FTA after five years: With a special focus on the trade of agricultural products

09-42 The current state of MERCOSUR's implementation of a new local currency payment system and future prospects

09-43 The recovery of major economies as viewed through GDP expenses and the implications thereof

09-44 The contents of the China-SEAN FTA and the implications thereof

09-45 The current state of foreign agricultural investment in Central Asia and the implications thereof

09-46 Assessment of the German election and the direction of future policy

09-47 Ireland's ratification of the EU Treaty of Lisbon and the significance thereof

09-48 Trends in the acquisition of foreign enterprises by Sovereign Wealth Funds (SWF) in the Middle East and the characteristics thereof

09-49 The financial deficits faced by major European countries and the prospect for financial soundness

09-50 Analysis of the competitiveness of the French economy amidst the current global economic recession and the implications thereof

09-51 The current state of China's implementation of green growth policies and the implications thereof

09-52 Direction of the economic policy of Indonesia's Yudhoyono government during its second term

09-53 The support structure for the development of solar energy system put in place by the Japanese government and the implications thereof

09-54 Economic trends in Iran amidst economic sanctions and the development of Iran-China relations

09-55 Trends in global immigration and remittance in the aftermath of the financial crisis

## 4 PERIODICAL PUBLICATIONS

### Journal of East Asian Economic Integration (JAEI)

Vol. 1 / 2009

| Title  | Author                            |
|--|-----------------------------------|
| Greenhouse Gases Emissions Reduction and WTO Trade Rules Diversification of Commercial Banks in OECD Countries | Younghwan Kim                     |
| Decomposing the Cyclical Movements in the Real Price of Equipment  | Kwang Hwan Kim                    |
| Out-of-sample Forecasting Performance of Won / Dollar Exchange Rate Return Volatility Model                    | Ho-Jin Lee                        |
| Structural Break in the Real Exchange Rates: The Asian Crisis  | Hoe Sang Chung and Young-Yong Kim |
| Modeling and Forecasting the Volatility of Eastern European Emerging Markets                                   | Sang Hoon Kang and Seong-Min Yoon |
| The Effect of Board Characteristics on Firm Performance in Japan   | Oona Cha and Taehun Jung          |

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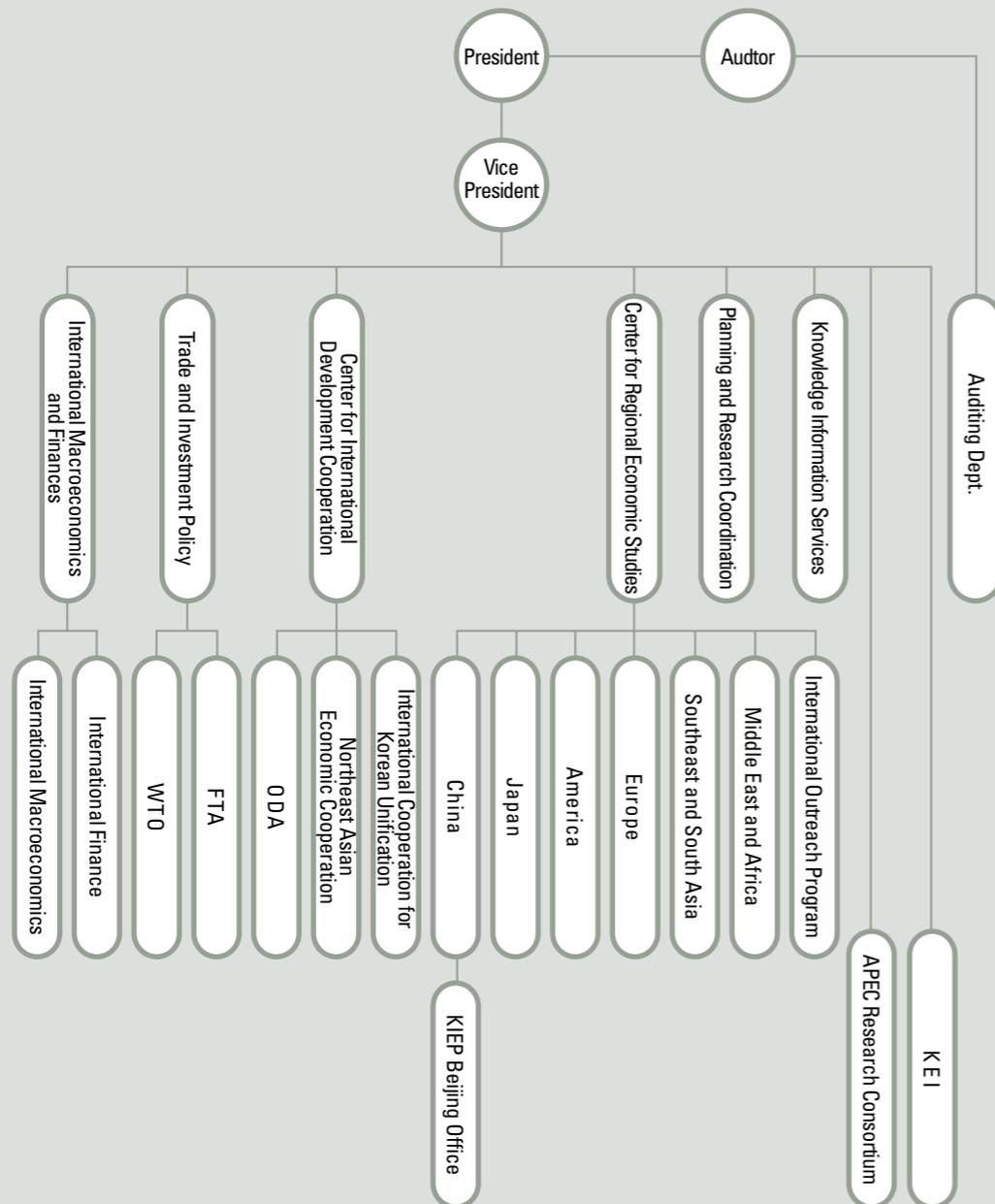
| Title  | Author                        |
|--|-------------------------------|
| What is Driving Global Imbalances?: The Global Savings Glut Hypothesis Reexamined                                      | Jai-Won Ryou                  |
| The Role of Cross-border Mergers and Acquisitions in Foreign Direct Investment: Evidence from the Chinese Stock Market | Yu Hua An                     |
| A Dynamic Approach to the FDI-Environment Nexus: The Case of China and India   | Jungho Baek and Won W. Koo    |
| Forecasting Performance of Asymmetric GARCH Stock Market Volatility Models   | Ho-Jin Lee                    |
| Decomposition of Domestic and International Linkages of the Korean Financial Markets                                   | Taiki Lee and Byoung Hark Yoo |
| Impacts of Service Offshoring on Productivity and Employment: Evidence from Korea                                      | Soonchan Park                 |
| Productivity(TFP) and Competitiveness of Listed Firms in China   | Moosup Jung and Min-Chan Pyo  |
| Dynamic Analysis on Domestic Demand Expansion and Labor Market Reform in China   | Dae-Won OH                    |

## III APPENDIX

*KIEP  
Annual Report  
2009*



● Organizational Structure



● Main Research Focus

| Department  | Research Focus  |
|---|---|
| <b>International Macroeconomics and Finances</b>        | <ul style="list-style-type: none"> <li>• Current issues related to international macroeconomics and finance</li> <li>• Regional financial and currency cooperation</li> <li>• Exchange rate and foreign exchange policy</li> <li>• Liberalization of financial services and opening of financial industry</li> <li>• Reorganization of international financial system</li> <li>• Strategy for the development of Korea as an international financial center</li> <li>• South-North Korean financial and currency cooperation</li> </ul>   |
| <b>Trade and Investment Policy</b>                      | <ul style="list-style-type: none"> <li>• Korean trade policy               <ul style="list-style-type: none"> <li>- Export, import, and trade structure</li> <li>- FDI/ODI</li> </ul> </li> <li>• WTO               <ul style="list-style-type: none"> <li>- Establishment of an international trade order at the WTO and at multilateral levels</li> <li>- The impact of DDA negotiations and negotiation strategy</li> <li>- Tasks related to the secretariat of the DDA Research Center</li> </ul> </li> <li>• FTA               <ul style="list-style-type: none"> <li>- Trends in regional trade agreements and the impact thereof</li> <li>- Strategy for the implementation of regional trade agreements</li> </ul> </li> <li>• APEC               <ul style="list-style-type: none"> <li>- Asia-Pacific economic cooperation and APEC related research</li> <li>- Provision of assistance to the secretariat of the National Center for APEC Studies in the conduct of its work duties</li> </ul> </li> </ul> |
| <b>Center for Regional Economic Studies</b>             | <ul style="list-style-type: none"> <li>• Study of regional economic trends: the United States, Japan, China and Russia, the EU, Central and Eastern Europe, Central and South America, Southeast Asia, the Middle East and Africa, and Oceania</li> <li>• The current state of the economic relations of the major regions and their economic relations with Korea</li> <li>• Regional economic policy and institutions, and economic integration</li> <li>• ASEM-related studies</li> <li>• Management of Korea's Official Pool of International Economists (KOPIE)</li> <li>• Training of regional specialists and DB project</li> </ul>  |
| <b>Center for International Development Cooperation</b> | <ul style="list-style-type: none"> <li>• Research on East Asian economic cooperation</li> <li>• Organization of an East Asian economic cooperation specialist network and the management thereof</li> <li>• Invitation of specialists in East Asian economic cooperation and implementation of joint research</li> <li>• Research on an East Asian business hub</li> <li>• North Korea's foreign economic relations</li> <li>• Study on the international cooperation required as part of preparations for unification</li> <li>• Policy studies related to international development cooperation and international aid strategy</li> <li>• Evaluation of ODA projects and international development consulting</li> </ul>  |
| <b>Knowledge Information Services</b>                   | <ul style="list-style-type: none"> <li>• Collection and management of information materials</li> <li>• Management of information systems</li> <li>• Publication, distribution and promotion of study results</li> </ul>   |
| <b>Planning and Research Coordination</b>               | <ul style="list-style-type: none"> <li>• Project planning, assessment of research projects, seminars, and research services</li> <li>• Personnel, assignment of work duties, document delivery, security, contracts, and assets management</li> <li>• Budgets, accounting, national assembly, board meetings, regulations, insurances, field trips, and audits</li> </ul>   |

● Staff

| President | Research staff   |             |          | Support staff     |                      |          | Technicians | Total |
|-----------|------------------|-------------|----------|-------------------|----------------------|----------|-------------|-------|
|           | Research fellows | Researchers | Subtotal | Specialized staff | Administrative staff | Subtotal |             |       |
| 1         | 44               | 41          | 85       | 8                 | 9                    | 17       | 16          | 119   |

| Position   | Name            | Main research field  |
|--|-----------------|--|
| Vice President   | Yeo-Cheon Jeong | Russian & Eastern European Economies (Germany, München University)   |
| Director of Planning and Research Coordination               | Jin Kyo Suh     | Agricultural & Resource Economics (US, University of Maryland at College Park)                               |
| Director of International Macroeconomics and Finances        | Yonghyup Oh     | International Economics (France, Ecole des Hautes Etudes en Sciences Sociales)                               |
| Director of Trade and Investment Policy                      | June Dong Kim   | Trade in Services, FDI (US, University of Chicago)   |
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| Director of Center for International Development Cooperation | Myung Chul Cho  | North Korean Economy, International Cooperation for Korean Unification (North Korea, Kim Il Sung University) |
| Director of Knowledge Information Services                   | Yunsil Kim      | Library and Information Science (Korea, Yonsei University)   |
| Senior Research Fellows                                      | Chang Kyu Lee   | Chinese Economy (US, University of Pittsburgh)   |
|  | Chang-Jae Lee   | Northeast Asian Economic Cooperation, East Asian Economic Integration (France, University of Paris I)        |
|  | Deok Ryong Yoon | International Economics, North Korea Economics (Germany, Kiel University)                                    |
|  | Sangkyom Kim    | APEC, International Economics (US, University of Pennsylvania)   |
|  | Jonghwa Cho     | International Finance (US, Washington State University)  |
|  | Nakgyoon Choi   | Trade Policies, Tariffs, Empirical Studies (US, University of Texas at Austin)                               |
| Research Fellows   | Yul Kwon        | Southeast Asian Economy, Development Cooperation (Korea, Sogang University)                                  |
|  | Yang-Hee Kim    | Japanese Economy (Japan, Tokyo University)   |
|  | Bokyeong Park   | Middle Eastern and African Economy (Korea, Seoul National University)  |
|  | Jae-Young Lee   | Russian & CIS Economies and Management (Russia, Moscow State University)                                     |
| Research Fellows   | Wolla Park      | Chinese Economy (China, Chinese Academy of Social Science)   |
|  | Sung Chun Jung  | Japanese Economy, Environment Economics (Japan, Hitotsubashi University)                                     |
|  | Chul Chung      | International Trade (US, University of Michigan)   |
|  | Hyung-Gon Jeong | North Korean Economy, Transition Economy, Northeast Asian Cooperation (Germany, University of Cologne)       |
|  | Mansoo Jee      | Chinese Economy (Korea, Seoul National University)   |

|                            |  |  |
|----------------------------|--|--|
| Assistant Research Fellows | Yoo-Duk Kang   | European economies, Trade policy (France, Institut d'Etudes Politiques de Paris)       |
|                            | Kisu Kwon  | Latin America Economy, MERCOSUR (Korea, Hankuk University of Foreign Studies)          |
|                            | Taeyoon Kim  | Regional Economics, Agricultural and Applied Economics (US, Oklahoma State University) |
|                            | HanSung Kim  | International Trade, Microeconomics (US, University of Washington)                     |
|                            | Kyu Pan Kim  | Japan Economy (Japan, Keio University)   |
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|                            | Young Ho Park  | Africa and ODA (Korea, Hankuk University of Foreign Studies)                           |
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|                            | Kitae Sohn   | Human Capital, Immigration (US, State University of New York at Albany)                |
|                            | Yeongkwan Song   | Service, FTA (US, University of Wisconsin-Madison)                                     |
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|                            | Yong Joon Jang   | FTA (US, Indiana University Bloomington)   |
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|                            | Meejin Cho   | FTA, IPR, RoO, Competition Policy (US, Brown University)                               |
|                            | Choong-Jae Cho   | India Economy, Service Economy (Korea, Hankuk University of Foreign Studies)           |
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| In Huh                     | Econometrics, Financial market (US, University of Rochester)                                     |  |
| Hea-Jung Hyun              | FDI, Service, Competition Policy (US, Indiana University)  |  |
| Dong-Eun Rhee              | Monetary Policy, Financial Economics, International Finance (US, Indiana University Bloomington) |  |
| Invited Research Fellows   | Bak Soo Kim  | EU Research, Trade and Development (France, University of Grenoble)                    |
|                            | Chang-In Yoon  | Electronic Commerce, WTO, Environmental Trade Policies (Korea, Hanyang University)     |
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 **KIEP** Korea Institute for International  
Economic Policy

108 Yangjaedaero, Seocho-Gu, Seoul 137-747, Korea  
Tel: 822) 3460-1142 / FAX: 822) 3460-1144  
URL: <http://www.kiep.go.kr>



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**KOREA INSTITUTE FOR  
INTERNATIONAL ECONOMIC POLICY**  
108 Yangjaedaero, Seocho-gu, Seoul 137-747, Korea  
Tel: (822)3460-1142 Fax: (822)3460-1144  
E-mail: [publications@kiep.go.kr](mailto:publications@kiep.go.kr)  
ULR: <http://www.kiep.go.kr>

Editorial Designed by JaeYong Lee