

# The Position of South Korea in East Asian Regionalization in the 21<sup>ST</sup> Century

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## I. Introduction

Regional economic integration shows distinctive characteristics in East Asia<sup>1</sup> as it is a mainly bottom-up, market-driven phenomenon. Although there is no well-developed, European style institutional integration here, the intensity of *de facto* integration (regionalization) is high. This study focuses on the analysis of East Asian regionalization from the perspective of one country – South Korea (hereinafter Korea). If economic integration in East Asia is presented mainly through the prism of rivalry between China and Japan or the leading role of ASEAN, then the importance of Korea in the process of East Asian regionalization may be unjustifiably neglected. This study is therefore aimed at placing Korea in the development of regionalization in East Asia in the 21<sup>st</sup> century, and in particular at answering the question of how Korea's position has evolved in intra-regional trade, foreign direct investment and regional value chains in East Asia after the year 2000.

In order to realize this goal, the study is divided

into parts. The first section covers intra-regional trade developments with a focus on the role of Korea in it. The second section is devoted to flows of foreign direct investments, and the third section concerns the role Korea plays in regional production networks. The final part of the study is a section of conclusions and recommendations for Korean foreign economic policy. In order to achieve the main goal of the study, we used methods based mainly on statistical data analysis and inference, as well as an analytical-descriptive method.

## II. The Role of Korea in Shaping Intra-Regional Trade Developments

The East Asian market is increasingly important for Korean exporters and importers. In 2000-2018, exports of Korea to the region increased from 58.9 to 297.5 USD billion, which meant an increase in the share of East Asian countries in total exports of Korea from 34.2 to 49.2%. At the same time, the value of imports

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<sup>1</sup> East Asia consists of the ten ASEAN member states, China, Japan, and South Korea.

increased from 60.4 to 222.7 USD billion, and the share from 37.6 to 41.6%. These changes meant a change of trade deficit with East Asia (-1.5 USD billion in 2000) into a surplus (+74.8 USD billion in 2018); thus, in general, it should be assessed positively.

The data in Table 1 illustrates significant

changes in the geographic structure of Korea's trade with partners from East Asia. It shows a high concentration only in selected markets, which is not a favorable situation. First of all, the concentration of exports on the Chinese market is growing (an increase from 31.4 to 54.4%) and the importance of the Japanese market is decreasing (from 34.8 to 10.3%).

**Table 1. Korea's Main Trade Partners in East Asia in 2000, 2010 and 2018, %**

		2000	2010	2018
China	Exports	31.4%	57.7%	54.4%
	Imports	21.2%	39.7%	48.0%
Japan	Exports	34.8%	13.9%	10.3%
	Imports	52.7%	35.7%	24.6%
ASEAN	Exports	33.9%	28.4%	35.3%
	Imports	26.1%	24.6%	27.4%

Source: Own calculations based on UNCTAD (2019).

At the same time, the significance of the ASEAN market is gradually increasing (from 33.9 to 35.3%), with Vietnam being the largest market here (16.3% share in total Korean exports to East Asia in 2018), to a lesser extent Singapore and the Philippines (4% each). On the import side, analogous changes can be noted, i.e., an increase in the importance of China, which became the dominant supply market (48%), a deep decrease in Japan's share (down to 24.6%) and a stable but slow increase in ASEAN share. Changes in geographical directions of trade flows affected the effects of that cooperation. Korea increases its trade surplus with China (from 5.7 to 54.9 USD billion), with ASEAN (from 4.2 to 44.1 USD billion), including Vietnam (from 1.4 to 28.8 USD billion) and the Philippines (from 1.5 to 8.4 USD billion). The only country with which Korea has a large and lasting trade deficit is Japan. In the years 2000-2018, the negative trade balance increased from 11.4 to 36.1 USD billion in 2010 and then dropped to 24.3 USD billion in 2018.

Analyzing the share of individual countries in the internal flows of East Asia, it is worth emphasizing the growing role of Korea in exports and weakening in imports. In export, the share of China almost doubled (from 15.7 to 30.1%), and the share of Japan decreased by almost a half (from 29 to 16.3%). With the decline in the share of ASEAN (from 42 to 38.2%), the increase of Korea's importance from 13.2 to 15.4% should be assessed as a considerable success. On the import side, the situation was different, as Korea's share fell from 14.1 to 11.6%, with China's high growth (from 21.1 to 36.8%), relatively stable share of ASEAN (around 44-45%) and a significant drop in Japan (from 30.3 to 16.7%).

As can be observed in Table 2, Korea was of varying importance for individual East Asian countries both as a sales and supply market. What is important and worth emphasizing is the fact that Korea holds the leading positions in the ranking for countries with the highest share in internal turnover in East Asia. For China,

Korea is the first sales market (an increase compared to 2000) and the second supply market. In turn, for Japan, it remains the second market for both sales and supply. For Vietnam and the Philippines, Korea is the second and third sales

market, respectively, while the third supply market for Vietnam and fourth for the Philippines. For other countries, Korea usually takes places in the first half of the ranking of trading partners.

**Table 2. The Rank of Korea as a Trade Partner for East Asian Countries**

	Export		Import	
	2000	2018	2000	2018
Brunei Darussalam	6	6	2	3
Cambodia	5	5	8	5
Indonesia	3	5	3	4
Laos	6	5	7	5
Malaysia	3	6	4	5
Myanmar	4	8	6	4
Philippines	2	2	4	4
Singapore	6	5	5	5
Thailand	5	5	5	8
Viet Nam	3	2	6	3
China	2	1	2	2
Japan	2	2	2	2

Source: Own calculations based on UNCTAD (2019).

From the product structure of trade in East Asia, it should be emphasized that Korea is both an exporter and an importer of selected groups of commodities only. In exports, the SITC7 group (Machinery and transport equipment) dominates with an increasing share, while other groups (SITC5, 6 and 8) also possess quite significant shares. All of these groups were responsible for as much as 89.3% of total exports to East Asia in 2018. In import, the concentration is not much less, because, for the same four groups of goods, it was 86.2%. Again, such intense concentration should be treated as a threat to economic stability under conditions of high openness of the country.

### III. Korea as an Intra-Regional Direct Investor

Korean corporations are increasingly active

foreign investors. According to Korea Eximbank data, in the years 2000-2018, the value of outgoing investments gradually increased from 5.4 to 49.8 USD billion (Korea Eximbank, 2019). Along with the overall investment growth, investments in East Asian countries also increased. In 2000-2018, the annual value of Korean FDI in the region increased from 1.4 to 12.2 USD billion. If we look at the importance of East Asia in the total outflows of Korean investments, approximately a third of Korean investments were located in East Asia.

Similarly to the case of trade, Korean investors concentrate only on a limited number of East Asian markets. The primary recipient of investments was China, and to a much lesser extent, Singapore and Vietnam, followed by Japan and Indonesia. The remaining countries had a rather small share in the inflowing FDI from Korea. In 2000, the share of China as a recipient of Korean FDIs was 55.5%, and by 2005 it had even

risen to 75.7%. This indicated the absolute domination of this geographical direction in the investment activity of Korean corporations. Since 2006, the country's share has been gradually decreasing, to reach 39% in 2018. These changes should be assessed positively as they confirm the desire to diversify the geographical involvement of Korean corporations. In the analyzed period, Vietnam was a relatively important market, which initially had a modest share (5% in 2000) and then gradually increased to 25.9% in 2018. In the case of Singapore, more substantial investments took place in 2003 (9.2% of total FDI in East Asia), and later, since 2011 (12.4%), they remained relatively high (12.9% in 2018). In turn, Japan was not the most important recipient of Korean FDIs. In 2004 its share amounted to 14.2% but

later fell and fluctuated within the range of 3.3-10.7%. For the sectoral structure of Korean investments, we can observe a certain regularity. In countries at a lower development level and with lower production costs, investments are mainly located in *Manufacturing* (China, Vietnam, Indonesia), while in more developed countries (Japan, Singapore), are directed to service sectors such as *Wholesale and retail trade, Business facilities management and business support services; Rental and leasing activities, Real estate activities or Financial and insurance activities*.

While assessing the role of Korea in the flows of direct investments in the region, we can use data from Table 3.

**Table 3. Share of Korea, China, Japan and ASEAN in Intra-East Asia FDI in Stock and Out Stock**

	In stock		Out stock	
	2001	2012	2001	2012
<b>Korea</b>	9.1%	8.1%	12.1%	13.8%
<b>China</b>	56.5%	33.6%	-	5.5%
<b>Japan</b>	1.4%	3.1%	53.0%	40.0%
<b>ASEAN</b>	33.0%	55.2%	34.9%	40.7%

Source: Own calculations based on UNCTAD (2014).

The share of Korea in the cumulative investment inflow to East Asia was at 9.1% in 2001, and by 2012 it fell to 8.1%. This was a much higher share than in Japan, but much lower than the share of China and ASEAN. It can also be seen that China's share declined sharply, and ASEAN's share grew. This was mainly due to the growing attractiveness of the markets of ASEAN countries, where other partners, including China, are increasingly present.

The geographical structure of the most important regional investors looks different. One can see here the clear dominance of two entities, i.e., Japan and ASEAN. However, while the

share of this first country is falling (from 53 to 40%), the share of ASEAN is increasing (from 34.9 to 40.7%). At the same time, the share of China on this background looks modest, because, in 2012, only 5.5% of the total outflow of FDI within the region was made by Chinese corporations. This signifies that China is more interested in investing in areas other than in East Asia. Against this background, Korea's share should be assessed positively because, firstly, it increased in the analyzed period (from 12.1 to 13.8%), and secondly, it was much larger than Chinese investments.

When analyzing the significance of Korean investments in individual East Asian partner countries, some differences can be noticed. In the case of China, the share of investments from Korea in the total FDI inflow to China from the region showed a considerable variation. From 2000 to 2004 it increased (to 42.4%), to fall to 17.4% in 2013. Since then, Korean investments to China have been growing (30.6% in 2017), while the importance of Japan is declining (27.1 % in 2017) and ASEAN increases (42.3%) (National Bureau of Statistics, 2019). In turn, the Korean market is not particularly attractive for Chinese investors who invest mainly in ASEAN countries. From 2004 to 2017, there was a decrease in the share of Korea, and beyond 2005, when the share once reached 88.7%, until 2017, it fell to 6%. Thus, it can be concluded that the significance of the Korean market for Chinese investors is relatively small. From the point of view of Japan, Korea also does not play a major role as either investor or recipient of investments. Korea's share in the cumulative value of investments that flowed to Japan in 2000 was 0.7%, and by 2018, it increased to 9.7% (JETRO, 2019). It should be remembered that the total inflow of investments to Japan is relatively low. In turn, the value of Japanese investments in East Asia is relatively high, but in Korea, about 10% of Japan's accumulated investments are located. Most investments were directed to ASEAN (58.4% in 2018) and China (31.6%). In the case of investments located in ASEAN, Korea was of relatively little importance. According to ASEANStatsDataPortal, the share of this country in the inflow of all investments from East Asian countries fluctuated in the range of 2.7 (2012) to 11.6% (2010) (ASEAN, 2019). A more important source of capital was the ASEAN countries themselves (often over 40% of inflow), Japan (1/4-1/3 of inflow) and, to a lesser extent, China (9.4-22.8%). Nevertheless,

depending on the country, the importance of Korean investors was different. In the less-developed partners, which did not constitute key markets for Korean investors, the share was relatively low (except for Cambodia, where it reached even 25%, but with low values of investments). However, in those markets where Korean corporations were more willing to invest, the share was slightly higher. For example, in the case of Singapore, it exceeded 15% (2018), and in Vietnam, it exceeded 10% (2018).

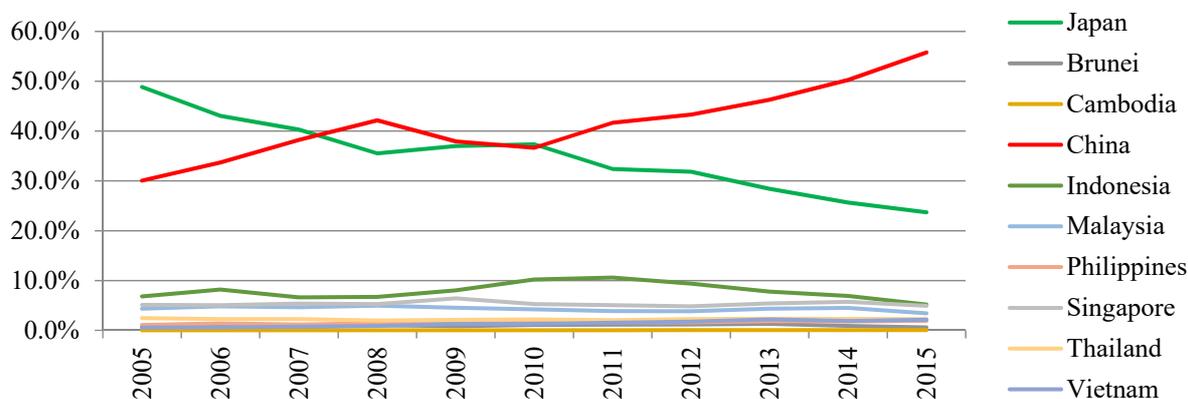
#### IV. Participation of Korea in Regional Production Chains

Korea is an active participant in global and regional production chains. In 2005, the share of foreign value-added (FVA) in the gross export of Korea was 32.7%, while for Japan 10.2%, China 26.3%, and ASEAN 31.4% (OECD, 2019). In subsequent years, this indicator for Korea increased (the maximum value of 42.4% reached in 2011), then decreased to 32.6% in 2015. Still, the remaining East Asian economies show a lower level of indicator (Japan 13.2, China 17.3, and ASEAN 28.9). It can, therefore, be concluded that Korea is more than other countries of the region engaged in international value chains. However, this also means that in conditions of a high degree of openness, which characterizes the Korean economy, it is strongly dependent on the external situation. In the event of disruptions in the value chain, Korea is exposed to high risk, mainly because the share of external sources in gross exports of the most important export groups of Korea is high (OECD, 2017). This situation is unfavorable, mainly when there exists a tendency of conflicts with the most im-

portant suppliers of materials, parts, and components for export production. Thus, diversifi-

cation of sources of supply in value chains becomes increasingly essential. Data illustrating this process are illustrated in Figure 1.

**Figure 1. East Asian Countries as a Source of FVA in Korean Gross Exports, 2005-2015, %**



Source: Own preparations based on OECD (2019).

This confirms the exceptionally high degree of Korea's dependence on a single country as the leading source of import for the country's export production within East Asia. With a high participation rate in global value chains, this situation should be assessed negatively. Although the importance of Japan as a source of imports fell from almost 50% (2005) to 23.7% (2015), China's share increased in the same period, from 30.1 to 55.8%. These two countries accounted for nearly 80% of foreign value added in Korean gross exports in the group of East Asian partners.

When assessing the role of Korea in East Asian production networks, it is worth presenting its significance for individual economies of the region. The OECD data indicate that Korea was the most important source of supply for China (an increase from 30.4% in 2005 to 36.4% in 2015) and Vietnam (18.3% and 18.7% respectively). At the same time, it is worth noting that Korea's significance is falling mainly for Japan (down from 17.2 to 11.6%) and Malaysia (11.7 and 8.8% respectively) (OECD, 2019).

Again, it can be concluded that Korea cooperates more intensively only with selected countries, which can bring excessive exposure for risk.

## V. Conclusions and recommendations

Korea is a medium-sized economy with high economic potential, and these features determine the country's position in the intra-East Asian regionalization. The analysis carried out in the study indicates the most significant changes that took place in the system of intra-regional trade, investment, and production ties in East Asia in 2000-2018, as well as assesses the role Korea plays in it.

First, in the area of trade, Korea increased its importance in East Asian exports, while its importance in import decreased. However, there exists an excessive focus on selected markets. Over 50% of Korean trade with East Asian

countries is realized with China (with a growing tendency). The role of Japan is significantly decreasing in export, while in imports, although decreasing, it is still high. Additionally, a problematic issue for Korea is an excessive concentration on exportation in limited groups of products. A lack of diversity means a larger sensitivity to external factors (positive but also negative ones).

Second, in the area of direct investments, Korea increases its importance as an investor in East Asia, but its share is falling as the destination of investments. Korean corporations focus on selected markets only – mainly China, and to a lesser extent Singapore and Vietnam, as well as on selected sectors (*Manufacturing* in less developed countries and *Services* in more developed countries). On the other hand, the Korean market is of only minor importance for Chinese, Japanese, and ASEAN corporations.

Third, Korea actively participates in global and regional value chains. In comparison with China and Japan, it has higher shares of foreign value-added in its gross exports, which means higher integration in global and regional production networks. However, similarly to trade and investment, Korea reveals excessive dependence on selected partners in East Asia. An evident change of leading partner is noted – China replaces Japan in that role, but those two countries represent nearly 80% of FVA in Korean gross exports. This situation must be a reason for anxiety, as any trade conflict with the partner will bring severe economic consequences for Korean exporters, and ultimately for the Korean economy.

Based on the above analysis, the most problematic issue of Korean economic links with East Asian countries can be identified – a high and excessive degree of concentration in trade,

investment, and production networks. On the one hand, specialization and comparative advantage in the production of only selected products make the country competitive on the international arena, but on the other, these make it more vulnerable to external economic disturbances.

These issues must be taken into account and adequately addressed by the Korean economic policy. Although it is impossible to change the industrial structure of the economy and modify specializations in the short term, a long-term strategy would be helpful. There are several initiatives that can be considered and implemented by policymakers. First, there is a need to build friendly relationships with all possible potential partners in the region and the world. This would create stable conditions for the development of activities over boundaries and diminish the possibilities of conflicts. Second, Korea should look for partners and build coalitions against protectionism. These efforts should take place on all possible levels of cooperation (global, regional, and bilateral). With rising protectionist sentiment worldwide, not only are economic benefits endangered under the conditions of a network economy, but also severe losses can arise. Third, Korea should develop its relations with ASEAN countries, which are promising markets for Korean exporters, importers, as well as investors. This would help to diversify the geographical structure of partner countries. Fourth, Korea should continue to implement its supportive FTA policy, which has already brought positive results. Establishing stable conditions of cooperation with East Asian countries under agreements would create a favorable business climate for Korean enterprises. Fifth, in order to facilitate the functioning of Korean enterprises in the East Asian market, full engagement in RCEP talks should be a priority for the government. It

would be a solution for perhaps excessively complicated economic links (noodle bowl) under numerous FTAs existing in the region, as well as resolving many problems Korean firms are facing (e.g., rules of origins). These recommendations may not be easy to implement but at least should be considered as points of reference for future policymaking. **KIEP**

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