

## South Korea's Economic Security Strategy amid Regional Competition

J. James Kim  
The Asan Institute for Policy Studies

### The Challenge of Economic Statecraft and Protectionism

One of the central challenges facing many firms and governments around the world today is the rise of economic statecraft<sup>1</sup> and protectionism<sup>2</sup> in major markets. There appears to be at least three forces at work. One is the domestic backlash to globalization that has resulted in rising inequality and decline of the middle class. Many countries struggling with these issues appears to have resorted to populism backed by a heavy dose of protectionism.<sup>3</sup> Second is the increasing use of economic statecraft or economic leverage to serve foreign policy objectives.<sup>4</sup> While advanced industrial nations and the United Nations have utilized sanctions to this effect, the type of economic statecraft utilized by China has looked qualitatively different. Through use of both incentives and targeted trade bans, China has tried to cajole and/or punish other nations to behave in certain ways as to further Beijing's policy objectives. For instance, China has restricted export of rare earth minerals to Japan to settle maritime disputes and the Chinese leadership has announced a national boycott against Korean retail imports as a way to punish South Korea for its decision to deploy US Terminal High Altitude Area Defense (THAAD) system in 2016. Finally, the Ukraine conflict shows how military clash or geopolitical tensions can spill over into the area of geoeconomics through a complex mix of international sanctions, domestic regulations, and even consumer-led boycotts.<sup>5</sup> While a potential conflict in Taiwan Strait has yet

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<sup>1</sup> Vinod K. Aggarwal and Andrew W. Reddie. 2021. "Economic Statecraft in the 21<sup>st</sup> Century: Implications for the Future of the Global Trade Regime," *World Trade Review*. 20(2): 137-51; Vinod K. Aggarwal and Andrew W. Reddie, "The New Reality of Economic Statecraft," *GlobalAsia*. 17(4) (December 2022): 8-17.

<sup>2</sup> Sean D. Ehrlich and Christopher Gahagan. 2023. "The Multisided Threat to Free Trade: Protectionism and Fair Trade During Increasing Populism." *Politics and Governance*. 11(1): 223-36; Robert G. Finbow. 2023. "Populist Backlash and Trade Agreements in North America: The Prospects for Progressive Trade." *Politics and Governance*. 11(1): 237-48; Marina Steininger, Erdal Yalcin, and Gabrel Felbermayr, "Economic implications of a protectionist US trade policy," *VOXEU Columns*. November 22, 2017. (<https://cepr.org/voxeu/columns/economic-implications-protectionist-us-trade-policy>). "What America's protectionist turn means for the world," *Economist*. January 9, 2023. (<https://www.economist.com/finance-and-economics/2023/01/09/what-americas-protectionist-turn-means-for-the-world>).

<sup>3</sup> Sarah Engler and David Weisstanner. 2021. "The threat of social decline: income inequality and radical right support," *Journal of European Public Policy*. 28(2): 153-73; Kyung Joon Han. 2016. "Income inequality and voting for the radical right wing parties." *Electoral Studies*. 42: 54-64.

<sup>4</sup> William J. Norris. 2016. *Chinese Economic Statecraft: Commercial Actors, Grand Strategy, and State Control*. Cornell University Press: Ithaca, NY; Matt Ferchen. "Does China's Coercive Economic Statecraft Actually Work?" *USIP*. March 2023. (<https://www.usip.org/publications/2023/03/does-chinas-coercive-economic-statecraft-actually-work>).

<sup>5</sup> Jose Miguel Alonso-Trabanco. "The Geoeconomic Front of the Ukraine War." *Geopolitical Monitor*. March 2022. (<https://www.geopoliticalmonitor.com/the-geoeconomic-front-of-the-ukraine-war/>); "What Ukraine Is Teaching US About Geoeconomics." *IGCC Experts*. June 15, 2022. (<https://ucigcc.org/news/what-ukraine-is-teaching-us-about-geoeconomics/>).

to be realized, there is little doubting the rise in tension between Beijing and Washington, which presents many countries around the world with a quandary.

Since China's opening under Deng Xiaoping in late 1978, countries have benefited from vibrant trade with and investment in China. Formation of trade blocs through the signing of free trade agreements throughout the 90s and the rise of regional integration regimes, such as NAFTA, MERCOSUR, and EU, have ushered in a golden age of trade during 1980s to the first decade of the new millennium. With rising tensions between Washington and Beijing, however, this benefit has now turned into liabilities for many firms and nations around the world. Among the countries trapped between the two geoeconomic and political behemoths in China and the US are countries like South Korea. For South Korea, the strategic competition between China and the United States takes on a special meaning due to the fact that trade accounts for over 80% of its economy (See Tables 1 and 2). If we count Hong Kong as part of China, then South Korea's trade with China and the United States accounts for over 45% of its total trade with the outside world. Only a handful of countries are as dependent on trade for their economic well-being.

**Table 1: South Korea's Top Trade Partners (2020)**

Country	Trade (US\$ Mil)	% of Exports	% of Imports	Overall share (%)
China	132,522	25.3	22.5	25.85
US	74,396	14.9	12.0	14.51
Vietnam	48,543	8.8	8.9	9.47
Hong Kong	30,630	5.8	5.4	5.97
Japan	25,092	4.7	3.9	4.89

Source: WITS

**Table 2: Trade as a Share of GDP (2021)**

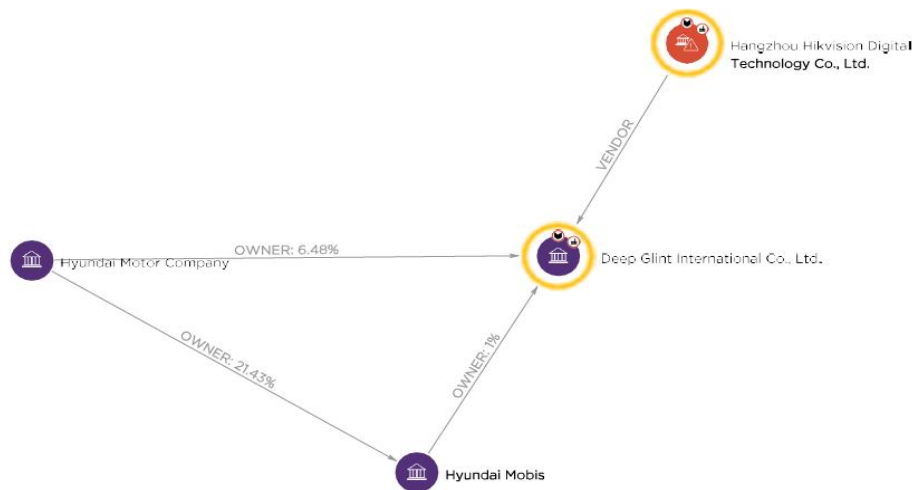
Country	Trade as % of GDP
Australia	40
Japan	37
South Korea	80
Singapore	338

Source: World Bank

What troubles South Korean government and firms is the rise of restrictions on trade with China and the United States. While much of this anti-free trade practices has been informally adopted in China, US regulatory controls have been more systematic. In recent years, the US has implemented a series of export controls and sanctions on various Chinese entities, including state-owned enterprises, government agencies, military organizations, universities, and

individuals.<sup>6</sup> These restrictions are in response to human rights abuses in Xinjiang, efforts to undermine Hong Kong's autonomy, and activities relating to US and UN sanctions against North Korea, Iran, and Venezuela. Certain Chinese military companies face investment related restrictions due to concerns about China's military industrial complex. Executive Order 13974, for instance, prohibits US investors from purchasing or investing in securities of companies on OFAC's Non-SDN Chinese Military Industrial Complex Companies List.<sup>7</sup> A new order, implemented in June 2021, expands the criteria for designation beyond military companies to include companies in the surveillance technology sector.<sup>8</sup> Companies involved in the mistreatment of Uyghur Muslims in Xinjiang and the development or sale of human surveillance technology are at an increased risk of sanctions.<sup>9</sup>

**Figure 1: Case Study of South Korean Firm Level Linkages to Listed Entities in China**



Source: Kharon Clearview

A review of investment practices illustrates the extent of South Korean firm-level exposure to these types of risks. In this example, which utilizes proprietary open source data collected by Kharon, an unnamed South Korean entity is shown to be a major shareholder (through its direct holdings and through its own South Korean subsidiary) accounting for nearly 7.5% of Deep Glint International Co., Ltd., which is listed by the United States for utilizing forced labor in Xinjiang and is also on the Department of Commerce Bureau of Industry and Security's (BIS) military end users list for being a supplier of the Chinese military (See

<sup>6</sup> Priscilla Kim, Edmun Xu, J. James Kim and Hyeonjung Choi. *South Korea and the Global Regulatory Landscape: Managing Risks Associated with Sanctions, Trade Controls, and Supply Chains*. Asan Report. August 2022.

<sup>7</sup> Executive Office of the President, "Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies," Federal Register, November 17, 2020.

<sup>8</sup> "Addressing the Threat from Securities Investments that Finance Certain Companies of the People's Republic of China," U.S. Department of the Treasury, June 3, 2021.

<sup>9</sup> "Global Magnitsky Designations; North Korea Designations; Burma-related Designations; Non- SDN Chinese Military-Industrial Complex Companies (NS-CMIC) List Update," U.S. Department of the Treasury, December 10, 2021.

Figure 1). This entity also happens to be a vendor for another sanctioned Chinese entity named Hangzhou Hikvision Digital Technology Co., Ltd., which is also listed as being a violator of the above two offenses. While partial ownership does not necessarily imply that these South Korean entities are also involved in conspiring with the named Chinese entities in condoning or encouraging forced labor in Xinjiang and/or transferring sensitive technologies to the Chinese military, what this example shows is that if the US federal regulators wish to make these potential violations an issue for these South Korean entities, they will have to do due diligence in examining their relationship with Deep Glint International. What this example illustrates is that the level of exposure to the regulatory risks associated with China-US strategic competition can have serious and significant consequences.

### South Korea's Strategic Approach

Given this to be the case, what is South Korea's strategic approach to its own economic security? One approach to this thinking is illustrated in a framework which covers the strengths, weaknesses, opportunities and threats (SWOT) to the South Korean economy.<sup>10</sup> First, South Korean economy's strength is that it is an export powerhouse for high tech manufacturing. This strength derives from the speed and extent to which South Korean technology firms can scale up its production. South Korean companies are also leaders in research and development, and information and communication technology. World Intellectual Property Organization ranks South Korea fifth in its 2021 Global Innovation Index.<sup>11</sup> With its successful development during the second half of the 20<sup>th</sup> century, South Korea has also elevated itself through cultural exports and promotion of democratic ideals. Finally, out of necessity from having to survive in a rather hostile security environment surrounded by China, Russia and North Korea, it needs to maintain a strong defense industry.

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<sup>10</sup> The framework introduced here is an adaptation of the approach taken by 김양희 “한국형 경제안보전략의 모색과 IPEF.” 주요국제문제분석. IFANS. June 24, 2022.

<sup>11</sup> *Global Innovation Index 2021*. World Intellectual Property Organization.

**Table 3: SWOT Analysis Approach to South Korea's Economic Security**

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Export powerhouse in high-tech manufacturing (i.e., scale)</li> <li>• Strong R&amp;D and ICT</li> <li>• Successful development story</li> <li>• Soft power: democracy and Hallyu</li> <li>• Strong defense industry</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Weakly endowed/lacking resources</li> <li>• Lacks strong basic science and technology</li> <li>• High dependence on global value chain linked to China and the US for core intermediate goods, natural resources, and base technology</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• US-China competition → SK's strategic value ↑</li> <li>• Technological paradigm shift (SK pursuit of advanced economies)</li> <li>• Rise of protectionism creates pockets of preferential trade opportunities for SK industries</li> <li>• Increased defense spending and arms buildup allows SK to pursue stronger national defense</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• US-China → Rise of protectionist blocs</li> <li>• Technological paradigm shift (emerging economy pursuit of SK market)</li> <li>• Diversify away from China and the US for core intermediate goods, natural resources, and base technology</li> <li>• Emergence of more conflict and tension (i.e., North Korea, Russia-Ukraine, Iran-Israel, and US-China)</li> <li>• Choice between US and China / Risk from over or under commitment</li> </ul>

South Korea's weakness is that it lacks natural resources so it depends quite a bit on the global supply chain for primary and intermediate goods as well as base technologies. The problem is especially acute if we consider how much of this dependence rests on South Korea's trade with China and the United States. While South Korea has innovative capacity, it lacks a strong foundation in basic science and technology as evidenced by the number of Nobel Laureates in basic sciences.<sup>12</sup>

The strategic competition between China and the US is a two-sided coin that also presents both opportunities and threats to South Korea's interest. First, the competition can increase South Korea's strategic value for both great powers, where South Korea can stand to gain

<sup>12</sup> <https://www.nobelprize.org/prizes/lists/all-nobel-prizes/>.

from the rise of protectionism that can create pockets of preferential trade opportunities. For instance, companies like Hanwha Solutions has benefited from expanding its solar cell and aeronautics portfolio in the US with preferential tax breaks and subsidies by making a strategic decision to lean in towards the United States and away from China.<sup>13</sup> Finally, rising tension between China and the US also gives South Korea the opportunity to increase its focus on defense spending and arms build-up to pursue a stronger national defense policy which would not have been possible during other times. Again the example here could be Hyundai Rotem and Hanwha Defense, which are winning contracts from countries like Poland.<sup>14</sup> This kind of opportunity would have been possible if Russia was not an immediate threat to NATO members in Eastern Europe during the Ukraine crisis. Both examples illustrate how the changing regulatory environment allows South Korean firms to pursue certain business opportunities that they would not have otherwise if the conditions were different.

Of course, the US-China competition can also threaten established corporate interests that have strong ties to both China and the US. These companies may now have to sever some of those links. If choosing to walk the fine line between China and the US, the risks of over or under commitment are quite real as regulators and politicians in Washington and/or Beijing begin to come down heavily against companies that are exposed to these risks. As a result, the established strongholds of South Korean economy would have to address the weaknesses derived from their high dependence on value chains linked to China and the US by diversifying away from these linkages for natural resources. Looking to new global value chain partnerships with countries like Australia and Canada and regions like South and Southeast Asia as well as Africa could be in the cards. South Korean firms would also have to be more defensively positioned against market challengers from emerging markets. Finally, increased tension makes for a less market friendly environment where threats from new conflict can also have serious economic consequences as we saw from the Ukraine situation.

### **South Korea's Indo-Pacific Strategy**

The South Korean government has been rather slow to adopt and implement a more forward-looking policy to address the economic implications of strategic competition between China and the United States. Part of the reason for this was that the previous Moon Jae-in administration championed a foreign policy that was decidedly more inward looking with a focus on improving inter-Korean relations. The realization of the brewing storm between Beijing and Washington only became apparent at the end of President Moon's term in 2021. South Korea's departure from an inward looking foreign policy only came after the new Yoon Seok-yeol administration was inaugurated in May 2022. South Korea and the United States have had two summits within the past year but the most significant development in economic security came during the first summit a little over a week after Yoon's inauguration. If we look closely at the reading of the joint statement from that meeting, strategic economic and

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<sup>13</sup> [https://www.hanwha.com/en/news\\_and\\_media/stories/sustainability/as-us-opens-door-to-clean-energy-shift-hanwha-steps-through.html](https://www.hanwha.com/en/news_and_media/stories/sustainability/as-us-opens-door-to-clean-energy-shift-hanwha-steps-through.html)

<sup>14</sup> "South Korea and Poland ink \$5.8bn contract for tanks, howitzers." Nikkei. August 28, 2022. (<https://asia.nikkei.com/Politics/International-relations/South-Korea-and-Poland-ink-5.8bn-contract-for-tanks-howitzers>).

technology partnership was identified as a central component of the alliance. Both leaders also emphasized the importance of cooperation in critical and emerging technologies, promotion of supply chain security and resiliency, development of IPEF, and ROK-US-Japan trilateral cooperation. Some months after the meeting, Seoul announced its own Indo-Pacific strategy as well.

While many observers in Seoul think that President Yoon was pushed into doing this by the US, the government's Indo-Pacific Strategy Report makes a very compelling case about why South Korea cannot simply downplay the recent developments and the significance of this region. With over 70% of total trade and over two-thirds of total South Korean investment going into the Indo-Pacific region, the region is consequential to South Korea's livelihood and economic health.

It looks as though South Korea has begun its paradigm shift, but it is much too early to assess the government policy performance. So far, we have seen South Korea acknowledge the importance of economic security and made it a central pillar of its own Indo-Pacific strategy, which was just announced in December. The government has moved firmly to establish a new Center for Economic Security and IPEF in the Ministry of Foreign Affairs.<sup>15</sup> Ministry of Economy and Finance is also working in this space with the National Assembly to propose a new Basic Act on Supply Chain Stabilization (in October 2022), which establishes a special committee on supply chain under the presidential office and mandates each relevant ministries to create an early warning mechanism for threats to South Korea's supply chain in critical sectors.<sup>16</sup>

The Ministry of Trade, Industry and Energy (MOTIE) has been working with the battery and semiconductor industries since July last year to strengthen their supply chain through diversification, R&D, and subsidies.<sup>17</sup> MOTIE is also working with the Prime Minister's Office to design plans and implement policy actions to promote and protect strategic industries – some of this effort is part of an ongoing program which South Korea has already implemented since 2007 – the law to protect outflow of strategic sectors and key technologies were last amended in 2007. Clearly some updating is needed here but the idea of protecting these key sectors predates the heightened tension between the US and China.

Most of these developments, however, are relatively recent and they have only occurred within the last few months. So fair assessment about the performance of these policies will likely come in the months and years ahead. Of course, the policy trajectory and rate of adaptation for South Korea can be affected by changes in domestic politics and/or international relations. For instance, South Korea has a general election in April of next year. Part of the reason for the delayed passage of the legislations like the Basic Act on Supply Chain is because the opposition party currently holds the majority in the National Assembly

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<sup>15</sup> “경제안보외교 강화를 위한 체제 정비.” Press Release. ROK Ministry of Foreign Affairs. January 16, 2022. ([https://www.mofa.go.kr/www/brd/m\\_4080/view.do?seq=372010&page=1](https://www.mofa.go.kr/www/brd/m_4080/view.do?seq=372010&page=1)).

<sup>16</sup> “경제안보를 위한 공급망 안정화 지원 기본법 법안 발의.” Press Release. ROK Ministry of Economy and Finance. October 17, 2022. (<https://www.korea.kr/briefing/pressReleaseView.do?newsId=156531084#pressRelease>).

<sup>17</sup> “제 3 차 인도태평양경제프레임워크(IPEF) 민관전략회의 개최.” Press Release. ROK Ministry of Trade, Industry and Energy.” March 26, 2023. ([http://www.motie.go.kr/motie/ne/presse/press2/bbs/bbsView.do?bbs\\_cd\\_n=81&bbs\\_seq\\_n=166886](http://www.motie.go.kr/motie/ne/presse/press2/bbs/bbsView.do?bbs_cd_n=81&bbs_seq_n=166886)).

and they are resisting the government's desire to get the legislative change that it needs to push through its policies. Of course, the legislative gridlock can be broken if President Yoon is able to get a favorable outcome in next year's April election. This also means that meaningful reforms *before* the election to address these concerns are not likely.

Instead, we can hope for some new developments on the diplomatic front that can open-up new possibilities. For instance, we have seen some promising developments between Korea and Japan on some complex history related issues recently and depending on how the two sides move forward, we may see the emergence of new areas of opportunities. There are other high level meetings scheduled throughout the year like the G7 in May and G20 in September. Geopolitical shocks can certainly also play a catalyzing role as Ukraine was for many countries. Some potential areas of concerns in looking ahead could be Iran or even Taiwan. Finally, slow accumulation of knowledge and information through various meetings and dialogues could help South Korea reformulate its thinking on economic security.

## Conclusion

South Korea faces significant hurdles as it looks to navigate the economic terrain between two major regional powers at odds with one another. The situation is unlikely to change between China and the United States given the relative strategic interests of these two countries and domestic political trends within each of these countries. While South Korea is a treaty bound ally of the US with nearly 30,000 active-duty US military personnel based in South Korea, China is South Korea's largest trade partner. The problem is also compounded by the fact that many strong South Korean business interests are tied to both China and the US. While the new administration in Seoul has worked diligently over the past year to build stronger ties with the United States and Japan, it is unclear what Seoul's position would be in response to pressure from Beijing. For now, South Korea appears poised to push ahead with its Indo-Pacific Strategy and strengthening ties with the United States and other likeminded nations.

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