



 KCS Country Risk & Threat Advisory

**Intelligence Risk Briefing: The Republic of Korea**  
21 November 2011

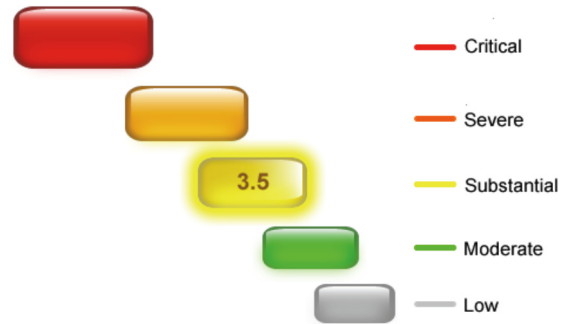
# Intelligence Risk Briefing: The Republic of Korea



**Country:** The Republic of Korea  
**Population:** 48,875,000 (2010 Census)  
**Source:** World Bank, World Development Indicators

## The Republic of Korea has a Critical risk/threat rating of 3.5

- 5 Critical** Incidents that pose significant risk to the life, health, security and safety to travellers.
- 4 Severe** Incidents that pose significant danger or disruption.
- 3 Substantial** Incidents that pose localised danger.
- 2 Moderate** Incidents that may cause disruption: public demonstrations, airport, airline delays, etc.
- 1 Low** Informational based notification such as a political event, public holiday or public event.



### **Korea's economic miracle despite on-going state of war**

As the so-called (economic) “Miracle of the Han River”, South Korea has long drawn the interest of international investors. South Korea (or simply, Korea) is widely seen as a major economic power and one of the wealthiest countries in Asia. The country's economy is highly developed, ranked among the four largest in Asia and 13th largest in the world. South Korea is the world's largest shipbuilder, the world's fifth largest automobile producer, the world's largest LCD and plasma display maker and, among other achievements, is the world's leading memory chip producer.

South Korea had one of the world's fastest growing economies from the early 1960s to the late 1990s, and during the last decade the country remained one of the fastest growing developed economies along with other Asian Tigers: Hong Kong, Singapore, and Taiwan. International trade, an orientation towards exports and foreign investment lie at the heart of the Korean growth and development model. In 2010 South Korea was the sixth largest exporter and tenth largest importer in the world, helping the country achieve its US\$1 trillion dollar gross domestic product (GDP) and a per capita income of US\$28,000.

Without doubt, these are impressive economic achievements which, due to Korea's high-income country status, ridicule the fact that this East Asian nation still tends to be referred to as an emerging market in the Western investment community. However, the fact that South Koreans live in the shadow of the chronic threat of violence due to the unresolved conflict with North Korea, tends to draw comparison with many of the emerging market environments in KCS' on-going reporting series. As is well known, Korea's civil war of 1950-53 ended in a ceasefire but no formal peace treaty, and although full scale hostilities have not been reignited since that time, the two countries remain technically in a state of war.

The demarcation line separating the two Koreas, at the 38th Parallel, is presently one of the most militarised border zones in the world, reminiscent of other longstanding unresolved inter-state conflicts, including those in Kashmir (India-Pakistan), Nagorno-Karabakh (Armenia-Azerbaijan) and Israel-Palestine. Independent observers who have recently accessed the (paradoxically sounding) Demilitarised Zone (DMZ) that has divided the North from the South since the 1953 armistice, speak of American and South Korean troops building bomb shelters, amid razor wire and minefields.

### **Was Korea on the brink of war in spring 2010?**

Investment promotion agencies, however, tend to reassure investors that the resumption of hostilities is unlikely, given the long-standing American-South Korean alliance, the presence of some 28,500 US troops in South Korea and the fact that any attack on the South by the North would in effect equate to an attack on the United States. Yet security specialists tend to speak of Korea as arguably the world's largest geopolitical risk, citing the fact that incidents of belligerence continue to spur tension along the 38th Parallel. In this context, very few people outside of a narrow group of intelligence officials knew how close (or far) the two Koreas were from a resumption of their conflict following the North's alleged sinking of the South Korean naval vessel, the Cheonan, which killed 46 South Korean servicemen in March 2010. The incident drew wide international attention and strong American condemnation of the North.

Were the two Korea's on the brink of war in spring 2010 and are investors at greater risk in the Korean frozen conflict environment in comparison to the island of Mindanao, in the Philippines, for example, where armed groups have waged an insurgency against the government in an attempt to establish an independent Muslim state, and where 57 people were killed by members of a powerful provincial clan in November 2009?

There are no simple answers to such questions. There is little doubt, however, that such incidents result in South Korea suffering perpetual damage to its credit rating and, bearing in mind the Asian Financial Crisis of 1997, the North's belligerence during times of such deep military crises has adverse effects on the Korea's financial markets.

## **Security related incidents continue to rattle the markets**

Security related incidents involving the two Koreas have been on-going for decades, spanning the near six decade long history of the unresolved conflict between the two states. Some of the more brazen and deadly episodes have included:

- January 21, 1968: Thirty-two North Korean commandos were killed by the South's security forces during an attempt to assassinate South Korean President of the time, Park Chung-hee.
- August 15, 1974: Another attempt was made by North Korean agents on President Park while he was delivering a speech, which the president survived but which claimed the life of Park's wife.
- November 29, 1987: The North's agents planted a bomb on a South Korean airliner in a tragic incident in which all 115 people on board the aircraft were killed.
- September 1996: Twenty-four North Korean commandos were killed after a submarine from the North dispatched them on the South Korean coast, prompting a huge manhunt.
- June 15, 1999: A North Korean warship was sunk and 20 sailors were reported killed after a clash broke out along the Yellow Sea border, in what was the first naval battle since the Korean War.
- June 29, 2002: A South Korean ship was sunk and six sailors died in another Yellow Sea clash, while Seoul was co-hosting the football World Cup.
- November 10, 2009: Naval vessels of the two Koreas exchanged fire near the Yellow Sea border and a North Korean patrol boat was reported to have retreated in flames, although no casualties were recorded.
- May 20, 2010: Following the sinking of the South Korean naval corvette, the Cheonan, on March 26, 2010, a report by a multinational investigation team revealed that the vessel was sunk by a torpedo launched from a North Korean submarine. South Korea suspended trade with the North and banned its ships from Seoul's waters. Washington backed Seoul with strong rhetoric and US President, Barack Obama, ordered the US military to work closely with South Korea.
- October 29, 2010: North and South Korean troops exchanged fire across their border, heightening tension in the lead up to the G20 Summit and meeting of world leaders in Seoul.
- November 23, 2010: North Korea fired artillery rounds at the South Korean border island of Yeonpyeong, prompting skirmishes with Southern troops and leading to the death of two South Korean marines and two civilians, according to Korean sources

### **Relations between the North and the South have dipped to new lows**

There is little sign that tension is abating on the Korean Peninsula at the time of present writing. Indeed, most security specialists suggest that relations between Seoul and Pyongyang have fallen to their lowest point for many years since last year's incidents, namely the international crisis resulting due to the sinking of the Cheonan and shelling of a South Korean military installation on Yeonpyeong Island. The two sides have continued to trade artillery fire in recent months amid continued sabre rattling from the North and investments into new defensive weapons by the South, including Israeli-made Delilah missiles.

Security officials in the South refer to such measures as "proactive deterrence", insisting that a future South Korean response would no longer be proportionate, but rather punitive enough to dissuade the Kim Jong-il regime in Pyongyang from making further attacks. Security specialists suggest that developments are becoming less predictable and are fraught with greater danger, given that Seoul's stance towards the North is hardening in light of the latter's recent escalation of tensions, which experts describe as "Pyongyang's efforts to extract concessions from the South."

### **Seoul and Pyongyang appear set for dangerous tit-for-tat escalation**

The government of President Lee Myung-bak in South Korea, which has been criticised for its cautious response to the Cheonan and Yeonpyeong Island incidents, and which faces elections in 2012, appears ready to unleash a far more punishing response to any further provocation from the North, say experts. The fact that Seoul is now less likely to back down amid any further spiking of tension from Pyongyang could set the scene for a highly unpredictable and dangerous tit-for-tat escalation. While some members of the South Korean security establishment speak of a future incident as an opportunity that would allow the two Koreas to restore a working level of deterrence, the current geostrategic manoeuvring being played out on the Korean Peninsula cannot be taken lightly. It represents a high-risk strategy from the standpoint of all stakeholders.

### **North Korean hit squads sent to kill South Korean Defence Minister**

In August of this year, the South Korean military returned fire after North Korean artillery shells fell in waters near Yeonpyeong Island, located about 110 km west of Seoul. South Korean forces continue to maintain a high state of vigilance at the time of present writing. These incidents took place against the backdrop of reports that the Seoul authorities were searching for an assassination squad assigned by North Korea to kill the South Korean defence minister, Kim Kwan-jin. North Korea has threatened to execute the South Korean defence minister, Kim Kwan-jin, a former army general who came to office shortly after the Yeonpyeong Island shelling and called for a swift and powerful retaliation against North Korean provocations.

### **Large-scale corruption scandals follow Korean presidents**

While the lingering state of the geopolitical risk overshadowing Korea's impressive economic and investment indicators is set to remain, the country has never quite managed to deal with governance fallout stemming from the cornerstone of the Korean growth model: the strong ties between politics and big business.

Although one often tends to view Korea as a far less corrupt jurisdiction than some of its East Asian neighbours, including high corrupt category states such as Indonesia and the Philippines, large-scale corruption scandals have undermined the legitimacy of virtually each and every one of the country's presidential administrations ever since the inception of the Korean Republic in 1948. Supporters of the Korean growth model tend to argue that in this case top-level governance abuse has not tended to undermine the tempo of the country's economic miracle. Even during the global financial crisis of 2008-09, Korea was one of the few major global economies that managed to avoid recession and keep unemployment at very low rates (3.6% in 2009), the argument goes.

### **Former-Korean president was sentenced to death on corruption charges**

That being said, for a country with such close ties to the United States and significance to the global economy, it is extremely worrying to reflect that two former Korean presidents, Chun Doo-Whan and Roh Tae-Woo, were convicted having been found guilty of corruption. Chun and Roh were accused of raising slush funds of US\$890 million and US\$654 million and of receiving US\$273 million and US\$396 million in bribery, respectively. In August 1996, Chun was sentenced to death while Roh received 22 and-a-half years in prison, although both men later received presidential pardons. Both men, in effect, fell victim to (former-) President Kim Young-sam's anti-corruption drive following his election in 1992. Kim made a show of implicating hundreds, if not thousands, of government and military officials allegedly involved in one form of corruption or another.

### **While another accepted bribes from multiple corporate groups**

However, Kim's own credentials as an anti-corruption Tsar were soon to transpire into "the emperor with no clothes", when Kim's son, Kim Hyun-chul, was convicted of having accepted illicit payments from the Hanbo Group, the corporate conglomerate whose financial troubles in 1997 signalled the start of the Asian Financial Crisis. Later, it was to be revealed that among other abuses of power - President Kim himself was already receiving donations from Hanbo in 1992 - he had accepted bribes from the Kia group and that businessmen had to extend huge sums "merely for the honour of dining with the president at his Blue House, much less than gaining favours."

### **Current Korean president engulfed in corruption scandal from day one**

Korea supporters tend to argue that all this was "back in the 90s" and that the Asian Financial Crisis of 1997 has, to some degree, disciplined the elite. Korea corruption watchdogs, however, point to the fact that a major corruption scandal engulfed the government of current Korean president, Lee Myung-bak (elected in 2007) early on in his presidency and call for improved governance standards.

In May 2008, Lee's intelligence chief and his top anticorruption aide were accused of receiving bribes from Samsung, Korea's largest conglomerate and leading multinational. KCS has reported in a number of previous writings as to the numerous sets of corruption allegations that tend to follow the commercial activities of Germany's electronics giant, Siemens, a company with numerous investments in many of the world's most challenging emerging markets. Samsung is, in this context, "the Siemens of South Korea", with one corruption scandal after another likewise tending to follow the company.

Just prior to the charges being brought against Lee's aforementioned top officials, Samsung's Chairman, Lee Kun-hee, was indicted on charges of tax evasion and breach of trust. Samsung's Lee was accused by Seoul's Special Counsel, Cho Joon-wong, of hiding billions of dollars in secret stock accounts and illegally transferring company assets to his son and heir. Cho cited numerous structural problems at Samsung, including the allegedly illicit transfer of management control and the lack of transparency, while accusing Chairman Lee of hiding up to 4.5 trillion won (US\$4.54 billion) in stock accounts held by Samsung executives and evading at least 112.8 billion won in taxes on the profits from those accounts.

Interestingly enough, the indictment against Chairman Lee came literally hours after President Lee appealed for foreign investment in South Korea's "struggling economy" while on a visit to the United States. President Lee's key message to the investor community on that occasion was that he would introduce international standards into the country's businesses environment.

### **Corruption levels keeping pace with Korea's economic miracle**

Although it is somewhat of a euphemism to refer to the Korean economy as "struggling", taking into the account the recent economic doom and gloom in the United States and troubles in the Eurozone, the challenge confronting Korea's current President Lee in introducing international standards into the country's business environment remains a daunting one. Referring to governance abuses (which still linger strong in the context of Korean economic management) during a speech earlier in 2011, Lee described how "the entire nation is rotten", in a similar stab at corporate corruption which his predecessors have all likewise exhibited.

Yet also like his predecessors, President Lee, a former-top business executive at Hyundai Engineering and Construction and ex-mayor of the city of Seoul, has been continually dogged by allegations about both his as well as some of his top aides' ethical standards. Lee's frank outburst earlier in the year appeared to be a response to pressure from both parliamentary and civil society forces, which are said to be frustrated that corruption levels in Korea have not fallen nearly as fast as economic indicators have climbed. Korean sources report, for example, that the number of officials found to have "broken the public-service ethics code" (i.e. involved in alleged corruption cases) almost doubled between 2008 and 2010.

### **Leaders of Korean chaebol corporate conglomerates attacked publically**

Much of the frustration has been directed at Korea's chaebol, the family-controlled corporate conglomerates which have for decades been the backbone of the Miracle of the Han River. The frustration is not unfounded. The fact that Samsung's aforementioned Chairman Lee was indicted on charges of tax evasion in 2008 but was pardoned in 2009 creates the impression that Korea's big business leaders are above the law.

Conglomerates such as Samsung, Hyundai and LG account for more than 70% of Korea's exports, equating to half of the country's GDP. Samsung accounts for 14% of Korea's stock market value, although it accounted for as much as 30% not so long ago. Korea's chaebol, which have always been linked to Seoul's political higher echelons and benefited from various forms of state subsidies allowing them to grow into highly profitable corporate giants, are now coming under increasing pressure to clean up their act.

In a similar manner to public attacks by Russian legislators against Russia's infamous oligarchs, chaebol bashing is becoming a favourite pastime in the Korean parliament and in the press. Like Russia's 'robber barons' of the reckless 90s decade, Korean newspaper editorials liken the chaebol to 'unfettered predators' robbing ordinary people of their livelihood, while in parliament lawmakers call them beasts. While in many ways Russian oligarchs are an unfair comparison to Korea's chaebol, given the development gap between a country with the world's most sophisticated electronic infrastructure and one with as many domestic ailments as present day Russia, such pressures at least partially explain President Lee's recent public attacks against Korea's privileged classes. In wake of Korea's own recent bout of Arab Spring, when activists chartered 'buses of hope' to travel to the southern port city of Busan in solidarity with a female labour activist protesting against layoffs at a shipyard owned by the Hanjin conglomerate, Lee has been forced to react.

### **Chaebol pressured into making mass public donations**

Lee, himself very much a product of Korea's chaebol-dominated economy, has recently withdrawn a promise to cut taxes to the conglomerates and has urged the chaebol to "win respect back from the people by doing more to help the poor." In Russia, Venezuela and numerous other countries in KCS' reporting series, such comments generally imply a subtle hint to the oligarchs that they should channel back some of the funds which state power bureaucrats helped them generate into areas of public interest deemed necessary by the state.

In Korea, the situation appears to be similar. While the chaebol are well known to have provided 'donations' to Korean presidents for various political objectives, Lee's recent comments have coincided with donations of some US\$930 million by Chung Mong-joon, head of Hyundai Heavy Industries (the world's largest ship builder), to help needy students and job seekers. In a similar development in August of this year, Chung Mong-koo, Chairman of the Hyundai-Kia Automotive Group (one of the world's largest car makers), donated 500 billion won for the advancement of similar causes.

When making the donation, Hyundai-Kia's Chung went on the record stating, "he wanted to give hope to the college students burdened with the plight of academic loans." Four years earlier, in 2007, Chung was convicted of embezzlement but received a suspended sentence after promising to donate 840 billion won by 2013. It is therefore not difficult to put two and two together and conclude not only that Chung's act of philanthropy on behalf of Korea's needy students was part of the wrist slapping measures levied on him by the courts, but also that current President Lee still has a mountain to climb in his stated objectives of introducing international standards into Korean business.

NB Exchange Rate: \$1US = 1139 South Korean Won