



Political Risk Advisory Briefing: South Korea

Grey Area Dynamics Risk Rating for South Korea is 72.19 (High)

Score	Colour	Rating	Description
< 100%		Very High	The assorted threats described are certain to have a derogatory effect.
< 83%		High	The threats are extremely likely to negatively affect the business.
< 66%		Very Possible	There is a strong likelihood of problems arising in this country.
< 49%		Possible	There is a fair chance of problems arising in this country.
< 33%		Low	There is a low likelihood of any threats impacting business.
< 16%		Very Low	There are virtually no impediments to successful business in this country.

Grey Area Dynamics (GADs) are all the risks, weaknesses and threats that have direct and measurable impact on businesses. They are a collective description of behaviours and factors that can at best, disrupt a firm, and at worst, close it down. Relevant to this market, the key division of Grey Area Dynamics is as follows:

	Legal	Illegal
Active	<ul style="list-style-type: none"> • Government policy and nationalism • Overt and disguised ownership • Bureaucracy and local government 	<ul style="list-style-type: none"> • Religious extremism • Terrorism • Civil unrest
Passive	<ul style="list-style-type: none"> • Language & dialects • Media relations • Pressure groups 	<ul style="list-style-type: none"> • Bribery & corruption • Vested interests and cronyism • Patronage and nepotism

The GADs methodology makes the invisible risks, visible, and serves to differentiate between alternative variables in each climate.

For each Grey Area Dynamic, we calculate separate IMPACT, FREQUENCY and LIKELIHOOD grades from 1 – 100%. These scores are based on a combination of over forty years of expert analysis and opinion on the severity of a GAD and its direct/indirect effect on personnel and business operating in a given country. These impacts are reviewed and updated quarterly to maintain their relevance.

The formula of $RISK = IMPACT + FREQUENCY \times LIKELIHOOD$ is then applied, and Standard Deviation employed across all 35 variants, to calculate the mean average GAD risk score (expressed as a percentage).

For a risk assessment to be thorough, it must encompass the potential for a broad array of economic, political, and business situations that might affect a business venture. Evaluations limited just to political issues or financial factors, may be completely misleading. The degree of severity of a risk portfolio will also depend on the origin of the investing entity; for example, European companies often face different risk profiles to American corporations considering the same investment opportunity.

Grey Area Dynamics pose a challenge of diagnosis¹. The key to avoiding problems before they occur or solving them after they have begun to take a toll on performance, lies in their early identification and evaluation. Ignoring the impact of GADs can be a costly business.

Not only does this allow decision-makers to get an immediate idea of the threat level, but also a deeper breakdown of which specific Grey Area Dynamics are in play, their severity and frequency, and how the divisions of legal/illegal, passive/active are weighted. This kind of information offers a substantial degree of clarity over how the GADs can independently affect a client, and how they may intersect with each other to create the threat profile in a given business environment – thereby allowing a client to better refine or prepare their business plan to take account of where the threats are understood to lie.

¹ KCS Group Europe won the European Service Provider of the Year, 1999-2000 at the European Risk Management Awards Magazine International Risk Management for their work on GADs. In 2004, the company won an award for Product of the Year from StrategicRisk.

Introduction

It is fair to say that the newly elected President, Yoon Suk-yeol, has his work cut out for him. Having won the presidency for one five-year term - the norm in South Korea - by just 0.79%, the possibility of him making any meaningful political difference seemed a highly unlikely proposition.

Firstly, from a political perspective, he was and remains an unknown. Secondly, given his win of less than 1%, it was extremely unclear whether his People Power Party (PPP) was going to see any support in the local elections that followed just one month later. Thirdly, as the Democratic Party of Korea (DPK) held - and continues to hold - 300 seats in the National Assembly, his presidency could, effectively, have been over before it started.

Fortunately for him, in stark contrast to his presidential win, Yoon's party managed to take nearly 60% of the votes in local elections, which marks an almost complete reversal of the local elections held in 2018. This spectacular result has given him the room to move and begin to assert his policies in earnest, though the National Assembly could still pose problems where new legislation is required in the near future.

Political

While President Yoon is not known as a political figure, he was the prosecutor involved in the conviction of two former presidents, Lee Myung-bak (bribery) and Park Guen-hye² (bribery and influence peddling). His involvement in these very public prosecutions, as well as having been registered as an independent up until 2021, may have been what President Yoon needed - just enough air of cleanliness to have reached the finishing line. His manifesto policies are certainly aimed to please the people most deeply affected by the last two years of COVID policies and the now rampant inflation facing all countries. This point alone could be *the* reason for the PPP's reversal of fortune in the local elections.

It seems difficult to believe that South Korea did not become a democracy until 1987, when it instituted its constitution modelled closely on that of the US. The main political parties are the People Power Party (PPP), seen as conservative and anti-communism, and the Democratic Party of Korea (DPK) seen as left of centre. However, it should be noted that, unlike Western politicians, in South Korea a politician's loyalty to one side or the other is very fluid in nature,

² The first female president of South Korea.

and it is not unusual to see them changing alliances regularly. Moreover, parties very often change their names and colours, which has been a point of contention between parties (if not the public) when one party ends up sharing a colour with another.

As a rule of thumb, the people are quite weary of the conservative side of politics due to its historical precedence of becoming authoritarian once in power when backed by big banks and industry. The public certainly felt fear of a return to that authoritarianism when President Lee Myung-bak - mentioned earlier - came to power in 2008. They may soon feel concern again given the current government's conservative policies being reminiscent (if not the same) to those of the past.

Economy

With the PPP in power today, the country's policies will see major revisions across the board. Important from both a real and PR standpoint is Yoon's focus on the reform of public institutions. He has drawn attention publicly to their growth in terms of departments, employees and therefore cost (US\$450 billion), along with their inability to perform. The combined rising government debt, he says, makes it clear that reforms can no longer wait.

He also did not miss the opportunity to point out that the unnecessary growth has occurred in the last 5 years under the previous government (read DPK). It is his stated intention to cut back these institutions' waste so the money saved can be used to help those in real need, though he has not, of yet, outlined just how this plan will unfold. He may well face one of his first real battles on this issue, as only time will tell if the National Assembly goes with him on these reforms or sees the weakening of 'their institutions' as a line in the sand. He is also pushing for the economy to be business-led and is aiming to remove a lot of red-tape getting in the way, something that might well raise concerns among those who see this as a possible return to the roots of authoritarian ways.

As part of that 'government getting out of the way' policy, his cabinet has already agreed to cut quota tariffs to zero on 13 imported items such as cooking oil and other oil related products, flour, eggs, wheat, and pork. They also agreed to extend tax incentives on new car purchases. The Bank of Korea (BoK) was already firmly focussed on the issue of inflation before Yoon got into power and has raised interest rates back-to-back in April and May, following 100 previous hikes since August 2021. Yoon, it appears, is in sync with this policy. The BoK benchmark rate

currently stands at 1.75% and Governor Rhee Chang-yong has implied there will be further rate rises coming soon. Analysts predict the next is due in July/August with the aim of hitting 2.25% by the end of the year.

As with many Asian countries, South Korea has also suffered greatly while trying to weather the global storms. Despite the interest rate rises designed to fight it, inflation is still up 5% for the first time in 13 years and, naturally, workers unions are pushing the government to raise salaries by around 18%. As a result, the Finance Minister, Choo Kyung-ho, has urged restraint in this regard, fearing that such a large increase in salaries will push inflation higher and dilute the effects of the on-going interest rate hikes.

The country's economy at a glance might appear strong but it is essentially teetering on a knife's edge. Overall industrial production, spending and investment in April, all dropped for the first time in two years; mining and manufacturing dropped 3.3% from the previous month. On the manufacturing side, the drop was seen mainly in semi-conductors and food production.

While in contrast to what was being seen elsewhere in the region, the country's economy actually grew 4.1% in 2021 (the biggest growth seen in a decade) and, year on year, overall shipping exports were up 19.3% May to May. This is thought to be as a direct result of China opening up ports and factories. Yet, it is recognised that this growth is likely impossible to maintain going forward, especially in light of Yoon's changes to the country's foreign policy, as well as the fact that the country is heavily dependent on imports for all its energy needs. Combined, those energy needs and import costs have spiked 84% due to the effects of sanctions on Russia, leaving a deficit in trade of US\$7.7 billion.

The domestic economy, for the moment, presents a similar picture. While retail is down 0.2% month on month, the drop has been attributed specifically to a reduction in the purchase of COVID medications. With the removal of many of the health restrictions, the restaurant and hotel sector jumped 11% during the same period. Nevertheless, this positive result may well be just the pent-up need for people to get out and about after two years of restrictions. Some economists see this as a blip that will deflate once rising enthusiasm meets the harsh economic realities of rising inflation, that are essentially unavoidable now.

Foreign Policy

Although the new government is presenting an image of sensible policy management at home, Yoon's foreign policy pledges are a very different matter and will anger China (South Korea's largest trading partner) on several fronts. The first of which has already provoked a flurry of diplomatic activity between the two countries.

President Yoon is extremely pro US. Indeed, he considers it the centrepiece of his foreign policy agenda. Where his predecessor, Moon Jae-in, was pro US discreetly and only in relation to security in the face of North Korean aggression, Yoon is trying to take a more leading role over current issues. He has been clear that he is not interested in trying to improve relations with North Korea until Kim Jong-un makes a lot of concessions, not the least of which being the first moves toward the disarmament of the North's nuclear arsenal. A very tall order indeed.

He has also discussed the possibility of strengthening the South Korean military and implied the possibility of participation in the US missile defence network, believing his predecessor's stance toward China in this matter presented a subservient image. Of course, at this early stage, much of this must be seen in the context of sabre rattling or presenting symbolic bargaining chips since it goes against his cabinet's clear statement of intent to reduce costs for the taxpayer. Any notable increase in spending in the military now would put an enormous burden on the country's finances when it can least afford to do so.

South Korea's participation in the US missile defence network is an extremely serious matter for China. When Moon Jae-in (Yoon's predecessor) accepted the US missile defence system on South Korean soil, China immediately struck back by cutting China-based activity involving Korean retail. The net result was a US\$7.5 billion loss. Naturally, Moon offered many concessions to help calm China, which Yoon has said was humiliating.

Obviously, this indicates if he were to allow US missile systems into South Korea, he would not back down to China's retaliation and will therefore accept a direct, negative impact on the economy. He won't be able to have it both ways. Given that Beijing knows where Yoon's economic weaknesses lie, next time it is quite probable the target will be the blocking of South Korea's shipping exports to China and be a far costlier affair, disrupting the country's recovery with little alternative options to turn to.

Moreover, Yoon wants to see an end to the political hostility between South Korea and Japan and for the two countries to begin working together. Becoming the first South Korean leader to participate in NATO talks, Yoon spent quite some time in Madrid working toward that very objective on the side-lines with Prime Minister Kishida and President Joe Biden. This is ostensibly to help counter what he sees as an aggressive China on the world stage. Although given his many statements desiring South Korea to be viewed as a more important player than it has been so far, it does appear an opportunity to gain greater presence for the country internationally.

Given that Yoon has also indicated a desire to engage in the QUAD alliance (the informal strategic security dialogue between India, USA, Japan and Australia), one must expect the relationship between South Korea and China to turn sour extremely quickly indeed. For South Korean observers, it will be particularly interesting to see whether Yoon is just calling China's bluff or really has the mettle to face Beijing's escalating retaliation efforts, designed to reign in an errant country within its sphere of influence.

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