FINANCE/BUSINESS
**South Korean business feeling the squeeze**

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As South Korean and U.S. negotiators huddle in Seoul for make-or- break free trade talks this week, corporate South Korea is grappling with a troubling question: How can the country avoid being crushed by competition from low-cost China and high-tech Japan? South Korea's fear of being caught in a nutcracker between its bigger neighbors is nothing new. Its history is largely defined by the struggle to maintain its political and cultural identity - and economic independence - from China and Japan.

But warnings about the economic future of South Korea have taken on an apocalyptic tone in recent months, as the jewels of its export- driven economy - including Samsung, Hyundai and LG Electronics - all forecast declining earnings and growing competitive threats to their businesses.

"We are sandwiched," said Lee Kun Hee, chairman of Samsung, which generates 20 percent of the country's exports and is widely seen as the country's most competitive conglomerate.

"China is catching up fast. Japan is racing ahead. But we are running in place. In five or six years, not only Samsung but the whole of South Korea could plunge into chaos."

In January, advisers to President Roh Moo Hyun warned that South Korean businesses were not investing aggressively enough in new facilities, even as China was enjoying an unprecedented surge of investment into new, high-tech factories making everything from cargo ships to computer chips.

By 2010, analysts say, South Korean companies will enjoy few technological advantages over China in the export sectors where they dominate today, including mobile handsets, flat-panel displays and high-end steel.

A key part of Roh's strategy for injecting new life into the South Korean economy is simple: Achieve a free trade agreement with the United States, something that neither Japan, with its politically powerful farmers, nor China, with its huge state-owned industries, can possibly do.

A deal with Washington would not only make South Korean exports more price competitive in the world's largest export market, but would also enhance the country's credibility in the eyes of foreign investors, proponents say.

A deal opening South Korean markets could lead to an injection of technological skills from all over the world, while weeding out moribund businesses by exposing them to direct competition at home.

But time is running out. Negotiators must clinch a deal by Saturday to give President George W. Bush a "fast track" through the U.S. Congress, under which he may ask for a straight yes-or-no vote without amendments after a mandatory 90-day review.

Once this authority expires, Bush will find it far more difficult to push a deal through the Democratic-controlled Congress.

As the deadline looms, South Korea's trade minister, Kim Hyun Chong, and his U.S. counterpart, the deputy trade representative, Karan Bhatia, must step gingerly.

The most sensitive issues are rice for South Korea and beef for the United States. Missteps on these could kill the agreement, either in South Korea's National Assembly, whose members face elections next April, or in the U.S. Congress.

Viewed from abroad, it is perhaps difficult to see why South Korea is so apprehensive.

During the four years that Roh has been in office, the country's main stock index, the Kospi, has doubled. The economy has grown at an average of 4.2 percent annually - which, although below the 9 percent annual growth rates posted during the 1990s, still compares favorably to the world's seven largest industrialized economies, including Japan.

Exports expanded an average 19 percent annually during the period, to $326 billion last year. Per capita income is expected to pass the $20,000 milestone before Roh steps down in February 2008.

South Korea's historical strategy has been a combination of quick imitation and selective innovation, enabling it to produce goods that China cannot make, and at a lower cost than Japan. But that approach to business - "ppali ppali," or "hurry hurry" - is losing steam, many South Koreans say.

Meanwhile, Japan has emerged from a long stupor with spectacular research and development resources at its disposal, while China's growing technological prowess is combined with labor costs that prevailed in South Korea three decades ago.

Earnings at Lee's Samsung Electronics, the biggest and most profitable South Korean company, slipped to 7.9 trillion won, or $8.4 billion, last year from 10.8 trillion won in 2004, as Chinese competitors gobbled up Asian market share. Net profit at LG Electronics profits plunged to 212 billion won last year from 1.5 trillion won in 2004. At Hyundai Motor, battered by labor strikes and a weak yen that made rival Japanese cars more appealing, earnings have fallen for four consecutive quarters.

South Korean corporate investment in 1996 was equal to 40 percent of gross domestic product. That ratio had plummeted to 28 percent by last year. South Korea's trade surplus with China last year shrank by 10 percent to $21 billion, the first such fall in five years, while its trade deficit with Japan expanded by 4 percent to a record $25.3 billion.

The data, experts say, testify to the onset of obsolescence for South Korea's role as technological middleman between China and Japan.

Corporate South Korea depends on exports of components and semifinished electronic goods to China for much of its earnings. But it still relies heavily on Japanese high-tech parts and manufacturing skill to produce those exports.

South Korea is the world's biggest producer of computer memory chips and flat-panel displays. But Samsung, Hynix and LG.Philips factories all operate on Japanese machinery. Meanwhile, China is moving fast to build its manufacturing inputs at home - often at a cost South Korea cannot match.

"Many Korean companies are benefiting from strong demand from China," said Tariq Hussain, the Seoul-based author of the book "Diamond Dilemma," which assesses the economic challenges and opportunities facing South Korea. "However, as China-based capacity comes online and longer-term demand eases off, Korean manufacturers will be among the hardest hit."

In January and February, Chinese shipyards won more orders than their South Korean counterparts for the first time, and China will soon overtake South Korea as the world's largest shipbuilding country.

Chinese shipyards build mostly low-tech bulk vessels, while their South Korean shipbuilders focus on value-added vessels, such as mammoth container ships and liquefied natural gas carriers.

Still, the rapid Chinese gain is "frightening," said Kim Joon Ho, a spokesman for South Korea's Hyundai Heavy Industries, the world's largest shipbuilder.

South Korean handicaps are not only cost-based or technological, analysts say.

"Japan has worked assiduously to reduce antagonism in the USA from industrial sectors," said **Usha Haley**, professor of international business and director of the Global Business Center at the University of New Haven.

"For example, Toyota makes most of the cars it sells in the USA in this country - Korean car companies do not. Conversely, Korea has the most protected automotive market in the industrialized world, causing enormous resistance and umbrage in certain influential sectors."

A free trade deal with Washington could ultimately change that. But experts say South Korea needs more than open markets to rekindle innovation at home and lure new investment from abroad.

Tightened tax rules and other policy changes contributed to a 7 percent drop in foreign direct investment in South Korea to $7.2 billion in 2005, according to the United Nations Conference on Trade and Development.

The free trade agreement "is seen as a necessary evil by many Koreans, indicating the continued, deeply rooted skepticism toward opening up," said Hussain. "It is not a panacea for Korea's economic woes."

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