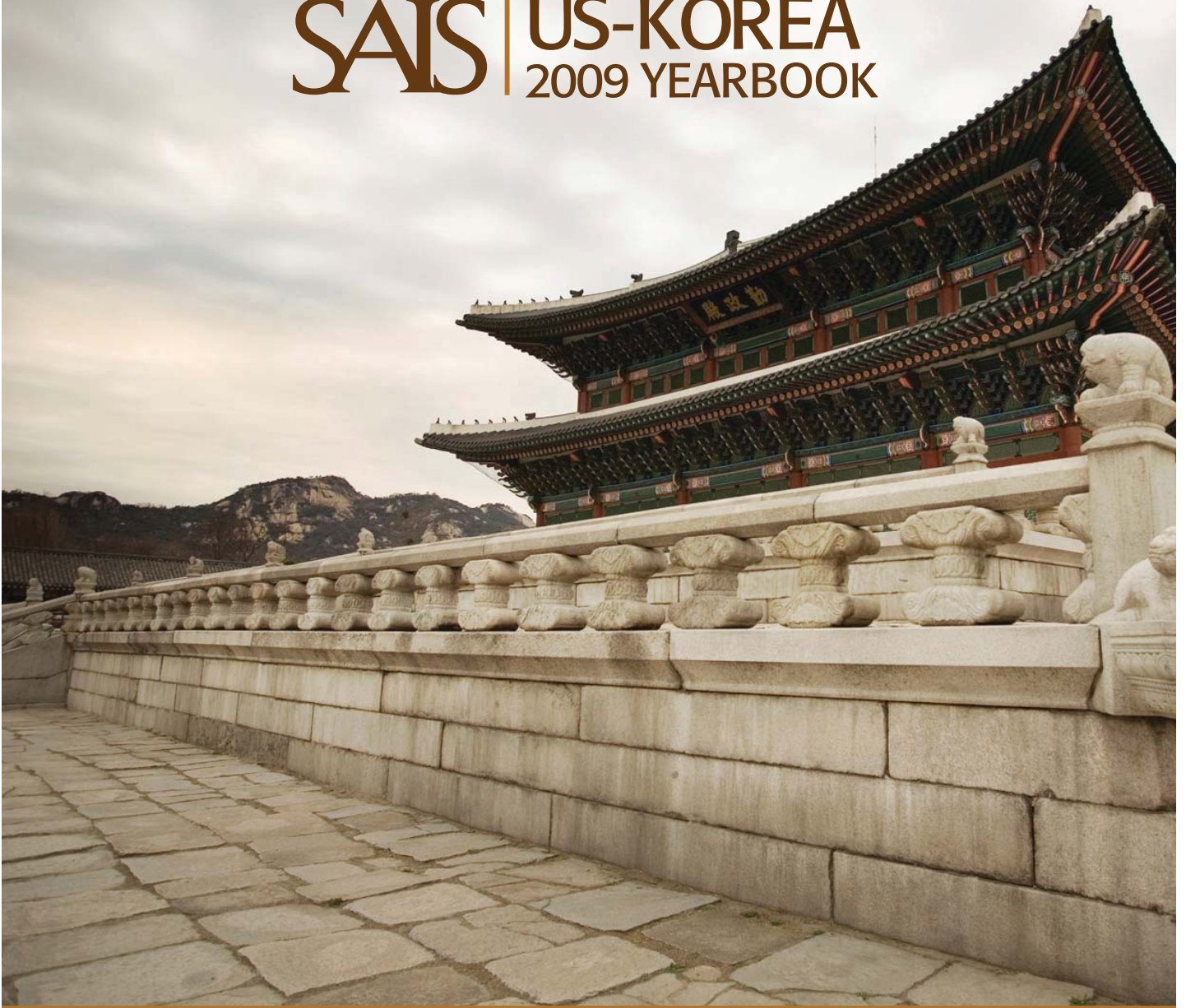


SAIS | US-KOREA 2009 YEARBOOK



JOHNS HOPKINS
UNIVERSITY

KAESONG INDUSTRIAL COMPLEX: IS IT CHANGING THE DPRK?

By Sarah Yun

I. INTRODUCTION

The Republic of Korea (ROK) and the Democratic People's Republic of Korea (DPRK) have undergone a series of tumultuous events in 2009. Amidst the numerous challenges and transitions that the two Koreas faced, there is an ongoing debate over the effectiveness of inter-Korean economic cooperation projects. The most prominent of the joint projects is the Kaesong Industrial Complex (KIC), which was launched in 2004. In 2009 alone, the DPRK announced on multiple occasions that the Kaesong Industrial Complex will be shut down unless certain conditions are met. The North further threatened to cut off communication ties with the South. Further straining the inter-Korean relations, a South Korean Hyundai Asan employee was detained by the North, a long-range missile was launched, an underground nuclear experiment was conducted, and the UN Security Council's sanctions against the DPRK became more stringent. The unstable environment for Kaesong persisted throughout the year, and the KIC appeared to be doomed. Nevertheless, the DPRK ultimately chose not to shut down the KIC, and the ROK continued its investment in the complex. Despite the souring of relations since Lee Myung-bak took the office of president, the two Koreas made a conscious decision to sustain the KIC. If the Kim Jong-il regime sees economic engagement projects such as the KIC as infiltrating and risky to the regime's political ideology, why does the DPRK continue to remain committed to inter-Korean economic cooperation projects? If the ROK government does not want to be manipulated by the DPRK threats, why does the South continue to engage with the North through the KIC? How effective is the complex in engaging the DPRK and improving inter-Korean relations? What kind of changes has the KIC brought about in the DPRK?

This paper assesses the legitimacy and effectiveness of the KIC in terms of the economic liberal theory that peace can be created through trade. By testing the main hypothesis that both the DPRK and the ROK remain committed to economic cooperation projects due to common vested interests, the paper also seeks to answer why the DPRK government continued to keep the KIC doors open despite the political risks and dangers attached to liberalization. The paper will first explore the history and objectives of the KIC in order to better assess the current situation. Thereafter, the paper will analyze the effectiveness of the KIC project in improving inter-Korean relations by assessing two aspects: (1) economic incentives versus political pressure and (2) social and human changes within the KIC.

II. HISTORY AND OBJECTIVE OF THE KAESONG INDUSTRIAL COMPLEX

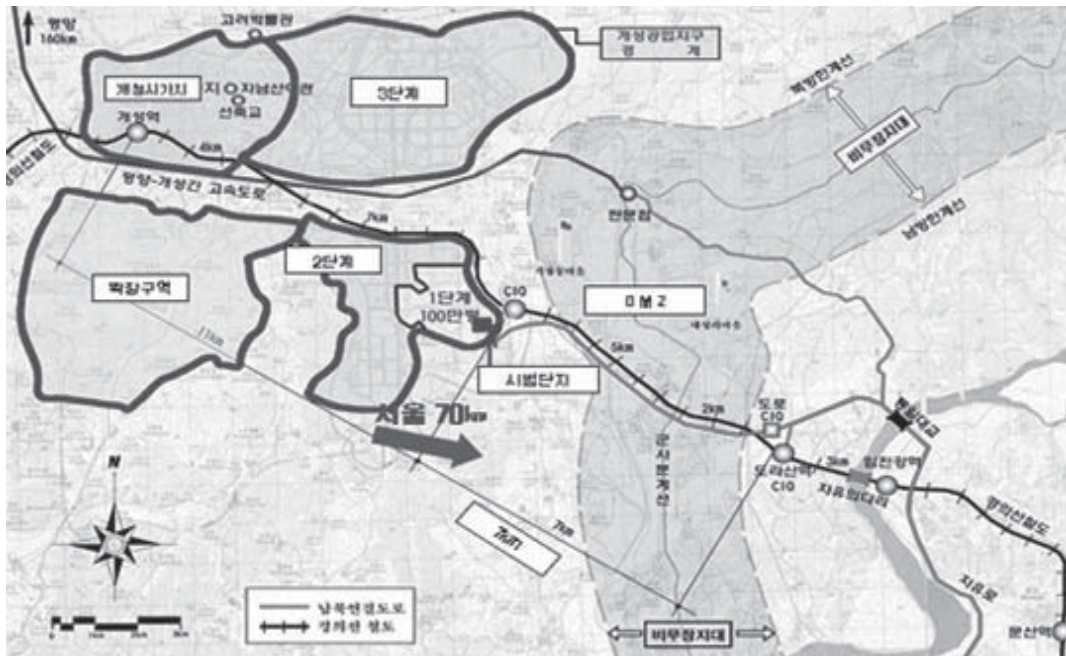
The idea of economic cooperation between the two Koreas originated in 1984 during the South Korean Chun Doo-hwan administration. Chun pioneered a series of ambitious dialogues with North Korea until the talks came to a halt after the U.S.-ROK joint military training exercise. Conversations restarted in the 1990s during the Inter-Korean Basic Agreement talks. The succeeding Kim Young-sam administration continued to engage the DPRK economically until the two Koreas hit a nuclear stalemate. Since then, a clear and radical vision for the ROK-DPRK economic engagement plan was officially launched during the Kim Dae-jung administration with the commencement of his "Sunshine Policy." During this era, Kim Dae-jung and the newly established North Korean leader Kim Jong-il agreed upon creating an ambitious economic project in Kaesong along with other groundbreaking trade exchanges. The Roh Moo-hyun administration followed the footsteps of his predecessor with his "Peace and Prosperity" policy by engaging the North and providing aid. Currently, the Lee Myung-bak administration takes a hard-liner stance towards the DPRK, diverting away from the ten years of friendly economic policies towards North Korea under the past two liberal administrations. Yet Lee, under his "pragmatic approach," still remains committed to the KIC and economic engagement with the North. In October 2009, the ROK Ministry of Strategy and Finance announced that South Korea is planning to raise its 2010 budget spending on inter-Korean economic cooperation by 30 percent from 2009. The Lee administration has planned for budget spending amounting to 398.2 billion won (approximately \$339.6 million) for 2010 in order to support economic cooperation projects within the DPRK, up from 304.6 billion won in 2009.

Contrary to common perception, the DPRK has actively engaged in economic cooperation projects for the past two decades. Although without much success, efforts at reform and engagement were initiated in the 1990s and 2000s by Chairman Kim Jong-il. The first of the economic reform efforts came in 1984 with the Joint Venture Law, which ended in failure. In 1991, the DPRK was forced to change its economic direction as the Soviet Union collapsed, China became more successful with their special economic zones (SEZs), and a disastrous famine was at its doorstep. In an attempt to boost the ailing economy, Rajin-Sonbong was declared as a hub for foreign investors in 1991 to allow capitalist management in the region. The Mount Geumgang project began in 1998 with the ROK's partnership and investment. In July 2002, the DPRK introduced the Economic Management Improvement Measures, which signaled market transition in increasing food prices and wages, devaluing DPRK won currency, creating performance-based profit sharing in enterprises, and more. In the early 2000s, Kim experimented with SEZs including Rajin-Sonbong and Sinuiju, both emulating the Chinese reform framework. Foreign direct investment from China, Russia, and now the ROK has been active and increasing in the DPRK in the recent years. In 2003, a land route across the DMZ opened to facilitate trade and exchange between the two Koreas. The current campaign launched by Kim entails ambitious economic targets under the umbrella of the "military-first" politics (*son-gun-jung-chi*). History over the last two decades indicates that the DPRK has been attempting to improve its economy without contaminating their political ideology.

With this as the backdrop of the DPRK's economic development efforts, the Kaesong Industrial Complex was launched in 2004. The KIC was the most recent and perhaps the most ambitious of any inter-Korean economic cooperation projects. The KIC was in large part initiated by the ROK government, who contracted with Hyundai Asan and the Korea Land Corporation to develop 20,000,000 *pyeong* (16,200 acres) of land in Kaesong, with 8,500,000 *pyeong* (6,885 acres) assigned for factories. Kaesong is located 70 kilometers southwest of metropolitan Seoul and has easy access to Incheon International Airport, a distribution hub in Northeast Asia. Kaesong is also in close proximity to the DMZ and Pyongyang (see figure 1). According to the ROK Ministry of Unification, as of October 2009 the KIC has 116 South Korean companies, with some 959 ROK employees working alongside more than 41,283 North Koreans.

The objectives of the KIC for both Koreas are largely twofold: economic and political. For the ROK, these two goals emerge to create one overarching

Figure 1: Kaesong Industrial Complex Map (Hyundai Asan's First Development Plan)



Source: ROK Ministry of Unification

goal of stimulating the DPRK transformation. According to one of the key developers of Kaesong, the KIC is an economic project, in which the first goal is to trigger market integration between the two Koreas by creating economic assets, physical infrastructure, and trade in a potential war zone. The second goal is to create economic mutual benefit by combining the ROK's comparative advantage in capital and technology with the DPRK's comparative advantage in labor and land. On the political end, the first goal is to lead the DPRK to engage in alternative forms of security dialogue over the long run by creating economic stakes in political cooperation. The second political goal is to create economic engagement in order to bring the DPRK out of isolation and to avoid complete collapse of the regime. For the North, the KIC is an important source, and one of only few sources, of foreign currency for the country. Moreover, the KIC gives Kim Jong-il an opportunity to experiment with marketization in a controlled environment. For a state that is desperate for economic revival, the KIC is a golden opportunity to stimulate growth with the South's capital and technology.

Through the KIC, synergy between economic and political goals is created. There are purely economic objectives of benefiting from comparative advantage as well as the political purpose of gradual integration and transformation of the

DPRK for the ultimate goal of reunification. Some subsidiary goals, according to a KIC developer, are to make Kaesong the hub of inter-Korean cooperation and an important SEZ in Northeast Asia, revive the DPRK's collapsed economy, create new jobs for North Koreans, assist the DPRK to acquire advanced technology, and help to improve North Korea's diplomatic image in the international community.

Underneath the overt objectives, however, there are underlying covert objectives that often go unnoticed. For the South, the KIC is not entirely driven by profit and economic comparative advantage but also by the leadership's political strategy. In a democratic country supported by the people, the closure of the KIC would have an immense negative impact on the popularity of the South Korean president. Therefore, the KIC is a good balance between practical economic gain and political support, while also fulfilling the emotional obligation of several South Koreans to help their "brothers" up North. For the North, the KIC is also coupled with its leadership in that its economic objectives reinforce Kim Jong-il's political legitimacy. Profits from inter-Korean economic projects are major cash cows for the Kim regime. According to the ROK Ministry of Unification, total wages compensated to Pyongyang in 2008 amounted to \$26.8 million, up from \$13.8 million in 2007. Moreover, Hyundai Asan paid the DPRK \$450 million in 2000 to purchase a business license in the North. One of the objectives of the DPRK is to sustain the KIC in order to continue the influx of foreign currency and to showcase the KIC's success to its people, thereby strengthening Kim Jong-il's legitimacy.

The DPRK and ROK share convergences on the means but disagreements on the ends of the KIC's objectives. The overlapping goal is to elevate the DPRK economy to a higher level. The divergence is the future impact from the North's economic growth through the KIC. The North views the KIC as a tool to strengthen the state by learning and adopting industrialized market structures. The South, on the other hand, regards it as a strategy to change the North's economic system, prevent a complete collapse of the regime, and eventually trigger social and political changes. For both Koreas, the KIC is essentially intended to be a market-opening experiment, but the ROK has an additional goal of triggering ripple effects into other parts of the social and political structure of the DPRK. Thus, from a first glance at ROK goals, it is evident that the KIC was established on the economic liberalism theory, in which economic engagement leads to political transformation.

III. RECENT DEVELOPMENTS: WHY DIDN'T THE KIC SHUT DOWN?

The year 2009 began with a chilly relationship between the ROK and DPRK, beginning with the DPRK's unilateral decision to restrict border traffic into Kaesong. On January 1, 2009, North Korea demanded that South Korean companies in Kaesong pay the entire \$10 per month transportation allowance

Table 1: Chronology of Important Events Related to the Kaesong Industrial Complex

Timeline	Date
Agreement between Hyundai Asan and North Korea to develop 20,000,000 pyeong of land in Kaesong	Aug 2000
Enactment of Kaesong Industrial Complex law by North Korea	Nov 2001
Launch of Phase 1 development	Jun 2003
ROK Ministry of Unification agrees to Phase 1 development of 3,300,000m ²	Apr 2004
Agreement of 15 companies to enter model development complex	Jun 2004
First KIC product made	Dec 2004
Beginning of electricity supply to model development complex (15,000 kW)	Mar 2005
Phase 1 of land development completed	May 2005
Agreement of 23 additional companies and 1 organization (Korea Industrial Complex Corp.) to enter main complex	Sep 2005
Beginning of telecommunication supply to KIC	Dec 2005
Power transmission between North and South connected	Dec 2006
ROK Kaesong Industrial Complex law established	May 2007
Agreement of 183 additional companies to enter main complex	Jun 2007
Kaesong Industrial District Management Committee launched	Dec 2007
Total output reached \$500 million	Nov 2008
DPRK closed border passage to Kaesong due to U.S.-ROK joint military exercise	Mar 2009
Hyundai Asan employee detained	Mar 2009
North Korea's declaration to annul KIC rules and regulations	May 2009
1 st and 2 nd round inter-Korean meeting over KIC	Jun 2009
3 rd round inter-Korean meeting over KIC	Jul 2009
Hyundai Asan employee freed	Aug 2009
DPRK restored border passage to Kaesong	Aug 2009
Restored Route 23 to KIC	Sep 2009

Source: ROK Ministry of Unification

to North Korean workers, as opposed to \$5 that was originally agreed upon. On February 10, an official notice was sent to all South Korean companies to increase the wage from \$57.50 to \$300, otherwise facing operation suspension in the KIC. On March 9, the DPRK cut off its military hotline with the ROK, citing its opposition to a ROK-U.S. joint military exercise. The same day, Pyongyang shut down the borders and barred workers from entering the complex, stranding those who were supposed to return home to South Korea. The next day, the border was reopened. On March 21, the DPRK reopened the military communication channel following the conclusion of the military exercise. The North shut down the border three times over a dozen days starting on March 9. On March 30, a South Korean Hyundai Asan employee was detained for allegedly criticizing the DPRK regime and encouraging North Korean workers to defect to the South. On April 21, the two Koreas met at Kaesong in an extremely brief (22-minute) meeting where the DPRK announced it would withdraw all preferences to South Korean companies in Kaesong unless agreement was reached on higher wages for North Korean workers and higher rent from companies. On May 15, the DPRK declared that all contracts and regulations under Kaesong were to become invalid and that South Korea should expect to completely pull out of the complex. Although the ROK government never formally announced retaliation for the DPRK threats and closures, prominent South Korean politicians fired back by urging the ROK government to withdraw from the KIC since the North can take South Korean citizens hostage whenever they want. For the next two months, a series of meetings were held over the KIC (see table 1), and the fate of the KIC appeared to be doomed.

However, Pyongyang began to reverse its hard-line policy in August. On August 20, the DPRK informed the ROK that it would lift all bans on traffic and exchange at the KIC, reopen the office, and resume train service between Panmun and Paju stations. On September 17, the North conceded to accept a 5 percent wage increase as opposed to the initially demanded amount of \$300. They also released the Hyundai Asan employee, ending months of negotiation and tension across borders. After a series of unpredictable decisions and declarations, the DPRK was suddenly entering into a conciliatory mood by September 2009.

Inter-Korean economic cooperation such as the KIC continues to expand despite the political stalemate and a series of dramatic events in 2009. The fact that the KIC, which accounts for about half of inter-Korean trade, continues to operate amidst the escalating tensions between the two Koreas is a testament to the project's strength. The fundamental questions regarding the KIC situation are:

Why didn't the DPRK shut down the KIC despite the high political tension between the two Koreas? Why did the DPRK reverse its earlier hard-line stance and demands after the summer of 2009? What does the survival of the KIC signal about the current state of the DPRK regime? In the following, I argue that the KIC was able to survive because economic engagement created enough stakes, common interests, and common wealth within the system to counterbalance political crackdown.

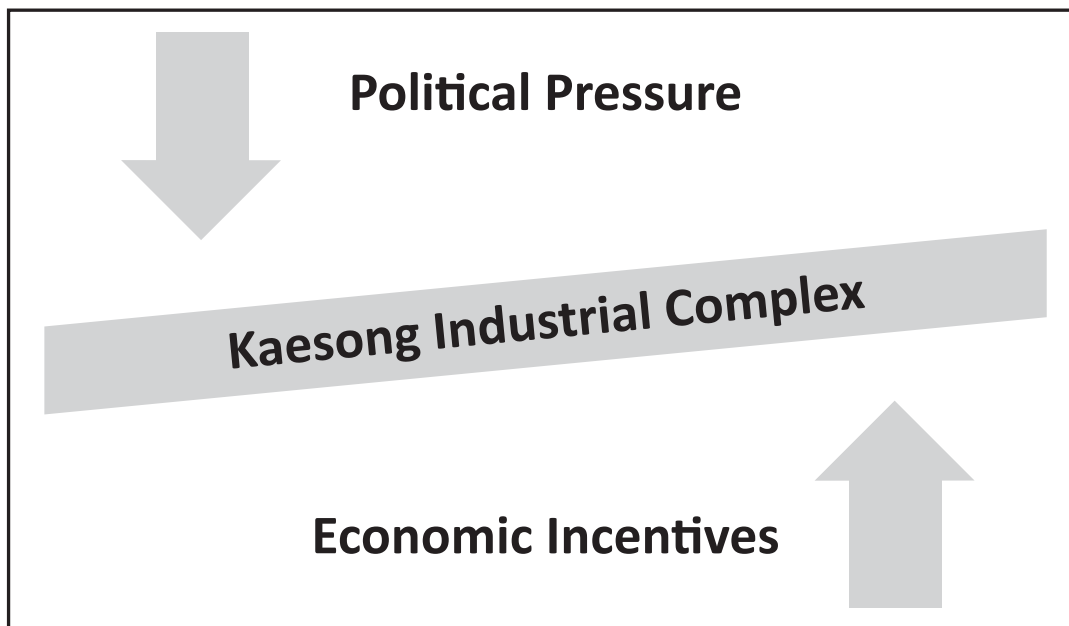
IV. COUNTERBALANCE BETWEEN ECONOMIC INCENTIVES AND POLITICAL PRESSURE

The Kaesong Industrial Complex and economic engagement projects in North Korea cannot be completely separated from politics, given the highly political nature of the relationship between the two Koreas. On the one hand, the KIC and other economic engagement projects remain vulnerable to political matters. Also, they can be dampened by negative political developments such as the South's concerns about the North's nuclear programs or Pyongyang's displeasure with the South's conservative Lee administration. On the other hand, economic engagement itself may affect political matters by creating common incentives to maintain, if not further, political cooperation. This is in line with the economic peace theory under the framework of economic liberalism. Early economic liberalism theorists, such as Adam Smith, argued that economic actions of individuals were largely motivated by self-interest and the invisible hand, which allowed individuals, therefore the society, to produce the best results. The responsibility of the government was to provide public goods, such as roads, bridges, and schools. The exchange of goods, with the government's provision of public goods, would lead to reduced warfare and increased peace. As society industrialized and advanced, the cost of war would exponentially rise, making war too costly for nations to bear. Immanuel Kant says in his book *Perpetual Peace*, "By virtue of their mutual interest does nature unite people against violence and war ... the spirit of trade cannot coexist with war, and sooner or later this spirit dominates every people. For among all those powers ... that belong to a nation, financial power may be the most reliable in forcing nations to pursue the noble cause of peace." A contemporary example of the democratic peace theory is the increased trade and the consequent mitigation of tensions between China and Taiwan under Hu Jintao and Ma Ying Jeou.

The two Koreas and the KIC project seem to demonstrate the democratic peace theory. North Korea has always been cautious of infiltration and contamination

of their political ideology. Nuclear and political factors influenced the status of the KIC. Therefore, the DPRK periodically cracks down on marketization for fear that its people are at the risk of abandoning their loyalty to Kim Jong-il. In 2009, for example, the North used Kaesong to protest against the conservative Lee administration by frequently closing the borders and exchanging harsh words with the South. This political shift almost led to the shutdown of the KIC. However, the KIC created enough stakes, common interests, and common wealth within the system to withstand the political crackdown. In North Korea, economic engagement cannot be completely severed from political moves, contrary to the framework of the past two ROK administrations under Kim Dae-jung and Roh Moo-hyun, which separated politics from economic engagement. In the case of Kaesong, political and economic stakes and interests created symmetry to sustain the complex. Figure 2 depicts how the counterbalancing effects of political pressure and economic incentives worked for the KIC.

Figure 2: KIC Counterbalance of Political Pressure vs. Economic Incentives



One of the main factors for building and maintaining community and peace is that there is common economic understanding and interest. On the other hand, communities are broken and peace-building fails when shared economic interest dissipates, common wealth does not form, or understandings of each other's vested interests begin to clash. Historically, these failures often led to conflict and war. Recognizing the economic vested interest in the KIC, the DPRK decided to use the KIC as a trading and negotiating factor instead. Furthermore,

it is noteworthy that North Korea used economic factors such as wage and land-rent increases as opposed to political factors as their bargaining chips. This may be an optimistic sign that the DPRK is making interest-driven and profit-driven choices as opposed to ideology-driven ones.

Furthermore, the KIC is a mutually benefiting project for the leadership on both sides. The DPRK's leadership benefits from acquiring economic profit that may be directly funneled into Kim Jong-il, his military, and the elites. The ROK leadership benefits politically as the democratically elected Lee Myung-bak administration must rely on public support and opinion. Although the ROK leadership may be aware of the KIC profit going directly into the hands of the dictator, Lee continues to support the project because of his political stakes within the KIC. According to a recent opinion poll conducted by the Hyundai Economic Research Institute, 75.3 percent of the respondents indicated that they wanted the KIC to continue, while only 20.7 percent wanted to end the business exchange in Kaesong. Interestingly, only 22.2 percent of the respondents indicated that they trusted North Korea, implying that the South Korean public sees the KIC as necessary and beneficial despite their distrust of the Kim regime. The two governments as well as the South Korean people want the KIC to continue for economic and political reasons. Yoon Yeo-sang, director of the Database Center for North Korean Human Rights, stated, "The KIC will not shut down because of the vested interests from Kim and Lee." He added, "But it will only expand to the scale that the DPRK can politically control and manage." The benefits of the KIC to Kim Jong-il and Lee Myung-bak are mutually reinforcing.

V. STAKES, INTERESTS, AND COMMON WEALTH CREATED BY THE KIC

Given the argument that economic liberalism and economic interests withstood political crackdown from the North, what are the stakes, common interests, and common wealth that the KIC created?

DPRK

The first obvious vested interest for North Korea is the sheer amount of economic earnings they receive from the KIC. According to the ROK Ministry of Unification, the total production output in Kaesong from the time it opened through October 2009 was \$728,590,000 (see table 2); in 2009 alone (January-October), the total output was \$203,730,000. The total composite export amount

Table 2: Production Level (Based on October 2009)

(in \$)

	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2007	1,506	1,490	1,570	1,711	2,090	1,927	1,940	18,478
2008	1,846	2,031	2,318	2,412	2,310	1,960	2,224	25,142
Comparison	23%	36%	48%	41%	11%	2%	15%	36%

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Total (‘05.1~‘09.10)
2008	1,887	1,768	2,422	1,906	2,058	1,846	2,031	2,318	2,412	2,310	72,859
2009	1,803	1,845	1,922	1,884	1,782	1,873	2,059	2,096	2,409	2,700	
Comparison	4%	4%	21%	1%	13%	1.5%	1%	9.6%	0.1%	16.9%	

Export Level (Based on October 2009)

(in \$)

	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2007	331	282	326	313	423	424	380	3,967
2008	234	253	245	282	281	219	187	3,584
Comparison	29%	10%	25%	10%	34%	48%	51%	10%

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Total (‘05.4~‘09.10)
2008	320	432	575	300	256	234	253	245	282	281	11,950
2009	189	133	200	193	200	213	232	316	342	311	
Comparison	41%	69%	65%	36%	22%	8.9%	8%	29%	21.5%	10.7%	

Source: ROK Ministry of Unification

was \$119,500,000; in 2009 the export amount was \$23,290,000. Although production decreased in some months of 2009, the decline is attributed to the continuous obstruction of KIC production from the repetitive border closures, unpredictable political climate of the complex, worldwide economic depression, and increase in the number of new companies and workers within the KIC. In recent months, total production and export showed a sharp increase. The export amount in September 2009 was \$3,420,000, a 21.5 percent increase from \$2,820,000 for the same month in 2008.

The KIC is a lucrative business for the DPRK, and money has become the center of North Korean activities. In 2004, the Hyundai Economic Research Institute estimated that Kaesong would help North Korea earn close to \$9.55 billion in economic gains over the course of nine years. For a country in dire need of direct foreign currency, the enormous earnings from Kaesong provide enough incentives to keep the complex in operation. Lim Won-hyuk, Research

Fellow at the Korea Development Institute, argues in his paper “Inter-Korea Economic Cooperation at Crossroads” that “while Pyongyang is still concerned about regime stability, it has made serious efforts to ensure commercial viability for companies in Kaesong.” In a speech to the Workers Party, Kim Jong-il emphasized that material gains befit the current times and that party members should be competent to produce real results. This change in the attitude towards the free market is parallel to the recent uproar against the currency revaluation in the DPRK. Many experts attribute this phenomenon to the increased awareness of the North Koreans’ concept of money. Even the military is known to have been behind the KIC’s establishment, as Kaesong is extremely close to the DMZ and Pyongyang. Now that the military bought into the idea of the KIC, too much is at stake and it would cost extreme amounts for the Kim regime to close the complex and restore the military system in the region.

Another vested interest for the DPRK is knowledge transfer. Through the KIC, the North has a perfect opportunity to learn the infrastructure of capitalist market systems from the thirteenth-largest economy in the world. Kim Jong-il has been persistently trying to develop North Korea’s economy through constitutional change, modeling of SEZs after the Chinese, and actually launching SEZs and other economic development projects. Despite his efforts, progress has been limited, if not unsuccessful. South Korea is relaying their free market expertise, such as accounting, business management, supply chain management, and more, to their North Korean employees. Many infrastructures have been built that increase the level of commitment to the complex. Factories were built with energy flowing from South to the North provided by Korea Electric Power Corporation. Korea Land Corporation, which acts as a developer along with Hyundai Asan, built a beautiful park and street inside the complex. Increasing numbers of North Koreans are involved in the KIC operations through the Kaesong Industrial District Management Committee (KIDMC). Ninety-four North Koreans are employed at KIDMC, which provides administrative services for companies located in the complex. The Inter-Korean Economic Cooperation Office runs the direct marketing and investment of the KIC, through which the DPRK has been rather cooperative in providing information requested by the ROK companies. Woori Bank opened as the first branch office in Kaesong. Korea Telecom launched the first direct telecommunication between Seoul and the complex. Cheongbong Bridge was completed in 2005 for the commute from Kaesong City to the complex. The number of commuter buses and bicycles increased with the construction of paved bicycle-only roads. A water system and other facilities, such as convenience stores, hospital, restaurants, and recreational infrastructures, were developed in the KIC. In October 2009, the first daycare

nursery opened in the KIC to accommodate the North Korean women in their 20s and 30s who make up 85 percent of the workers. Additionally, negotiations are underway to build an employee dormitory in the complex. An official of the Central Special Direct General Bureau (CSDGB) of North Korea said, “there is nobody in North Korea now who is against the KIC project. If there were any opposition, the project wouldn’t even leave the drawing board. However, they still discuss a number of ways to develop the complex proposed by the South. In terms of the will to develop the KIC, however, there is no room for doubt.” The North is receiving and learning plenty of new technologies and systems through the KIC.

ROK

South Korea also has its vested interest in the KIC. Much is at stake for the South Korean government, which would bear most of the economic and political burden in the case of a KIC failure or closure. Furthermore, the ROK has many different actors invested in the KIC, such as the government, companies, civil organizations, and the South Korean people. For example, South Korean companies who receive investment incentives from the government will incur huge amounts of losses. In June 2009, the Companies’ Association of the Kaesong Industrial Complex appealed to the South Korean government for economic measures. According to *Hankyoreh* on June 13, 2009, an official of the association of firms in Kaesong said, “Due to deterioration in relations between South Korea and North Korea, tenant companies in the complex have run in the red. We ask our government to take measures for financial assistance and for opening up our ability to exit from the project in order to minimize our management losses.” According to KIDMC, South Korean companies had already invested 450 billion won (\$304 million) as of November 2008. Since the launch of the KIC, the South Korean government has invested 658 billion won (\$443 million) to build roads, railways, and logistics, and an additional 311.8 billion won (\$210.1 million) to build the infrastructure and power and communication lines. According to the Forum for Inter-Korea Relations, an NGO in South Korea, the closure of the KIC would cost the ROK government and businesses an estimated \$1 billion. Moreover, the South Korean government has to take into consideration the costs incurred if the North Korean economy or regime completely collapses and the ROK is forced to absorb the shock.

Not only has the ROK government already invested too much money to allow the KIC to fail, it would lose political ground with the North as well, as the KIC is currently the only method in which the ROK can exert leverage over

the DPRK without the involvement other states such as the United States and China. Moreover, it would also eliminate one of the few remaining channels for inter-Korean communication and interaction. Although the ROK's conservative government announced the possibility of pulling out of Kaesong entirely at the height of KIC-related tension in 2009, the vested interests on economic and diplomatic levels prevent this from occurring. Similar to the DPRK case, the government, private sector, and civil organizations in the ROK have large political incentives and financial interests to sustain the KIC.

The ROK is trying to inject more incentives into the KIC structure by including Kaesong-made products in the Korea-U.S. Free Trade Agreement (KORUS FTA). South Korea has been arguing strongly that products made in the KIC need to be verified as products of South Korea. If the products of the KIC are verified as such, zero or very low tariffs would be levied on them. On the other hand, if they do not qualify as made-in-Korea products, they will be levied over 100 percent tariff upon exportation, due to the sanctions on the DPRK by the U.S. government. However, U.S. trade representative Wendy Cutler said after the first negotiation that "the U.S.-Korea FTA is limited only to the U.S. and South Korea." This still is an important issue of debate, and how the KIC and inter-Korea relations will be affected by future negotiations between the two countries remains to be seen.

VI. SOCIAL AND HUMAN CHANGES WITHIN THE KIC

Lim Eul-chul, in his book titled *Kaesong Industrial Complex: History, Pending Issues, and Outlook*, writes that the North Koreans' understanding of money is slowly changing. North Koreans used to believe that the regime could survive as long as its ideology was not compromised, but there are indications that they are gradually giving more weight to material gains. If economic liberalism and economic interests ultimately rescued the KIC from complete closure in 2009, what were some of the changes that the KIC was able to cause in Kaesong City and the DPRK?

Human security and labor standards have been introduced, established, and improved for those working in the KIC. The 41,283 and steadily growing number of North Korean workers in Kaesong are subjects of envy to other North Koreans (see table 3). They earn \$57 per month plus benefits, which is far more than the earnings of the average North Korean workers. As of August 2009, workers will receive a wage 5 percent higher. Normal work hours are 48 hours

per week. If they work overtime, workers receive a 50 percent premium on their regular hourly rate. Companies have also implemented incentive systems such as a year-end bonus to encourage worker productivity. Kaesong workers have higher wages, better nutrition, and restored health through the KIC system. Andrei Lankov, Associate Professor at Kookmin University, claimed that the more than 40,000 workers combined with their families and friends would make up about 100,000 people who are under the KIC's influence. Moreover, there is increasing demand for additional labor, which requires outsourcing of employment from other cities due to a labor shortage in Kaesong. This will lead to increased exposure of more people to the South Korean lifestyle and business methods. Female workers are allowed 60-day natal, 90-day postnatal, and 60-day paid maternity leave. Although the growth of social capital is difficult to measure within the DPRK, growth in human interactions can easily lead to construction of concrete social capital in the future. Furthermore, training for North Korean workers has created new ways of civil education. Trainings for technical knowledge, safety measures, production quality control, and more take place in the KIC by KIDMC and South Korean companies. The ROK strategically uses the employee training to engage in civil education for North Koreans. North Koreans want more of this training because they realize that better training leads directly to higher productivity and profit, which is another indication that profit is changing the mindset of many North Koreans in Kaesong.

Table 3: Number of Workers in the KIC

(Unit: No. Of People)

	Jan		Feb		Mar		Apr		May	
	South	North	South	North	South	North	South	North	South	North
2008	823	22,778	884	23,529	1,081	28,769	1,081	28,769	1,034	27,341
2009	1,225	38,594	1,262	38,323	1,029	39,238	1,124	38,851	1,079	38,867

Jun		Jul		Aug		Sep		Oct	
South	North	South	North	South	North	South	North	South	North
1,147	29,489	1,187	31,758	1,251	33,037	1,236	33,688	1,461	35,375
1,005	39,801	952	39,504	958	39,933	974	40,848	959	41,283

Source: ROK Ministry of Unification

By opening up North Korea through the KIC, the international community has also become more vested in North Korea, especially on such issues as the regime's questionable adherence to the labor laws. The KIC has put the DPRK under increased scrutiny by international human rights organizations,

which led to some positive changes in labor standards within the KIC. An issue that the international community has voiced much concern over is the lack of transparency in wage distribution. South Korean companies are not able to pay the North Korean workers directly. Instead, they pay through the North Korean government agency CSGDB. Many allege that the government mostly diverts the wages of the North Korean workers towards government coffers, whereby the workers receive only \$8 out of their \$57 monthly wage.

Consistent pressure on human rights issues from the international community has caused some behavioral changes in the North. Amidst the human rights criticism from international organizations such as Human Rights Watch, it was observed that a small group of South Koreans were allowed to cross over the border even after North Korea shut down the border for the first time in 2009. The small group included foreigners, someone who was to be wed, and someone who was sick. The incident implied that the North wanted to avoid an international outcry or further criticism about human rights violations, indicating that pressure on soft issues such as human rights and labor laws can be effective on the DPRK. By engaging with the DPRK through the KIC, the North faces increased exposure and accountability on human rights and peace.

Since the KIC launched, there has also been a high frequency of inter-Korean contact, especially on the economic front. As table 4 indicates, economic contact is a fairly recent phenomenon, with a heavy emphasis in the 2000s. This indicates that both governments are placing value on economic exchanges such as the KIC.

Table 4: Number of Inter-Korean Talks by Field (Unit: No. of Cases)

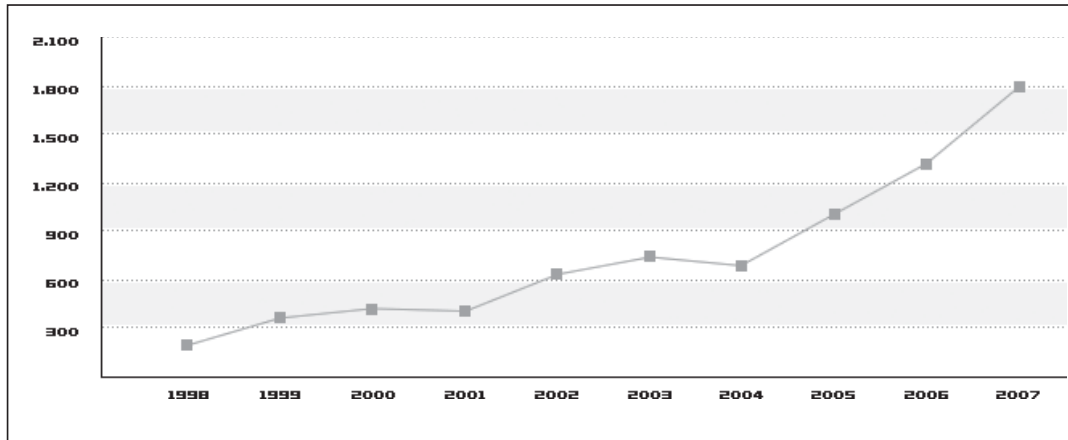
Area/Year	71-99	2000	2001	2002	2003	2004	2005	2006	2007	2008	Total
Political	189	18	2	4	5	2	10	5	13		248
Military	0	4	2	9	6	5	3	4	11	2	46
Economic	5	3	3	14	17	13	11	8	22	3	99
Humanitarian	119	2	1	3	7	2	4	3	3		144
Social and Cultural	34			2	1	1	6	3	6	1	54
Total	347	27	8	32	36	23	34	23	55	6	591

Source: ROK Ministry of Unification

When the North-South Exchange Cooperation law was first created in 1990, human exchanges between North and South were at a mere 400 persons per year according to Seok Yoon's article in the *American Journal of Applied Sciences*, entitled "An Economic Perspective of Kaesong Industrial Complex in North Korea." This number increased dramatically by 2008 to 180,000 persons. Additionally, the types of interaction have diversified to include everyday entry and stay, family visits, tourism, long-term stays, and more. Entry and exit of commodities between the two Koreas grew from \$100 million to \$1.82 billion over 17 years, to which the KIC contributed greatly. The KIC has also encouraged other similar projects to start in the surrounding Kaesong area or in other parts of the DPRK. There have been continued talks about replicating the Kaesong model in other parts of North Korea, such as Haeju. Furthermore, foreign direct investment (FDI) has expanded to include non-South Korean companies such as the German company Prettl. In September 2009, a delegation of Dutch businessmen visited the North Korean Chamber of Commerce and wrote a report on the North Korean business environment. When this report gets distributed to other EU countries, it is expected that FDI from the EU countries will increase in the future.

As figure 3 below shows, inter-Korean trade, which takes place mostly through the KIC, has been steadily increasing for the past decade. Table 5 shows numbers of inward and outward trades between the two Koreas. Although the inward volume has not increased as much as in previous years and the outward volume has decreased since the current South Korean President Lee Myung-bak's administration took office in 2008, the two Koreas remain committed to the KIC. In fact, Korea Customs Service announced that inter-Korean trade increased in September 2009. Table 6 shows month-by-month numbers for inter-Korean exits and intakes of goods in 2009, in which both the volume and amount are shown to have increased gradually.

North Korea's perception of South Korea is also changing slowly. In a 2005 Ministry of Unification survey of recent defectors, only 32.8 percent of them regarded South Korea as an enemy, a decrease from 49.2 percent in 1999. Furthermore, 67.2 percent of North Koreans viewed South Koreans as friends, an increase from 50.8 percent in 1999. While the North and South Korean workers within the complex live in separation from one another, they work together and continuously interact with each other. Exposure to South Korean lifestyles, outfits, business methods, and human interactions has caused some small and gradual changes. Lim Eul-chul, research professor at Kyungnam University's Institute of Far Eastern Studies, testified that North Koreans are

Figure 3: Inter-Korean Trade (1998-2007)**Table 5: Inter-Korean Trade (Unit: USD Million)**

Year	1989	1990	1991	1992	1993	1994	1995	1996	1997	1997	1998
Inward	19	12	106	163	178	176	223	182	193	92	122
Outward		2	6	11	8	18	64	70	115	130	212
Total	19	14	112	174	186	194	287	252	308	222	334

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	Total
Inward	152	176	272	289	258	340	520	765	932	5,170
Outward	273	227	370	435	439	715	830	1,032	888	5,845
Total	425	403	642	724	697	1,055	1,350	1,797	1,820	11,015

In 2008, trade between the two Koreas totaled \$1.82 billion, which is a 1.2% increase from a year ago.

Source: ROK Ministry of Unification

Table 6: Inter-Korea Exits & Intakes of Goods in 2009

Month	Number of Exits	Amount of Exits	Number of Intakes	Amount of Intakes
Jan	2,840	42,816	2,535	68,512
Feb	2,918	41,640	2,529	59,251
Mar	3,085	40,889	2,791	67,684
Apr	3,056	40,181	2,958	64,721
May	2,963	42,252	2,937	64,265
Jun	3,391	52,138	2,891	61,011
Jul	3,643	63,888	3,012	75,525
Aug	3,397	53,603	3,005	82,809
Sep	3,793	74,250	3,621	98,752

Source: Korea Customs Service

starting to emulate South Koreans. The use of Kaesong dialect is decreasing and slowly being replaced with South Korean tone and language. For example, the word *hwa-jang-shil*, which means “bathroom” in South Korea, is now used more widely within the KIC than *wi-seng-shi-sul*, which is the equivalent term in North Korea. Lim added that their clothing, hair, and makeup are becoming more South Korean-like. The DPRK government strongly condemns and restricts such behavioral changes. Despite the strict surveillance, however, outsiders can often detect behavioral changes among North Koreans to emulate South Koreans.

It may be that the DPRK decided to detain the Hyundai Asan employee because of its awareness of and opposition to these behavioral changes. This incident can be interpreted as a public showcase of the North Korean government’s warning to South Korean and North Korean Kaesong workers that the regime will not tolerate any activities that threaten or challenge its legitimacy, just as the government often performs public executions to induce fear and consequently tighten its grip on the people. Detainment of the Hyundai Asan employee was a classic North Korean case of economic liberalization clashing with political pressure. Despite the strong control of the DPRK regime, people’s exposure to each other inevitably increases, especially as the KIC needs more North Korean laborers and begins to recruit from outside of the Kaesong area. Even with drawbacks due to political tension, uncertainties over laws, institutions, infrastructure, management, and overall environment are being reduced.

VII. LIMITATIONS OF THE KIC’S INFLUENCE

The impact of the KIC is limited, however, as long as North Korea avoids the challenge of broader national reform. North Korea has been unwilling to establish a SEZ that fosters a stable investment and commerce environment. Although they crave the financial benefit of the open market in the open city of Kaesong, they continue to limit expansive economic liberalization in order to protect their ideology. The newly emphasized *son-gun* (military-first) politics also places a cautious regulation on the level of growth, activities, and interactions within Kaesong by emphasizing military and security rather than marketization. Therefore, the North’s political economy has been able to develop only within the boundary of harsh political measures. Five years after the KIC launched, its situation within the “open city” is still volatile as ever. In 2009, the KIC has faced complications and instability stemming from various factors such as the detainment of the South Korean Hyundai Asan employee, North Korea’s

rocket launch, and North Korea's demand to increase the KIC wages to \$300 and land lease to \$5 billion. In the eyes of many, the future of the KIC is indeed unpredictable and seemingly hopeless. Many critics argue that KIC is a failure without clear results of transformation in North Korea.

However, one must remember that economic reform in China and Vietnam also required time and intense commitment even though they were not divided countries like North Korea that required a significant amount of funds to go into the military. The fact that the KIC remains in active operation today can be a hopeful sign that the DPRK is ready to accept some changes. The ROK Ministry of Unification states that the level of inter-Korean economic engagement has not decreased despite the political tension since the conservative Lee Myung-bak administration took leadership. In fact, the amount of trade has increased. Referring to the statistics on the growth of the KIC production and employees, Kim Yong-hyun, professor of North Korean studies at Dongguk University, stated, "The latest statistics show North Korea will not shut down Kaesong but thoroughly protect business there."

VIII. CONCLUSION

Economic cooperation and engagement projects are effective tools to open doors, increase interaction, and instigate change and peaceful transition in the DPRK. Not only is the KIC improving market structure and influencing the larger communist machine as a whole, but these developments are also seen in the welfare of individual lives of North Koreans working at the complex. The KIC continues to grow despite Lee Myung-bak's conservative and hard-line policies towards North Korea and Kim Jong-il's crackdown on drastic reform. However, the DPRK now faces a dilemma: It wants to return to the old classical socialist system by tightening government control, but it also wants to experiment with marketization. This is evidence that the KIC has contributed significantly in creating and systematizing economic incentives and common interests so that both Koreas see value in the project. Due to these economic stakes, interaction on various levels has increased, labor and human rights standards have come under increased international pressure, and North Koreans' perceptions of South Koreans have improved. The overarching goal of the KIC is to induce gradual, small, and short-term changes rather than a big-bang approach with drastic changes that may lead to political breakdown. Within the framework of gradual change, the KIC has been effective at engaging and opening up the DPRK economy. Marcus Noland, Deputy Director and Senior

Fellow at the Peterson Institute for International Economics, stated in his paper “North Korea and the South Korean Economy,” that “it is worth engaging with the North and hoping that through a policy of engagement either Pyongyang will evolve toward a less threatening regime, or engagement will undermine the ideological basis of the Kim Jong-il regime and eventually cause its collapse. Either way the military threat to Seoul is eliminated.” The KIC is a strategic part of this larger plan to engage the DPRK.

Economic development is necessary in order to achieve political stability. Although it is important not to exaggerate its effects, economic engagement projects such as the KIC can have a long-term significant effect when it comes to political transformation. The true value of the KIC is in creating economic integration that leads to increased human interactions, which may provide added opportunities to change the DPRK. The more the DPRK economy is integrated with the South through economic cooperation and the more North Korean people are exposed to South Koreans, the more likely it is for the DPRK to cooperate rather than take military action. Interaction between the two Koreas in itself can be an important learning experience for the DPRK. The KIC can also be a tool to enhance trust, revitalize the economy, reduce reunification costs, and create a buffer zone between the two Koreas such as hosting the South-North family reunions and inter-Korea talks. The KIC has grown too large for either Korea to abandon it; incentives outweigh political risks on many levels. Further steps should be taken to continue to leverage incentives in order to better engage with the DPRK. Thomas Byrne, Moody’s Investors Service analyst, stated after touring the KIC, “[The] Kaesong Industrial Complex is the optimistic future of South and North Korea.” For the two Koreas, the KIC remains to be a land of much potential and opportunity.



U.S.-Korea Institute at SAIS
1740 Massachusetts Avenue N.W.
Washington, DC 20036
www.uskoreainstitute.org



JOHNS HOPKINS
UNIVERSITY