

FROZEN INTER-KOREAN RELATIONS & THE IMPACT ON THE KAESONG INDUSTRIAL COMPLEX

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ISSUES WITH THE KIC PROJECT AND THE RESPONSE OF THE TWO KOREAS

The main difficulties surrounding the Kaesong Industrial Complex have come into even sharper relief following the launch of the Lee Myung-bak government. Of particular concern has been the delay in implementation of the agreement from the first round of North-South prime ministerial talks over the implementation of the October 4 Declaration, which included matters related to the development of the KIC such as the construction of dormitories for North Korean workers and the resolution of the 3C issues (communications, customs, conveyance). Delays in the construction of dorms in the area around the KIC, the building of a day care facility for the children of workers, and repair of the highway between Kaesong and Pyongyang has led to issues concerning stable access to the North Korean labor pool.

North Korea is implementing policy that links resolution of the 3C issues, which are demands made by the South Korean government and South Korean firms, with construction of a nursery, a dormitory, and other demands from Pyongyang. North Korea has said that if the agreement made by South Korean authorities regarding the construction of a dormitory is implemented, it will cooperate aggressively to resolve the 3C issues. Under the previous Roh Moo-hyun government, the expected cost of dorm construction was reflected in the inter-Korean cooperation fund, but as power shifted to the Lee Myung-bak government, implementation of the agreement became bogged down.

NORTH KOREAN PERSPECTIVE

It is worth noting that after the launch of the Lee Myung-bak government, as

inter-Korean relations froze and implementation of agreements on the development of the KIC were halted, the influence of the North Korean defense ministry grew. The defense department began to participate more directly regarding the 3C issues, and are using these issues as a bargaining chip to pressure the South Korean government to shift its policy.

Since the beginning of October 2008, the North Korean leadership has become incensed over South Korean NGOs' sending of leaflets into the North, and began to using travel restrictions over the MDL and cutting of communications with the South as tools to pressure Seoul to change its policy toward the North. By restricting border crossings, the North has stirred up discontentment among businesses operating in the KIC with the intention of getting them to pressure the Lee Myung-bak administration.

As North Korea announced the December 1 measure to restrict travel into the KIC, it stated, "This and other similar harsh conditions are the responsibility of the South Korean authorities who disregard the June 15 Joint Declaration and the October 4 Declaration and pursue a policy of confrontation," and, "From now on, the future of inter-Korean relations depend on the position of the South Korean authorities." North Korea is stressing that the South must choose between implementation of the two declarations and full closure of the KIC.

Looking at this from the North Korean military's perspective, it is difficult to expect its support for a KIC project that gives the appearance of being the result of the inter-Korean declarations. North Korea basically sees the Kaesong Industrial Project as an inter-Korean economic cooperative project that could be pursued in accordance with the June 15 Joint Declaration, and the October 4 Declaration that outlined the actual steps needed to be taken. The expansion and development of this project are seen as being important factors in creating a peaceful national coexistence and balanced development of the North and South.

That said, the Lee Myung-bak government continues to refuse to implement the October 4 agreement, and if this casts a negative shadow over the KIC, the future of the complex is very unclear. The North Korean leadership laid out a vision of quickly improving the lives of its people and building a Strong and Prosperous Nation by the year 2012, and if at all possible, the North will put forth efforts to maintain the Kaesong project, which is one part of that vision.

Domestically in North Korea, there are both those who are agree with the usefulness of the KIC, particularly in supporting the DPRK regime, developing inter-Korean relations, and restoring the homogeneity of the nation, and those who

do not. It is obvious that an increasing number of North Korean bureaucrats are agreeing that the KIC is very economically useful and utilitarian. The KIC has occasionally been used as a test case for a range of market-economic functions that are later applied in other regions in attempts to revive the ailing economy. However, these are at the mercy of changes in the political atmosphere, and their influence is limited.

SOUTH KOREAN PERSPECTIVE

The South Korean government is basically of the opinion that North Korea is wrong to put the blame on Seoul for the failures in inter-Korean relations. The Lee Myung-bak administration has, since its outset, consistently pursued a mutually beneficial inter-Korean relationship of co-existence. It insists that it has shown, through a variety of measures, that it respects the spirit of agreement between the two Koreas as is in the June 15 and October 4 declarations. In addition, Seoul repeatedly points out that President Lee Myung-bak has, on a number of occasions, called for sincere inter-Korean dialog (April 17, June 6, July 11, August 15, September 22, etc.)

Even in the face of domestic criticism, the Lee government offered to provide North Korea with materials and equipment to set up an inter-Korean military hotline (November 13), and on the same day, held a meeting with representatives from businesses operating in the KIC and listened to their difficulties, releasing the "Kaesong Industrial Complex Activation Measures Plan". According to this plan, the budget for the cooperation fund for 2009 would reflect projects such as expansion of basic facilities, repair of roads used to travel to and from work, construction of a dormitory, establishment of a fire department and other items, and an agreement between authorities for the construction of dormitories could begin as soon as early 2009, in accordance with the pace of nuclear disablement. In addition, positive progress on the nuclear issue would lead to active study into projects for the expansion and development of the KIC area, including the surrounding roads.

On November 14, 2008, the South Korean government resolved to allocate 10.4 billion won to the inter-Korean cooperation fund for repair of KIC basic facilities, NGO projects aiding North Korea, and other expected expenditures. The Lee Myung-bak administration is of the opinion that if dialog between authorities could begin, it would make efforts toward resuming tourism to Kumgang Mountain and Kaesong City and completing Stage 1 of the KIC project. Following the North's restrictions put in place on December 1, Seoul has been working actively to ensure smooth operations in the factories located within the Kaesong Industrial Complex.

For example, power, water and other basic services are being supplied steadily, Seoul is ensuring that materials and goods travel in and out of the complex as smoothly as possible, an exhibition of goods produced in the KIC was held, and measures are being implemented in response to concerns or losses of the businesses in the complex. In addition, the South Korean government's position is that, in the event inter-Korean relations improve, resolution of the biggest current issues, the 3C issues, could be resolved through inter-Korean agreements, lodging for North Korean workers could be built to ensure a steady supply of labor, repair of roads to and from the complex could be repaired, and other measures to boost productivity and output of the KIC could be advanced.

THE KIC PROJECT'S PROSPECTS AND THE IMPACT OF FROZEN N-S RELATIONS

As of December 2008, all 93 South Korean businesses (including 30 'apartment-style' businesses) in the KIC were in operation, and 38 more businesses were under construction. Between December 2004 and November 2008, a total of around 502.61million USD-worth of goods had been produced, of which 94.33 million USD-worth had been exported. Currently, approximately 36,650 North Korean workers are employed, and 952 South Korean workers are residing in the complex. This is more than 400 less than the 1,370 ROK workers in the complex during November.

After the restrictive measures enforced by the North Korean authorities on December 1, complaints from businesses in the complex over customs, conveyance, and other issues grew sharply, but at the same time, the businesses have been working hard to adapt. The biggest problem at the moment is still the lack of a steady supply of North Korean workers. South Korean businesses are facing a shortage of manpower, but because the supply of workers from Kaesong City is limited, without the construction of a dormitory and other facilities, the gap between supply and demand of labor will continue to grow. Currently, businesses in the KIC are approximately 12,000 workers shy of the number they are seeking to employ. The Lee Myung-bak government has assured financing for the construction of a dormitory, but has taken the stance that actual use of the funds will depend on movement in inter-Korean relations and resolution of the North Korean nuclear issue, making it unlikely that the concerns of these businesses will be met in the near future.

ECONOMIC IMPACT OF THE KIC

As the freeze in inter-Korean relations continues, its negative impact on the

Kaesong Industrial Complex is not insignificant. Firstly, the actual rate of operation in the factories within the complex has fallen since the North's December 1 measures. The slowdown of the KIC project is also immediately reflected in a fall in inter-Korean trade. In 2008, trade between North and South amounted to 1.82 billion USD, a 1.2 percent rise over the previous year. Of that, the amount of trade related to the KIC was 810 million, an 83 percent increase over the year prior. However, after November of last year, the slowdown in Kaesong led to a fall in overall trade. It will be impossible to resolve the issues currently being faced in the KIC, such as the labor supply and the 3C issues, without a resumption of dialog between North and South Korean authorities. These are not issues that can be tackled by private-sector businesses alone, but they are issues that could push almost all of the businesses that have invested in the KIC into bankruptcy.

Currently, as the North continues to fail to provide additional laborers, the impact on small and mid-sized businesses in the KIC is palpable. Other businesses that have plans to move into the complex are also facing the threat of canceled contracts due to inability to deliver on orders because of the shortage of North Korean labor. The Kaesong Industrial Complex is a significant 'plus' in inter-Korean relations, with the South investing significant amounts in the North in the way of land rents, construction equipment, production facilities, and other provisions necessary for factory operations. In addition, with the exception of some North Korean aggregate, all the materials used in the construction of the complex came from the South. On the other hand, all of the manufactured goods shipped back into South Korea were produced by North Korean labor.

Some of these partially-finished or finished products shipped back to mother companies or partner companies in South Korea get shipped to third countries. This means profits for the companies, and increases efficiency in the domestic economy's production, value-added goods, and employment sectors. In this way, the KIC and the South's economy are linked through cross-border traffic; South Korean investment into the complex is realized through the goods shipped back in return.

In regard to the North Korean economy, North Korean workers receive wages through the South Korean businesses, and the North Korean government benefits by collecting social insurance fees, income tax, and rent from the companies, as well as a percentage of the North Korean workers' wages, in the form of 'socio-cultural taxes'. Therefore, the North Korean economy also benefits through higher employment, more efficient production, and the injection of capital.

Ultimately, investment in the Kaesong Industrial Complex is limited to cost reduction investment, but it differs from investment in China or Vietnam, of which a

significant portion is spent on delivering materials to the factories, in that the use of South Korean raw materials has a more positive impact on the domestic economy. On the other hand, the economic impact the KIC imparts on the North Korean economy is less than the impact of foreign direct investment in China or Vietnam because the KIC is isolated from the rest of the North's domestic economy.

The impact of the KIC on the South Korean economy has been slight, with production and value-added effect amounting to between 510-670 million USD and 170-220 million USD, respectively. However, in the future, if the North Korean nuclear issue, the KIC labor shortage, and capital inflow issues are resolved, the development of the complex can continue as planned, reaching production worth 3.6-4.72 billion USD, and value-added effect worth 1.19-1.56 billion by 2010. Compared to the national average income, these are increases of 0.3-0.4 % and 0.1%, respectively.

With no statistics on North Korea's economy, only the increase in income can be estimated. In 2006, North Korea's national income was approximately 6.7 million USD, but by 2010, this is expected to rise to 100-120 million USD. Investment in the KIC has a positive impact on the domestic economy, and despite the fact that, to date, the impact has been minimal, in the future, following the resolution of the North's nuclear issue, there is a significant likelihood that investment and production in the Kaesong Industrial Complex will grow, further broadening inter-Korean economic cooperation. While many obstacles still remain in the path of successfully implementing the KIC project, its success would result in a major boost to North Korea's economic rehabilitation efforts and would create a spillover effect for the rest of North Korea's economy and society.

CONCLUSION

As we have seen, the freeze in relations between North and South Korea has had direct and indirect impact on the Kaesong Industrial Complex, providing both opportunities and challenges.

The continuing freeze in relations led to the active involvement of the North Korean military, and as its military and political influence has grown, it has caused the KIC to be faced with decisive problems. The 3C (communications, customs, and conveyance) issues and the labor shortage have handicapped South Korean business' efforts to normalize factory operations and expand their businesses. However, if inter-Korean dialog is resumed normalization of the KIC will be a top priority, and these issues will likely be resolved quickly.

Ultimately, whether or not the North Korean nuclear crisis is resolved will be the deciding factor in the future of the KIC. In addition, the KIC project cannot be expected to progress without some political stability in U.S.-DPRK and inter-Korean relations. Furthermore, the project is highly likely to remain in a very unstable position for the time being.

Despite that, in order to ensure the stable development of the Kaesong project, which is an important symbol of inter-Korean peace and cooperation, efforts are needed to reduce, as much as possible, any outside influences. Both North and South Korean authorities need to stop using the KIC as a political tool. In particular, the South Korean government needs to present a more clear vision for the future development of the KIC, and put forth more positive efforts toward the complex's success. Currently, the most helpful action President Lee Myung-bak could take would be to should direct leadership, and clearly show his support for the complex. This would lessen the concerns of South Korean small and medium-sized businesses as well as the apprehensions of the North Korean government, helping to ease unnecessary tensions between Pyongyang and Seoul.