

HRI Monthly Economic Review

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< Executive Summary >

□ Recent Economic Trends

Although economic indices of the US, China, and Japan improve, Europe's real economy deteriorates amid growing political uncertainty. Stock markets of major advanced countries were on the up-turn with economic indices improving. In terms of Korean economy, production and investment increased while the falling rate of consumption slowed down. Trade balance recorded a surplus for 14 consecutive months. Employment environment shows some sign of improvement and inflation rate remains stable.

□ Economic Issues Around The World

- 『The Size of Korea's Underground Economy and Policy Suggestion』: The size Korea's underground economy is larger than those of the developed countries'. Korea's higher ratio of the underground economy compared with developed countries can be explained in four folds: (1)high self-employment rate, (2) fast growth rate of tax rate, (3) high level of corruption, and (4) illegal employment
- 『Sharp Decline of Household Savings and its Ripple Effect』: Domestic household saving ratio is on the downturn since the 1990s, and is one of the lowest of OECD member countries. Reasons for the falling household saving ratio: (1)slowing growth rate of disposable income, (2)burden of contributions to public savings and increased non-living expenditure, and (3)falling interest rate.
- 『The Five Major Trends of China's Economy Manifested in the Two Major Conferences of China』: (1)Growth Acceleration focused on domestic market, (2)Macroeconomic Coordination, (3)Reorganization of Industrial Structure, (4)Income Distribution: Solution of disparity between regions and classes, and (5)Enhancement of Transparency in Politics.

□ The North Korean Issues

The KIC, since established eight years ago, successfully settled down as a symbol of economic cooperation between the North and South Korea, employing more than 50,000 N. Korean workers and producing over US\$400 million worth goods per annum. As a result of survey on KIC Project, experts and participating businesses both agreed that the KIC is very important for maintaining South-North economic cooperation.

I . Recent Economic Trends

□ Recent Global & Domestic Economic Trends

Major Foreign Economies

Although economic indices of the US, China, and Japan improve, Europe's real economy deteriorates amid growing political uncertainty.

The GDP growth rate of the US in the fourth quarter of 2012 was officially announced at 0.4% compared with that of the previous quarter, a slight increase from the figure reported in a newsflash. Household consumption expenditure and corporate investment are increasing and the housing market recovery is strengthening, eased by sustained Fed monetary policy, although fiscal policy is anticipated to be tightened in the near future.

The industrial production in February marked a month-on-month increase of 0.8%, and retail sales rose by 1.1%, showing a sign of continuing economic recovery.

The industrial production and retail sales of Europe delivered mixed results as Europe's political uncertainty persists, highlighted by the financial crisis of Cyprus and Italy's failure to form a coalition government, thereby casting growing doubt over the possibility of Eurozone's successful economic recovery. Although industrial production in January dropped by 0.4%, retail sales rose by 1.2% compared with that of the previous month. The surplus scale of goods balance of Eurozone in January reduced as economic recovery slowed down with the UK and other Eurozone member countries implementing austerity budget measures.

Japan's industrial production in January 2013 increased by 0.3% while retail sales fell by 0.2%, showing a sign of marginal slow-down of growth rate. However, the Bank of Japan raised economic trend forecast of March for the third consecutive month, the first time since November 2009.

The industrial production and retail sales of China in February 2013 increased by 9.9% and 12.3% respectively, a continued rise since the end of the last year. The trade balance in February recorded unexpectedly high surplus (a year-on-year increase of 21%) thanks to the global economic recovery and investment increase.

Global Financial Market

Stock markets of major advanced countries were on the up-turn with economic indices improving.

The US stock market rose by a small margin with economic indices improving. Upbeat German investor confidence data led to a marginal increase of DAX index amid struggling real economic indices. Japan's stock market rallied thanks to the improving real economy resulting from the sustained Japanese government's policy toward a weaker yen and determination for economic revitalization.

JPY/USD exchange rate continues to depreciate in-line with the Japanese government's policy for quantitative easing.

< Economic Indices of Major Countries >

Economic Sectors		2011					2012					2013				
		Annual	Nov	Dec	Jan	Feb	Annual	Nov	Dec	Jan	Feb	Annual	Nov	Dec	Jan	Feb
US	Industrial Production	3.4	1.2	0.1	0.1	0.8	US	DJIA	12,218	13,104	14,054	14,579	14,662			
	Retail Sales	4.7	0.7	0.5	0.2	1.1		DAX	5,898	7,612	7,742	7,795	7,944			
EU	Industrial Production	3.2	-0.8	0.9	-0.4	-	EU	EUR/USD	0.772	0.756	0.761	0.780	0.778			
	Retail Sales	-0.2	0.2	-0.8	1.2	-		NIKEI	8,455	10,395	11,559	12,398	12,003			
Japan	Industrial Production	-1.4	-1.4	2.4	0.3	-	Japan	YEN/USD	77.66	85.86	92.28	94.24	93.21			
	Retail Sales	-1.2	0.5	0.0	-0.2	-		SSE	2,199	2,269	2,366	2,237	2,228			
China	Industrial Production	13.9	10.1	10.3	-	9.9	China	CNY/USD	6.3190	6.2317	6.2273	6.2145	6.2080			
	Retail Sales	17.1	14.9	15.2	-	12.3										

Source : US Department of Commerce; Eurostat; The People's Bank of China

Source : Bloomberg
Note : SSE denotes SSE Composite Index

Korean Economy

Production and investment increased while the falling rate of consumption slowed down. Trade balance recorded a surplus for 14 consecutive months. Employment environment shows some sign of improvement and inflation rate remains stable.

Production and investment increased while consumption marginally dropped. Industrial production marked a month-on-month increase of 1.2% with production in service and construction sector rising although production in mining industry fell. Retail sales fell by 0.1% due to weaker sales of nondurable goods such as foods and vehicle fuels although the sales of durable and semi-durable goods increased.

The trade balance in March 2013 recorded a surplus despite reduced exports to Japan (-18%), marking a surplus for 14 consecutive months. Exports in March reached US\$47.5 billion, a year-on-year increase of 0.4%, while imports fell by 2% to US\$44.1 billion, showing a monthly surplus of US\$3.4 billion. Reduction of exports to Japan, EU, and US has offset increase of exports to ASEAN, China, and Latin American countries. Exports of steel and ship items were weak while IT products strengthened. The export amount in the first quarter of 2013 marked US\$135.5 billion, a year-on-year increase of 0.5%, while imports dropped by 3% to US\$129.7 billion, making a quarterly surplus of US\$5.9 billion.

The number of workers in employment as of February 2013 recorded a y-o-y increase of 200,100. The background for the decrease in the expansion of the employed from more-than-thirty thousand to around the twenty thousand is that people employed as daily workers fell due to the lunar new year national holidays in the survey period. The unemployment rate marked 4%, a y-o-y decrease of 0.2%p, and the number of the unemployed fell by 53,000 to 990,000. The unemployment rate in February virtually dropped compared with that of February 2012 when adjusted for the seasonal factor of new graduates searching for jobs.

The consumer price index remained at a low level. The inflation rate of

February 2013 marked a y-o-y increase of 1.3%, a 1%+ increase for five consecutive months. Compared with previous month, the overall inflation rate fell by 0.2% with prices of agricultural and livestock products, and personal service sector falling by 2.2% and 0.8% respectively.

The stock market fell with European crisis factors reemerging, and despite some volatility , KRW marginally appreciated against the dollar. Corporate bond yields dropped during the month of March.

The KOSPI fell in March alongside the Cyprus crisis and the slow-down of the won's strengthening trend. KRW/USD exchange rate rose due to the wariness of the reemerging European crisis and North Korean issue. Corporate bond yields dropped to 8.50% in March.

< Korea Major Economic Indices >

(p, %)

Economic Sectors		2011			2012					2013	
		Annual	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Jan	Feb
Domestic Market	Retail Sales	4.3	4.7	1.9	1.8	2.1	1.0	1.6	0.2	-2.8	-
	Facility Investment Index	0.7	-3.1	-4.7	-1.1	10.2	-0.2	-7.1	-5.6	-6.5	-
	Construction	-6.7	-8.4	-0.5	-7.2	0.6	-8.3	-2.9	-7.4	9.4	-
Foreign Trade	Export Growth Rate	19.0	21.4	9.0	-1.3	3.0	-1.7	-5.7	-0.3	10.9	-8.6
Employment/ Prices	Unemployment Rate	3.4	3.1	2.9	3.2	3.8	3.3	3.0	2.8	2.9	-
	Consumer Price	4.0	4.3	4.0	2.2	3.0	2.4	1.6	1.7	1.5	1.4
Finance	KOSPI	-	1,770	1,826	-	2,014	1,854	1,996	1,997	1,962	2,026
	KRW/USD	-	1,178	1,152	-	1,133	1,145	1,111	1,071	1,089	1,083
	Corporate Bond (BBB-)	10.38	10.31	10.12	-	10.05	9.69	8.69	8.81	8.70	8.58

Source: Bank of Korea, National Office of Statistics, Foreign Trade Association

II . Economic Issues Around The World

□ The Size of Korea's Underground Economy and Policy Suggestion

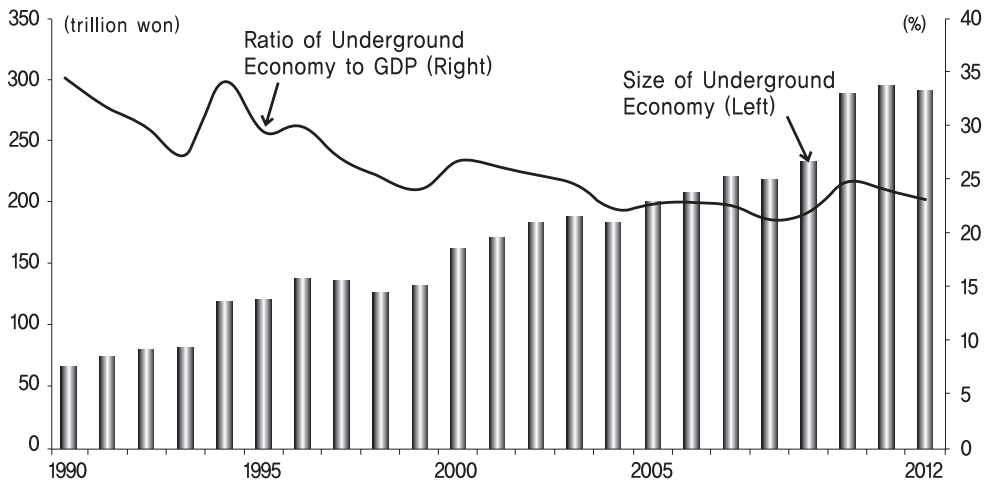
Recent government attention appears focused on identifying funding sources to finance the expansion of the welfare system not by direct taxation which would inevitably generate high social costs, but by acknowledging and decriminalizing the underground economy. The National Tax Office declared an all-out war against all illegal trading including circulation of fake gasoline while intensifying investigations for tax evasion by high income professionals and the self-employed. The National Tax Office recently formed a 'Fair Taxation Planning Task Force' and completed its preparation for the war against underground economy. However, there are different views on the potential consequences of raising tax revenue by 'legalization of underground economy'. What on earth is the underground economy? The underground economy can be defined in two categories: illegal trade and legal economic activities. Specifically, legal economic activities in terms of the underground economy refers to legal trades which are not included in the official statistics for the sake of tax evasion. The underground economy can also be divided into money transactions and non-money transactions. Regardless of the definition, there is limited scope in determining the true nature or size of the underground economy as it is an actively hidden economic sector.

The size of Korea's underground economy is larger than those of the developed countries'

The methods of estimating the underground economy are largely divided into three types: direct, indirect and model-based estimating method. The size of Korea's underground economy in 2012 determined by employing one of the

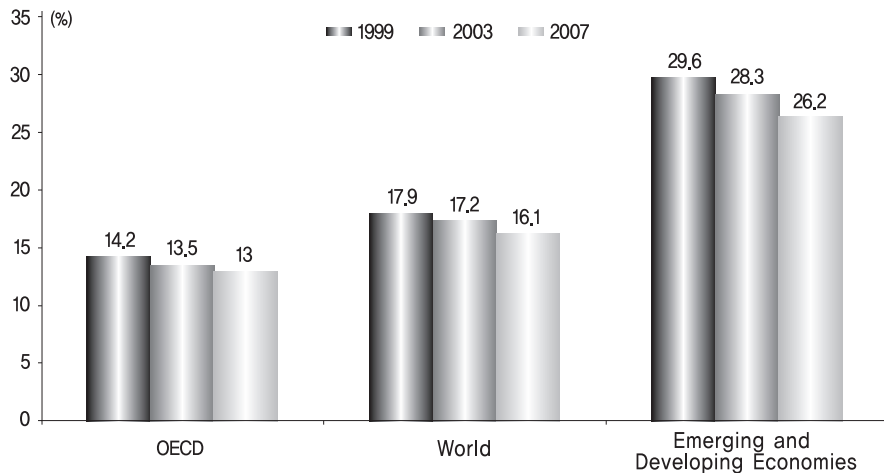
indirect estimating methods utilizing currency demand model is approximately 290 trillion won, which is about 23% of Korea's nominal GDP. Although the ratio of the underground economy to the nominal GDP is on the downturn, it appears to have recently increased by a small margin. The average size of the underground economy of OECD member countries is 13% while average underground economy size of developing countries is 26.2%. Korea's underground economy size is larger compared with developed countries for which measures for legalization have to be found. Tax evasion, the main issue arising from the underground economy, is not only causing a decrease of tax revenue, but also increasing the social burden, contributing to polarization of wealth due to disproportionate income distribution. Therefore, the legalization of underground economy is a must not simply for securing source of finance, but for the sake of equitability in taxation, fighting against corruption, and rooting out illegalities.

<Trends of Estimated Size of Korea's Underground Economy>



Source : Estimates by HRI(Detailed estimating method is attached under separate cover)

<Trends of Size of Underground Economy by Region>



Source : Schneider, F., Buehn, A., & Montenegro, C. E. (2010). "Shadow Economies all over the World: New Estimates for 162 Countries from 1999 to 2007." World Bank.

Note : Average sizes of underground economy in each region were drawn based on the Multiple Indicators Multiple Causes(MIMC) model and the estimates of each country's underground economy size with different weights placed on each country's GDP

The background for Korea's high ratio of underground economy

Korea's higher ratio of the underground economy compared with developed countries can be explained in four folds:

1. That the ratio of the self-employed in Korea is much higher than the average ratio of OECD country members, and it is very difficult to determine the real income of those self-employed leads to the high rate of failure to declare income. Korea's ratio of the self-employed is 28.8% as against 7.0% of the US, 12.3% of Japan, and 13.9% of the UK. According to statistics of the National Tax Office, the amount of undisclosed income of the self-employed with high income is estimated at 3.6 trillion won, indicating a 48% rate of income omission.
2. The growth rate of Korea's total tax rate¹⁾ is rising very fast compared with those of developed countries, leading to an incremental taxation-burden

1) total tax rate=(taxation+social security contribution)/GDP

and to an increasing temptation toward tax-evasion. Korea's total tax rate increased by 3.3% to 25.9% in 2011 from 22.6% in 2000, marking the fastest growth rate of all OECD member countries.

3. The corruption level of Korea is very high compared with major developed countries, becoming a major factor of the expansion of the underground economy. Corruption Perceptions Index (CPI), which shows Korea's corruption sentiment level, was improving until 2008, but appears to have stagnated since. Korea's corruption level is very high compared with major developed countries such as Japan, the US, and the US, raising a serious alarm.
4. Workers who failed to find jobs in official economic zone due to the prolonged economic depression are entering black labor market, resulting in illegal employment and untaxed income which contributes to the expansion of underground economy. Likewise, illegal employment of foreign laborers enables businesses to evade tax and reduce expenses. The temptation to save labor costs by avoiding regulations on payment and working hours appears to help the underground economy expand. Korea's Index of Labor Freedom is very low compared with those of the US, Japan or the UK.

Targeted policies required to reduce Korea's underground economy.

Major advanced countries are adopting policies to reduce the underground economy by encouraging trading transparency and tax payment in good faith, and at the same time intensifying access to financial transaction data and introducing an independent system to appeal to civic conscience. These advanced countries are exercising both carrot and stick measures by giving incentives to the good tax-payers and by imposing corrective measures including an intensive tax inspection and a strict control to tax-evaders. Korea should also prepare for tailor-made measures to bring out and legalize underground economy while minimizing tax resistance and the impact on the national economy. Considering the background to Korea's underground economy and similar policies adopted by major advanced countries, Korea should:

1. Offer incentives to the self-employed engaged in industries closely related to day-to-day living such as businesses dealing with the four ceremonial occasions of coming-of-age, wedding, funeral, and ancestral rites, food-serving, wholesale and retail, education and medical services, and professionals with high income to encourage faithful declaration of their real income.
2. Maintain rigid supervision to prevent omission of income declaration by the self-employed running large-scale service businesses involved with frequent cash transactions, and tighten controls and monitoring of unfaithful tax payers.
3. Provide tax office with supervising powers in financial-information access in order to prevent tax evasion, and strengthen collaboration between financial information organizations and the tax offices in order to carry out effective tax inspections on suspicious business dealings.
4. Stop and prevent illegal and law-evading transactions such as trading of fake products and money laundering by allowing enhanced accessibility of tax offices to the financial transaction information.
5. Reduce the size of black labor market by easing labor regulations, whilst creating jobs of good quality as well as tailor-made-jobs for the aged by revitalizing economy.
6. Enhance people's sense of duty of tax payment through education and tight control while applying rigid penalties to unfaithful tax payers and raising opportunity cost for tax evasion. Education on the duty of tax payment should also be a part of standard education curriculum.

□ **Sharp Decline of Household Savings and its Ripple Effect**

Continuing decline of household saving rate

Domestic household saving ratio is on the downturn since the 1990s, and is one of the lowest of OECD member countries. The net personal saving ratio announced by the Bank of Korea showed high ratio of 20%+ until 1990 thanks to the rising household income generated by the economic development, but is

continuing to decline since early 1990s. Korea's household saving ratio is now no higher than half of 5.3%, the average OECD ratio, much lower than 10.4% of Germany and less than the 4.2% of the US.

Reasons for the falling household saving ratio

(Income Aspect) The slowing growth rate of disposable income has caused the saving ability of households to fall. The average annual growth rate of disposable income in the 1990s was above 10% before it started to decline to more or less 5% in 2000s. The growth rate of real national income has been less than the economic growth rate for more than a decade as the terms of trade continue to deteriorate. The average growth rate of real national income shows 3.5% since 2000, 1.0% lower than the average growth rate of GDP for the same period.

(Expenditure Aspect) The burden of contributions to public savings such as national pension, and increased non-living expenditure such as medical insurance have hampered individual's ability to save. The ratio of non-living expenditure to income of urban households with two or more members was 15.6% in 1990, but has now increased to 18.8% in 2012.

The enforcement and expansion of the national pension scheme, and system change has weakened individual's motivation for saving. The ratio of national pension subscribers was stable at around 30%+ in the 1990s, but jumped to 80%+ since 1999 when the national pension scheme was expanded to capture urban households with 5 or fewer members.

(Financial Aspect) The falling interest rate is discouraging individuals from saving. The real interest rate reached up to 10% range in the 1990s, but owing to Asian financial crisis in the late 1990s, Korean credit card crisis, and subsequent global financial crisis in the US and Europe, has since collapsed to 0.41% in 2011 and 1.57% in 2012. The growing burden of paying interest for the fast-increasing household debts sharply reduced the wherewithal to save. The household debt ratio to disposable income was 114% in 2002, which briefly dipped due to the temporary reconstruction of household debts after the credit card crisis before again moving upward in 2004 and has since increased to 135% in 2011.

The ripple effect of the falling household saving ratio

The reduction of investment caused by the falling household saving ratio leads to a softer economic growth rate as there is less investable capital that can be allocated to expenditure for building new factories and equipment. Regression-based statistical analysis indicates that a 1%p fall of net personal saving ratio reduces gross fixed investment ratio by 0.25%p, resulting in a 0.19%p fall of economic growth rate.

The shrinking household saving due to the falling net personal saving ratio is likely to destabilize household financial structure. Most Korean household assets comprise of real and tangible property with low liquidity, seriously lacking in liquid financial assets. Faced with a situation of repaying its bank loans, a household would likely become bankrupt without the successful sale of its illiquid assets.

Lately, the issue of income security for the aged comes to the fore as household saving shrinks due to unstable earned income and asset income. Korea's population is aging at an alarmingly fast rate with the sustenance for the aged and aging index of 7.7% and 20.0% respectively in 1990 rising to 16.1% and 77.9% in 2012. The level of preparation for old age appears inadequate with falling property prices and shrinking household saving: the main source of income for the aged.

Suggestion

The following measures should be taken to enhance the household saving ratio and address the income security issue for old age and prevent the economic growth rate from further falling:

1. The saving ratio which indicates the level of future growth engine should be raised to the average level of OECD member countries and become a virtuous circle of expanding investment, economic growth, and rising income leading to a stable saving ratio.
2. Every effort must be made to raise individual's saving ratio by expanding income infrastructure, stabilizing consumer prices, and creating good quality jobs.

3. Individual real income needs to be increased by improving terms of trade.
4. Registered retirement savings plans yielding high interest such as workers' asset building savings should be developed to encourage ordinary people to save.
5. Growing ratio of non-living expenditure should be dealt with and stabilized.
6. Public savings such as pension fund should be managed effectively and transparently to ease national burden.

□ **Five Major Trends of China's Economy Manifested in the Outcome of the Two Major Conferences of China**

Xi Jinping's government officially launched

China officially launched Xi Jinping's government at the Two Major Conferences held for two weeks from March 3 to March 17. The Two Major Conferences, which marks the 12th term this year, refers to the National People's Congress of the People's Republic of China and Chinese People's Political Consultative Conference. The Two Major Conferences of this year are significant as the outcome of both Conferences will show policy direction, particularly in relation to the issues of economic structure such as economic growth policies focused on domestic market, industrial reconstruction, addressing income disparity, fighting corruption and macroeconomic policy coordination of Xi Jinping government to revitalize China's economy.

< Target of Economic Growth Set by China for 2013 >

Sections	Targets	
	2012	2013
GDP	7.5%	7.5%
CPI	4.0%	3.5%
M2	14%	13%
Fixed asset investment	16%	18%
Fiscal spending	11 trillion and 72 million yuan	13 trillion and 82 million yuan
New employment	9 million	9 million

Source : Hsinhua

Five Major Directions of China's Economic Policy for 2013

① Change of Economic Growth Pattern: Growth Acceleration focused on domestic market

Having delivered economic growth target at 7.5% for three consecutive years since 2011, this year's Two Major Conferences suggested policy change for economic growth based on domestic consumption. The background of this change is believed to be China's awareness of the possibility of China's global exports meeting demand limitize in the future due to the continuing low economic growth of global economy. Therefore, China is anticipated to focus on domestic demand in the future for economic growth.

② Macroeconomic Coordination: Currency Stabilization amid Fiscal Expansion

China, as a means of macroeconomic coordination to address the slowdown of its economy, is likely to flexibly coordinate the total money supply for fear of inflation and a property market bubble while enforcing expansionary fiscal policy such as tax-cuts and expansion of investment in infrastructure of road and railway. China is also anticipated to continue to allow government grant for energy-saving products and expand investment in the public sector. China will adopt a financial and monetary policy such as deposit-reserve ratio coordination and open market operation to prevent domestic economy such as property market from becoming overheated.

③ Reorganization of Industrial Structure: Promotion of Higher Value-added Service and Manufacturing Industries.

China is expected to focus on upgrading its industrial competitive edge by promoting higher value-added manufacturing and service industries. Although the ratio of tertiary industry is 44.6% as of 2011, close to 45.2% of secondary industry, the mainstay of the tertiary industry comprises of lower value-added industry such as restaurant business and wholesale/retail business, and the ratio of manufacturing industry is stagnant, delaying development and creation of a higher value-added new industry through innovation. Chinese government is therefore expected to gradually reform industrial structure for the

enhancement of cutting edge technological innovation, promotion of environment-friendly low-carbon green industry, industrial clusters, support of M&A and small & medium businesses, and for tightening of competition law such as antimonopoly law.

④ *Income Distribution: Solution of disparity between regions and classes*

Development drive will shift from the eastern regions to the west, and financial injection will be expanded to address the issue of income disparity between the urban and the agricultural areas. China’s economic development has been focused on particular regions for the last ten years as the ratio of regional GRDPs of 2011 shows: eastern region 52%, central region 20%, western region 19%, and northern region 9%. The level of urbanization also shows serious disparities between regions with the coastal region such as Beijing and Shanghai twice or three times higher than the central and western region such as Quiju and Xijing. Gini’s Coefficient, an index showing income imbalance, has grown from 0.42 in 2000 to 0.47 in 2012, and the income disparity between the urban and the agricultural area has expanded during Hu Jintao’s term of office(2003-2012) with urban area three times as high as that of agricultural area.

⑤ *Anticorruption : Enhancement of Transparency in Politics*

China is likely to set up a new agency and introduce new laws to solidify socialist system of government and to enhance national brand of China. According to the national corruption index surveyed by the Transparency International, China marked 3.9 well below the OECD average 6.9.

< Trends of China's Corruption Index >

Sections	2012	2010	2005	2000
OECD average	6.9	6.9	7.1	6.9
Finland	9.0	9.2	9.6	10.0
China	3.9	3.5	3.2	3.1

Source : Transparency International

Note : Corruption index starts from full mark of 10, with 0 mark denoting the most corrupt nation

Suggestions

China is likely to go through an industrial reorganization for the sophistication of industrial structure with its economic policy focused on the expansion of domestic consumption, and therefore, Korea needs to respond with appropriate measures with the following points in consideration:

1. Korea should seek to find a way to participate in China's projects for new buildings and expansion of infrastructure required for the urbanization policy of Chinese government, and set up strategy to promote exports of consumer goods to China in line with China's economic focus on expansion of domestic consumption.
2. It is also important for Korea to lead the private sector service market including sightseeing and leisure industry, which is rapidly growing as average household income rises.
3. Korea should urgently enhance overall industrial competitive edge in response to the growing sophistication of China's industrial structure. In the near future, not only in low-carbon industry, but China's overall industrial efficiency will be significantly enhanced, and therefore Korea should continue to strengthen innovative capability of overall industries and non-price competitiveness to stay ahead of China.
4. Korea should carefully review relevant Chinese laws before launching a project in China in response to China's antimonopoly act and price act designed to protect China's industries.

III. The North Korean Issues

□ Assessment of Kaesong Industrial Complex(KIC): A Survey Conducted on Experts and Participating Businesses

The KIC, since established eight years ago, successfully settled down as a symbol of economic cooperation between the North and South Korea, employing more than 50,000 N. Korean workers and producing over US\$400 million worth goods per annum. However, the strained South-North relation and subsequent May 24 sanction imposed on the North resulted in suspending additional investment as a part of the first phase development and delayed the launching of the second and the third phase of developments. We conducted a survey from November 5 to 15, 2012, on 104 experts on North Korea, and KIC participant businesses to assess eight years of the KIC project in our desire to assist new S. Korean government create new policy directions for effective South-North economic cooperation.

Assessment and Prospect of KIC Project

(Assessment of KIC Project) Experts as well as KIC participating businesses responded that the Project was successful(89.4% and 94.1% respectively), and absolute majority of participating businesses (97.1%) and a great majority(72.1%) of experts answered ‘yes’ to the question of whether KIC positively contributed to revitalization of S. Korean small & medium businesses and enhancement of competitive edge.

< Assessment of KIC Project >			< Contribution to Revitalization of S. Korean Small & Medium Businesses and Enhancement of Competitive Edge >		
	Experts	KIC businesses		Experts	KIC businesses
Successful	89.4%	94.1%	Contributed	72.1%	97.1%
Not successful	10.6%	5.9%	Not contributed	27.9%	2.9%

(Successful Aspect of KIC Project) Experts and participating businesses(80.6% and 56.3%) most positively agreed that the KIC offered ‘an ideal model for South-North economic cooperation.

< Successful Aspect of KIC Project >

	Experts	KIC businesses
KIC offered’an ideal model for South-North economic cooperation.	80.6%	56.3%
Revitalization of small & medium businesses	6.5%	21.9%
Promotion of understanding and sense of affinity between the North and South	3.2%	12.5%
Contribution to easing the tension between North and South	7.5%	6.3%
Testing site of unification	1.1%	3.1%

(Assessment on the competitive edge of KIC compared with other overseas industrial complexes) Absolute majority of KIC businesses(97.1%) and a great majority of experts(86.5%) responded that KIC has a cutting edge compared with overseas industrial complexes in the areas of ‘competitive labor cost’(70.0% and 36.4% respectively) and ‘convenience of communication in the same language’(17.8% and 24.2%). KIC businesses in particular showed a very positive response to ‘efficient worker-training and ability to produce trendiest commodities with geographical advantage(36.4%).

< Competitive Edge of KIC Compared with Overseas Industrial Complexes >

	Experts	KIC businesses
Good	86.5%	97.1%
Not so good	13.5%	2.9%

< Areas with Good Competitive Edge Compared with Overseas Industrial Complexes >

	Experts	KIC businesses
Low labor cost	70.0%	36.4%
Communication in the same language	17.8%	24.2%
Efficient worker-training and ability to produce trendy items	4.4%	36.4%
Saving of incidental expense such as logistical cost	5.6%	3.0%
Preoccupation of N. Korean market	2.2%	0.0%

(Direction of KIC Project Operation and Challenges) Absolute majority of KIC businesses and experts(97.1% and 84.6%) responded that KIC should be ‘gradually expanded’, and the top priority issue to be solved for invigoration of KIC is to address difficulties of passage, telecommunication, and custom clearance(38.9% and 35.3%). KIC businesses in particular answered that building of dormitories is important(20.6%).

<Forecast of KIC Project>

<Pending Issues Facing KIC Project>

	Experts	KIC businesses		Experts	KIC businesses
Should expand	84.6%	97.1%	Three issues of passage, communication and customs clearance	38.9%	35.3%
			Unilateral action of the North	26.9%	11.8%
Maintain the status quo	12.5%	2.9%	Construction of dorm for and securing of N. Korean workers	17.8%	20.6%
			Issues of movement of strategic materials and country of origin	12.0%	13.2%
Scale down	2.9%	0.0%	Insufficient government grant	1.4%	14.7%
			Others(poor infrastructure etc)	2.9%	4.4%

Task of the New Government for the inter-Korean Economic Cooperation

(Pending issues facing the inter-Korean economic cooperation)

Absolute majority of both experts and KIC businesses are ‘for’ easing the May 24 Sanction by the new government(93.2% and 97.1%), and also responded that enforcing previously agreed projects should be implemented before ‘planning any new projects’(86.4% and 91.2%).

< Easing of May 24 Sanction >

<Priority in Inter-Korean Economic Cooperation>

	Experts	KIC businesses		Experts	KIC businesses
Yes	93.2%	97.1%	Already agreed projects first	86.4%	91.2%
No	6.8%	2.9%	New projects first	13.6%	8.8%

(Priority task of existing agreement on the inter-Korean economic cooperation) Experts and KIC businesses believe that KIC should be promoted for quality improvement, while carrying out the second & the third phase of KIC project(33.5% and 47.1%), resumption of Mt. Kumgang & Kaesong tourism, and pushing forward with Mt. Backdu tourism project(28.2% and 29.4%).

(Factors constraining enforcement of the inter-Korean economic cooperation) Respondents pointed out that non-economic factors such as ‘political and military tension’ and ‘lack of trust and determination of authorities of the North and the South’ are the main hurdles constraining further development of economic cooperation. Considering that economic factors such as institutional challenge and poor infrastructure are posing no great hindrance to the economic cooperation(5.9% and 2.9%), non-economic constraint factors mentioned above remain as serious challenge.

<Priority in Inter-Korean Economic Cooperation>

<Factors Constraining Enforcement of Inter-Korean Economic Cooperation>

	Experts	KIC businesses		Experts	KIC businesses
Expansion of KIC project	33.5%	47.1%	Political and military tension between S&N	54.4%	70.6%
Expansion of S&N tourism project	28.2%	29.4%	Lack of trust and determination between S&N	39.8%	26.5%
Development of underground resources of N. Korea	12.1%	8.8%	Lack of institutional framework	4.9%	0.0%
Infrastructure building such as connecting railway	11.7%	10.3%	Insufficient logistics & communication infrastructure	1.0%	0.0%
Project of peace and cooperation in the west coast	10.2%	1.5%	Insufficient finances for inter-Korean economic cooperation	0.0%	0.0%
Light industry project for the North	4.4%	2.9%	Others	0.0%	2.9%

Policy Suggestion

Experts and KIC businesses assessed the KIC as a model of mutually-beneficial projects for both North and South, and the following measures should be taken to further develop the KIC and the inter-Korean economic cooperation:

1. Both authorities should make joint-efforts to create favorable operational conditions for the KIC by easing political and military tension and by promoting security in the Korean peninsula.
2. For the purpose of reinstating trust between the North and the South, both authorities should push forward with the projects already agreed upon by easing the May 24 sanction. Prompt resumption of Mt. Kungang tourism, consolidation of the first phase of KIC, and expansion of the KIC project to its second and third phase are highly recommended.
3. Meetings between the two authorities should be regularly held and relevant laws amended to build a system for the inter-Korean economic cooperation under the principle of separation of economic affairs from politics, and where economy is prioritized ahead of politics.

[Annex]
Domestic and Global Economic Indices

[Annex] Domestic and Global Economic Indices

□ Global Growth Rate

Category	2011					2012					2013
	Annual	1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Annual(E)
US	1.8	0.1	2.5	1.3	4.1	2.2	2.0	1.3	3.1	0.4	2.0
Euro Region	1.4	0.8	0.2	0.1	-0.4	-0.4	0.0	-0.2	-0.1	-0.6	-0.2
Japan	-0.6	-7.3	-2.8	10.4	0.3	1.9	6.0	-0.1	-3.8	-0.4	1.2
China	9.3	9.7	9.5	9.1	8.9	7.8	8.1	7.6	7.4	7.9	8.2

Note : 1) IMF figures of January 2013 for 2013 global projections.

2) Annual rates were compared with those of previous term for the US and Japan, with the rates of the previous term for Euro region, and with the same term in the previous year for China.

□ Economic Indicators of South Korea

Division		2011	2012			2013(E)
			the first half	the second half	Annual	
National Account	Economic Growth rate (%)	3.7	2.6	1.5	2.0	3.1
	Private Consumption (%)	2.4	1.2	2.2	1.7	2.5
	Construction Investment (%)	-4.7	-1.9	-2.4	-2.2	2.2
	Facility Investment (%)	3.6	2.3	-6.1	-1.9	4.8
Foreign Trade	Current Account (100 million Dollars)	265	138	295	431	285
	Exports (100 million Dollars) [Increase rate, %]	5,552 [19.0]	2,750 [0.5]	2,729 [-3.1]	5,479 [-1.3]	5,786 [5.6]
	Imports (100 million Dollars) [Increase rate, %]	5,244 [23.3]	2,641 [2.3]	2,555 [-4.0]	5,196 [-0.9]	5,529 [6.4]
Consumer Price (Average, %)		4.0	2.7	1.7	2.2	2.5
Unemployment rate (Average, %)		3.4	3.6	2.9	3.2	3.3

□ Economic Indicators of North Korea

(USD million)

Category	2005	2006	2007	2008	2009	2010	2011	2012	
Per capita GNI	105	103	104	114	119	124	133	-	
Amount of Trade by Year	South-to-North	715.5	830.2	1,032.6	888.1	744.8	868.3	800.2	897.2
	North-to-South	340.3	519.5	765.3	932.3	934.3	1,043.9	913.7	1,074.0
	Total	1,055.8	1,349.7	1,797.9	1,820.4	1,679.1	1,912.2	1,713.9	1,971.2

Source: THE BANK OF KOREA, Ministry of Unification

Hyundai Research Institute

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HRI is established by Chung Ju-yung, the first CEO, founder and honorary chairman of Hyundai Group in 1986. HRI is a leading Korean research think tank committed to studying and analyzing the economic and industrial environment as well as reunification economy of Korea. HRI, further, has its own businesses such as business consulting, education and training service, and knowledge-content business.

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