

## SOUTH-NORTH ECONOMIC COOPERATION: CURRENT STATUS AND FUTURE PROSPECTS

by Soon-Jick Hong and Jong-Hoon Park  
(e-mail: sjhong@hri.co.kr, parked@hri.co.kr)

### *Declining Trade in 1998*

Inter-Korean economic cooperation showed some mixed signs in 1998, with trade being down but investment on the rise. Total trade dropped by 28% to \$220 million in 1998. However, as the year progressed, there were some encouraging signs. In particular, the start of Hyundai's Mt. Kumgang tourism project has opened a new age in bilateral economic cooperation, setting the standard as a model joint business project.

Processing on commission (POC) trade also fell by 10.2% from the previous year because of the difficulties being faced by domestic textile manufacturers and also the higher exchange rate. However, the number of firms engaging in POC trade increased from 48 to 61, and the range of products has diversified.

### *Progress in Terms of Investment*

Meanwhile, significant progress was made in terms of investment, thanks to the new Kim Dae-jung Administration's firm policy principle of separating politics from the economy and also the supporting measures to boost inter-Korean economic cooperation announced on April 30, 1998. As a result of these changes, the total number of cooperation partnerships approved increased to 40, while the total number of cooperation projects approved rose to 15.

The largest investment was made by three Hyundai companies (Hyundai Merchant

Marine, Hyundai Construction & Engineering, and Keum Gang Development Industrial) into the Mt. Kumgang project (\$133 million), which marked a shift in the type of cooperation from "light industries/small-size investment" to "service industries/large-scale investment." In addition, there have been over 30,000 visitors to Mt. Kumgang since the tours started on November 18, 1998, which has helped ease tensions on the Korean peninsula.

### *Many Opportunistic Factors in Outlook for 1999*

As was evidenced by the nearly simultaneous timing of the Mt. Kumgang cruises and the North Korean submarine incursion incident, North-South relations are characterized by a certain duality or even schizophrenic nature. Accordingly, the outlook for inter-Korean economic cooperation in 1999 is marked by a number of opportunistic factors, but some pessimistic constraints.

On the South Korean side, now that the currency crisis has passed and the economy is beginning to show signs of recovery, the country is in a better position to focus on the North Korea problem. The government is expected to take its "sunshine" policy toward North Korea to the next level and more actively pursue a policy of reconciliation and engagement to eliminate the remaining vestiges of the Cold-War system.

At the same time, material trade and investment are expected to increase in 1999. In addition to Hyundai's North Korea projects includ-

*"The largest investment was made by three Hyundai companies into the Mt. Kumgang project (\$133 million), which marked a shift in the type of cooperation from "light industries small-size investment" to "service industries large-scale investment.""*

ing the Mt. Kumgang tourism and the construction of an industrial complex on North Korea's west coast, other business groups and organizations for small- and medium-sized business are also planning to expand their investment activities and participation in joint ventures.

In addition, once the issues of North Korea's suspected nuclear facility and weapons development are settled, the main part of the light-water reactor construction project can get underway, which will also significantly boost bilateral trade and exchanges.

On the North Korean side, it seems there is growing recognition of the need to expand South-North economic cooperation and improve relations if the North is to escape from its economic difficulties and preserve the Kim Jong-il regime in the face of worsening external conditions. North Korea's revised constitution emphasizes increased external trade and opening of the economy, suggesting a more realistic approach in dealing with its economic problems. Furthermore, North Korea seems to be responding favorably to the South's sunshine policy, as evidenced by their agreeing to participate in negotiations on the four-party talks, and the Kumchang-ri facility, and the proposal for South-North high-level political talks, which should also help boost cooperation in the future.

Another important factor which will affect South-North economic cooperation this year will be the U.S.-N.K. negotiations on on-site inspections of the Kumchang-ri nuclear facility. Resolution of this issue could facilitate the U.S.'s lifting of economic sanctions on North Korea or the initiation of Japan-N.K. and war compensation negotiations.


### *Possible Constraints*

In spite of the above-mentioned optimistic signs, there are several possible constraints. First of all, South Korean firms are still

undergoing restructuring at this time and the overall burden of restructuring along with lack of liquidity during this process will limit their ability to fully pursue expanded business cooperation.

Next, the non-resolution of the lingering suspicions over North Korea's nuclear facilities and the instability of the North Korean political system may be keeping the investment risk high, which is compounded by the lack of an investment protection guarantee and other legal and institutional safeguards. In addition, infrastructure and basic industrial facilities are lacking; the consumption market is weak; logistical and transport costs are high because of the indirect trade; and on-site technical training remains problematic.

In addition, if South Korean firms are to set up factories in North Korea as export promotion bases. For this to happen, realistically U.S.-N.K. relations will have to improve and the U.S. will have to lift economic sanctions. However, any lifting of sanctions will probably be gradual and limited in effect, as seen in the examples of Vietnam and Cuba.

All in all, it can be expected that South-North private economic cooperation will increase this year, especially in light of the expected changes in North Korea with its adoption of a more realistic approach to its economic difficulties, the expected upturn in the South Korean economy's business cycle, the government's active engagement policy, and increasing trade and investment stemming from Hyundai's North Korea projects. With the scrapping of limits on the transfer of unused South Korean facilities to the North, POC trade of light industry goods and simple assembly of electronic goods should increase. Investment should pick up with the Hyundai Mt. Kumgang project, the West Coast industrial complex construction project, and the main part of the light-water reactor construction project. Cooperation will also expand in the fishing, tourism and electricity sectors. 

*"The government is expected to take its "sunshine" policy toward North Korea to the next level and more actively pursue a policy of reconciliation"*

*"On the North Korean side, it seems there is growing recognition of the need to expand South-North economic cooperation and improve relations if the North is to escape from its economic difficulties and preserve the Kim Jong-il regime in the face of worsening external conditions."*