

KAESEONG INDUSTRIAL COMPLEX: Pending Issues and the Task of International Cooperation

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1. Introduction

The international community, especially the US, has expressed strong concerns over the issues of human rights and working conditions pertaining to North Korean workers in the Kaesong Industrial Complex (hereafter, the KIC). It seems that the US is worried that the effectiveness of its pressures on North Korea over the issues of North Korea's nuclear program and counterfeiting would diminish if the construction of the KIC goes smoothly. Moreover, the US might be considering that the cash transactions and export of strategic materials which will likely result in the operation of the KIC would go against international regulations and the interests of the US.

The US has also taken the human rights issue of the indirect payment of wages to North Korean workers as an opportunity to criticize the country. During an Internet chat forum with Koreans on June 27, US Ambassador Alexander Vershbow expressed his view on this matter saying that South Korean companies in the KIC should be able to pay the wages directly to North Korean workers.¹ The international community, especially the US, has made clear its position that it would consider the KIC as a positive change when the working conditions of the KIC meet international standards.²

The question I would like to ask is whether such concerns of the international community, especially the US, have any objective ground. How realistic is their demand for international standard working conditions in the KIC? This paper attempts to discuss objective and realistic responses to these issues. This discussion is preliminary in that the issues raised by the international community must be dealt with in a serious manner and via scrupulous analyses. This paper argues that the KIC is not a concern only for the two Koreas but is becoming an international interest. Pointing to the fact that international cooperation is critical to the success of the KIC, this paper identifies some concrete tasks of international cooperation. In other words, I will examine the approaches and tasks for the international community while considering the current situation North Korea is facing at home and abroad.

¹ *Yonhap News* (2006.6.27).

² The interview of Mitchell Reiss, former policy director at the US Department of State. *Chosun Ilbo* (2006.6.29).

2. International Issues and Objective Reality

1) Payment of Wages

The direct payment of wages to North Korean workers in the KIC is the biggest concern for the US. While stating that “it hopes for a much bigger change in the North Korean economy through projects” like the KIC, the US made it clear that “the first positive stage is for North Korea to allow South Korean companies to give wages directly to the workers.” The main argument of the United States is that the direct payment of wages to the workers would help workers obtain a just amount of wages paid and also give them an opportunity to understand the benefits of working in the market economy system.³

South and North Korea agreed to the direct payment of wages to workers in the KIC (Article 32 of the Labor Regulations) and North Korea has expressed that it is willing to implement this condition. North Korea is well aware of the importance of meeting the demand of the South Korean government to implement the direct payment system and stated that it will execute the system as soon as logistic preparations—such as a banking system for foreign exchange—are complete. At the moment, North Korean workers get a wage stub and they confirm the amount of wage by signing the stub, thus guaranteeing indirect transparency. In a way, these individual signatures act as a pressure to the North Korean authority.



According to experts, changes in the existing economic institutions like the centralist system of foreign exchange, the distribution system of basic necessities, etc., and the introduction of commodity markets are needed in order for North Korea to implement the direct payment system. As it is now in the North, an ordinary worker would need to go to a special store to purchase goods with a foreign currency. Taking similar cases like that of China into consideration, it is expected that a substantial amount of time for preparation would be required for the implementation of the direct payment system. Moreover, it seems that the North Korean authority is concerned with the negative effects the direct payment system will have on the whole country if it was to be implemented only in the KIC.

2) Low Wage and Labor Exploitation

There is an argument that “North Korean workers receive \$57.5 per month regardless of the job position. But the wages are paid to the North Korean government who then pays the workers around \$8 per person (*LA Times*).” Some people also argue that South Korean companies in the KIC are basically exploiting North Korean workers by paying such low wages.

In fact, some South Korean companies are willing to pay higher wages in order to increase the North Korean workers’ will to work. However, they are currently holding back the increase as they see the importance of keeping the wage competitiveness of the KIC as a whole. The

³ “Internet chatting between US Ambassador Alexander Vershbow with Koreans.” *Yonhap News* (2006.6.27).

agreement between the South and North has set the annual wage increase rate at 5%.

The North Korean authority is also fearful that a drastic wage difference between workers working in traditional workplaces and those working in South Korean companies might cause social problems. Nevertheless, it is reported that the North Korean authority is taking measures to provide economic incentives to KIC workers who work hard.

Compared to the minimum wages of China (\$72 in Beijing) and of Vietnam (\$50), the wages of KIC workers (\$57.5-\$75) are not low, especially compared with real wages that take prices into consideration. Moreover, workers who work nights and holidays claim overtime pay with a 50%-100% bonus. Workers that work additional hours are also paid for those hours. Compared to ordinary North Korean workers whose average wage is less than \$20 (estimated from the monthly wages between 2,000-4,000 won at an exchange rate of 150 won per dollar), the wage of KIC workers is twice as high. If the full wage was paid in dollars, the actually wage would be much higher than the ordinary workers' wage due to the higher exchange rate used by the people.

Table 1. A comparison between KIC, China, and Vietnam

	Unit	KIC (A)	China (B)	Vietnam (C)	China Ratio (A/B)	Vietnam Ratio (A/C)
Monthly Minimum Wage	\$	57.5	72	50	0.80	1.15
Weekly Work Hour	Hour	48	40	48	1.2	1

Source: KOTRA Survey Report, The Wage Guideline, Social Security Bureau, Beijing, China

When work conditions are considered, the real wage increases further. The welfare benefits for KIC workers are much better than that of workers in China or Southeast Asia. The factories in the KIC are all new and similar to—to a certain extent—orbetter than other industrial complexes in South Korea. Workers commute by bus transportation provided by South Korea. Each factory is also equipped with shower rooms, infirmary, etc. Furthermore, South Korean companies provide meaty soup and noodles for lunch and snacks (like chocolate cakes) in the afternoon to improve workers nutrition. .

3) Rule of Origin for KIC Goods

In February 2006, the governments of South Korea and the US announced the start of negotiations for establishing a free trade agreement (FTA). The two plan to hammer out and sign an agreement by the first half of 2007. In South Korea, the FTA negotiation is considered to be the most influential event affecting all aspects of Korea-US relations since the Korea-US Security Treaty was signed in August 1953. The negotiation for the Korea-US FTA (KORUS FTA) will also play a major role in determining the future of the KIC. On this matter, the issue of the rule of origin is the most critical one.

From the position of South Korea, it would be best if the US, the biggest consumer market in the world, recognizes KIC goods to have originated from South Korea. However, the US has shown a negative response to the idea of including KIC goods in the KORUS FTA saying it would be difficult to treat KIC goods made in very different working conditions and wage rate from that of South Korea as equal to South Korean goods. Accordingly, the rule of origin is a very sensitive and delicate issue requiring the consideration of not only pure economic interests but also political and diplomatic interests.

4) Unstable Investment Climate

“With the capricious North Korean Communist regime, an investment in North Korea would be very dangerous. The KIC is a pawn for the US hardliners wanting to put pressure on Pyongyang over the issue of the NK nuclear program. In order to succeed, the KIC must survive the fierce competition from neighboring China.” When UK Reuters had this to say about the KIC, some people accepted the statement as plausible. In fact, a significant number of foreign investors attending investment promotion events for the KIC identified the political instability of the KIC as a negative factor in its investment climate. Unpredictability of North Korea was also identified as a major concern.

Table 2. Reasons why the investment climate is unsatisfactory

Reasons	Rule of Origin	Political Instability	Strict Passage and Customs Control	Low Market Accessibility
Total	24	64	29	11

Source: KOTRA Hyundai Asan, 2006 FIKP Report on the Survey of Companies Participated in the KIC Investment Promotion Events, 2006.6.22.

* Redundant answers allowed.

However, we need to keep in mind that Kaesong used to be one of North Korea’s military zones and needed to be transformed. Now it has been turned into a peace zone and a place where South and North Korean workers work together for co-prosperity. The two Koreas initiated the KIC project based on joint economic agenda. This is why the project is able to continue despite the changes in the political atmosphere or South-North relations.

The North Korean authority is taking necessary measures to guarantee a smooth operation of the KIC. In fact, through the South-North dialogues, they requested for speedy progress to be made in the project. They also designated Kaesong as a special zone and created 56 laws and regulations needed for the operation of the KIC. Such active support from the North Korean authority played a key role in the completion of the construction of the model area, as well as the related buildings’ foundations and basic infrastructures.

The competition among the companies wanting to come to the main area of the KIC was high (a ratio of 4 to 1). Some of the companies, like Taeseong-Hatawa, were invested by Japanese investors (10% share). These facts and others go to show that the investment climate of the KIC is considered to be somewhat stable. Nevertheless, it is clear that the deterioration of DPRK-US relations over the issue of the DPRK nuclear program and other issues is no small matter to the investment climate of the KIC.

5) Cultural Confrontation

There exist certain negative views in the international community about cultural contact. The *LA Times* once reported that contacts with capitalist South Koreans who enjoy high tech consumer goods are seen as a burden in communist North Korean society as they can weaken the regime's control and they often result in misunderstanding and frustration. The *Washington Times* also reported that many things like the prohibition of South and North Korean workers from befriending each other are veiled in secrets.

Nevertheless, considering the fact that South and North Koreans were divided without contact for 55 years, they are rapidly acquiring 'habits of cooperation.' They resolve tensions through mutual respect for their cultures, patience, and understanding based on common language and cultural affinity. Furthermore, what we are seeing is that South and North Korean workers are bonding not through discussion of ideological or political issues but through discussion of technology and its application. The fact that the two sides share a common language is a big advantage considering that many South Korean companies have gone abroad (to China or Southeast Asia) and returned, citing language difficulties as a major obstacle to doing business.

In addition, North Korean workers are fast learners, diligent, skillful, and achievement oriented. They have improved their productivity in surprisingly short time.

Overall, the cultural difference between the South and North is small and can be overcome.

6) Cash Payment

Contrary to popular belief, the amount of cash given to North Korea in association with the KIC project is \$15 million. If we exclude the rent payment, most of the cash payment is wages to North Korean workers. Currently there are 6,500 North Korean workers and the total annual wage is \$2 million. A wage payment system is implemented to calculate labor hours for individual workers, to determine the wages, and for payment. Cash payment to North Korea is about \$400,000 per month. As such, the North Korean authority has expressed its disappointment over the unexpectedly low payment. This goes to show that the South Korea government's intention to use the KIC as an engine to further North Korean policy changes is not being met.

7) Strategic Materials Export

In order to observe the ban on strategic materials export, the South Korean government is reviewing all materials that go into the KIC before hand. For strategic materials critical to the operation of the KIC, tags are attached to trace and regularly check the final destination of usage and to report and explain to the US government through the American embassy in Seoul. Currently, the preparation for the introduction of the Radio Frequency Identification (RFID) system is under way and a special management team will be created in the Kaesong Site Management Committee. Each company also has a person in charge of managing and checking the whereabouts of strategic materials.

8) Other Issues

It is expected that other comprehensive issues including electric power delivery, governmental assistance, and formation of labor unions will be raised in the future. There is also a possibility that the project will confront strong opposition from conservatives groups in the US and South Korea, in particular those concerned with human rights. Some US human rights organizations have defined the North Korean workers' labor as 'slave labor'. Labor organizations also criticized the absence of labor unions and unclear labor-management relations in the KIC.

Some companies have also expressed concern over the possible market distortion by the South Korean government's financial assistance (the Compensation for Loss System of the South-North Cooperation Fund) to the companies in the KIC. The Compensation for Loss System is an insurance policy and not a guarantee of profitability. A company must purchase the insurance policy and pay insurance fees. Compensation is made only in cases of natural disaster or extraordinary circumstances. So far only 2 companies in the KIC model area have purchased the policy.

Now I would like to turn to a different topic and ask how much North Korean workers of the KIC are satisfied with their working conditions and treatment.

3. Satisfaction of North Korean Workers

It is difficult to objectively measure the degree of satisfaction North Korean workers in the KIC have. Moreover, it is unclear how the North Korean authority is treating these workers. Nevertheless, many South Korean managers, entrepreneurs, and experts have made a relatively concrete evaluation of North Korean workers' satisfaction and labor productivity based on objective circumstances observed over the last one and a half years.

The summary of the evaluation is as follows. North Korean workers in the KIC are slowly becoming aware of the economic incentives. Many workers in other regions of the DPRK now

wish to work in the KIC. KIC workers volunteer to work overtime in order to meet deadlines and have special meetings to make improvements in their production quality. Previously, they only worked on things that they were instructed to do by the South Korean managers. They are learning the basics of market economics as they are learning the methods of capitalist accounting for bookkeeping and expressing interest in changes in stock prices and foreign exchange rates. Recently, they learned the fact that workers can enjoy their rights in companies are successful. Workers now keep their monthly wage stubs for their own records and for comparison with fellow workers' stubs. Some workers even request that they be allowed to work overtime and holidays or have nightshift so that they can receive pay. With the improved income standards, their living standards have also improved. They are better dressed and look healthy. Women workers have even started to wear make-up to work.⁴

It is possible for South Korea and the US to have different views toward the KIC. Nevertheless, it would be difficult for ordinary South and North Koreans to accept the evaluation that KIC workers are being exploited considering the satisfaction KIC workers have. Perhaps, KIC workers are privileged residents in North Korea. As mentioned above, they enjoy relatively better working conditions and other various incentives like prepared meals and fixed income.

Since the productivity improvement is the most important concern for the South Korean companies in the KIC, they try to provide material incentives as much as possible if it enhances productivity. It is also well known that the North Korean authority is giving various privileges to the KIC workers. In fact, a survey showed that the living standards and nutrition of KIC workers have improved over the last year and a half since the first production in December 2004. In this sense, labor exploitation—defined as low income and long working hours—does not apply to the KIC workers. They receive higher wages compared to other workers in North Korea and always receive overtime pay when they have to work overtime. KIC workers also receive the benefit of training in various technical fields, including computer, accounting, and other advanced technical and management skills.

4. Importance of International Cooperation and Tasks

The KIC cannot succeed without the support and cooperation of the international community. Especially, the improvement of DPRK-US relations is an important task for the development of the KIC. In order to secure consumer markets, US economic sanctions against North Korea must be loosened up or abolished. Considering the fact that the KIC is to house mainly companies in labor-intensive light industry sector, exports to the US would be most critical to the success of the complex. The ban on strategic materials must be lifted also. As long as US economic sanctions are in effect, introduction to the KIC of technology intensive machineries categorized as having dual usage would be nearly impossible. Generally, in order for a special economic zone (SEZ) like the KIC to flourish, it must be supported by economic reforms. Future reforms elsewhere will be concretized through the various reform experiments carried

⁴ Kim Dong-geun, Chairperson of the KIC Management Committee, *Yonhap News* (2006.4.19).

out in the SEZs. In order for these experiments to succeed, the international community must provide sound advice and cooperation with interest and patience.

1) Resolving Security Issues through Development Assistance

Despite a deadlock over the DPRK nuclear issue, the talks surrounding North Korean economic reforms are very much alive. During his visit to Japan and South Korea at the end of May 2006, Paul Wolfowitz, the president of the World Bank, hinted that there is a possibility of North Korea receiving assistance if the North Korean leadership shifts its policy line and embraces drastic economic reforms.⁵ He also highlighted the fact that even in the early stage of reform and opening up in China, in which the PRC benefited a great deal from World Bank financing, the country benefited more through knowledge transfers and training.⁶ Wolfowitz's remark was understood as the need for North Korea to change its policies and institutions in order for reforms to work and for the country to possibly receive World Bank assistance.

In fact, the Bush administration is troubled by the tremendous costs of restoring postwar Afghanistan and Iraq. For that reason, some policy makers and specialists are strongly arguing that it would be much safer and more cost effective to push North Korea to follow in the footsteps of China and Vietnam and implement economic reforms, rather than attempt forceful regime change.


Another argument raised in the international community in support of assisting North Korea's economic reform is the obligation for the international community to support the so-called "fragile states". In the post 9/11 era, certain states are being closely watched as they are considered to present serious threats to the security of their neighbors and the international community. Such threats come in the form of armed internal conflict, humanitarian crises, refugee flows, epidemics, terrorism, and the development of WMDs. Ideas of how to develop these states, also known as "low income countries under stress" (LICUS), are quickly becoming a matter of interest for the international community. The OECD Development Assistance Committee (DAC) has labeled North Korea as one of the most difficult countries to build partnership with.⁷ More and more people are calling for the increase of development assistance to these fragile states. Francis Fukuyama argued that in the case of failed states, the task of strengthening state functions or governmental institutions or rebuilding it to have the ability to create a new state instead of limiting or reducing the power of the state is the most urgent task in the world and at the same time an important condition for the international security.⁸ Especially, as a fertile soil for military challenges against the US to grow poverty has become a security

⁵ On May 29, World Bank President Paul Wolfowitz stated that China joined the World Bank and received not only financial but also technical assistances during the Tung Shao Ping era and such experience of China carrying out economic reforms without changing the communist system will be a good example to follow for North Korea. *Nihon Keijai* (2006.5.30).


⁶ See online at <http://intranet.worldbank.org>. (Search date: 2006.5.30).

⁷ ODI (Overseas Development Institute), "Draft Report for Senior Level Forum on Development Effectiveness in Fragile States," OECD DAC, 2005.

⁸ Francis Fukuyama, *Conditions of Strong States*, trans. by An Jin-hwan (Seoul:

threat to the US. The problem the US needs to seriously reconsider in order to protect itself from danger is similar to the problem faced by international development organizations.  time for us to think seriously about how to assist from outside the countries experiencing internal difficulties in state-building.

In this context, North Korean economic reform is a matter of concern not only for South Korea but also for the international community. North Korean economic reform needs to be approached from the perspective of development and cooperation, going beyond the humanitarian perspective, with stable and sustainable economic development of North Korean society as a goal. The KIC project is a very useful means to bring about changes in North Korea's security policy through concrete practice of such development and cooperation.

Already, the KIC project has lessened the military threat of North Korea and contributed to the realization of peace on the Korean peninsula. This demonstrates that development and cooperation has a high probability of success. Visitors to the KIC will notice that major North Korean military machinery, weapons and facilities targeting South Korea have been redeployed 1 km from the DMZ.  the KIC project contributes to stable management of the South-North relations and peace on the Korean peninsula.

2) DPRK-US Relations

It is reported that the US does not oppose the KIC project itself. However, it would be difficult for the US to talk positively about the KIC under the current circumstances. Nevertheless, the US must officially announce that it is ready to support the KIC project and provide assistance when North Korea is ready to negotiate and make compromises on the pending issues.

In fact, the KIC project does not go against the goal of North Korea policy adopted by the international community. If the goals of US policy on the Korean peninsula are to bring about reform and opening of North Korea in order to eliminate the security threat North Korea presents and also to guarantee free investment and business activities for American entrepreneurs, then the KIC should certainly be an important lever in achieving such diplomatic goals.

North Korea has always focused its attention on how the US perceives the KIC. North Korea knows well that the key to the success of the KIC is the improvement of DPRK-US relations. Having studied the reform and opening up process of Vietnam—which, like Korea, has a similar historical background of imperialist colonial rule, division, and civil war—North Korea might have concluded that, in the end, the success of the KIC depends on its relations with the US. Therefore, it would not be an exaggeration to say that North Korea will show a gesture of reconciliation to the US by allowing the visits of officials from the American government, media, and Congress to Kaesong, and even show its willingness to invite them.

Hwanggeumgaji, 2005), pp.5-7.

On the other hand, the failure of the KIC may become a serious political burden to the US, the international community might hold the US partly responsible for its failure if it does fail. Failure of the KIC would imply the failure to achieve the joint objectives of South and North Korea, such as decreasing the North Korea's security threat and securing peace and prosperity through exchange and cooperation. This will be met with strong criticism. Especially, in South Korea, there is a strong possibility that certain sectors of the population may perceive the US as the main cause of any such failure of the KIC. The rising anti-Americanism that would follow would strain relations between the two country's and likely hurt US interests in the region.

3) Providing Benefits of Cooperation

Not only South Korea but also the international community must put a priority on getting successful results in the early stages of the KIC. Most important, the failure of the KIC in reality would lead to further destabilization of inter-Korean relations, which in turn would increase instability in the region.

If the goal of the North Korea policy of the international community is to stimulate reform and opening of North Korea, the most important step at this stage should be to boost the confidence of technocrats who support reform and opening. Certainly, failure of the KIC may provide valuable lessons. Nevertheless, the consequences of failure would be far greater than ever to pro-reformists in North Korea, more so than the failures that have preceded the KIC (that is, Najin-Sonbong Free Trade Zone, the Shinuiju Special Region Plan and, most recently the termination of the construction of the light water reactor project in Kumho). If the KIC fails to get off the ground, the strength of pro-reconciliation and cooperation reformists would be further weakened. As a result, the conservatives opposing the construction of the KIC in North Korea would gain the upper hand in voicing their position of militarism.

In order for the international community to realize its objectives of deterring North Korea's WMD program and easing the tension on the Korean peninsula, it must at least support directly or indirectly projects like the KIC. In other words, the international community must be willing to deal with various criticism in order to obtain its security and economic objectives.⁹ Even if it is too early to trust North Korea completely, North Korea must be brought to the negotiation table for an agreement with results that can be monitored.¹⁰ Most important, we must induce North Korea to carry out policy changes by showing them concretely what would be the benefits of cooperation. In this context, the international community must provide an opportunity for the North Korean leadership to experience the economic benefits for introducing a market economy and related legal systems and international standards pertaining to working conditions.


⁹ Glenn Kessler, "N.Korea is Inner Conflict for Bush," *Washington Post* (January 16, 2003).

¹⁰ Wendy R. Sherman, "Past Progress and Next Steps with North Korea," Speech in USIP (March 6, 2001), p. 6.

4) Supporting International Market Access

The international community must open—even if temporary—its doors to products made in the KIC, as this can be offered to North Korea as a benefit of cooperation. The success of the KIC will depend on international market access. For the smooth operation of the KIC, issues such as the ban on strategic materials, rules of origin, and the sales of KIC products to international markets must be resolved. In this context, the KIC would fail without international cooperation.

5) Foreign Investment

The theory of commercial liberalism argues that when inter-state relations are formed through a capitalist market structure, liberal trade and financial relations will be bridged by capitalists, the peacemakers, and eventually states will co-exist in peace. The KIC is a laboratory for the testing of the practicality of this theory. In particular, North Korea is showing its desire to integrate into the world market through its effort to invite foreigners to the KIC  even bring investments from foreign companies.

As we saw in the case of Eastern Europe and the former USSR after the transition where foreign companies went into these countries with aims to develop new markets, natural resources, and consumer goods even if they were unfamiliar with western systems or market economy and ridden with political and economical instabilities, and have a dual attitude toward foreign investment, foreign companies also need to show similar interests toward the KIC.

6) Providing Momentum of Economic Transition

The KIC is not just for the North Korean regime. In fact, the KIC is more significant in that it could be a breakthrough for South Korean small- and medium-sized enterprises facing difficulties. Unlike the North Korean SEZs in the borderlands of China and Russia, the KIC is operating with vitality. South Korea's investment in the KIC is not only to save small and medium-sized companies from high wages, but also to respond to Chinese companies and capitals entering North Korea. Even if this will assist North Korea, this is not one-way nor unconditional support; it is bilateral in that the KIC would serve as an educational ground for capitalism and further induce North Korea to change.

The KIC also symbolically demonstrates North Korean leader Kim Jong-il's intention of conceding 'security' to gain 'economic benefits.' North Korean leader Kim Jong-il has shown his will to reform and open up North Korea through the SEZs. The fact that the KIC is development according to the North Korean laws and supervised by the North Korean authority (Central Special District Development Bureau) while the management and operation of the industrial complex is done by South Korean entrepreneurs is unprecedented and demonstrates North Korean leader Kim Jong-il's consistency in keeping promises and his will.

The North Korean authority's attitude toward the KIC is very favorable and remains so. In other words, however slow, they have met South Korea's various demands in reasonable fashion and tried to maintain the changes through legal systems and institutions. Most transitional states were able to experiment with flexible institutional incentives in SEZs, keeping possible political and economical side effects contained within the zones. Especially in the case of China, the experiment with liberal market reform, which was politically too dangerous on a national level, was possible in the SEZs. Based on the experience, China began to reform its laws and institutions, creating more diverse SEZs all over the country—such as the Shanghai-Podong Development District, the Weihai Torch High-Tech Industries Development Zone and free trade zones—and opening up further to become what it is today.¹¹

North Korea also has shown deep interest in learning how to run a market economy from China's model of SEZs. Frequent visits to China's most successful SEZs by North Korean leader Kim Jong-il and the leadership is a good example that North Korea is benchmarking China. As foreign correspondents that visited the KIC have described, the KIC is a melting pot of capitalism and communism.¹²

7) Patience

Lastly, the international community needs to have patience when it comes to dealing with the KIC. As many previous transitional states have experienced, the success of the SEZs and economic transition require much trial and error and many adjustments. Especially, in order to establish the system necessary for the maintenance of a market economy in the KIC, the international community must show continued support and cooperation.

5. Tasks of the South and North

In addition to the pending issues mentioned above, the international community stated that the future of the KIC is unclear due to the following reasons.

LA Times reported that the biggest obstacles to the success of the Kaesong project are North Korea's nuclear program and hostility toward the US. Japan's NHK said the main reasons why not only foreign companies but also South Korean conglomerates are not lowering their guards in the investment of the KIC are the increased tensions due to the DPRK nuclear program and the delay of the trans-Korean railroad construction caused by the North Korean authority. Another Japanese newspaper, *Mainichi*, said although the low wage for workers is its biggest attraction, the most urgent task of the KIC as a conflict zone near the military demarcation line is to bring stability to inter-Korean relations. In other words, North Korea's caprice and bureaucracy demonstrated by the deadlock of DPRK nuclear program negotiation and

¹¹ Ministry of Justice, *A Study on Chinese SEZs*, 2005. Balgansa.

¹² *Yonhap* (Washington ed.) (2006.3.1).

temporary reducing the maximum number of tourists to Mt. Kumgang coupled with fierce competition with Chinese enterprises are major factors limiting the progress of the KIC.¹³

As shown in Table 3, foreign companies in South Korea identified political instability of the Korean peninsula as the most urgent problem in improving the investment climate.¹⁴ The second most urgent task was to ease the passage and customs control. Passing through CIQ was very strict and there is a need to lower the customs barrier. However, this issue is closely related to the military security of the two Koreas and its resolution. Improvement of the security relationship will greatly improve the environment of the KIC. This, however, depends very much on the attitude of the North Korean leadership. In other words, foreign investors have all agreed that political stability of the Korean peninsula and the North Korean government's will to support the KIC are very important factors.

Table 3. Urgent Tasks of Improving the KIC Investment Climate

Task	Political Stability of the Korean Peninsula	International Market Access	Free Passage and Customs	Tax and Financial Incentives	Rules of Origin
Total	56	21	34	12	20

Source: KOTRA Hyundai Asan, 2006 FIKP Report on the Survey of Companies Participated in the KIC Investment Promotion Events, 2006.6.22.

Moreover, to bring in more investment, the KIC needs to demonstrate high efficiency. Some experts argue that the KIC is more labor intensive, has lower productivity, and lacks infrastructure compared to China. They argue foreign investment comes after the construction of strong infrastructure. In this sense, the North Korean authority must listen to the concerns, criticisms, and advice of foreign investors. If and only if North Korea demonstrates its willingness to meet the demands of foreign investors will the KIC have a chance of success.

The South Korean government must also understand that the success of the KIC depends heavily on not only inter-Korean cooperation, but also on cooperation with the international community. More active communication with the US and the international community is also needed. In parallel it must make the operation of the KIC transparent and eliminate political instabilities at home and abroad, such as the issue of the DPRK nuclear program, and seek active support from the North Korea authority. Future tasks include having consistent policies, providing investment incentives to domestic and foreign companies without discrimination, and

¹³ *Yonhap* (Washington ed.) (2006.3.1).

¹⁴ FIKP, Report on the Survey of Companies Participated in the KIC Investment Promotion Events, 2006.6.22. This survey was conducted with 85 foreign companies operating in South Korea.

including KIC goods in the FTAs with major trading countries.

Table 4. Policies the South Korean Government Must Take

Policy	Active Investment Promotion of the KIC	National Treatment in Tax and Financial Incentives	Support Joint Ventures with Korean Companies	Others
Total	31	40	23	12

Source: KOTRA Hyundai Asan, 2006 FIKP Report on the Survey of Companies Participated in the KIC Investment Promotion Events, 2006.6.22.

6. Conclusion

The main argument this paper tries to present is a simple and clear one. In order for North Korean SEZs to succeed, North Korea itself must continue to carry out policy changes and at the same time the international environment must change. The goal of turning the KIC into an export base can only be accomplished through the resolution of the nuclear issue, easing of the US economic sanctions against North Korea, and the granting of special treatment to the KIC related to the export of strategic materials. Resolving the issue of rules of origin and having the goods made in the KIC by South Korean companies classified as originating from South Korea is also an urgent task. The international community, including the US, must recognize the strategic importance of the KIC and consider the fact that the KIC has a huge impact on the change of North Korean policies. Active support is needed. The South and North Korean authorities too must realize that the success of the KIC does not depend only on inter-Korean relations but also on international cooperation. Both Koreas must try to eliminate any concerns the international community and potential investors may have. Ultimately, bold and full-scale introduction of a market economy in the KIC would increase the possibility of its success. North Korea must, institutionally, prepare in phases to accept direct employment and dismissal of North Korean workers, free wage negotiation, and incentive programs. In response, the international community must provide an opportunity for the North Korean leadership to experience what kind of economic benefits await them if they introduce broad market economy systems and elevate working conditions to international standards.

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