

THE CURRENT CONDITIONS AND FUTURE PROSPECTS OF THE KAESONG INDUSTRIAL COMPLEX

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Introduction

On December 15 of last year, kitchenware manufacturer Living Art completed its facilities and began production in the Kaesong Industrial Complex (KIC), moving the Kaesong Industrial Complex development project into a new phase. As Living Art, SJ Tech, and others complete their factories and moved into production, fifteen companies in total are expected to move into the model complex during 2005 and look to be in full production-mode by the end of the year.

More than four years ago, in October 2000, even when North Korea and Hyundai came to an agreement on the development of Kaesong, there were more than a few people who doubted the project could be carried out as planned. However, the KIC is not a dream but rather has actually been a reality developed in South Korea's own back yard.

That said, while mundane matters have been cleared up, the reality of the KIC is no trivial matter. While handling issues concerning strategic materials and rules of origin, voices of concern over the days ahead are many. Many people are concerned that the Kaesong Industrial Complex's road to the future is a steep and thorny path.

In spite of that, there also exists a sentiment that the KIC must succeed. There is a concern that if it fails, entrepreneurs in the future would be ill inclined to even dream of inter-Korean cooperatives.


The Current Condition of Kaesong Industrial Complex Activity

The development of the Kaesong Industrial Complex is one step in the actualization of Hyundai Group Honorary Chairman Jung Joo Young's step-by-step Western Sea Industrial Complex Development plan. Jung traveled to North Korea in December 1998 and February 1999 in order to present a plan to North Korean officials for an 26,448,000 square-meter Western Sea Industrial Complex, and discussions began.

Regarding the selection of a site, Hyundai first took into consideration approach from the South, the possibility of an overland route, electrical supply, and other stipulations and presented a proposal. North Korean leader Kim Jong Il, in an interview with Jung in October 1999, proposed Sinuiju, but differences in DPRK and Hyundai perspectives were visible. Following the June 2000 inter-Korean summit meeting, the inter-Korean relationship greatly improved and with this background, Hyundai's representative Chairman Mong Hun Jung and Hyundai Asan President Yoon Kyu Kim traveled to North Korea. Through talks with Kim Jong Il in August 2000, an agreement was reached to develop between 66 to 133 million square-meters in the Kaesong region. With Hyundai Asan and the DPRK Asia Pacific Committee, the creation of the Kaesong Industrial Complex was agreed upon and the complex development project took shape.

Full-fledged pursuit of the KIC project began in the first half of 2002. In November of that year, North Korea officially announced the 'Kaesong Industrial Complex Act', and designated the KIC as a special economic zone. In December of the same year, Hyundai Asan acquired 50-year land use rights to the complex. In the same month, the (ROK) Ministry of National Unification handed down approval of the first stage of development for the complex, it gained legal recognition by both governments.

Along with KIC construction and operation, and in recognition of the need to ensure the

smooth cross-border passage of personnel and materials, physical and regulatory structures had to be prepared by the North and South Korean governments. To this end the Kyunghui rail line and highway was reconnected and transit, customs, and quarantine agreements were concluded. The Kyunghui rail line and highway construction began in September 2000,  is now open to traffic. With agreements on Kaesong Industrial Complex's entrance and exit requirements, sojourning, communications, customs and quarantine, and North Korea's announcement of the 'Kaesong Industrial Complex Act' and 10 lower regulations, preparations for the KIC's development and operation were in place.

Despite delays up until now in the development of the KIC, it has received continued support. Barely three years after the August 2000 Hyundai Asan · DPRK Asia Pacific Committee's 'Kaesong Industrial Complex Construction and Operation Agreement' was concluded, on June 30, 2003 construction began. Only 10 months later, in June of 2004, full-scale site preparation was underway.

During that time, the reasons for the delay of development were, firstly, more than North Korean rigidity toward the ROK government and the Korea Land Corporation, there was a need to prepare an overall mechanism for transparent investment regulations and guarantees of freedom to manage operations. This required a considerable amount of time. The effort and patience put into this endeavor led to significant concessions from the North. Secondly, while a development plan existed, the most important guarantees of safe passage and negotiations on low land lease rates were not visible. Luckily, last year safe passage guarantees were finalized and in March, North and South Korean developers signed a land lease agreement, leading the Ministry of National Unification to push forth with preparations under the 'Agreement on the Kaesong 1st Stage Development Cooperation Plan'.


Following the current stage of development of a 3,306,000 square-meter sector, a 92,568 square-meter housing development is underway. The requirements of South Korean businesses for the first stage of the Kaesong Industrial Complex are being met and the legal and institutional systems for operation, the atmosphere for investment, etc. are being inspected through the pilot project. Last year two enterprises (Living Art and SJ Tech) completed construction of their facilities while at the end of February nine more factories were under construction and another four had plans to begin.

The first stage of development is expected to be in full-scale operation this year. Site preparation is currently underway and expected to be complete in 2006. With the 1st stage of development completed in the first half of this year, the plan is for stage-by-stage development of sectors.

In the 1st stage, 165,300 square-meters will be parceled out and the remaining land will be sectored off in stages as construction progresses.

Goals and Development Aims of the Kaesong Industrial Complex

It is difficult to sum up the goals of Kaesong Industrial Complex in one statement. The goal extends over several dimensions. That said, in order to clarify discussion, there is a need to organize these goals.

First, to strengthen the competitiveness of South Korean industry. Here, the key point is that faced with employment and expenditure structures, etc. small- and medium-sized enterprises have been given a second chance. By moving to Kaesong, these so called restricted enterprises can regain competitiveness. This has come about with the restructuring of businesses and  push for South Korean enterprise's rise along with new dynamic growth. This has meant not just the moving overseas of manufacturers,

but also the prevention of cooperation among businesses.


Second, it eases North Korea's economic crisis and promotion of transition. Through the Kaesong Industrial Complex, North Korea can expect that foreign currency revenue will increase through wages, payment of shipping costs, etc. There is also the possibility to acquire South Korean technology and improve the infrastructure, such as roads and rail, etc., of the area surrounding the industrial complex. These projects can bring more than a little relief to North Korea's economic woes. This is a big opportunity for the push for Kaesong to act as a tool in forcing the acceleration of reform.

Third is the expansion and improvement of inter-Korean relations. The KIC is an inter-Korean cooperative effort that increases mutual economic reliance and strengthens the relationship. At the same time, large-scale personnel exchanges and economic cooperation have the effect of substantially reducing tensions between the two Koreas. In the mid- to long-term, it also means considerable contribution to the building of a joint economic system and peninsular peace structure.

Fourth, more than the first three, through many mid- to long-term goals, it promotes Northeast Asian (NEA) economic cooperation and helps construct a structure of peace in the region. This is not a solution of a Korean problem through inter-Korean cooperation, but rather action that promotes peace and prosperity throughout the NEA region.

These goals are not independent. There is a deep mutual connection. For example, the spread of North Korean reform directly contributes to the improvement and expansion of inter-Korean relations. It is also linked with NEA economic cooperation and the construction of a structure for regional peace. At the same time, as inter-

Korean relations improve and grow, this raises the interests of South Korea's potential overseas partners, contributing to the strengthening of South Korean industry's economic clout.

On one hand, the Kaesong Industrial Complex project is a basic industrial zone development plan. In that regard, the following two aims are desirable. The first is furtherance of 'clustered' manufacturing zones. Not just enterprises, but support facilities, research institutes, housing, hospitals, sports and leisure facilities, training facilities, etc. must all be included in industrial zones. The second is it is environmentally friendly industry. While minimizing environmental pollution, an environmentally pleasant industrial atmosphere must be maintained. Especially, through the regulation of waste, the on-site recycling of by-products, etc production supporting the revival of natural resources must be established. The Kaesong Industrial Complex project is not simply the development of an industrial area. To the Korean people it is important on several different levels  It is necessary to develop this region not just for the region's industry, but also for these considerably more important reasons.

As everyone knows, Kaesong was the capital of the Koryo Dynasty. If viewed from a Korean perspective, Kaesong is a historical and cultural city. It cannot be overlooked that it is in this border region where North and South Korea have constructed a foundation to pursue peace. At the same time, Kaesong Industrial Complex has the potential to become a window to inter-Korean interchange. Kaesong is an important link. Both Seoul and Pyongyang are in its sphere. Pyongyang is only 170 km, Seoul a quick 70 km away from Kaesong.

In light of these various conditions, Kaesong Industrial Complex is more than just a manufacturing site, it has history, culture, sightseeing, etc, and as a stronghold of inter-

Korean interaction and cooperation, a role in the era of peace is one more of the many functions this city can provide.

Kaesong Industrial Complex Project and North Korean Reform

From the North Korean perspective, the KIC is a laboratory for open-door policy. Just looking at Kaesong Industrial Complex's progress up to now, it is clear that open foreign policy has expanded to the point that it is not even comparable with contractual joint ventures in Rajin-Sonbong. It is also worth noting the North Korean leader's progressive support for open foreign policy. This is not just about inter-Korean economic cooperation, more than that; it is the North's visible change in policy direction. Any such change is a good change.

That said, it has not resolved the dilemmas involved with North Korean leaders' open-door policy and inter-Korean economic cooperation. Serious economic difficulties require nothing short of fundamental, all encompassing full-throttle reforms. Not fundamental solutions, but just easing of economic difficulties also cannot avoid expansion of reform measures. Fundamental reform or expansion of reform is extremely burdensome from the North Korean leadership perspective due to the dangers involved in moving forward into unknown territory.

This is also true for inter-Korean economic cooperation. With domestic support for economic development drying up, and international isolation, North Korea is absolutely reliant on South Korea for economic assistance. However, it is a major political burden for Pyongyang to increase reliance on Seoul through increased inter-Korean economic cooperation. It raises personal concerns about unification by absorption by the South.

In any case, North Korea's change cannot help but take a passive form. Rather than having an active, progressive transitional plan, it is more appropriately described as having no choice, having nothing to eat leaves transition as the only option.

Focusing on the short term, here and there when certain conditions appear in domestic or foreign realms, depending on the situation quite a lot of flexibility is allowed. Also, there is the possibility that the transition could build up, and that the change could be irreversible.

Our focus needs to be on the considerable possibility that the Kaesong Industrial Complex could serve as a catalyst to accelerate the opening of North Korea.

From a North Korean economic perspective, the KIC, more than anything else, offers the resources necessary to restart the economy. The North is faced with a drying up of domestic resources. It would be extremely difficult for the North to save its economy alone, without any outside assistance.

Through the Kaesong Industrial Complex, North Korea can increase employment, as it is reasonable to assume that in the Kaesong Industrial Complex, South Korean firms will employ North Korean laborers, as they are now in the pilot project -- 3200 to be exact.

It can also increase foreign currency revenue. This occurs through payment of wages and shipping costs from using the railway connected to the South. If tours of the complex and area are allowed, there is money to be made there, as well.

There is also the opportunity to obtain advanced technology. Through the industries setting up in Kaesong, South Korea's advanced technology will be moved to the North.

North Korea can use Kaesong Industrial Complex as a market economy's experimental market. It will act as South Korea's industries and organizational mechanisms operating in a market economy.

Also, North Korea will be able to portray an image of openness to the international community through the development of the Kaesong Industrial Complex. By displaying the details of the KIC and the efforts made to restructure the investment environment, North Korea will be able to do more than just wash its hands of its image as a closed nation but will be able to build an image of openness. If it can manage this, North Korea raises its chances of receiving necessary funds from international financial institutions.


However, this opportunity is not currently available. Much more effort must be put forth before this is possible.

For example, Considering North Korea's lack of industrial development and special economic zone management experience, industrial management operational mistakes and bottlenecks are certainly possibilities. Even with legal guarantees, in the real world, real guarantees are absent. This amount of risk and uncertainty causes difficulties.

For South Korea, North Korea has adopted this standard of openness, and this is historic. However, to know that North Korea will continue to support this level of openness is difficult. It is difficult to predict how actively North Korea will restructure the investment environment in the Kaesong Industrial Complex.

The most important investment appeals in the complex are low wages and labor production. Until North Korea's technology has expanded as much as is possible

within its horizontal division of labor, industrial division of labor according to the tech level is inescapable. When considering North Korea's technical level, one can see that for considerable time the investment has focused on rudimentary labor-intensive industry and that management of labor power is important.

There is a large possibility that there will be a significant difference in North Korean labor management policy and the expectations of South Korean businesses. A flexible labor market is necessary, and if labor providers and employers cannot reach agreement through market mechanisms, it will be difficult for North Korea to bring in investors. Closing this gap is a mammoth task. 

Kaesong Industrial Complex Project and North/South Korean Government Issues

More important than anything to the Kaesong Industrial Complex is the international environment, represented by the U.S.-DPRK relationship. There is the problem of taking strategic materials into North Korea; the problem of a market cut down by rules of origin; and a method of responding to U.S. demands regarding the control of the speed of the complex's development. The success or failure of the project, directly related to these issues, is reliant on the decisiveness of the international environment.

The key point here is the North Korean nuclear issue. It is not overstating it to say that the future of the project relies entirely on the nuclear issue.

It is not that the nuclear issue cannot be resolved in the early stages. However, the nuclear issue is an historical and structural problem. The predominant theory among many experts is that resolution of the nuclear issue will take much time. That recognition is more productive than grasping for one overall solution.

As a resolution of the nuclear issue continues to be delayed, North Korea continues in its attempt to ignore U.S. tangible and intangible pressure. This can only cause more concerns for the South Korean government.

A point of contention is who will control the speed of the project. The Kaesong Industrial Complex project cannot be promoted to the point where U.S.-ROK relations are damaged. This means that the speed of development must be slowed in order to preserve the U.S.-ROK alliance.

However, controlling the speed of development is not easy. South Korean domestic small and medium-sized enterprises have set expectations regarding Kaesong Industrial Complex and their complaints are being ignored. An even larger problem is the North Korean leadership. Even though the North Korean leadership defied the military's opposition to the Kaesong project, South Korean criticism of a lack of concord could, in the end, effectively pour cold water on the deal. The ability to negatively influence the inter-Korean relationship is as plain as day. This could lead to an attitude of not even dreaming of inter Korean economic cooperation.

U.S.-ROK relations are important and inter-Korean relations are hard to just leave off. In the end, the Kaesong Industrial Complex project requires compromise, what is referred to as the three paths. However, in the real world, perfect middle ground is difficult to find. Even when weakening one's position, a decision cannot be avoided. Value judgments are an additional factor.

So, in order to grasp the three paths, what is necessary? In the policy field, choices cannot be avoided. To a pluralized and centralized modern society choice is required. Choosing between various policy goals involves deciding what goals to ditch, what sacrifices must be made. Obviously, it is not as simple as choosing A or B. It is a

matter of weighing costs and benefits.

First, before anything else, a decision must be made between the perspective of society and of the government. Regarding the infrastructure necessary for the construction of an industrial complex, the government's role appears to be sympathetic, however on a more concrete level, there is no visible agreement between the government and society.

Through conferences with North Korean officials, while at the same time building various systematic apparatuses for domestic endeavor, there appears to be no large difference in opinion. However, a considerable gap in perception exists between the government and the business world regarding tax systems and financial support structures. Viewed on a basic level, the government cannot help but support the security of businesses, however businesses' reliance on or need for the government is a difficult problem.

Candidates are sympathetic to the government's position. A few business planners and coordinators have differing opinions regarding who is generally more sympathetic to their positions.

One indicator is the role in government of industrial policy makers. Among government functions is industrial policy. Kaesong Industrial complex can serve to normalize not only the government's unification policy but also its industrial policy. However, there is doubt over just how devoted to this the government has been up to now. A South Korean government response is in order regarding these doubters.

Second, the United States and North Korea must be persuaded. Here, how much these two parties can be persuaded is important, but a bigger issue is the problem of how to persuade them. For North Korea, there are comparative distinctions. If North Korea

does not take a positive stance on the restructuring of the investment environment in the Kaesong Industrial Complex, entrepreneurial support will be difficult to maintain. Also, if the resolution of the nuclear issue is postponed, the South Korean government will be unable to ignore the U.S. stance on North Korea. Persuading a demanding U.S. government will be complicated. The issue of limiting production speed is also an issue, making three tracks for South Korea.

One is that the KIC enterprises can aid in resolving the nuclear issue. Through KIC businesses, North Korea can open its eyes to the benefits of opening up to the world. Also, through inter-Korean cooperation, mutual trust can be built and political and military tensions can be reduced.

Another point is that while businesses in the Kaesong Industrial Complex are demanding from a North Korean perspective, they are also acutely necessary to the South Korean government as there is strong pressure to revive business' competitiveness. It is giving a second chance to those South Korean businesses on the brink of collapse.

Third, the Kaesong Industrial Complex acts as a domestic response to the North Korean economy's increasing reliance on trade with China. In the last 1-2 years, Chinese funds have flooded into North Korea, trade has increased, and China's ability to influence North Korea economically has increased to the point that it has been said that 'North Korea is China's North East province'. With China's grip on the North Korean economy, South Korea must expand and strengthen its North Korean economic ties through the KIC. This also aligns with U.S. friendly relations. It is extremely important to supplement this plan as well as to develop others.

Conclusion

When Kaesong Industrial Complex development hits a barrier one can usually think that it is the responsibility of the United States or North Korea. However, this might not be entirely accurate. South Korea firmly grasps the key to many of the issues related to the relationships with the United States and North Korea.

Of course, success of the KIC is dependent on decisive international variables, represented by U.S.-DPRK relations. At the same time, the decision of North Korean leaders to restructure the investment environment cannot be ignored.

The position of the U.S. administration and the North Korean leadership's attitude do not completely dictate the future of South Korean government or business. While South Korea does receive some pressure, it is inconsequential. It is important for the South Korean government to continue to convince the U.S. of the goals of the Kaesong Industrial Complex and, with ongoing inter-Korean economic cooperation, foster an economic frame of mind in the North.