

Inter-Korean Economic Cooperation

A 38 North Interview

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TRANSCRIPT

Part I: Overview of Inter-Korean Economic Cooperation

Mike Chinoy: Dr. Yu Byounggyu, thanks very much for joining us. Let me start by asking you for a general overview—what's your sense of inter-Korean economic relations?

Dr. Yu Byounggyu: Inter-Korean economic cooperation officially began after the July 7 declaration in 1988 and has since advanced significantly both in quantity and quality over 20 years. In particular, in 2007, inter-Korean trade amounted to \$ 1.8 billion. However, with the deterioration of inter-Korean relations since 2007, at this point, economic cooperation between the two Koreas is at a standstill. While economic cooperation between the two Koreas is deteriorating, economic ties between North Korea and China are growing stronger. For example, North Korea's economic dependency on South Korean economy was reported at 18% in the year 2000, but grew to 38% in 2007 with the increase in inter-Korean cooperation. However, with the recent stagnant economic cooperation between the two Koreas, North Korea's economic dependency on South Korea has fallen to 21%. In contrast, North Korea's economic dependence on China has risen significantly. North Korea's economy has rapidly gone from being 20% dependent on China in 2000 to 70% in 2007.

Chinoy: You've really got only two main projects; Mount Kumgang and the Kaesong industrial complex. Where do things stand right now?

Yu: Inter-Korean economic cooperation largely consists of two areas. One is tourism and the other is developing the Kaesong Industrial Complex. The tourism scheme is again implemented along two projects: Mount Kumgang tourism and Kaesong tourism. Tourism of Mount Kumgang began in November of 1998. In the beginning, tourist groups from South Korea would sail up the East Sea to Mount Kumgang, but later the program had tourists travel by land up to the mountains. The tourism program was very successful for the first ten years until 2008. During that decade, 1.95 million visitors were able to see Mount Kumgang.

Unfortunately, in July 2008, one South Korean tourist in the program was shot and killed in a guarded area in North Korea, which resulted in the tourism program being shut down to this day. Meanwhile, the Kaesong tourism project had three pilot tour visits in 2005 and began regular tour programs in December of 2007. The Kaesong tourism project was successfully run until November of 2008. However, the aforementioned incident led to a discontinuation of tourism at Kaesong as well. During the three years that Kaesong did welcome tourists, 112,000 visitors went on tours to Kaesong.

Part II: Prospects for Continued Inter-Korean Economic Cooperation

Chinoy: Given the tensions in inter-Korean relations, what are the prospects that Mount Kumgang might reopen at some point? Is that even remotely possible?

Yu: As of now, we do not expect the Mount Kumgang tourist site to reopen immediately. Because the relations between South and North Korea need improvement, I would say it will be difficult to resume tourism at Mount Kumgang right away. However, I am confident that Mount Kumgang will reopen sooner or later. I believe so because when we survey South Koreans on whether Mount Kumgang tourism should resume, the majority of the people say that it should begin again. Because so many people are hoping that the program will run again, I expect that Kumgang will open again sooner rather than later. Citizens of the Republic of Korea are wishing for the restart of Mount Kumgang tourism because they believe this project is essential to maintaining peace between the two Koreas.

Chinoy: The Kaesong Industrial Complex has managed to survive despite all of the recent tensions and relations between the North and the South. It survived the sinking of the South Korean ship Cheonan in 2010, it survived the shelling of Yeonpyeong island... is there any chance it, too, could close?

Yu: First, I would like to provide some background on the Kaesong Industrial Complex (KIC). Since groundbreaking in June 2003, KIC has been quite successful in sustaining steady development over nine years. Now the output from Kaesong amounts to \$400 million a year. There are currently 123 South Korean companies in the complex and 51,102 employed North Koreans. The accumulated production from the complex as of now amounts to \$1.7 billion, and 13% of these products is being exported. In particular, production from the complex has managed to continue to grow in spite of declining inter-Korean relations. For example, the production from KIC in 2011 recorded a 24% increase from 2010, and as of Quarter 1 of 2012, KIC production has gone up 23% again. KIC is currently generating 99% of inter-Korean trade. I think that KIC will continue to operate successfully. In other words, we do not see any possibility that it will close down. This is because both South and North Korea recognize that KIC is conducive to economic growth on both sides, and that the complex has great symbolic meaning in maintaining peace on the Korean peninsula. Also, citizens do not want the project to end. When the Hyundai Research Institute conducted a survey on South Koreans last March, most respondents answered that they would like the KIC project to continue to

grow and expand. Because both Koreas share the view that KIC is needed, South Koreans are supportive of KIC. And because the small and medium enterprises in South Korea need the complex, it is most likely that KIC will continue to grow.

Chinoy: In the last year or so, China and North Korea have expanded their economic cooperation and in particular, have begun work on two new special economic zones, at Hwanggumpyong and at Rason. What's the impact of this on South Korea, particularly on the Kaesong zone? Does this potentially mean that South Korean companies that are operating at Kaesong might want to move operations to one of these other zones, or could it deter South Korean companies that are thinking of investing in Kaesong from doing so, instead looking at the other zones? Does it represent a threat or a challenge to Kaesong?

Yu: The recent chilling of inter-Korean relations has resulted in closer economic cooperation between North Korea and China. One very good example would be the cooperation for economic development in Hwanggumpyong and Rason. However, economic cooperation in Hwanggumpyong and Rason is still in very early stages, and there is some doubt whether this initiative will be successful. This is because development of these areas will require massive investment for infrastructure development. Much investment is required to construct necessary infrastructure such as roads and power grids. There is still much uncertainty on whether this level of investment can be expected. More recently, there are even suggestions that the Chinese central government is reconsidering its plans for economic development in Hwanggumpyong and Rason. If this turns out to be true, there is a possibility that plans for economic development in Hwanggumpyong and Rason might be, at least temporarily, put on hold. Considering this situation, the North Korea–China economic development cooperation will probably not adversely affect the companies in the KIC. In particular, on the question of if companies operating in the KIC might relocate to such new zones, we would say it is highly unlikely. This is because KIC is much better positioned than the investment environment in China. To be more specific, wages, land costs and logistical costs, etc., put KIC in a much more favorable position than such zones in China. One thing that makes KIC especially attractive is that South and North Koreans are from the same roots and thus have no language communication issues. This is why productivity in the KIC is regarded as much higher than when you would invest in another country like China or Vietnam. Also, KIC is located within two hours' distance of the Seoul Metropolitan Area, which is the largest market nearby. So the fact that products from the KIC already have direct access to the gigantic markets of Seoul and its surrounding areas reduces the possibility that companies in KIC will move to other economic zones in China. These days, we find that Korean businesses that had invested in China are actually relocating to KIC because of the worsening investment climate in China.

Chinoy: The free trade agreement between South Korea and the U.S. that recently went into effect has a clause that forbids products made in Kaesong from getting the same kind of access to the U.S. market that other South Korean goods are getting. How much of a drawback is this; how much harm does it cause to South Korean companies who might otherwise want to invest more or set up operations in Kaesong, that

products made there are banned from the U.S. market?

Yu: In the recently concluded KORUS FTA, South Korea and the U.S. could not agree on recognizing products from Kaesong Industrial Complex as products from the Republic of Korea. However, it is still possible that KIC products might gain recognition as Korean products, because both countries agreed to set up a committee for Outward Processing Zones to discuss whether KIC products should be recognized as South Korean products. If the ROK and the U.S. can agree on including KIC products in the KORUS FTA, this will help substantially boost exports of the products not only to the United States, but also around the world. The ROK currently has FTAs with many countries and regions. Singapore, ASEAN and EFTA are some examples of where KIC products are already recognized as Korean products. This is why the KIC products are being exported to these regions without difficulty. If the U.S. recognized KIC products as South Korean-made within the FTA framework, we expect the brand value of KIC products to go up and lead to more production and exports.

Part III: Inside the KIC

Chinoy: One of the criticisms of Kaesong has been in the area of labor rights and the treatment of the North Korean workers there. How do South Korean companies respond to those concerns? Has there been any effort to educate the North Koreans about labor rights; have you seen any signs of changes or progress in this area?

Yu: I would say that the rumors of the status of North Korean workers come from misunderstanding. If you would just visit KIC, you would witness that the working conditions and welfare of the workers are actually at quite high levels. To look at the working environment and welfare of the KIC workers, their work area is much cleaner and their welfare is much better than in China or other Asian countries. There are shower facilities for the workers and also daycare centers to help mothers while they work. There is also a large skills training center where work-related training is provided. Considering this, North Korea's working conditions and workers' welfare are considerably more advanced than those of other countries or other industrial complexes, if not on a global level.

Chinoy: One of the things in particular that people have worried about in this regard is the question of payment, because the payments go to the North Korean government, which then gives money to the workers; the payments don't go directly to the workers. How do you respond to that concern?

Yu: Well, that pertains to North Korea's internal policy, internal issues, and that is not something we can interfere with. Those kinds of issues, should they become problems, will probably be improved through inter-Korean dialogue and other mechanisms. However, it must be said that that pertains to North Korea's economic system and institutions, and we do not have any say in that.

Chinoy: What do you think the North Korean government could do, to try and make investing in North Korea, investing in Kaesong, more attractive for South Korean companies?

Yu: For the ongoing development of KIC, there are two things that need to be improved. First, the issue of the “three *tongs*” has to be cleared. By the “three *tongs*”, I mean *tonghaeng* (passage), *tonggwan* (customs), and *tongshin* (telecommunications). In other words, 24-hour, around-the-clock passage should be allowed in KIC, the current severely complicated customs process should be streamlined, and finally, wider use of telecommunications, such as the internet and mobile phones, should be permitted. These “three *tongs*” are the most urgent issues. The next, perhaps most important challenge would be pressing North Korean authorities to pursue more consistent economic policies in order to strengthen mutual trust between North and South Korea so that the Kaesong Industrial Complex can develop successfully.

Chinoy: Dr. Yu, thanks very much for speaking with us.