

## ENGAGEMENT IN ACTION: THE KAESONG INDUSTRIAL COMPLEX

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As 2005 wound down, the Six Party Talks appear stalled with the talks likely to resume no earlier than mid-January. North Korean officials spent December deriding the new U.S. Ambassador to Seoul, Alexander Vershbow, as a “tyrant” for his criticism of the North’s reported counterfeiting of U.S. \$100 bills. North Korea also suggested that it would begin constructing new light water reactors.

Less heralded, but perhaps more significant, was the deepening of inter-Korean relations as the year concluded. Kim Dae-jung, the first ROK president to visit the North (in 2000), announced that he planned to accept the DPRK’s invitation for him to make a return visit to Pyongyang. December 28 witnessed the connection of the South Korean-funded industrial complex of Kaesong in North Korea via 300 direct telephone and fax lines with the South. U.S. Department of Commerce approval of the use of a switchboard with American components at Kaesong in mid-November made the telecommunications link possible. The connections marked the first time in 60 years direct phone service existed between the two halves of the Korean peninsula, highlighting the aspirations of the ROK’s engagement policy with the North, which find no greater symbol than the Kaesong Industrial Complex.

Located north of the demilitarized zone in North Korea and 60 kilometers from Seoul, Kaesong, as South Korea Unification Minister Chung Dong-young pointed out during his December trip to Washington, saw fierce fighting during the Korean War and the beginning of armistice negotiations. The complex, now in the first stage pilot phase, presently houses 15 South Korean small and medium enterprises employing 5,400 North Korean workers along with 500 South Koreans. Each day, two commuter buses depart Seoul at 7:30 a.m. en route for Kaesong. According to the Unification Ministry, 600 South Koreans and 300 vehicles travel to Kaesong and back each day from the South. The present 15 companies manufacture kitchenware, apparel, hydraulic packings, shoes, air conditioning systems, automobile parts, LCDs, plastic products, electrical wire, sewing supplies, watches, and semiconductor mould parts. The first sales of Living Art’s pots and pans made at Kaesong took Seoul by storm and sold out in short order.

The South Korean government, the primary investor in the \$6.2 billion project, anticipates that 300 ROK companies will have begun operations by the end of 2006. One thousand enterprises are expected to be operating within 3 years, by which time 100,000 North Korean workers, or nearly 1 in every 200 North Koreans, will be working at Kaesong, if the complex proceeds according to plan.

The complex will ultimately cover 6,611 hectares (66 million square meters) in North Korean territory. The industrial portion of the complex will cover 2,644 hectares (26 million square meters) with the surrounding city covering the remaining 3,967 hectares (40 million square meters). The first stage of construction will measure 330 hectares in size and should be completed by 2007 at a projected cost of \$376 million. The ROK government initially planned to pay \$224 million of the first phase costs with \$115 million to be recouped. Hyundai Asan and the Korea Land Corporation are constructing the complex. Early plans call for the North Korean government to receive \$16 million for land rental and existing building removal; \$30,000 a month for the purchase of materials; and \$190,000 a month for wages. Construction of stage 2 is set from 2006 to 2009 and stage 3 from 2008 until 2012. By agreement, the ROK companies pay \$57.50 a month for each North Korean worker, including \$50 for the wage itself and \$7.50 for social insurance premiums. The selection process for the North Korean workers by the DPRK government agencies and the amount of wages that the workers are permitted to retain remain less than clear.

During his recent trip to Washington, Unification Minister Chung called Kaesong a peace zone that “is a ‘place of hope’ for our small and medium sized business. The industrial park paves the way for an inter-Korean economic community,” which the Minister envisions will be created by 2020. Whether the complex ultimately becomes a peace zone, a capitalistic Trojan Horse, or a North Korean cash cow, as proponents and opponents variously contend, the project’s underpinning rationale is undisputed: to increase the mutual prosperity of the two Koreas by using the technology and capital of South Korean SMEs and cheap North Korean labor to keep South Korean companies competitive and in Korea, while training North Korean workers in the ways of market capitalism to the benefit of ordinary North Koreans and the North Korean economy. Ministry of Unification officials stress that the Hyundai Research Institute estimated that the first stage will reap US\$5.8 billion in gains for the South Korean

economy and \$1.3 billion for North Korea. Korea International Trade Association figures from January for the first 10 months of 2005 indicate that goods traded between Kaesong and South Korea equaled \$142.1 million with \$131 million coming from Southern exports to the zone. The total trade figure amounted to 16.2 percent of all inter-Korean trade, a sizeable increase over the 3.8 percent for the comparable period in 2004.

Whether goods made at Kaesong can be sold abroad as “Made in Korea” or must be labeled “Made in North Korea” remains a contentious issue and country-specific. Few analysts realistically expect that, if free trade agreement negotiations begin between the United States and South Korea in 2006, Korean negotiators will push for the inclusion of Kaesong-made goods. This issue combined with the Commerce Department’s switchboard approval and the Department of Treasury’s imposition of sanctions on a Macau-based bank for laundering North Korean funds from illicit activities and allegations of DPRK counterfeiting of millions of dollars worth of “supernotes” or forged \$100 bills highlight current U.S. law towards doing business in the DPRK. The relevant laws are, in fact, less numerous than many observers presume.

The crux of South Korea’s engagement policy appears to be bringing gradual change to North Korea through increased interaction: change through contact in short. Unification Ministry officials highlight that nearly 85,000 South Koreans visited North Korea in 2005. This figure nearly doubles the number of visitors to the North for the preceding 60 years. Moreover, in the past seven years, 1.1 million ROK tourists visited the North’s Diamond Mountain resort. 165 intergovernmental meetings took place in the last decade—17 rounds of ministerial-level meetings have occurred since 2000. 12,000 Koreans met with relatives across the DMZ in the last half decade. Further, in addition to the new phone lines, Kaesong saw the opening in October of an Office for Inter-Korean Economic Cooperation jointly run by DPRK and ROK officials. Less progress has been made in the military area. But the Koreas now have naval hotlines and a joint fishing zone, and have held nine rounds of general officer talks, with another round of military talks expected in 2006.

In sum, the year of 2005 ended with a dial tone. Whether the North Koreans pick up and what they say remains to be seen.