



South Korea's Economic Engagement toward North Korea

Lee Sangkeun & Moon Chung-in

On February 10, 2016, the South Korean government announced the closure of the Gaeseong Industrial Complex, a symbol of its engagement policy and inter-Korean rapprochement. The move was part of its proactive, unilateral sanctions against North Korea's fourth nuclear test in January and rocket launch in February.¹ Pyongyang reciprocated by expelling South Korean personnel working in the industrial complex and declaring it a military control zone.² Although the May 24, 2010 measure following the sinking of the *Cheonan* naval vessel significantly restricted inter-Korea exchanges and cooperation, the Seoul government spared the Gaeseong complex. With its closure, however, inter-Korean economic relations came to a complete halt, and no immediate signs of revival of Seoul's economic engagement with the North can be detected. This chapter aims at understanding the rise and decline of this engagement with North Korea by comparing the progressive decade of Kim Dae-jung (KDJ) and Roh Moo-hyun (RMH) with the conservative era of Lee Myung-bak (LMB) and Park Geun-hye (PGH). It also looks to the future of inter-Korean relations by examining three plausible scenarios of economic engagement. Section one presents a brief overview of the genesis of Seoul's economic engagement strategy in the early 1990s, section two examines this engagement during the progressive decade (1998-2007), and section three analyzes that of the conservative era (2008-2015). They are followed by a discussion of three possible outlooks on the future of Seoul's economic engagement with Pyongyang.

ECONOMIC ENGAGEMENT WITH NORTH KOREA: GENESIS & BASIC STRATEGY

Inter-Korean economic relations were thoroughly frozen during the period of the Cold War. Exchanges and cooperation including trade and investment were not allowed. Even a simple personal contact with North Koreans was seen as a violation of the Anti-communist Law and the National Security Law. A major thaw came with the advent of the Roh Tae-woo (RTW) government (1988-1993), which pursued *Nordpolitik*. A South Korean version of Willy Brandt's *Ostpolitik*, it first sought diplomatic normalization with communist bloc countries and then attempted to pursue engagement with North Korea. The shift away from the past defensive posture was a reflection partly of a changing international security environment signaling the end of the Cold War and partly of Seoul's confidence in economic and military standing and national pride gained through the successful implementation of the 1988 Seoul Olympics.³

Nordpolitik was successful. The RTW government normalized diplomatic ties with communist countries, first with Hungary in 1989, then Poland and Yugoslavia in 1989, then Czechoslovakia, Bulgaria, Mongolia, Romania, and the Soviet Union in 1990, and finally China in 1992. Along with the diplomatic offensive toward communist countries, the Roh government undertook an equally proactive engagement policy with North Korea. In the July 7 declaration of 1988, RTW affirmed that South Korea no longer regarded North Korea as a target of confrontation and competition and that North Korea is an integral part of the Korean national community as well as a "benign partner" with which to achieve common prosperity. The declaration allowed inter-Korean trade, which was previously banned, and treated it as intra-national, not inter-state, trade. Moreover, Roh sought balanced economic development with the North, while pledging not to obstruct North Korea's non-military trade with South Korea's allies and friendly nations.⁴

Roh's July 7th Declaration was a milestone in inter-Korean relations in general and inter-Korean economic relations in particular. Following it, his government initiated a series of official talks with North Korea, resulting in the historic Basic Agreement on Non-aggression, Reconciliation, and Exchange and Cooperation in 1991. The Basic Agreement laid the foundation for new principles for confidence-building measures modeled after the Helsinki Final Act of 1975. In addition, the RTW government adopted the principle of separation of economics and politics, significantly fostering inter-Korean economic relations. The volume of trade rose from zero to a cumulative total of \$1.25 billion in 1989-97, and humanitarian assistance to the North also considerably increased.

President Kim Young-sam (KYS) also pledged to continue the engagement policy with the North. In his inaugural speech on February 25, 1993, KYS proposed a summit with Kim Il-sung, stating that "no allies can be better than a nation."⁵ After tensions followed by the first North Korean nuclear crisis, Kim Il-sung accepted KYS's proposal. The two agreed to hold the summit during July 25-27, 1994, but it was aborted as Kim Il-sung passed away on July 8. North Korea's political uncertainty in the wake of Kim's death strained inter-Korean relations, affecting trade. In 1995, the amount of inter-Korean trade was \$287 million, about 2.2. percent of Pyongyang's total trade volume. Most trade involved South Korea's imports of minerals, agricultural, and fishery goods. Seoul's investment in North Korea was restricted, and South Korean firms simply assembled finished goods by bringing raw materials, intermediate goods, and capital goods into North Korea and re-imported them. In addition, North Korea was not ready to induce South Korean investments institutionally.

THE PROGRESSIVE DECADE & ECONOMIC ENGAGEMENT (1998-2007)

In his inaugural speech on February 25, 1998, KDJ announced that his government will seek engagement with the North by facilitating its exchanges and cooperation with the outside world, giving food aid to the North, and promoting economic, social, and cultural exchanges.⁷ He offered assurances that he would enhance economic cooperation by separating economics from politics,⁸ and conceived the sunshine policy as a proactive way to induce incremental and voluntary changes for peace, opening, and reform through patient pursuit of reconciliation, exchanges, and cooperation. It went beyond simple engagement, comprising of components such as military deterrence, international collaboration, and domestic consensus. Its objective was crystal clear: to lay the foundation for peaceful Korean unification by severing the vicious cycle of negative and hostile actions and reactions through peaceful co-existence, exchanges, and cooperation.⁹

The sunshine policy was founded on three fundamental principles as outlined in the inaugural speech. First was the principle of non-tolerance of military threat or armed provocation by North Korea. Second was the official abandonment of the idea of unification by absorption and the negation of any other measures to undermine or threaten North Korea. And the third was the promotion of exchanges and cooperation through resumption of the 1991 Basic Agreement on Reconciliation, Non-aggression, Exchanges, and Cooperation.¹⁰

Its most important operating principle was *flexible dualism*, which was predicated on major changes in the sequential order of inter-Korean interactions. Operational terms of engagement with the North under the Kim government can be summarized as follows: 1) "easy tasks

first, and difficult tasks later”; 2) “economics first, politics later”; 3) “non-governmental organizations first, government later”; and 4) “give first, and take later.” It represents a profound departure from past practices. Previous governments failed to overcome the inter-Korean stalemate precisely because of their rigid adherence to the principles of “government first, civil society later,” “political-economic linkage,” and “the primacy of mechanical reciprocity.” Thus, the sunshine policy can be characterized as incremental, pragmatic, and functionalist in dealing with the North.¹¹

The core of flexible dualism can be found in the separation of politics and economics. Previous governments were preoccupied with the primacy of politics and its linkage to the economy, which entailed structural barriers to the promotion of inter-Korean exchanges and cooperation, not only because of the compartmentalized decision-making structure in the North that separates politics from the economy, but also because of the negative backlash associated with it. Temporal improvements in inter-Korean relations through socio-economic exchanges were instantly wiped out by new political bottlenecks or sporadic military provocations by the North, producing an amplified feedback loop of distrust and hostility. But the Kim government attempted to sever the mechanism of negative reinforcement between the two by pledging to promote economic exchanges and cooperation even if the North engaged in military and political provocation. Infiltration of North Korean submarines into the South, resumption of a negative propaganda campaign by the North, and naval clashes in the West Sea did not block the continued pursuit of economic exchanges and cooperation. It is this functional flexibility that differentiated the sunshine policy from previous governments’ North Korean policy. Such engagement was, by and large, continued by and implemented throughout the RMH period (2003-2008).

The engagement policy during the progressive decade aimed primarily at improving the economic conditions of the North Korean people and fostering its opening and reform. Such developments were, in turn, seen as providing new momentum for easing military tension on the Korean Peninsula and, ultimately, contributing to peaceful co-existence with the North. But equally critical was the economic motive. Both KDJ and RMH strongly believed that inter-Korean economic exchanges and cooperation would bring about mutually beneficial “win-win” outcomes. On the one hand, for the North, lacking capital and technology, economic cooperation with the South would significantly contribute to overcoming its economic stagnation. On the other, such cooperation would be beneficial to the South, suffering from comparative disadvantage in natural resources and labor costs. It was more so because a growing number of South Korean firms were deliberating on relocating their plants to China and elsewhere because of high labor and land costs. Geographic proximity and linguistic and cultural affinity were other factors facilitating economic complementarities between the two Koreas. The two leaders were aware of structural and institutional barriers to such cooperation stemming from the socialist system deeply embedded in North Korea, but they hoped that steady and continual economic exchanges and cooperation would eventually help to remove such barriers.¹²

Economic engagement with the North during the progressive decade (1998-2007) was robust. Total inter-Korean trade, commercial (general trading, processing-on-commission, economic cooperation projects) and non-commercial (trading of goods and services involving governmental and non-governmental assistance as well as social and cultural exchanges and cooperation) rose from \$222 million in 1989 to \$1.79 billion in 2007. From 1989 to 1997

the total amount of imports from the North was \$1.25 billion, whereas that of exports to the North was merely \$293 million, but there was a reversal during and after the progressive decade in which exports to the North exceeded imports, e.g., exports to the North were \$1.03 billion, whereas imports from the North were \$765 million in 2007.¹³ This can be attributed largely to the operation of the Gaeseong Industrial Complex in which South Korean firms' supply of raw materials as well as intermediate and capital goods were counted as exports, and shipments of finished goods from Gaeseong to Seoul as imports.

Data in Table 1 present the amount of inter-Korean trade by type since the first Korean summit in 2000. The overall amount of general trading and processing-on-commission increased more than three times from \$236 million in 2001 to \$790 million in 2007. The amount of money allocated for joint economic projects such as the Mt. Geumgang tourist project and the Gaeseong Industrial Complex rose rapidly from \$19 million in 2001 to \$640 million in 2007. Meanwhile, non-commercial trade such as governmental and non-governmental assistance increased steadily from \$148 million in 2001 to \$367 million in 2007. Such an expansion was due partly to KDJ's new engagement policy emphasizing the separation of economics from politics and partly to several institutional changes. On April 30, 1998, the KDJ government introduced a "measure to activate North-South economic cooperation" that simplified procedures for economic engagement with the North and removed the ceiling on the amount of investment in the North. In addition, since the June 2000 Korean summit, regular inter-Korean ministerial talks and the operation of the South-North Economic Cooperation Promotion Committee helped resolve various obstacles by reaching agreements on investment guarantees, prevention of double taxation, procedures related to the settlement of commercial disputes, and maritime cooperation.¹⁴

Table 1. Amount of Inter-Korean Trade by Type Since the 1st Korean Summit in 2000 (unit: \$ million)											
	Type	1989-2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Commercial	General Trade & Processing-on-commission Trade	2,034	236	343	409	347	419	557	790	808	666
	Joint Economic Cooperation projects	120	19	25	21	89	270	371	640	904	976
Non-Commercial	Gov't and nongov't assistance and goods and services related to social and cultural exchanges	373	148	273	294	261	366	422	367	108	37
	Total	2,527	403	642	724	697	1,056	1,350	1,798	1,820	1,697

Source: Korea International Trade Association, <http://www.kita.net/interkorea2/html/business/namb3.jsp> (accessed April 23, 2016).

Table 2 shows data on Seoul's public and private assistance to Pyongyang during the progressive decade. Prior to the KDJ government, Seoul's assistance involved mostly the supply of heavy oil and the construction of two light water nuclear reactors in Shinpo, North

Table 2. Assistance to North Korea during the Kim Dae-jung & Roh Moo-hyun Governments (unit: billion won)

Type	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gov. Assistance & Grants	24.0	15.4	33.9	97.8	97.5	114.0	109.7	131.3	136.0	227.3	198.3	43.8
Gov. Food Loans	0	0	0	105.7	0	151.0	151.0	135.9	178.7	0	150.5	0
Private Assistance & Grants	18.2	27.5	22.3	38.7	78.2	57.6	76.6	155.8	77.9	70.9	90.9	72.5
Total	42.2	42.9	56.2	242	175.7	322.6	337.3	423.0	392.6	298.2	439.7	116.3

Source: ROK Government Index, http://www.index.go.kr/potal/main/EachDtlPageDetail.do?idx_cd=2784 (accessed April 23, 2015).

* Government assistance includes expenses related to transportation costs and other overhead costs, but private assistance does not include those costs.

Korea.¹⁵ The KYS government also provided 150,000 metric tons of rice to the North in 1995. Assistance rose considerably after the inauguration of the KDJ government in 1998, owing to an increase in both government and private sector humanitarian assistance. As can be seen in Table 2, total assistance increased almost ten times from 42.9 billion *won* in 1998 to 439.7 billion *won* in 2007. Government assistance rose from 15.4 billion *won* in 1998 to 227.3 billion *won* in 2006 and 198.3 billion *won* in 2007. Private humanitarian assistance was 27.5 billion *won* in 1998, but peaked at 155.8 billion *won* in 2004. It was maintained at the level of 70 billion *won* on average during 2001-2007. The Korean Red Cross played a pivotal role in extending private humanitarian assistance to the North.¹⁶

The most noticeable trend is a sharp expansion of food loans from zero in 1998 to 178.7 billion *won* in 2005 and 150.5 billion *won* in 2007. At the beginning, food aid took the form of grants, but from 2002 it changed into loans with an annual interest rate of 1 percent with 30 years' maturity because of the opposition party's insistence. It was required that South Korean agents purchase and deliver food on behalf of North Korea in order to prevent the diversion of Seoul's food loans for other purposes. No food loans were provided when relations worsened. For example, when Pyongyang undertook missile tests and the first nuclear test in 2006, the South refused to provide food loans. But they resumed when the North agreed to hold the second inter-Korean summit in October 2007. Likewise, food aid was linked to a political agenda even during the progressive decade.

South Korea's private investment in the North was negligible prior to the KDJ government. As Table 3 demonstrates, the South Korean government approved only three cases during 1991-1997. After 1998, however, 325 cases were approved, of which 274 were for the Gaeseong Industrial Complex. The successful launching of this complex in 2004 had positive spillover effects on investments in other areas, which were mostly concentrated in Pyongyang and Nampo, each equipped with relatively good infrastructure.¹⁸

The most successful cases were the Mt. Geumgang tourist project and the Gaeseong Industrial Complex. The former was launched in November 1998 through a sea route linking Donghae in the south to Jangjeon in the north. It continued without disruption despite such incidents as the infiltration of a North Korean submarine in June 1998 and a controversy over suspected nuclear facilities in Geumchangri, North Korea. The KDJ government's operating principle of separating economics from politics persisted; however, the Mt. Geumgang

Table 3. Government-Approved Private Investment in North Korea (unit: # of cases)

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	TOTAL
Gaeseong Industrial Complex	-	-	-	-	-	-	-	-	17	26	15	163	53	274
Other Areas	1	2	6	0	2	5	1	2	6	10	4	6	9	54

Source: ROK Ministry of Unification, *Intra-Korean Exchange & Cooperation Monthly*, August 2010, p. 107.

tourist project using the sea route was losing money because of the long travel time, high costs, and procedural difficulties related to border control. North Korea fixed these problems by designating the Mt. Geumgang area as a tourist district and relaxing border passage control procedures in 2002. It also allowed travel through a ground route as road construction between Goseong, South Korea and Mt. Geumgang was completed in 2003. As a result, the number of South Korean tourists visiting Mt. Geumgang exceeded 20,000 per month. 345,000 tourists visited in 2007, and the cumulative total reached 1.95 million until it was closed in 2008 by the MB government.¹⁹

Two months after the first Korean summit in June 2000, Hyundai-Asan and the Asia-Pacific Peace Committee of North Korea signed an agreement to develop the Gaeseong Industrial Complex in three stages in which 8 million *pyong* (1 *pyong* is equivalent to 3.3 square meters) was allotted for plant sites, and 1,200 million for supporting facilities. The first stage was to develop a one-million-*pyong* industrial complex, but no progress was made until North Korea enacted the Law on Gaeseong Industrial District on November 27, 2002 that stipulated provisions on the development, administration, establishment, and operation of firms, and dispute resolution. Such progress notwithstanding, however, removal of mines in the DMZ, which was essential for the launching of the complex, and opposition by the North Korean military remained major barriers. The RMH government initiated the launching ceremony on April 1, 2004. It started with a pilot project of 28,000 *pyong* and the first shipment of “made in Gaeseong” products occurred on December 15, 2004. By the end of 2007, 65 South Korean firms had set up plants in Gaeseong, hiring 22,538 North Korean workers and producing goods worth \$100 million.²⁰

In addition, KDJ placed emphasis on railway connections with North Korea since he was interested in connecting the Seoul-Shinuiju railway to the Trans-China railway and the East Coast railway to the Trans-Siberian railway. Such connections, if materialized, could have not only reduced logistical costs between South Korea and Europe, but also allowed South Korea to escape the geo-economic position of an isolated peninsula.²¹ KDJ called both the trans-China and trans-Siberia railways the “Iron Silk Road.”

The RMH government honored and even intensified inter-Korean economic cooperation projects. The October 4th joint summit declaration, which Roh and Kim Jong-il adopted, identified specific projects for mutual cooperation. They include the launching of the second stage of the Gaeseong Industrial Complex, the establishment of the “West Sea Special Zone for Peace and Cooperation” in Haeju and its vicinity for common fishery areas, a special economic zone, and joint utilization of the Han River estuary. In order to follow up the joint declaration, the North-South Joint Commission for Economic Cooperation was established at the level of deputy prime minister and designated 45 major projects for inter-

Korean economic cooperation. They included the exchange of the North's minerals for the South's raw materials for light industry, the construction of joint shipbuilding complexes in Nampo and Anbyeon, setting up pig farms, and a wide range of cooperative projects in the agricultural, fishery, and environmental sector.²² But the agreements were reached too late in his tenure, and the succeeding LMB government did not honor them.

Both the KDJ and RMH governments sought active economic engagement with North Korea; however, assessments of their performance seems polarized. Conservative critics argue that economic engagement during the progressive decade was an outright failure because it could not foster opening and reform in the North as well as improve the living conditions of the North Korean people. On the contrary, they claim, unilateral "give aways" (*peojugi*) helped the North to develop nuclear weapons and sustain its regime. Meanwhile, progressive pundits in South Korea advocate for the economic engagement policy by claiming that it did contribute to inducing opening and reforms in the North, albeit limited, and helped ameliorate North Korea's economic hardship. They further maintain that inter-Korean economic exchanges and cooperation had a positive impact on tension reduction and peaceful co-existence. More importantly, they argue that the Gaeseong Industrial Complex greatly benefitted South Korean small and medium-sized firms.²³ In sum, we can draw at least four major implications from the economic engagement policy of the progressive decade.

First, economic engagement of the progressive decade definitely contributed to improving economic conditions of the North Korean people. The North could overcome severe food shortages owing partly to Seoul's humanitarian assistance, and income from economic cooperation projects assisted Pyongyang in managing chronic hard currency shortage problems, enabling it to import much needed food, fuel, and other necessary goods. As a result, economic engagement played an important role in stabilizing overall social and economic conditions in the North, with generous side benefits to its ruling elite.

Second, economic engagement has undoubtedly influenced the North Korean people's mindsets. Increasing frequency of contacts with South Koreans made North Koreans aware of Seoul's economic prosperity, and North Koreans gradually expressed their appreciation of the South's humanitarian assistance and began to change their image of the South and its people. More importantly, North Koreans began to appreciate the value of money, especially hard currency, as South Koreans spent cash in Mt. Geumgang, Gaeseong, Pyongyang, and elsewhere. Bureaucrats and managers also learned the logic of market operations through interactions with South Korean counterparts. Likewise, exposure of North Koreans to South Korea and its people has profoundly affected their psychological status.

Third, extensive economic engagement was conducive to inter-Korean confidence-building and overall military tension reduction. There were two naval clashes in the West Sea during the KDJ period, of which North Korea's naval provocation in June 2002 during the World Cup match in Seoul particularly enraged South Korean people. But Pyongyang immediately sent Seoul unprecedented words of regret. Both sides maintained hot lines as well as multiple channels of communication, which served as effective means to avoid misperceptions and conflict escalation. It is also noteworthy that North Korea did not undertake any overt military provocations during the RMH government. It did carry out its first nuclear test on October 9, 2006, but that can be seen as a protest against the Bush administration rather than an expression of hostility against the South. All this can be attributed to North Korea's heavy

economic dependence on the South, which was an outcome of active economic engagement.

Finally, the economic engagement policy during the progressive decade was not necessarily a unilateral, altruistic gesture. The South also greatly enjoyed benefits from the engagement. Improved inter-Korean relations reduced the level of political risk on the peninsula and enhanced Seoul's credit rating.²⁴ And the Gaeseong Industrial Complex and other offshore production sites in Pyongyang and Nampo provided small and medium-sized firms with new opportunities for business operation, and they began to enjoy greater profits.

THE CONSERVATIVE ERA & SETBACKS TO ECONOMIC ENGAGEMENT (2008-2015)

Transition to the LMB government was accompanied by big changes in inter-Korean relations. In sharp contrast to the progressive governments, Lee emphasized "principled engagement" with the North, advocating linkage between politics and economics rather than separating them, as evidenced by his "De-nuke, Open 3000" policy. He pledged that if the North abandoned its nuclear ambition, his government would help it achieve \$3,000 per capita income within ten years. Thus, economic engagement was contingent on its denuclearization. Lee was extremely critical of previous governments' "give first, take later" policy, and instead stressed a mechanical reciprocity in economic exchange with the North. He viewed the flexible reciprocity of "give first, take later" as an excuse for a "unilateral give away" to the North. The LMB government also adopted the principle of "government first, civil society later" in promoting exchange and cooperation with the North. In so doing, his government virtually suspended non-governmental actors' interactions with the North. Finally, LMB was skeptical of gradualism of "easy things first, difficult things later," saying no meaningful progress in inter-Korean relations would be possible without tackling the nuclear problem. LMB's operational principle in dealing with the North was diametrically opposed to that of the progressive decade. This is, in part, due to his perception of inter-Korean relations. He believed that as long as the North played the nuclear weapons card, there would be no chance for inter-Korean confidence-building. Equally critical was his perception that the sunshine policy failed to foster opening and reform in North Korea. For him, forced change through pressure was more probable than voluntary change through cooption and persuasion. Finally, he, arguably, believed in the coming collapse of the North Korean regime. Thus, extending economic assistance to the North was tantamount to prolonging the evil North Korean regime. For all her rhetoric, President Park's policy line seems no different than LMB's.²⁵

The two conservative governments were radically different from the progressive governments in dealing with the North. Empirical data show three paradoxical outcomes. First, total trade volume between the South and the North almost doubled from \$1.79 billion in 2007 to \$2.71 billion in 2015, and it steadily increased during the conservative era until 2016. Second, North Korea's exports to the South unexpectedly surpassed exports to the North during this period.²⁶ Finally, North Korea's provocative behavior did not impede the overall nature of inter-Korean trade. Despite the second nuclear test in 2009, the *Cheonan* naval vessel being torpedoed by a North Korean submarine, and the shelling of Yeonpyeong Island in 2010, the overall volume of inter-Korean trade was on the rise. The successful operation of the Gaeseong Industrial Complex made such paradoxical outcomes possible.

Table 4. Inter-Korean Trade by Type during the Conservative Era (2008-2015) (unit: \$ million)

	Type	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Commercial Trade	General Trade & Processing-on-commission Trade	557	790	808	666	435	4	1	1	0	0
	Economic Cooperation	371	640	904	976	1,454	1,698	1,961	1,133	2,338	2,704
	(Gaeseong Complex)	299	441	808	941	1,443	1,698	1,961	1,132	2,338	2,704
	Non-Commercial Transactions	422	367	108	37	23	12	9	3	4	10
	Total	1,350	1,798	1,820	1,697	1,912	1,714	1,971	1,136	2,342	2,714

Source: Korea International Trade Association, <http://www.kita.net/interkorea2/html/business/namb3.jsp> (accessed April 23, 2016); “Inter-Korean Trade Statistics,” Newsletter on Inter-Korean Trade, Vol. 2 (February 2012), http://www.sonosa.or.kr/newsinter/test_edition2/sub4.html (accessed April 25, 2016); ROK Ministry of Unification, Unification White Paper 2015, p. 61.

Table 5. Assistance to North Korea during the Conservative Era (2008-2015) (unit: billion won)

Type	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Gov. Assistance & Grants	227.3	198.3	43.8	29.4	20.4	6.5	2.3	13.3	14.1	14.0
Gov. Food Loans	0	150.5	0	0	0	0	0	0	0	0
Private Assistance & Grants	70.9	90.9	72.5	37.7	20.0	13.1	11.8	5.1	5.4	11.4
Total	298.2	439.7	116.3	67.1	40.4	19.6	14.1	18.3	19.5	25.4

Source: ROK Government Index, http://www.index.go.kr/potal/main/EachDtlPageDetail.do?idx_cd=2784 (accessed April 23, 2015).

Table 4 presents data on inter-Korean trade during the conservative era, when trade was increasing. However, general trade and processing-on-commission went down from \$808 million in 2008 to \$1 million in 2012 and to zero in 2014 and 2015. Non-commercial transactions such as government and private sector assistance to the North also decreased from \$367 million to \$9 million in 2012 and to \$4 million and \$10 million in 2014 and 2015 respectively. The PGH government allowed a bit more than the LMB government, but an overall decrease in commercial and non-commercial trade has been a common pattern. The only exception was trade exchange involving the Gaeseong Industrial Complex, where trade rose from \$808 million in 2008 to \$2.70 billion in 2015. Shipment of raw materials, intermediate and capital goods to Gaeseong was less than shipment of finished goods to the South, implying that operation of this complex has become normal and even profitable.

As the data in Table 5 demonstrates, Seoul’s assistance to the North has been rather limited during the conservative era. Overall assistance declined from 439 billion *won* in 2007 to 14.1 billion *won* in 2012 and 25.4 billion *won* in 2015. Assistance and grants decreased from 198.3 billion *won* in 2007 to 43.8 billion *won* in 2008 and 2.3 billion *won* in 2012. The figure increased to 13.3 billion *won* in 2013 and 14.0 billion *won* in 2015 during the PGH government, but compared with the progressive decade, the amount seems negligible. And no food aid or loans were extended to the North during the conservative period. The LMB government was initially interested in extending food loans to the North, but required Pyongyang to come up with a detailed proposal on how the food would be distributed. Pyongyang refused, and no food loans took place.²⁷ Private assistance to the North shows a similar pattern, but, though limited, the LMB government was more generous than the PGH government in allowing it.

During the conservative era, three noticeable incidents negatively affected economic engagement with North Korea. The first is the shooting death of a South Korean female tourist by a North Korean soldier in a restricted military zone of the Mt. Geumgang area on July 11, 2008. The LMB government demanded that the North make a formal apology, pledge not to repeat similar incidents, and show its commitment in writing to protect the safety of South Korean tourists. As the North Korean authorities responded in a lukewarm way, the LMB government suspended the entire Mt. Geumgang project, which has never reopened. Hyundai Asan paid \$486 million to North Korea for the 50-year concession of the Mt. Geumgang area and made an additional investment of 226 billion *won* for the construction of various facilities. The Korea Tourist Corporation and other firms also invested 132 billion *won* in the area. All these investments were confiscated by North Korea. What was once a blessing turned into a curse.

The second incident involved the sinking of the Cheonan naval vessel in March 2010. Two months later, the ROK government joint investigation team concluded that the naval vessel had been torpedoed by a North Korean submarine, and announced the May 24th measures that suspended inter-Korean trade, banned further investments in North Korea inclusive of the Gaeseong Industrial Complex, prohibited North Korean vessels' passage in South Korean territorial waters, and stopped assistance to the North with the exception of humanitarian aid for children and the vulnerable. In addition, South Koreans were no longer allowed to visit North Korea, including Gaeseong and Mt. Geumgang. The May 24th measures fundamentally altered the terms of interaction with North Korea, signaling an end to engagement with the North.

Finally, North Korea undertook its third nuclear test on February 13, 2013 even before the new PGH government was inaugurated. The ROK and the United States responded to the provocation by elevating the intensity of annual joint military exercises and training. The United States deployed strategic forces capable of delivering nuclear bombs such as F-22s, B-2 strategic bombers, nuclear submarines, and a carrier battle group. Pyongyang reacted hysterically and announced a temporary suspension of the Gaeseong Industrial Complex operation on April 8 until military tension on the peninsula was reduced.²⁸ PGH was angered by the provocation and refused to resume the operation without North Korea's assurance that it would not close the operation for political and military reasons. She prevailed over the North and *won* Pyongyang's consent to insulate operation of the complex from political and military pressures on August 14. The agreement stated, "under any circumstances, the North will guarantee the safe passage of South Korean personnel, normal attendance of North Korean workers, and protection of private properties in the Gaeseong complex."²⁹ The incident implied that the Gaeseong Industrial Complex, which was considered a Maginot line of inter-Korean economic relations, would not be vulnerable to political and military purposes on either side.

Conservative governments placed the utmost priority on political and military concerns over economic ones. Denuclearization was the top priority, and economic engagement was seen as a source of nuclear and conventional military build-up and regime survival. But such thinking has costly consequences for the South. Hawkish engagement in the name of mechanical reciprocity brought adverse effects on the South. For example, damage from the suspension of the Mt. Geumgang tourist project has been hurting South Korean firms more than the North. As of November 2014, the sales loss of Hyundai Asan due to the closure of

the project was estimated at about 809 billion *won* and that of other firms related to the project about 325 billion *won*.³⁰ Damages incurred by the May 24th Measure have been known to be far greater. Whereas North Korea lost about \$2.6 billion as a result of the measure, South Korean firms suffered from a total loss of \$8.9 billion (\$1.1 billion from the failure to resume the Mt. Geumgang project, \$30 million from the failure to resume Gaeseong tourism, \$3.2 billion from a ban on additional investment in the Gaeseong Industrial Complex, \$4.3 billion from the suspension of inter-Korean trade, and \$80 million incurred from the diversion of air routes).³¹ A four month suspension of the Gaeseong Industrial Complex by the PGH government also turned out to be costly: 234 South Korean firms engaged in the complex reported that they lost 1.56 trillion *won* in these four months. This figure does not include losses for state enterprises, the Woori Bank, and Hyundai-Asan.³² All of this implies that sanction measures have been self-damaging.

Another negative externality was North Korea's growing dependence on China, which now accounts for almost 93 percent of North Korea's external trade. While North Korea was able to make up for losses from economic transactions with the South by diversifying into China until China announced its own sanctions in March 2016 after the fourth nuclear test, South Korean firms lost business opportunities in the North, and many of them ultimately went bankrupt. The LMB and PGH governments were initially confident that they could prevent Pyongyang's military provocations by utilizing economic leverage. But their calculations proved wrong, and their economic leverage became futile in the face of continuous military provocations such as nuclear tests, missile launches, the sinking of the Cheonan naval vessel, and the shelling of Yeonpyeong Island.

Judged according to the indicators above, economic non-engagement during the conservative era has been quite disappointing. It failed not only to prevent the North from undertaking nuclear tests and missile launches, but also to change its economic policy behavior. Despite eight consecutive years of hard works to isolate, contain, and punish North Korea, its regime remains intact.

CONCLUSION

February 10, 2016 will, arguably, be recorded as a tragic page in inter-Korean history because the South Korean government closed the Gaeseong Industrial Complex unilaterally and indefinitely as a response to North Korea's nuclear test and rocket launch. The PGH government justified the decision by arguing that Pyongyang has been diverting economic gains (about \$100 million per year) from the complex into nuclear weapons and missile development. Apart from the diversion issue, Seoul had to take the measure in order to set an example before the UN Security Council began to deliberate on a sanctions resolution.³³ Some suggest that a deeper, hidden motive can be found in PGH's personal belief that the North Korean regime is coming to an end and that unprecedented tougher sanctions could foster its collapse.³⁴

Progressive pundits and those who were affected by the decision strongly opposed it. They argue that there is no concrete evidence of Pyongyang diverting cash from Gaeseong to nuclear and missile development. Since the amount of money earned from Gaeseong is not large enough, the closure of Gaeseong would not stop North Korea's nuclear weapons ambition. On the contrary, the decision would transform Gaeseong, the zone of peace, into a military

zone, eventually heightening military tension. Moreover, they claim that the closing of the Gaeseong Industrial Complex would be seen as a sign of high political risk such as imminent war. More critical was the loss of government credibility. They were particularly angry because the Park government abruptly closed the complex without any prior consultation and even sufficient notice for evacuation. Ironically, it was the PGH government, not North Korea, which violated the August 2013 agreement not to “close the complex under any circumstances.” Consequently, 54,000 North Korean workers and their families, along with 5,000 South Korean firms, fell prey to collateral damage.³⁵ Finally, the Gaeseong Industrial Complex was seen as the most successful model of economic transformation for the North as well as a confidence-building measure, but with its closure, a ray of hope for economic engagement with the North, its opening and reform, and inter-Korean confidence building has become a distant dream.

What, then, is the outlook for economic engagement with North Korea? Three scenarios can be envisaged. The first is the most desirable, but least feasible. Under this scenario, North Korea would comply with international calls for denuclearization and seek economic benefits from the international community. Economic engagement will be maximized under this scenario. Judging by Kim Jong-un's remarks at the 7th Party Congress of the Korea Workers' Party on May 7, it is highly unlikely. He not only declared a continuation of the *byungjin* (simultaneous pursuit of economic development and nuclear weapons) line, but he also took great pride in testing a hydrogen bomb in January and launching the satellite *Gwangmyongsung 4*.³⁶

The second scenario is least desirable, but highly probable. Under this scenario, the North would continue to undertake nuclear tests and missile launches in response to international sanctions. Thus, any chance for economic engagement will be slim, and military tensions could be heightened. The outbreak of major or limited military conflicts cannot be ruled out.³⁷

Finally, the scenario of short-term confrontation and mid-term transformation could be possible. This could become plausible if a progressive candidate is elected in the 2017 South Korean presidential elections. The new president would seek a parallel approach of resuming inter-Korean dialogue, while attempting to resolve the North Korean nuclear quagmire through the Six-Party Talks process. South Korea under new leadership would take a more proactive role in linking denuclearization of North Korea to a peace regime on the Korean Peninsula and likely would resume economic engagement with the North.

ENDNOTES

1. Lim Byeong-sik, “Jeongbu Gaeseong gongdan gadong jeonmyeonjungdan Bukhaek-misail cheotdokjajejae,” *Yonhap News*, February 10, 2016, <http://www.yonhapnews.co.kr/bulletin/2016/02/10/020000000AKR20160210064052014.HTML> (accessed April 26, 2016).
2. The New York Times, February 11, 2016, http://www.nytimes.com/2016/02/12/world/asia/north-south-korea-kaesong.html?_r=0 (accessed April 27, 2016).
3. Kim Hyeong-gi, *Nambuk gwangye byeoncheonsa* (Seoul: Yonsei University Press, 2010): pp. 141-142.
4. President Roh Tae Woo, “Mijok jajon-gwa tong-il beonyeong-eul wuihan 7.7 Teukbyeolseon-eon,” July 7, 1988.
5. President Kim Young-sam, “Inaugural Address of the 14th President,” February 25, 1993, <http://15cwnd.pa.go.kr/korean/data/expresident/kys/speech.html> (accessed April 25, 2016).

6. Hong Sun-jik, "Nambuk gyeonghyeop-ui hyeonhwanggwae gwaje," *Gukhwoi tongil wuegyo tongsang wuiwonhwoe gandamhwoe Jaryojip*, March 24, 2004, p. 5.
7. The "engagement" (*pyong* or *gwanyeo*) policy has been interchangeably used with the sunshine policy or the reconciliation and cooperation policy. Whereas Kim Dae-jung preferred to use the sunshine policy, its official title was the reconciliation and cooperation policy. For an overview of the sunshine policy, see Moon Chung-in, *The Sunshine Policy* (Seoul: Yonsei University Press, 2012), Ch. 3.
8. President Kim Dae-Jung "Kim Dae-jung Daetongryeong chui-imsa jeonmun" February 25, 1998, Policy Briefing, <http://www.korea.kr/archive/governmentView.do?newsId=148741323> (accessed April 20, 2016).
9. Soon-young Hong, "Thawing Korea's Cold War: The Path to Peace on the Korean Peninsula," *Foreign Affairs*, May/June, 1999, pp. 8-12; Ministry of Unification, *Policy Towards North Korea for Peace, Reconciliation, and Cooperation* (Seoul: The Ministry of Unification, 1999).
10. President Kim Dae-Jung, "Kim Dae-jung Daetongryeong chui-imsa jeonmun."
11. Moon Chung-in, *The Sunshine Policy*, p. 26; Moon Chung-in, "Kim Dae-jung Daetongryeong-ui oegyo cheolhak" in Yang Sung-chul and Lee Sangkeun eds., *Kim Dae-jung oegyo: bijeon-gwa yusan* (Seoul: Yonsei University Press, 2015): pp. 35-37.
12. Cha Eunyoung and Jung Young-cheol, "Nambuk gyeonghyeop-ui yeoksawa hyeonjae," in Ewha Institute of Unification Studies, *Nambuk gwangyesa* (Seoul: Ewha Womans University Press, 2009): pp. 311-312.
13. ROK Ministry of Unification, *Unification White Paper* (Seoul: Ministry of Unification, 2015): p. 60.
14. Kim Hyeong-gi, *Nambuk gwangye byeoncheonsa*, pp. 224-225, 255-65.
15. Mark E. Manyin, "Foreign Assistance to North Korea," CRS Report for Congress, May 26, 2005, pp. 24-26, <http://www.au.af.mil/au/awc/awgate/crs/rl31785.pdf> (accessed April 28, 2016).
16. Kim Jung-soo, "Indojeok Daebuk jiwon-gwa Bukhan cheje jonsokryeok-e michin yeonghyang," *Tongil jeongchaek yeongu*, Vol. 19, No. 1 (2010.6), pp. 216-218.
17. "Daebuk sikryang jiwon," ROK Ministry of Unification Information Portal on North Korea, <http://nkinfo.unikorea.go.kr/nkp/term/viewKnwldgDicary.do?pageIndex=7&dicaryId=129&searchCnd=0&searchWrds=> (accessed April 24, 2016).
18. Choi Su-yeong, *Bukjung gyeongje gwangye-wa Nambuk gyeonghyeop-ui Daebuk pageuphyo-gwa bigyo bunseok* (Seoul: Korea Institute for National Unification, 2010): pp. 74-75.
19. Lee Hye-jeong, "Keumgangs-gwangwang-ui uimi jaejomyeong," *Hyeonan-gwa gwaje*, No. 14-10 (February 25, 2014), p. 1; "N Korea's Inner Geumgang Mountain Tours to Start in June," *Imagine Your Korea*, April 30, 2007, http://english.visitkorea.or.kr/enu/AKR/FU_EN_15.jsp?gotoPage=278&cid=290295 (accessed April 27, 2016).
20. Kim Hyeong-gi, *Nambuk gwangye byeoncheonsa*, pp. 330-331.
21. Kathy Wolfe, "Koreas Open DMZ at Last: 'Silk Road' Rail Construction Starts," *Executive Intelligence Review*, Vol. 29, No. 37 (September 27, 2002), pp. 48-50; Ra Jong-yil, "Han-EU oegyo" in Yang Sung-chul and Lee Sangkeun eds., *Kim Dae-jung oegyo*.
22. Cha Eunyoung and Jung Young-cheol, "Nambuk gyeonghyeop-ui yeoksawa hyeonjae," pp. 322-323; Kim Hyeong-gi, *Nambuk gwangye byeoncheonsa*, pp. 338-340.
23. On this debate, see Moon Chung-in, *The Sunshine Policy*, pp. 218-235.
24. Nam Seong-uk, "Nambukhan gwangye-wa Gukgasin-indo," a paper presented at the Political Science Association Annual Summer Conference, July 2002.
25. Jung-Ho Bae, "Myung-Bak Lee Administration's North Korea Policy and the Inter-Korean Relations," in Jung-Ho Bae and Abraham Denmark, eds., *The U.S.-ROK Alliance in the 21st Century* (Seoul: Korea Institute for National Unification, 2009): pp. 46-55.
26. ROK Ministry of Unification, *Unification White Paper 2015*, p. 60; ROK Government Index, "Changes in Inter-Korean Trade," http://www.index.go.kr/potal/main/EachDtlPageDetail.do?idx_cd=1698 (accessed April 26, 2016).
27. Min Hong Sik, "Nambuk gyeonghyeop-eul tonghae bon Hanguk-ui daebuk jeongchaek," *Munmyeong yeonji*, Vol. 15, No. 2 (2014), pp. 129-130.
28. Jang Yong-hun and Lee Jun-sam, "Buk, Gaeseong gongdan jamjeong jungdan seoneon," *Yonhap News*, April 8, 2013, http://www.yonhapnews.co.kr/northkorea/2013/04/08/1801000000A_KR20130408183052014.HTML (accessed April 27, 2016).
29. Ibid.
30. Ok Cheol, "Hyeondae-asan Keumgangs deung maecheul sonsil 1jowon yukbak," *Yonhap News*

- (November 18, 2014), <http://www.yonhapnews.co.kr/economy/2014/11/17/0302000000AKR20141117142700003.HTML> (accessed April 27, 2016).
31. Lee Jaeho, "5.24 jochi ihu Namhan gyeonjejeok bihae 10jowon yukbak," November 1, 2013, Pressian, <http://www.pressian.com/news/article.html?no=109658> (accessed April 28, 2016).
 32. Ko Yu-seon and Oh Ye-jin, "Ipjugieop yumuhyeong sonsil bulgapi," Yonhap News, February 10, 2016), <http://www.yonhapnews.co.kr/bulletin/2016/02/10/0200000000AKR20160210069300030.HTML> (accessed April 18, 2016).
 33. Kim Ho-jun and Hwang Cheol-hwan, "Jeongbu, Geaseong gongdan gadong jeonmyeon jungdan," Yonhap News, February 10, 2016.
 34. Kang Byeong-cheol, "Bakdaetongryeong daebuk jeongchaek daejeonhwan," Yonhap News, February 16, 2016, <http://www.yonhapnews.co.kr/bulletin/2016/02/16/0200000000AKR20160216095251001.HTML> (accessed April 18, 2016).
 35. Yim Eul-chul, "Gaeseong gongdan pyeshoe ihu Nambuk gwangye jeonmanggwa dae-eung," GSJ Focus, No. 216 (March 2016): pp. 2-4.
 36. Julie Makinen, "Kim Jong Un, hailing hydrogen bomb test and satellite launch, predicts 'final victory,'" *Los Angeles Times*, May 6, 2016, <http://www.latimes.com/world/asia/la-fg-north-korea-party-congress-20160506-story.html> (accessed May 9, 2016).
 37. Lee Sang-keun, "Gimjeongeun lideosip yeongu," in Ministry of Unification, ed., 2015 *Sinjin yeongu nonmunjip* (Seoul: Ministry of Unification, 2015), pp. 365-366.