

# The Politics of Inter-Korean Economic Cooperation: 1998-2009

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### Introduction

It has been ten years since the Democratic Peoples' Republic of Korea (DPRK or North Korea) embarked on a path of change. The first major course correction occurred in 1998 when the DPRK amended its constitution. A new cost accounting system in economic management was introduced, and a new political line of Songun (Army-First Politics) was promulgated in addition to the Juche ideology of national self-reliance. Although this adapted form of Marxism-Leninism continued to guide the country on its way to "Korean-style socialism," the proposed changes would bring some elements of economic liberalisation and commercialisation of the economy. As part of this cautious plan, several enclaves scattered across the country were allocated by the DPRK government exclusively for inter-Korean cooperation.



### Zones of NK-SK economic cooperation

Pyongyang's readiness for cooperation was welcomed and supported by Seoul which, with the ascendance to power of a liberal group led by Kim Dae-jung in 1998, stopped waiting for North Korea's collapse. South Korean business conglomerates volunteered to sponsor a number of joint projects in which Koreans from the North and the South could communicate, work and relax. Two inter-Korean summits took place in June 2000 and October 2007, reviving

the hope for reconciliation and closer cooperation between the two parts of the divided country. The development of inter-Korean economic cooperation can be measured by the pace of growth of special economic zones'. It can be divided into two stages: 1998-2003, during which the Mt. Kumgang resort and Kaesong Industrial Park area were created and market economy activity inside North Korea intensified; and 2003-2009, when cooperation in these special economic zones continued to evolve before suddenly stalling, coinciding with the rapid curtailment of economic freedoms inside North Korea.

Despite expectations that cooperation in Mt. Kumgang and Kaesong would bring about a substantial impact on the economic policy of the DPRK, the results were hardly encouraging. Still there is no consensus as to the consequences of such cooperation on the long-term economic course of North Korea. After the 10 years of inter-Korean cooperation, most international experts continue to assess the North Korean regime as "Stalinist" and "secluded," and its economy as "moribund." Optimists insist to the contrary, however, that despite the return of socio-economic despair, the country is on the move and the changes have been profound. They believe that under favourable circumstances the DPRK might follow China and Vietnam in building a dynamic market-oriented economy. Pessimists too admit some positive changes of the last 10 years but dismiss the possibility of fundamental reform in North Korea. They predict inevitable economic catastrophe and regime collapse, followed by open civil conflict and violent unification.

The lack of verifiable data makes any attempt to analyse the situation in and around the DPRK speculative and subjective. Publications on North Korea tend to be prejudiced and mystifying, mixing up a variety of different issues (nuclear proliferation, human rights, economic reform and political liberalisation) and confusing cause and effect. Information

sourced from government-sponsored research, diplomatic and business press releases usually presents conservative views. Testimonies of refugees, media reports, and travelogues tend to be sensationalist and unreliable. But, if scrupulously collected and verified, put in order and analysed, all sources can contribute to the creation of a wider and fairly accurate picture of DPRK motivation (or the lack of such) for engagement and cooperation.

Although it is unquestionably easier to collect statistical data and monitor the actions initiated by the Republic of Korea (ROK), the economic rationale and the mechanism of decision making in Seoul can often perplex even a veteran analyst. The South Korean media, wary of national image and investment climate, often tends to beautify complex or unresolvable situations and portray contentious events in a favourable light for incumbent governments. As a result, presumably pragmatic steps in reality turn out to have been purely political, and the proclaimed goals are never achieved. The true reason for such a gap between the declared aims and the hidden intentions is deeply embedded in the unresolved political and ideological conflict on the Korean peninsula.

When issues of inter-Korean economic cooperation are presented and discussed what is usually missing is analysis of the hidden political agenda pursued by both governments. While wondering why North Korea acts irrationally toward cooperation and exchange which could significantly improve the livelihood of its population, we often forget the inevitable consequences of such changes for the political and ideological foundations of the DPRK. Similarly, in blaming the current South Korean administration for actively curtailing the scale and prospects of developmental aid to North Korea we must not dismiss the ROK's national interests and economic concerns. After all, both Pyongyang and Seoul continue to contest the exclusive right and legitimacy to unify the

nation under their social and ideological order. Impartiality of analysis and readiness to understand the reasoning pursued by both sides is essential when inter-Korean conflict or cooperation is discussed.

In other words, a pragmatic approach to economic cooperation must assume that the DPRK will never do anything that would jeopardise its national security and stability objectives regardless of how much cash it might earn in the process. The ROK, as well, cannot be viewed as a state prepared to indefinitely forfeit economic returns and its citizens' lives only to sustain national reconciliation and cooperation. The politics and economics of inter-Korean cooperation are closely interlinked, but the priorities are set differently by the two governments. Pyongyang and Seoul both believe that they act in full accordance with their assumed responsibility to protect national security and integrity. Therefore, it is hardly surprising that in such an ideologically driven environment the politics of confrontation may easily clash with economic rationale. The impartial viewer has to attempt to reveal obvious mistakes in policy and offer solutions to avoid further damage or unnecessary confrontation.

The scope of the present analysis is deliberately limited to the inter-Korean relationship. This is done to assess the self-serving interests of the two rival states ferociously competing for economic success and political legitimacy. Nevertheless, the North and the South do not exist in a vacuum. Choices made in Pyongyang and Seoul usually reflect the broader multilateral frame within which economic and political influence over the Korean peninsula is contested by neighboring regional powers. Any prospect of change in the status quo in a divided Korea immediately leads to the resurrection of a "zero-sum game" logic among China, Japan, Russia, and the US. Keeping this in mind, we can simply assume that the North-South Korean relationship is

heavily influenced by the "foreign factor". The multilateral negotiation process on denuclearisation of North Korea (the Six-Party Talks) is not discussed here for the reason that this particular issue has more to do with bilateral relations between Pyongyang and Washington than inter-Korean affairs.

This article, therefore, analyses hidden links between the dominating political agenda and auxiliary socio-economic methods deployed by both governments to achieve inter-Korean reconciliation through cooperation in the period between the 1997 Asian Financial Crisis and the current 2009 Global Financial Crisis. The policy fluctuations of Pyongyang and Seoul toward Mt. Kumgang and the Kaesong Industrial Park will be examined in connection with the changes in political climate and economic circumstances, as well as changes in popular mood on both sides of the DMZ. Media publications, academic reports and fieldwork observations are used here as primary sources [1].

## North Korea Struggles for Survival

North Korea is an industrialised (43%) nation, with a moderately developed (33%) service sector and a smaller (23%) agricultural sector, which has been badly affected by policy mistakes and natural disasters, compounded by the energy crisis and foreign trade sanctions. Economic sanctions, invoked against the DPRK during and after the Korean War (1950-1953), were counterbalanced by massive assistance from the Communist bloc countries. With the collapse of the bloc in the early 1990s a rapid decline of the centrally planned economic system in North Korea began. Interruption of cheap energy supplies from Russia and a reduction in aid from China led to the breakdown of the Public Distribution System (PDS) and the rise of a non-monetary barter economy inside North Korea.





### **Collapse of public distribution and rise of the barter economy**

The North Korean economic debacle culminated in the Great Famine (1995-1997), which left an unaccounted number of people dead (1-3 million) and many more dying even after the famine officially ended. From the late 1990s, most economic activity was concentrated in the semi-private “farmers’ markets,” where the non-official or black economy thrived. The explosion of private initiative in economic life, although in conflict with official ideology, was the product of necessity. The political leadership centring on Kim Jong-il (son of the eternal President Kim Il-sung) silently endorsed but never welcomed these changes. Understanding that such elements of market-oriented economy as private property, freedom of travel and information would undermine the government's grip on power and eventually lead to the collapse of the DPRK as a state, the central authorities staged periodic crackdowns on the black markets.

Those campaigns had little effect because the populace had no other means for survival, and local officials were more than willing to ignore deviations if bribes were paid. Bribes, in these circumstances, can be seen as a price paid for

waiving many restrictions, including those on private trade and travel. In the meantime, border control with China loosened to the point that a few hundred thousand economic migrants rushed to the neighbouring Korean Autonomous Region of the People's Republic of China (PRC). In other words, in the last years of the 20th century, the old “Stalinist” system of North Korea was breaking down and a new market-oriented system began to grow in its place.



### **Army-First Politics: Kim Jong-il's on the spot guidance**

This upset the bureaucratic system, causing greater corruption and abuse of power by the local authorities. In such circumstances, public order and the political regime in general could not survive without extraordinary measures. One such measure was the introduction of a new political and ideological doctrine, “Army-First Politics” [Sŏn'gun chŏngch'i], that emphasised national security. For the first time in DPRK history the Korean People's Army (KPA) enjoyed greater power than the Korean Workers' Party (KWP). It was in 1998 that Kim Jong-il, who had assumed the post of Chairman of the National Defence Commission in 1993, formulated the principles of Sŏn'gun. The concept of military communism was

emphasised, counterbalancing the inevitable revival of capitalist individualism in society.

The moribund economy could not be revitalised by political means alone and, in the face of economic peril, the government bowed to the growing pressure and further liberalised some aspects of economic life. On 1 July 2002, the so-called "Economic Management Improvement Measures" [Kyŏngje kwalli kaeseon choch'i] were introduced to address the desperate situation in industrial management and to provide an alternative to the defunct PDS. The changes were moderate, somewhat akin to the half-hearted Soviet "reforms" of the 1960s and 1970s. Nevertheless, the North Korean leadership abstained from calling these measures a "reform" because this word could raise suspicions that the system of central planning had been imperfect and even be associated with possible political changes.



### **Economic Measures: market revival**

The "July 1 Measures" were welcomed outside of North Korea where they were misinterpreted as a sign of long-awaited economic opening and looming political change. Many people in South Korea and overseas believed that Kim Jong-il and his entourage were preparing to embrace Chinese-style reforms. The ROK government at that time was pursuing the "Sunshine Policy" [Haetpyŏt chŏngch'aek] toward the North that made its goal to help Pyongyang during this supposedly transitional period. In fact, the 2002 measures were not revolutionary at all.

The DPRK government simply gave belated endorsement to activities that had been going on for years and which the regime had failed to eradicate [2].

Another reason why these changes were never called "reforms" is that they were aimed at improving the DPRK's economic performance without allowing overall improvements in the livelihood of the people. The piecemeal adjustments in the economy from the beginning were supposed to be counterbalanced by the Sŏn'gun politics of military communism. These conflicting goals delivered controversial results. Overlapping intents sent mixed signals domestically and internationally, bringing fortune and optimism to some but confusion and despair to others. The later harsh decisions of the government in relation to market activities inside the country and its inconsistent approach toward the zones of inter-Korean cooperation similarly frustrated North Korean workers and South Korean investors.

To avoid confusion within the inner circles of the State and the Party, middle-level government officials and the Korean People's Army were assured that market liberalism, which had swept the country after 2002, was a temporary phenomenon that would not be tolerated in the future. In 2005, the first signs of policy reversal became visible. The regime began to crack down on potentially dangerous elements (peddlers, border-crossers, and people with anti-socialist behaviour). The old patterns of central economic planning, public distribution system, and strictly controlled market activity began returning. The economic policy of partial liberalisation gradually waned.

In late 2007, active anti-market actions were launched. At this time Kim Jong-il's brother in law and technocrat manager, Chang Sun-taek, was promoted to the newly created post of First Vice-Director of the ruling Korean Workers' Party, with oversight over the police, judiciary, and other areas of internal security. He visited

the border area with China to “clean up” smuggling and speculation, and issued a special instruction tightening the regulations relevant to free markets elsewhere in the country. A year later, Kim Jong-il’s ill health emptied the space for Chang Sun-taek in the top decision-making body of the National Defence Committee. With his ascendance, a conservative group in the North Korean leadership triumphed.

### **The Sunshine Policy and Inter-Korean Economic Cooperation**

The policy which South Korea pursued towards the North between 1998 and 2008 was known as the “Sunshine Policy”. It was first formulated by the then ROK presidential candidate Kim Dae-jung in 1997, when few people expected North Korea to survive the end of the century. Hardly anybody believed that zones of inter-Korean cooperation could start with passenger cars, buses, and trains crossing the DMZ on a daily basis. But after the historic summit between Kim Dae-jung and Kim Jong-il in June 2000 this plan started materialising. In 2003 the Roh Moo-hyun government gave a new name to its attempts to build trust in its relations with the North. By announcing the “Peace and Prosperity Policy”, Seoul tried to convince Pyongyang that Seoul’s intentions were more profound than simply luring North Korea out of its shell.



### **2000 Summit Kim Dae-jung and Kim Jong-il**

The growing air and maritime traffic between South and North Korea was another achievement of this policy. During the 10 years of Sunshine Policy, almost 2 million South Koreans visited the scenic Mt. Kumgang resort in the eastern coast of Korea as tourists, and half a million more crossed the fortified border for business purposes. On any given day, 300 to 400 South Korean vehicles crossed the DMZ with some 1,000 people going to North Korea to conduct business activities. Annually, about 100,000 North and South Koreans visited each other (this figure doesn't include those visiting Mt. Kumgang). At the end of 2007, total inter-Korean trade reached USD \$1.79 billion, accounting for 40 percent of North Korea's total outbound trade.

The Mt. Kumgang resort project was launched in 1998 and jointly operated by Hyundai Asan and the DPRK Tourism Authority. In 2003, a land route across the DMZ was opened to facilitate access to the area. In 2007, the number of visits continued increasing after South Korean tourists were allowed to use their own cars to travel to the jointly-managed resort. These visits allowed South Koreans to get a glimpse of the North, although free movement outside the official routes was restricted by the DPRK side. Contacts with authorised North Korean employees in hotels, shops and restaurants were permitted and used by both sides to collect information [3].





### Mount Keumgang

Since 2002, Mt. Kumgang resort was used by the national Red Cross organisations as a place for family reunions. During 16 rounds of face-to-face reunions 10,673 ROK and 5,539 DPRK citizens were able to meet with their loved ones for the first time since the Korean War (1950-1953). For this purpose a special Reunion Centre for separated families was nearly completed in 2008. However, the last family reunion at Mt. Kumgang resort took place on 17-22 October 2007, bringing together 396 South Koreans and 97 North Koreans.

In 2003, on the western end of the DMZ, just 60 km north of Seoul, construction began on the Kaesong Industrial Park (KIP) as a symbol of inter-Korean reconciliation. KIP officially opened in March 2005 and all infrastructure facilities and half of the planned First Development Stage targets were accomplished by the end of 2007. Covering more than 350 hectares (or 3.5 square kilometres) it attracted more than 32,000 North Koreans to work for 83 South Korean-owned factories with some 1,600 ROK managers. Initially, this zone of cooperation was treated as exclusively inter-Korean. However, in March 2008, some German and Chinese companies began investing in KIP. German car parts manufacturer Prettl was expected to employ 500 North Koreans and begin operations by

spring 2009 [4].



### North Korean workers at Kaesong Industrial Park

The majority of KIP workers were young women employed in factories and infrastructure projects. The minimum monthly salary of US \$57.50 was increased 5 percent in 2008 to US \$60 with overtime to be paid extra. This money was not paid directly to the North Korean workers but via the Central Special Direct General Bureau [Chungang T'ukku Kaebal Chido Chongguk] (CSDGB). This cabinet-level administrative organisation paid salaries to the North Korean employees of KIP at the official exchange rate (USD \$1 = KRW 142) after collecting USD \$7.50 social security levy and other insurance payments. Thanks to low wages and ROK government subsidies the production costs were sufficiently low to attract small and medium-sized investors.

However, doing business in the KIP had serious disadvantages. Goods produced there were labelled as "Made in DPR Korea" for which high import tariffs were imposed. This made many KIP products uncompetitive on the international market. Moreover, due to restrictions imposed by the Wassenaar Arrangement on Export Controls of Conventional Arms and Dual Use Goods and Technologies, many goods and materials cannot be brought into the KIP even for

processing-on-consignment. Nevertheless, goods such as textiles, cosmetics, chemicals, semi-conductors and cable loops have been produced at the KIP, earning the North up to 100 million US dollars each year. As of February 2008, KIP's production was worth US\$ 309.7 million [5].

As another symbolic step in reconciliation, in December 2007, North and South Korea began regular freight train service across the heavily armed DMZ border. The 12-car train carried construction materials from the South Korean station of Munsan to the North Korean border station of Pongdong, and returned the same day carrying shoes, underwear and other items produced at the KIP. The freight train made the 16-kilometer round trip every weekday but the planned regular passenger train service never started. Instead, daily bus tours from Seoul brought on average 500 people per day to the North Korean scenic city of Kaesong, the ancient capital of the Koryo kingdom (918-1392). This service was one of the tangible results of the October 2007 summit between Kim Jong-il and Roh Moo-hyun that also outlined a series of new joint projects.

The two South Korean administrations provided the North with unconditional aid of huge proportions. Kim Dae-jung delivered the first US\$2.48 billion worth of aid, and Roh Moo-hyun authorised the release of an additional US\$4.7 billion (of which US\$1.57 billion was in cash). About 450,000 tonnes of food was delivered free of charge to North Korean granaries from the South every year from 2003 to 2007. Its distribution was almost unmonitored and no obligations of any kind were attached. Additionally, 300,000 tons of chemical fertiliser was sent to the North each year to improve agricultural yields. Chinese shipments of food aid and trade were roughly equal to those of South Korea and seen by Pyongyang as a valuable alternative to inter-Korean cooperation.



**2007 Summit Roh Muh-hyun and Kim Jung-il**

One can endlessly list the shortcomings of the Sunshine Policy but, if compared with confrontation and war, it seemed to work well and achieve plausible results. Former unification minister under the Kim Dae-jung and Roh Moo-hyun administrations, Chung Se-hyun, opined that "instead of criticising the Sunshine policy as being non-reciprocal or as being taken advantage of by North Korea, it's wiser to make the best use of North Korea's growing reliance on South Korea" [6]. Nevertheless, signs of North Korea's growing openness, as well as its deepening ties with the South, should be assessed with caution. The DPRK leadership understood that the ultimate goal of Sunshine Policy was to lure Pyongyang out of its ideological shell. Neither were South Koreans patient enough to wait until this policy of unconditional help could bear enough fruit to make it truly attractive to the North.

The ROK presidential elections of December 2007 led to a change of leadership in Seoul. The new government of right-of-centre President Lee Myung-bak rushed to announce that the era of unconditional concessions to the North was over. The rhetoric of "pragmatic relations with North Korea" was broadly supported by the South Korean electorate and soon it became clear that it was not merely a



campaign trick. The Pyongyang media remained silent about Lee and his new government for nearly three months after the elections, obviously on the assumption that Seoul would resume the old line. However, the new administration abolished the Sunshine Policy as “unsuccessful” and effectively scrapped all plans for expanding inter-Korean cooperation.

### Conservatives in South Korea

Throughout the ten years of Sunshine Policy a war of words was going on between two camps inside South Korea: the supporters of unconditional engagement and the “pragmatic” conservatives. Even before Lee Myung-bak moved to the Blue House, many people in Asia and beyond associated his ascendance to power with the potential deterioration of inter-Korean relations. If not a complete freeze, a serious cooling was anticipated in the fragile North-South Korean economic cooperation. Some political groups found his conservative stance and rhetoric disturbing, while others welcomed the fresh approach. The victory of the Grand National Party [Hannaradang] in December 2007 did not end the debate.



**Lee Myung-bak**

Lee Myung-bak's criticism of the Sunshine Policy concentrated on the "unilateral

appeasement" which the two previous governments had allegedly pursued in their relations with Pyongyang. Since this policy was based on the principle of almost unlimited help to North Korea, it was nicknamed an "ATM policy", under which the North turned to the South primarily for ready cash. The policy was alleged to have cost a fortune to South Korean taxpayers. Moreover, it attracted a negative attitude from the ROK's strategic partners, chiefly the United States and Japan. Paradoxically, even North Korea was suspicious of this policy and repeatedly denounced the South's intentions as “window-dressing to conceal their anti-north confrontation policy” aimed at implanting capitalism and destroying socialism in the DPRK” [7].

President Lee, instead, set out to push for his own "Vision 3000" policy, designed to provide conditional economic assistance to the DPRK over the next decade with the purpose of helping to boost its per capita national income to US\$ 3,000 [8]. Assuming that the country's economy started growing at 10 percent annually, it could achieve the target in less than 10 years. In the meantime, South Korea promised to provide the North with a comprehensive package in five major sectors - industry, education, finance, infrastructure and welfare. For example, in the case of industry, the South could cultivate 100 North Korean companies that would export goods worth more than US\$ 3 billion. In education, the South could assist the North by training 300,000 industrial workers and investing about US\$ 40 billion through an international development fund.

If implemented, Vision 3000 would have turned North Korea's economy into an export-driven one. However, the plan was premised on full implementation of the Joint Statement adopted on 19 September 2005 at the Fourth Round of the Six-Party Talks in Beijing before any developmental or financial aid could be offered. Paradoxically, this approach was named

"complete and flexible" and was supposed to serve as incentive in inducing the North to scrap its nuclear programs. In other words, denuclearisation was turned by Lee and his associates into the primary policy goal and premise, dominating other policies and regulating the speed and nature of inter-Korean economic cooperation, including South Korean national and private investments in North Korea.

The new presidential administration in Seoul divided all inter-Korean cooperation projects into three categories according to importance and cost. Humanitarian aid (in the form of rice, fertiliser, medical equipment, forestation and environmental support) would continue. Second category projects, which included commercially viable ventures directly benefiting the South (such as development of natural resources, cooperation in transport and communication) would be regulated by a new Inter-Korean Cooperation Fund. Projects requiring significant financial investment – among them reconstruction of the dilapidated North Korean infrastructure and the creation of a special "peace and cooperation zone" in the Yellow (West) Sea – were placed in the third category and indefinitely suspended.

Almost everything that Kim Jong-il and Roh Moo-hyun had agreed on at the October 2007 inter-Korean Summit fell into this "third category." The key development plan aimed at the construction of an economic centre in and around Haeju, the North Korean port city about 75 kilometres west of Kaesong. Experts projected the modernisation of Haeju and the creation of a West Sea Economic Centre as the second largest project after the Kaesong Industrial Park. Apparently, a proper feasibility study did not precede the signing of this multi-billion dollar agreement between Roh and Kim, prompting the Lee Myung-bak administration to scrap the deal. This decision could not but have alarmed Pyongyang and left a deep scar of mistrust on inter-Korean relations and

cooperation.

One of the deadliest steps undertaken by the new South Korean President was making human rights a top priority in the government's policy on North Korea. The DPRK is customarily criticised for serious violations of human rights and its refusal to cooperate with the UN Human Rights Commissioner or special investigators. Lee Myung-bak promised that he would not shy away from telling North Korean leaders the truth about their society's "shortcomings" and emphasised that "constructive criticism, if pointed out with affection, would go a long way toward improving North Korean society." The effect on inter-Korean cooperation was devastating.

The revamped Unification Ministry under President Lee was set to play a new role, completely at odds with its purpose as formulated by the previous two governments – which had been "to promote co-prosperity and peaceful coexistence through the expansion of reconciliation and cooperation between South and North Korea." By aggressively pursuing the denuclearisation and democratisation of North Korea, Seoul further alienated Pyongyang and, by so doing, made its economic recovery and political opening even more problematic.

Although cancelling the inter-Korean agreements signed by his predecessors, the Lee Myung-bak government did not officially refuse to provide food aid to the North. Lee continued repeating that such aid would be delivered as soon as the North lodged an official request. The Pyongyang media responded from March 2008 by labelling the Lee administration a "reactionary war-mongering clique" and introducing special indoctrination sessions for common citizens (including North Korean workers in Special Economic Zones) to inculcate the official view of the new Seoul leadership.

The North Korean military also threatened to

cut all dialogue with South Korea, calling for an apology over remarks by the South's top general and signalling a further slide in relations. South Korea's new chairman of the Joint Chiefs of Staff, General Kim Tae-young, told parliament that the South was ready to strike the North's nuclear site should the communist country attack it with nuclear weapons. "These outbursts are the gravest challenge ever in the history of inter-Korean relations and a reckless provocation little short of a war declaration against us," the North's military said in a note sent to the South's chief delegate to inter-Korean general-level military talks [9].

The North's retort was accompanied by the test firing of several short range missiles, an action backed by a warning that it could slow down work on disabling its nuclear plant in Yongbyon. "If the south side does not retract the outbursts calling for 'pre-emptive attack' nor clarify its stand to apologise for them, the Korean People's Army will interpret this as the stand of the south side's authorities to suspend all inter-Korean dialogues and contacts," it said [10]. This warning was issued in late March 2008 and added to a series of actions and statements from the North. The actions were aimed at the South and the United States in response to Seoul's tougher policy and continuing US sanctions. "We will counter any slightest move of the South side for 'pre-emptive attack' with a more rapid and more powerful pre-emptive attack of our own," the North's military was quoted as saying by the official Korean Central News Agency. Then, the North's Navy Command issued a fresh warning against the South's warships intruding into its "territorial waters" in the Yellow Sea, which are claimed by both Koreans.



### Kaesong Industrial Park

Several days earlier, the DPRK had expelled 11 of 13 South Korean government officials working in the Kaesong Industrial Park, where they were providing South Korean investors with administrative advice and supporting communications between North and South Korean business partners. The remaining two officials were maintenance workers who were deemed essential. Clearly, it was an angry response to moves by Seoul to toughen its approach to North Korea. The expulsions also followed the mounting international pressure on the North to make a full declaration of its nuclear programmes and calls for action on the sensitive issues of human rights, prisoners of war and abductees.

Lee Dong-kwan, the ROK President's spokesman, said after an emergency meeting of ministers that Pyongyang's measure "was a very regrettable incident that could damage progress of economic co-operation between the South and the North." Lee also said that the government would deal with the crisis "based on thorough principles but with a flexible approach" to prevent a "deterioration into an unnecessary situation." The new ROK Vice-Minister for Unification, Hong Yang-ho, told reporters that the government would not offer North Korea concessions in the wake of the expulsions. "This move could hinder the



development of the Kaesong industrial complex by making companies hoping to invest there anxious,” the Unification Minister said [11]. His words proved prophetic as a more substantial setback in inter-Korean cooperation followed.

### Inter-Korean cooperation in crisis

On 11 July 2008, a 53-year-old housewife from Seoul, Park Wang-ja, was shot dead by a North Korean soldier while vacationing at the Mt. Kumgang resort. Park had entered a fenced-off North Korean military zone while strolling along the beach before dawn. After North Korea rejected Seoul’s demand for a joint probe into the killing and defended the shooting as a “self-defence measure” South Korea suspended tourism to Mt. Kumgang. Seoul further escalated tensions by bringing the matter to the meeting of senior officials of the ASEAN Regional Forum (ARF) in Singapore.



**Park Wang-ja**

The DPRK was prepared to risk serious damage economically, including on long-term development programs and economic cooperation projects. The most serious potential damage was the loss of international

confidence, especially in the context of attracting foreign investors, which the DPRK had been pursuing alongside the nuclear talks. Yoo Ho-yul, professor of North Korean studies at Korea University, predicted that the DPRK’s image would be further tarnished, resulting in long- and short-term economic loss [12].

Pyongyang further sent a senior-level official of its Guidance Bureau for the Comprehensive Development of Scenic Spots to visit Hyundai Asan’s office at Mt. Kumgang and deliver the verbal message that “unnecessary staff” at the resort should be cut to 200 people. At that time, 536 workers (including 114 South Koreans), were staying in the unoccupied resort, 337 of them scheduled to return to the South by 20 August 2008. Following the pullout, there remained only 199 people (74 South Koreans and 125 ethnic Koreans from China) who were deemed “necessary” to manage the resort. Staff cuts and deportations sent a strong signal that Pyongyang was not afraid to strike back at the hard-line policy of Seoul.

South Korea tried to ease the situation in September 2008. Two months after the shooting incident in Mt. Kumgang and amid worsening ties with Pyongyang, liberal civic groups were allowed to resume sending large-scale delegations to North Korea. A group of 15 activists and advocates of the 2000 inter-Korean summit agreement visited Pyongyang. This group was followed by two other left-leaning South Korean organisations that also received government permission to visit North Korea and tried to discuss ways to enhance exchanges with their northern counterparts. In October, the ROK government abolished a system under which companies were required to receive permits to do business in the DPRK, simplifying procedures for starting inter-Korean projects [13].

In this slightly improved climate an inter-Korean joint venture firm started operations in

Pyongyang. The 50/50 joint venture Pyongyang Hemp Textiles was the first South Korean business established in the North Korean capital. A cooperative effort between the South's Andong Hemp Textiles and the North's Saebyol General Trading Co., it had a total investment of US\$ 30 million shared equally by the two sides. It was planned that some 1,000 North Koreans would work for the textiles and logistics firm, built on 47,000 square meters of land in Pyongyang. The ceremony, delayed for about two months due to deteriorating inter-Korean relations, was held on 30 October 2008, attended by hundreds of people from both Koreas [14].



### Pyongyang skyline

In the meantime conservative law makers and officials in the South continued to express doubts over the efficacy of increasing South Korean investment in the North, which they said "would only prolong the life of the communist regime". The ROK postponed shipment of 3,000 tons of steel pipe to North Korea, linking the new delivery date with the agreement to be reached at upcoming six-party nuclear disarmament talks on a verification protocol. In response, the North Korean Rodong Sinmun accused the conservative South Korean administration of continuing a policy of "reckless confrontation" with Pyongyang and defaming its dignity [15].

Trouble brewed from mid-October, when North Korea called upon the Lee government to stop South Korean non-governmental organisations from sending air balloons with anti-North and anti-Kim Jong-il propaganda leaflets. Lee's only response was to say that the ROK was a democracy and had no legal means to stop the leafleting. Pyongyang said many times that the activities of the NGOs were in breach of a 2002 agreement which explicitly prohibited both Korean governments from waging propaganda battles against one another. When this agreement was signed, the militaries of both sides switched off their loudspeakers at the demilitarised zone between the countries. The practice of sending leaflets by balloons was resumed in 2008.

Raising the stakes, the North's military threatened to evict South Koreans from the Kaesong Industrial Park in protest against the leaflets. Only then did the ROK Unification Ministry call on activists to desist, sending a senior official and a written appeal to urge NGO groups to halt the leafleting that, they said, was having a "negative impact" on relations and on companies operating in Kaesong. But the head of a group linking families of people abducted by Pyongyang, Choi Sung-young, said his organization and its partner - the Fighters for Free North Korea - would launch another 100,000 leaflets. "South Koreans should not give in to North Korean threats," he told AFP. "If we make a concession here, North Korea will demand that we make another. It will never stop demanding concessions from us." Park Sang-hak, head of the Fighters for Free North Korea, which includes defectors, also dismissed Seoul's request. "We have sent leaflets for the past five years to expose the North Korean regime, and we cannot accept that the government now suddenly raises this issue," Park told Yonhap news agency [16].

In 2008, amid rumours that DPRK leader Kim Jong-il had suffered a stroke and was

incapacitated, the North's authorities appeared increasingly concerned about the propaganda flyers, some of which had reached the outskirts of Pyongyang. The Network for North Korean Democracy and Human Rights said on its website that DPRK troops, police and army reservists had been mobilised and deployed along the border to collect them. Authorities were trying to stop people from reading them by spreading rumours that the pamphlets had been sprayed with radioactive material that could blind people, and anyone reading the pamphlets faced punishment. In fact, South Korean activists often mixed US dollar bills or Chinese yuan notes with the leaflets to encourage North Koreans to pick them up.

In mid-November 2008, the Korean Central News Agency (KCNA) announced that it would restrict movement across the border with the ROK, suspend an historic railway, and "selectively expel" South Koreans based at both the Kaesong Industrial Park and the Mt. Kumgang tourist resort. The decision to place tough restrictions on border crossing came as a surprise for conservatives in Seoul. The conventional opinion was that the controversial inter-Korean cooperation projects had been benefiting the North more than the South. In this light, Pyongyang's decision seemed to be irrational: by disrupting operations at Kaesong, where tens of thousands of North Koreans were earning cash and learning advanced technologies, the DPRK would be cutting off a valuable source of cash and industrial expertise.

According to an October 2008 statement by the ROK Unification Ministry, trade between North and South Korea decreased 23.2 percent year-on-year due to worsening ties between the two sides. Inter-Korean trade volume totalled US\$ 160 million, down 23.2 percent from USD \$210 million a year earlier. It was the first time that trade across the heavily armed border recorded a double-digit reduction on a yearly basis.

Nevertheless, on 24 November the DPRK delegation to the inter-Korean general-level military talks announced five new measures related to bilateral ties with the ROK, which were effectively implemented on 1 December 2008. The Korean People's Army selectively expelled resident personnel and vehicles of the South Korean institutions and enterprises established in the KIP and Mt. Kumgang tourist area. They also cut off overland passage through the DMZ, totally suspending the daily bus tours to Kaesong city. The ROK's train service between Munsan and Pongdong was also discontinued. The access of all ROK personnel to the KIP and Mt. Kumgang tourist area was restricted to three times per day [17].

Stricter discipline was enforced and stringent sanctions applied against violators. The DPRK also blocked all ROK publications from entering the country. In the past, the DPRK permitted 20 newspapers from nine publishers to be brought over the demarcation line on a regular basis to be read by ROK employees working at the Kaesong Industrial District Management Committee (KIDMAC). "The decision can be seen as extending the ban that had been in place for ordinary people to KIDMAC employees", concluded the Korean Herald [18]. However, this tightening of screws was only a prelude to the real crisis.



**Kaesong workers 2009**

On 30 March 2009, a 40-year-old South Korean businessman named Yoo Sung-jin was arrested



by the North Korean authorities in KIP for "derogatory" comments on the DPRK and for allegedly attempting to entice a North Korean female worker to defect. Pyongyang refused to discuss the issue in its bi-lateral negotiations with Seoul. As of June 2009, Yoo remains in custody without access to South Korean officials and attorneys. The ROK government announced that if the North filed formal charges against him it would thereafter require each South Korean border crosser to obtain a written guarantee of safety from Pyongyang before leaving South Korea. This would effectively prevent South Korean managers from entering the KIP and would likely bring an end to operations there.

On the heels of UN Security Council Resolution 1874, which pursued tough new sanctions against the DPRK for firing a long-range rocket and conducting a second nuclear test, North Korea's moves against the KIP became particularly hard. On 11 June 2009, the KCNA announced the nullification of all contracts on rent, salaries and taxes applying to the industrial park in Kaesong. Pyongyang demanded that the minimum monthly wage be raised to \$300 from \$75 and an immediate lump-sum land lease payment of \$500 million. It asked Seoul to empty the industrial estate unless the money is paid. This notification came after the two Koreas were unable to set a date for the new round of talks due to wrangling over the release of detained South Korean worker Yoo. "We are nullifying contracts and benefits on rent, salaries and taxes that we have offered in the Kaeseong complex in accordance with the June 15 Joint Declaration." The report added that the North will begin to adjust laws and rules to meet the current situation. "South Korean companies and officials must accept the notification, if not, they can evacuate from the complex," it said.

Even without salary increases, the 106 companies that invested in Kaesong have been in trouble and have said they were considering

requesting ROK government support. The companies have already reported weakening sales, slipping 6.6 per cent year-on-year between January and April to US\$ 74.54 million. Exports dropped 56 per cent to US\$ 7.15 million [19]. From May 2009 they started withholding wages to their DPRK staff in protest at the North's demand for increased pay and a tax raise. The fur-maker, Skinnet, became the first South Korean enterprise to announce cessation of operations in the complex. A decade of booming inter-Korean cooperation seemed to be drawing to a close.

### **Lessons for the Future of Inter-Korean Cooperation**

What lessons can be drawn from the recent rise and fall of inter-Korean economic cooperation? Pyongyang blames the South's "extreme confrontation policy" for destroying the foundation of the industrial park, adding that the future of the complex is up to the South. Restrictions imposed by the North on all jointly operated Special Economic Zones will lead to substantial losses for the South Korean government which had guaranteed its investors up to 90 percent of their capital in case of forced closure or military conflict. North Korea will also lose a significant source of revenue, but since both the Kaesong Industrial Park and Mt. Kumgang tourist resort are physically on North Korean territory, they will remain the property of the DPRK government even if closed or abandoned by investors.

Andrei Lankov of Kookmin University in Seoul believes that the ROK authorities now face a difficult dilemma about the future of Kaesong Industrial Park. "The complex is one of the best things which ever happened in North-South cooperation. It is unlikely that it will be profitable for the South in purely financial terms, and its contribution to local political stability is marginal albeit real," he said [20]. Nevertheless, Lankov recognized that KIP is the only place where North and South Koreans

work together, and it is also a place where countless encounters lead to the dissemination of knowledge about the South and gradually undermine the North Korean regime, laying foundations for a change in the North.

Indeed, there are no figures indicating the extent to which the South Korean side might have profited from these cooperation projects in monetary terms. Hyundai Asan and the companies investing in the KIP have always been subsidised by Seoul through direct and indirect channels. The South Korean government has always concealed from taxpayers how much money it spent on aiding the inter-Korean projects in Kaesong and Mt. Kumgang.

During the decade of Sunshine Policy, the Kaesong projects (industrial park and daily bus tours) were frequently criticised by hawks in Washington and Tokyo, who saw them as indirectly subsidising the North Korean regime. Pyongyang was indeed making good money out of economic cooperation in Kaesong amounting to around US\$ 25 million per year in salaries and wages. So why did it decide to close it so resolutely? The North's official explanation about "extreme confrontation policy" and propaganda balloons infiltrating its air space from the South seems to be a mere pretext. The leaflets might be annoying, but they hardly constituted a direct threat to the regime. After all, Pyongyang had not been influenced by much larger ROK propaganda efforts prior to 2002.

The real reason could be the Kaesong project itself. As Lankov suggests, it created a stage where North and South Koreans worked together for the first time in 60 years since the division of the country. It provided a rare opportunity for unauthorised exchanges. The North Koreans not only learned modern technical skills, they also had a chance to see that their southern compatriots did not look or behave as they are normally portrayed in DPRK

propaganda. Cautious political discussions cannot be ruled out, which in the long run could have a great impact on the internal situation of North Korea [21].

Anticipating this detrimental development, the North started cooperation with the South on the precondition of switching workers once a year. But switching workers every year was impossible for technical reasons. Inevitably rumours about life in South Korea started circulating among KIP workers and their families. It seems that illusions about the South became so widespread that the authorities found the situation intolerable. From the KWP's point of view, each worker in Mt. Kumgang and Kaesong was like a poster advertising capitalism.



### North Korean workers as billboards of capitalism

At least 20 people affiliated with Kaesong came under questioning for talking highly about South Korea and capitalism. In 2007, there was a thorough cadre reshuffling in the Party to stop people talking about Kaesong or Mt. Kumgang [22]. North Korea also purged key officials who had urged reconciliation with South Korea. Choe Sung-chol, who for a number of years was in charge of DPRK relations with the ROK, reportedly was fired and executed in 2008, held responsible for incorrect predictions about Seoul's new

conservative government. It may also be that he was caught taking payments from South Korean corporations, which often happened during the years of blooming inter-Korean cooperation [23].

Pyongyang's survival depends on maintaining the myth of the "poor and desperate" South, starving under the yoke of American imperialism. In recent years, the spread of smuggled South Korean DVDs and first-hand communication with southerners in Special Economic Zones has subverted this propaganda image. The new propagandistic theme claims that the South, while economically affluent, is morally corrupt and socially discriminatory. Southerners are said increasingly to admire the spiritual purity and national independence of the North, and to welcome the guidance of Kim Jong-il (who, they say, is as popular in the South as he is in the North).

Perhaps, the Pyongyang leadership does not want this myth to be exposed. It must also fear that people will realise how badly the North fares in comparison to the prosperous and free South. From this angle, the Kaesong and Mt. Kumgang projects from the outset were a dangerous gamble. For some 10 years the top bureaucracy tolerated cooperation with the South because the monetary rewards were good and political risks manageable. Perhaps, when the principal decision was made in 1989 for Mt. Kumgang and in 2002 for Kaesong, they also wanted to check whether the spread of dangerous information could be contained. At that time North Korea was going through a period of unprecedented political relaxation and experimentation with reforms. However, the period of relaxation ended with the beginning of nuclear crisis in October 2002.

From 2003 onward, North Korean leaders have worked hard to turn back the clock. All news coming recently out of North Korea has been about greater control and tougher restrictions. Busy markets are a nightmare for Pyongyang

retrogrades. The DPRK government is now confiscating land from individual tillers, Japanese-made buses and trucks are being taken from small businesses. The sale of many consumer goods at the markets is restricted, while the Public Distribution System, which dominated the country's economic life before 1996, has been reintroduced. In the last few years instances of public unrest may have made the North Korean government nervous, though they have managed to retain control and prevent unrest from spreading. Cabinet Decision No. 61 (6 November 2008) stipulated that starting from January 2009 all markets across the country would work only three days per month (1st, 11th, and 21st), much as in pre-modern Korea. Currently, there are reports that the government plans to close down the Pyongsong Market, the largest wholesale market in the country.



### Individual business activity: the cell phone

Ruediger Frank and Sabine Burghart, in their report, *Inter-Korean Cooperation 2000-2008*, compare inter-Korean cooperation with the East European experience. When analysing South Korea's Sunshine Policy and describing its dangers for the North Korean regime, they remind us that "everyone who has lived under socialism in Europe can confirm how this slow ideological poison spreads like cancer, how these cells grow and how they finally unfold their destructive, lethal power, hollowing out the system from within" [24]. In this



connection, Frank and Burghart cite Kim Jong-il himself who is recorded as saying in 1995 that “the most serious lesson of the collapse of socialism in several countries is that the corruption of socialism begins with ideological corruption” [25].



### North Korean workers enjoying life at the beach

North Korea cannot afford to emulate the success of China in transforming its economy as this would require a considerable relaxation of domestic police control. China has survived such a relaxation, but there is a great difference between North Korea and China. The PRC leaders did not have to deal with the existence of a rich and powerful “other”, where people speak the same language but enjoy significantly higher levels of freedom and prosperity. The DPRK leaders fear that political unrest is unavoidable if their citizens learn how prosperous South Korea really is.

Over the past few years these developments made Kaesong and Mt. Kumgang something of an anachronism. These two projects, which can function only with a greater level of openness and transparency than in the rest of North Korea, became too dangerous for Pyongyang to tolerate and were put under direct control of the People’s Army. The era of relaxation and experimentation, which prompted the beginning of inter-Korean cooperation, is well

and truly over and North Korea seems to be heading back in the direction of military communism. Only those elements of market economy which are necessary to keep the country afloat are being preserved.



### 150-Day Battle mass campaign

Conservatives in Seoul might hope that this decision will deprive the North Korean regime of revenue and bring its end closer. But the truth is that the regime can survive much longer in isolation. Poor and weak people do not have the energy or weapons to rebel, particularly when they have little knowledge and understanding of how different their life could be. Therefore, by closing the borders the North Korean elite is buying extra time to stay in power at the expense of the common people’s suffering.

### Conclusion

Despite ten years of successful North-South cooperation, most agreements reached at the summits of June 2000 and October 2007 have not been fully implemented and are now being wound back. The Mt. Kumgang tourist resort has been abandoned, the reunions of separated families are at a standstill, the 2008 Beijing Olympics was never greeted by the joint Korean team, the inter-Korean train no longer runs, and the Kaesong Industrial Park is on the verge of collapse. These regrettable setbacks resulted from actions initiated by both

Pyongyang and Seoul.

Despite the ostentatious gestures aimed at keeping inter-Korean cooperation free from politics, the leaders of North and South Korea have never really achieved the level of trust and understanding necessary for economic cooperation. The reckless language of a South Korean general or investor, a housewife's early morning promenade blunder or the air balloons bringing propaganda leaflets were used by the North Korean side to halt ideological contamination of a much grander scale. The nuclear and human rights issues were employed by South Korean conservatives to stop aiding North Korea unconditionally. Collaboration in such circumstances became impossible.

During the first five years of the period discussed here (1998-2003), inter-Korean cooperation was risky but profitable for Pyongyang. Seoul also had more financial and political freedom to manoeuvre. During the second period (2003-2009), however, inter-Korean cooperation demanded more from Seoul and posed greater danger for Pyongyang. The complexity of regional politics and the current state of global economy also contributed to the early demise of this experiment.

The year 2008-9 clearly shows that neither DPRK nor ROK is sufficiently motivated to keep the zones of inter-Korean cooperation and their associated infrastructure functioning. Conservatives and hawks, currently dominating the political landscape in both Pyongyang and Seoul, are not visionary but reactionary leaders, driven by the short-term goals of populism or regime survival.

The divided nation is now pushed back towards the Cold War era which dominated North-South Korean relations before December 1991, when the Non-aggression and Denuclearisation Pacts were signed by Seoul and Pyongyang.

Nevertheless, the past 10 years did make a difference and changed the Korean people's perceptions of each other. A new attempt at cooperation, if undertaken soon, could be more successful.

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See also Sabine Burkhart and Rudiger Frank, [Inter-Korean Cooperation 2000-2008: Commercial and Non-Commercial Transactions and Human Exchanges](#).

Ruediger Frank, [Dreaming an Impossible Dream? Opening, Reform, and the Future of the North Korean Economy](#)

## Notes

[1] The author's personal observations made during his visits to the DPRK in 1999, 2004, 2005, and 2007 and to the ROK in 2003-2005, 2006, 2007 and 2008 are used in this paper.

[2] Andrei Lankov, '[North Korea dragged back to the past](#)', Asia-Times on-line (24 January 2008).

[3] The North Korean staff was so proactive in communicating with South Koreans and other foreigners that one could suspect them of deliberately collecting information from visitors.

[4] "Monthly Recap: March", NK Brief, No. 08-4-1-1, Institute for Far Eastern Studies (01

April 2008)

[5] Sabine Burghart and Ruediger Frank, 'Inter-Korean Cooperation 2000-2008: Commercial and Non-commercial Transactions and Human Exchanges', in Ruediger Frank, Vienna Working Papers on East Asian Economy and Society (Vol.1, No.1, 2008), p.13.

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[7] '[KCNA blasts rubbish of S. Korean "ambassador" to Russia](#)', KCNA (6 April 2000).

[8] Currently the North's per capita income is estimated roughly at no more than \$1,700. [Source](#).

[9] '[NKorea Threatens to Cut All Dialogue with SKorea](#)', AFP (30 March 2008)

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[24] Burghart and Frank, 'Inter-Korean Cooperation 2000-2008, p.6.

[25] Kim Jong-il, 'Giving Priority to Ideological Work is Essential for Accomplishing Socialism', Pyongyang (19 June 1995)