

The Factors of South Korea's Closure of the Kaesong Industrial Complex (KIC) in 2016

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Abstract: South Korea's decision to close Kaesong Industrial Complex (KIC) on February 10th 2016 was a response to North Korea's nuclear testing. As a result, the closure led to economic losses for South Korean companies of approximately 2 trillion won. KIC and its political implications are significant and need to be examined since it was the only remaining bilateral cooperation between the two Korean states, as they had been divided after the Korean War in 1953. This research paper aimed to examine the reasons behind the decision that was made by South Korea to close the KIC in 2016. This research is an explanative research study that used qualitative data analysis. The theoretical framework that was used was foreign policy and rational choice theories. This paper found that South Korea's response to North Korean's nuclear testing in 2016 regarding the role of KIC was different compared to their response to the previous nuclear tests in 2006, 2009 and 2013. Regarding the last three nuclear tests, South Korea had not interrupted the operations of the complex. On the contrary, North Korea was the one who usually disrupted the complex; they even choose to close the KIC in 2009 and 2013. This research revealed the four determinants that influenced South Korea's decision to close KIC; North Korean governmental revenue, nuclear proliferation, the political tension between the two Koreas, and pressure from the United States.

1 INTRODUCTION

Kaesong Industrial Complex (KIC) is an inter-Korean economic cooperation project in the form of a Special Economic Zone, officially opened in 2004 (Yang, 2016). Up until 2016, KIC was the only form of cooperation that was left between South Korea and North Korea. It served as part of the implementation of the Sunshine Policy to achieve a state of reconciliation between the two Koreas. The KIC here had the role of being a 'lifeline' that connected the two countries to allow them to continue high-level dialogue as well as people-to-people diplomacy. Through this interaction, KIC was expected to function as a facilitator to encourage social exchange, which then became a springboard for reconciliation between the two Koreas. However, on February 10th, 2016, the South Korean government, under President Park Geun Hye (박근혜), decided to close KIC.

South Korea's decision to close the KIC is a surprising act to many parties. The KIC closure has caused more than 50,000 North Korean workers to lose their jobs and more than 120 South Korean firms lost their place of business, causing a loss of more than 2 trillion won for the South Korean companies involved (Manyin, 2016; Woo, 2016). When the KIC was operational, the region was usually unaffected by inter-Korean political tensions. However, the KIC was only ever temporarily closed unilaterally by the North Korean government in 2009 and 2013 because of annual joint military exercises conducted by South Korean alongside US forces.

South Korea's attitude then changed due to inter-Korean political tensions in 2016, when North Korea conducted its fourth nuclear test on January 6th, 2016, and there was the launch of a satellite violating the UN Security Council Resolution on February 7th, 2016. South Korea finally decided to close the KIC in response to North Korea's action. Contrary to the South Korean government's attitude

in previous years, this decision is interesting to further examine, since although previously North Korea showed provocative action, South Korea never has previously had the intention to close the KIC, given how it was the only form of cooperation between two Koreas.

2 RESEARCH METHODS

This research is an explanative research study which aimed to explain and test the hypotheses associated with the research variables (Singarimbun, 1981). The variables used in this study included nuclear proliferation, government revenue, inter-state tensions and international pressure. This study was limited by focusing only on the causal analysis of the KIC's closure by South Korea in 2016. The scope of this study began from the establishment of KIC in 2004 up until its closure in 2016.

The data collection techniques were qualitative which, according to Cassel and Simon, is a social science research method that attempts to accurately describe and interpret the meaning of symptoms that occur within a social context (Cassel & Simon, 1994). The collection of the data required in this research used books, journals, lecture notes, articles, and other publications from print media, the internet or mass media as determined to be relevant to this thesis writing. The data analysis in this research was in parallel with Miles and Huberman's model framework. The analysis was done gradually through data reduction, data presentation, and conclusion and verification (Punch, 2005).

3 RESULTS AND DISCUSSION

3.1 KIC Funding Flow Potential for North Korea's Revolutionary Fund as a South Korean Security Threat

The main objective of the KIC closure was to pressure North Korea to halt its nuclear development. This is because South Korea saw that North Korea used the money originating from the KIC to fund its nuclear program development instead of using the money to improve the welfare of North Koreans.

The argument was proven by KIC's significance to North Korea's hard currency revenue. Up until the KIC closure in 2016, South Korea served as North Korea's second largest trade partner (KOTRA,

2016). The hard currency here is an important revenue source for a country conducting transactions related to the development of nuclear technology, and the KIC here plays an important role as a hard currency contributor to North Korea. In this case, the KIC's role to provide a surplus of hard currency for the North Korean government can be seen from the payment system used in KIC.

Article 34 of the Employment Act in KIC stipulated that South Korean companies must pay the North Korean workers' wages directly in cash (KIC Council of Industry Representatives 2006). However, at the request of the North Korean government, the South Korean company was required to send the salaries to the North Korean government. The KIC wage payment process was as follows: the North Korean workers' wages were paid in hard currency first to the KIC's Special Bureau of Public Regions for KIC. Later on, the Bureau distributed some of the wages received from the South Korean company to the North Korean government, and then handed it over to North Korean workers after the North Korean government cut the wage due to social insurance and other expenses.

The 15 percent wage deduction mentioned by the Ministry of Unification, from what was received by the North Korean workers, was for social insurance. The remainder of their workers salary was cut again for the 15 percent or 30 percent socio-cultural tax (Korean Institute for National Unification 2006). Only \$35 is paid to the workers in cash in North Korean won or it is exchanged with the daily necessity coupons for food, clothing and other basic necessities (Korean Institute for National Unification 2006). Up until it closed in February 2016, North Korean workers at the KIC received only 250,000 KPW as described by the North Korean government and an additional bonus of 50,000 KPW (Lee 2016). In fact, the minimum wage prior to the closure of KIC increased to \$73.78 and was capable of reaching \$150 per month (Ministry of Unification, 2016b). Given the amount calculated based on the USD and KPW exchange rates, the amount earned by the North Korean government was much greater than what was estimated. The exchange rate of 1 USD equals 8,200 KPW. Therefore, based on the exchange rate, 250,000 KPW was received by the North Korean workers, equivalent to 30 USD or about 20 percent of the \$150 that the North Korean workers should earn. Based on the number of wages, the North Korean government not only cut as much as 30 percent, but they even cut up to 80 percent

from the total salary payment from the South Korean companies.

The funding therefore flows to the North Korean government, and the KIC also channelled its funds indirectly to the North Korean leaders, called 'revolutionary funds'. The revolutionary fund is one of the funds contained in the North Korean financial system that can only be obtained through foreign trade. The main function of the revolutionary fund is to maintain the leadership's power in North Korea. In addition, the fund could also be used by North Korean leaders to import luxury goods for the North Korean elite, as a source of corporate funding under the guidance of North Korean leaders and to run state-owned enterprises and institutions (Kim, 2017). When viewing some of the functions of the revolutionary fund, they all have the same final effect - maintaining the regime and increasing the regime's leadership in North Korea. To maintain leadership in North Korea, nuclear development is one of the ways that its leaders continue to do so.

3.2 The significance of KIC Revenue for North Korea Hard Currency Revenue

The revolutionary fund that serves to maintain leadership in North Korea can only be obtained through foreign trade. In addition to South Korea, North Korea's largest foreign trade partner is China, which occupies the first position as North Korea's largest trading partner. Thus, in order to know the significance of the KIC fund flows for North Korea, a comparison of China's foreign trade volume with North Korea and South Korea with North Korea was made. It should be noted that KIC contributes to 99 percent of the total foreign trade between South Korea and North Korea (Ministry of Unification, 2016c).

It can be recalled that KIC has an increasingly significant role in the North Korean government's revenue, especially the North Korean leader's revolutionary fund. The increasing volume of trade between South Korea and North Korea shows that North Korea has a tendency to become increasingly dependent on South Korean trade. Although not yet able to exceed the total trade with China, South Korea has reached half of the total trade of China and North Korea in 2015. In recognising the increasingly significant hard currency received by North Korea through KIC, it is a rational choice for South Korea to decide to close the complex to avoid potential revenue to North Korea's revolutionary funds that could threaten South Korea's security.

3.3 North Korea's Nuclear Capability Improvement since KIC's Opening

The closure of KIC is related to the increasing threat from North Korea, which continues to conduct provocative actions through nuclear and missile tests. The use of KIC funds acquired to develop nuclear weapons can be proven through North Korea's ability to expand its nuclear power, both in terms of quantity, quality and intensity. In terms of intensity, this can be seen from the increasing frequency of the nuclear tests and missiles compared to ten years before the opening of KIC. During that time, North Korea had only conducted a one-time missile test in 1998. Since the opening of KIC in 2004, North Korea conducted four nuclear tests in 2006, 2009, 2013 and 2016 and seven missile launches in 2005, 2006, 2007, 2012, 2014, 2015 and 2016 before its closure.

In terms of quantity, an increase also occurred in the amount of raw materials for nuclear weapons that is possible to be produced by North Korea. North Korea has had the capability to produce one of the main sources of nuclear material, plutonium, through its nuclear reactors in Yongbyon since the 1980s. In February 2003, exactly one year before the KIC was opened, North Korea reactivated the reactor. North Korea is able to process uranium fuel and produce about 7 kilograms of plutonium per year (Niksich, 2002) compared to the plutonium production before the closure in 1994. In mid-2006, it was estimated that North Korea had produced at least 15 kilograms of plutonium. In 2008, this increased to 38.5 kilograms and in 2009, North Korea stated that the country had started uranium enrichment. This uranium enrichment, according to David Albright and Chritina Walrond (2012), has the potential to produce 17 kilograms of uranium-grade weapons per year.

Since the early development of ballistic missile technology in the 1970s, North Korea was able to produce and deploy short-range missile systems (SRBM) including artillery missiles and short-range rockets, including Scud missiles and a new SS-21 variant called KN-02 with a distance of 120 - 170 kilometres (Albright 2015). Scud-B and C, with a range of 300km and 500km respectively, began to be developed in the mid-1980s (Albright 2015). In the late 1990s, North Korea fielded a 1,300km (MRBM) missile and then the Scud-ER, which expanded the scud's previous range (Wit and Ahn 2015). To date, North Korea has several medium-range missiles that have been tested and that are able to operate such as Hwasong, Pukguksong and Nodong. They have the

ability to shoot from 1000 to 1600 kilometres away, which can be used to threaten South Korea and Japan. However, in line with the North Korean treaty which was not to develop its nuclear arsenal since 1999, there was no increase in its missile-firing capability until 2003.

Nevertheless, since the KIC operations, the abilities of the missile types owned by North Korea became increasingly sophisticated. After North Korea decided to re-develop its nuclear program in 2007, three years after the opening of KIC, North Korea was able to deploy its first long-range missile (IRBM), the Musudan missile with a minimum distance of 3,000 km (ROK Ministry of Defence, 2014). The IRBM missile is expected to be able to reach Guam, which is a United States territory. In April 2015, Admiral Bill Gortney, commander of the North American Air Defence Command (NORAD), also confirmed that North Korea is developing two other ICBM missiles; KN-08 and KN-14 (Harper, 2015). In 2016, North Korea successfully conducted its first test of an ICBM missile when it launched Taepodong 2 as a launch vehicle space (SLV) called "Unha 3" on February 6th, 2016. It is believed to be able to reach the United States mainland. The launch came three days before South Korea finally decided to close KIC (NTI, 2016).

3.4 KIC Failure to Bridging the Peace between the two Koreas

The main objective of the formation of KIC was to reduce the tension between the two Koreas. However, since the KIC's inauguration and up until its closure in 2016, tensions and conflicts between the two Koreas still happened. This shows that KIC failed to achieve its main objective to strengthen bilateral cooperation. The conflicts and threats happened almost every year after KIC began operating. There have been four crises caused by nuclear testing, and four crises when the conflict was caused by gun attacks. There was one border conflict and there was a verbal threat three times.

On 12th November, 2009, South Korea and North Korea engaged in a battle along the Northern Limit Line. This conflict was preceded by a North Korea ship that crossed the NLL toward the West Sea near Daechong Island, which was then involved in fighting with a South Korean ship. On March 26th, 2010, a conflict broke out which further complicated South Korea's and North Korea's ties, which involved the sinking of the Cheonan ship that killed 46 South Korean sailors. The investigation

conducted showed that North Korea was the mastermind of the incident (BBC, 2016).

On February 19th, 2012, a telegram issued by North Korean officials threatened that they would launch an attack on South Korea if South Korea still continued with their military training. Two months later, on April 13th, 2012, North Korea launched a satellite that worsened the relationship between the two Koreas. On August 4th, 2015, two South Korean soldiers conducting a patrol in the DMZ area were seriously wounded by landmines stationed outside the South Korean guard post. The UN investigation found that the mines were planted by North Korean troops, which was immediately opposed to by the North Korean side (United Forces Korea, 2015). On August 9th, 2015, the South Korean government responded to this incident by continuing its propaganda through a loudspeaker in the border areas, where both countries had agreed to stop their military actions since in 2004. In response to this, North Korea fired four bullets into South Korea, and in return, South Korea responded with artillery fire.

3.5 United States' Pressure to Close KIC

The United States, as South Korea's biggest ally, encouraging the sanctions toward North Korea following the nuclear tests in January 2016. The US has always helped South Korea to face the North Korea's provocative actions through military aid and guarantees South Korea its protection. It firmly states that the nuclear tests that have been conducted by North Korea have violated the previous resolutions and clearly pose a threat to international peace and security. The United States Ambassador to the UN, Samantha Power, said that the international community should respond to this incident by "increasing the pressure" and upholding the sanctions continuously (US Mission Korea, 2016).

The United States, as one of the UN Security Council members, will step up the economic sanctions against the North Korean regime and propose sanctions to discontinue North Korea's access to the international financial system and hard currency sources (Kim, 2017). By the United States continuing to put pressure on North Korea, this gives North Korea limited options to survive: denuclearisation or face the collapse of their regime. In addition, in response to the post-nuclear tests conducted by North Korea, White House press secretary Josh Earnest said that the President of the United States had spoken separately with the South

Korean and Japanese leaders, Park Geun-Hye and Shinzo Abe on the phone, and convinced the two that the country will commit to ensuring the security of the US's allies both in Asia and around the world (The White House, 2016).

The United States did not directly ask South Korea to close the KIC, but the United States was pushing to increase the multilateral sanctions and closing access for North Korea to the international financial system in order to stop the country from developing its nuclear weapons. The pressure placed from the United States onto South Korea was limited to increasing the multilateral sanctions for North Korea and increasing the US-allied commitments to achieving peace and security on the Korean Peninsula. As an ally of the United States under the protection of the nuclear umbrella of the United States, South Korea interpreted the United States' strong response to North Korea's nuclear test and decided to close the KIC in 2016. The KIC's closure is the most effective bilateral sanction that South Korea can provide.

As previously mentioned, the KIC is a hard currency source for North Korea. Therefore, closing the KIC for North Korea is equivalent to putting more economic pressure on North Korea, hoping to halt its nuclear development. Furthermore, South Korea's decision to close KIC also provides a higher bargaining position for South Korea at the UN, to encourage the increase of sanctions against North Korea. If South Korea decides to keep the KIC operational, then it means South Korea indirectly supports North Korea in its nuclear development.

In the process of developing nuclear technology, hard currency is a crucial source of income, especially for a closed country like North Korea which has limited sources of hard currency. Thus, realising the collapse of KIC in relation to achieving its ultimate goal of easing inter-Korean tensions and the US's pressure to increase sanctions for North Korea, the closure of KIC is the most rational choice for the South Korean government. This is because South Korea no longer benefits from the region, but the region threatens South Korea's security since that the flow of KIC funds is for North Korea's nuclear development.

4 CONCLUSIONS

It can be concluded that the reason behind the South Korean government's decision to close KIC is influenced by three factors. The first is because KIC served as the main source of revenue for the North

Korean government's nuclear proliferation that could threaten South Korean security. This is proven by the increasing intensity, quality and quantity of North Korea's nuclear development since the opening of KIC.

The second is because the KIC failed to achieve the main goal of reducing inter-Korean tensions. Although the KIC was established as the main point of cooperation between the two Koreas, tensions and conflict between them still happened. Tensions occurred almost every year since 2006 until the KIC's closure in 2016. The third was because the United States put on pressure to close the KIC. This proves the United States' strong response to North Korea's nuclear test by increasing sanctions on North Korea. South Korea's position here is an ally of the United States under the US "nuclear umbrella", which has a strong influence on South Korea's decision to close the KIC.

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