Closing Kaesong: A Good or Bad Decision by South Korea?

By Sung-han Kim

South Korea reacted to North Korea’s latest nuclear test and missile launch with a bold decision to close the Kaesong Industrial Complex, the only remaining symbol of inter-Korean co-operation. It thereby inflicted short-term pain on some of its own businesses in the cause of the long-term goal of pushing Pyongyang to denuclearize. In the words of an old Chinese proverb, sacrificing the plum tree for the peach tree. It was the right decision.

By Rüdiger Frank

Heated debate has taken place since February on whether Seoul’s closure of the Kaesong Industrial Complex was a bad idea or not. The answer is in the eye of the beholder. Will North Korea change its course because of it? Probably not. There are reasons to be optimistic about change in North Korea, but now South Korea will be much less of a part of this process than it could and should be.
It’s All a Matter of Perspective

By Rüdiger Frank

HEATED DEBATE has taken place since February on whether the closure of the Kaesong Industrial Zone by the South Korean government was a bad idea or not. It turns out that the answer is in the eye of the beholder. A good or bad decision for whom? President Park Geun-hye? First Chairman Kim Jong Un? The North Korean workers? The South Korean companies? The future of Korea?

Tough questions, indeed; ask three people and you will likely get four opinions, each well founded. Therefore, rather than attempting the impossible and giving a normative answer, I will briefly discuss the effects of the Kaesong closure, leaving it for the reader to decide who won or lost.

I start with the economic effects. For the South Korean side, these are reportedly very small. This seems to make sense if we compare the US$500 million annual turnover of the zone in 2015 with South Korea’s gross domestic product of US$1.5 trillion. Except for about 900 South Korean managers, the 55,000 jobs that were lost were held by North Koreans and therefore will not contribute much to the unemployment rate in South Korea. However, I would be careful not to assume that the Kaesong closure did not affect South Korea’s economy at all, not least because aggregate data tell only half of the story. For some businesses and individuals, the end of Kaesong is a big deal. The total of 124 companies involved is quite a number; and they were part of a value chain that started and ended in South Korea. The manager of one of these firms claimed that “hundreds of thousands of South Korean workers and families” relied on the Kaesong zone.1 Most important, these companies are typical sunset industries; they depend on huge inputs of labor and thus cannot compete in a high-wage environment. If they can’t go to Kaesong, they need to find another low-cost place, or cease business.

Despite the possible underestimation of the economic effects on South Korea, it is obvious that North Korea lost much more economically. The combined annual income from wages, taxes and fees for land leasing and so on amounted to over US$120 million, according to the Ministry of Unification. For a country that does not have a convertible currency and is excluded from access to the international financial system through loans, bonds or stocks, every dollar/euro/yen/yuan is valuable because it allows the purchase of products that — despite all efforts toward self-reliance by North Korea — need to be imported, including oil, machinery and electronics. What matters in such a situation is not profit, but the actual inflow of hard currency. If we want to understand the relative size of that US$120 million generated from Kaesong, we have to compare it to the value of North Korean exports, which are in the range of roughly US$5 billion. If Kaesong remains closed, North Korea loses about 2.4 percent of its annual hard currency inflow. This is definitely not negligible, although I wonder how much of a game-changer this loss actually is. It would also be interesting to see how long this effect will last.

As for the political impact, South Korea has gained in the sense that it was able to show some strength and resolve. You can’t draw lines in the sand and then do nothing if they are crossed. Seoul has run out of such options, however, in the few last years. Kaesong was the only card left, and they played it. April’s parliamentary elections will show whether voters support that decision. South Korea has lost its last card, and they played it. April’s parliamentary elections will show whether voters support that decision.

North Korea gained politically. From Pyongyang’s viewpoint, the massive poisoning of the minds of Kaesong’s workers has stopped, and the embarrassing sale of the country’s youth to the southern capitalists is over. And it will be easy to argue that Seoul is not supporting national unification, because it was South Korea that closed the only remaining project of inter-Korean co-operation.

What will happen next, in addition to the usual escalation that takes place each year during the South Korea-US joint military maneuvers? North Korea will try to quickly compensate for the loss of the hard currency income from Kaesong. There are many options for doing so. One is to try to keep the zone running with new partners. To some degree, the seized facilities are still able to produce value even without South Korean management. Think about Mt. Kumgang, the mountain resort where the North Koreans, after its closure in 2008, tried to replace South Korean tourists with those from China. What if a smart Chinese businessman delivers the necessary inputs to revive the Kaesong project?

China is also offering the greatest potential for increasing hard currency income through the export of cheap labor, especially since China is at the moment arriving at a stage of economic development where domestic wages are rising to a level that makes the outsourcing of production necessary. Southeast Asia and Africa are potential destinations, but neighboring North Korea would, of course, be a much more convenient option, with lower transportation costs. Russia is also willing to expand its economic co-operation with North Korea.

If history is a teacher of anything, then we will in a few years find that North Korea has even expanded its hard currency income, while South Korea’s leverage over North Korea has become even weaker. Few of us remember that until 2002, Japan was North Korea’s biggest trading partner. Did North Korea collapse because they stopped trading? No. Will North Korea change its course because of the Kaesong closure? I wouldn’t bet on it, although I am, in general, still quite optimistic about change in North Korea. Only now, South Korea will be much less of a part of this process than it could and should be.

Rüdiger Frank is Chair Professor of East Asian Economy and Society at the University of Vienna and Head of the Department of East Asian Studies. He is the Vice Chairman of the World Economic Forum’s Global Agenda Council on Korea and has visited North Korea numerous times since 1991.