

# Examining the Nexus between Economic Ties at the Kaesong Industrial Complex and Security on the Korean Peninsula: Theoretical frameworks and evaluations

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## Abstract

*This article examines the nexus between economic ties and security on the Korean Peninsula by discussing three causal mechanisms. First, economic ties increase opportunity costs to constrain the two Koreas' conflict behavior. Second, inter-Korean economic ties allow either or both to send a costly signal about their resolves during a crisis. Third, economic ties transform domestic interests and preferences in favor of cooperation. Through these analytical lenses, the past operation at the Kaesong Industrial Complex (KIC) did not clearly show its pacifying effect on security on the Korean Peninsula due to its low opportunity costs, weak signaling, and stalled transformation of interests and preferences in both countries. Those who support the liberal peace process with hope for the KIC resumption need to articulate these mechanisms from a long-term perspective while acknowledging the marginal impact of pacifying security effect in the short term. Without measures to improve its efficiency of operation and earn domestic support, the KIC, if reopened, would remain liberals' unfulfilled promise.*

**Keywords:** *Inter-Korean Relations, Economic Cooperation, Security, Kaesong Industrial Complex*

## I. Introduction

The Kaesong Industrial Complex (KIC or Complex), a joint North-South Korean manufacturing park in Kaesong, North Korea, has remained closed since February 2016. It was a response by the Park Geun-hye government to North Korea's nuclear test and rocket launch. Despite early inter-Korean détente under the Moon Jae-in government, the hope for the reopening of the KIC gradually dissipated as inter-Korean tensions arose after a failed bilateral summit between Kim Jung-un and Donald Trump. North Korea's demolition of an inter-Korean joint liaison office building in Kaesong in 2019 and the inauguration of the conservative Yoon Seok-yul government delivered a serious blow to the optimism for the KIC's reopening, further increasing the uncertainty of its future.

The KIC has been one of the controversial issues of inter-Korean relations since its establishment in 2002. Some argue that the KIC should have survived political and security crises. They expect the KIC, as the last but important component of connection between the two Koreas, to facilitate economic cooperation, leading to more economic interdependence and eventually peaceful inter-Korean relations.<sup>1)</sup> It is rooted in the liberal idea that economic ties decrease the likelihood of inter-state conflict and war.<sup>2)</sup> By contrast, others contend that security concerns associated with North Korea's continuing attempt to develop missile and nuclear capacity should be heavily weighted in deciding to continue economic cooperation with Pyeongyang.<sup>3)</sup> This perspective implies that the inter-Korean economic cooperation would not ensure but even jeopardize South Korean security by possibly funding North Korea's nuclear and missile programs. It subscribes to realists' tenet that security trumps the economy and that economic benefits are at best temporary and may have negative security externalities.<sup>4)</sup>

The past stop-and-go experiences of the KIC and the current stalemate of nuclear negotiations prompt the advocates for reopening the KIC to make a case for the KIC and inter-Korean economic cooperation in general. They would need more reasons than the economic benefits of using cheap North Korean labor. Realists' relative

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1) John Delury and Chung-in Moon, "A Reunified Theory," *Foreign Affairs*, November/December 2014, pp. 179-183.

2) Michael Doyle, "Liberalism and World Politics," *The American Political Science Review*, 1986, pp. 1151-1169; John Oneal and Bruce Russett, *Triangulating Peace: Democracy, Interdependence, and International Organizations* (New York: W. W. Norton & Company, 2001), pp. 127-133.

3) Robert Kelly, "Re-Opening the Kaesong Industrial Zone Would Give North Korea Something for Nothing," *The National Interest*, January 16, 2019, available at <https://nationalinterest.org/feature/re-opening-kaesong-industrial-zone-would-give-north-korea-something-nothing-41742> (accessed on Aug 15, 2021).

4) Katherine Barbieri, "Economic Interdependence: A Path to Peace or a Source of Interstate Conflict?" *Journal of Peace Research*, 1996, pp. 29-49.

gains concerns would come back to haunt the advocates, suggesting that economic gains for Pyongyang, which desperately needs U.S. dollars, would be much larger than the shares for South Korea. Its symbolic image of one small step but a giant leap for the Korean peace process has also been tainted partially by the fluctuating inter-Korean relations in the past decade. It is more than ever clear that the South Korean government would face difficulties in gaining domestic and international support for resuming the operation of the KIC unless the linkage between security and economic cooperation is clearly understood.

However, there has been a lack of a theoretical framework to explain how the KIC and further economic cooperation would affect security on the Korean Peninsula. Most literature on the KIC describes its origin, development, and challenging issues to improve its operation, economic efficiency, and legal frameworks.<sup>5)</sup> Concerning security, the existing studies focus on its political implications or South Korea's decision to shut down the KIC.<sup>6)</sup> The absence of analytical tools has done a disservice to the policy and academic community together. Especially for those who favor engagement with North Korea, it is problematic to simply assume a pacifying effect of economic interdependence on security without offering any mechanism through which it would happen. Likewise, pro-containment and -pressure groups also need a framework to understand the complex relations between economic ties and security. The absence of a clear understanding of the KIC's role and its effect on security hinders both sides from monitoring, evaluating, and predicting the effect of inter-Korean economic cooperation on security. Damages have been already made in South Korea with a flood of politicized arguments over and inconsistent policies toward inter-Korean economic cooperation over the past two decades.

This article contributes to our theoretical understanding of the nexus between economic ties and security on the Korean Peninsula.<sup>7)</sup> It introduces and discusses three causal mechanisms: opportunity costs, costly signaling, and transformation of preference and interests. Economic cooperation between the two Koreas creates greater opportunity costs that would add to the costs of war, lowering the chance of

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5) Eul-chul Lim, *Kaesong Industrial Complex, History, Pending Issues, and Outlook* (Haenam Publishing, 2007), pp. 1–245; Bongchul Kim and Ho Kim, “Analysis and Proposals to the Laws in the Kaesong Industrial Complex,” *Korea Journal*, 2014, pp. 80–105; Ralph M. Wrobel, “Ten Years of Kaesong Industrial Complex: a brief history of the last economic cooperation project of the Korean Peninsula,” *Economic and Environmental Studies*, 2014, pp. 125–148.

6) Jamie Doucette and Seung-Ook Lee, “Experimental territoriality: Assembling the Kaesong Industrial Complex in North Korea,” *Political Geography*, 2015, pp. 53–63; Leif-Eric Easley, “Kaesong and Thaad: South Korea’s Decisions to Counter the North,” *World Affairs*, 2016, pp. 21–27; In Seong Kim and Hyun Koo Cho, *Asian Politics & Policy*, 2019, pp. 80–103.

7) Hyo Joon Chang and Scott Kastner, “Economic Interdependence and Conflict,” In *Oxford Research Encyclopedia of Politics*, edited by William R. Thompson (Oxford: Oxford University Press, 2017), pp. 628–645.

war. It also helps them send a costly signal of their intent and resolve to reduce the risk of miscalculation, thus making militarized disputes less likely. Furthermore, interests and preferences on either or both sides can be transformed by a higher degree of economic interdependence, driving inter-Korean relations to be more cooperative.

From these perspectives, the past KIC experiences have not successfully demonstrated the pacifying effects on security. The opportunity costs are not high enough to constrain North Korea from maintaining and developing nuclear weapons and missile programs. Nor did it prevent low-intensive military conflicts. Although both Koreas used the KIC to show their resolves, it was still a function of security concerns, not vice versa, and did not lead to policy or behavioral concessions on security. The lack of domestic consensus in South Korea regarding the KIC and its relation to security on the Korean Peninsula also hindered a transformative effect on the public despite the emergence of stakeholders supportive of inter-Korean economic ties. Without a domestic consensus on its role in facilitating the peace process as well as an expansion of the KIC, the KIC project is likely to be an unfulfilled promise of liberal peace.

The remainder of this article is organized as follows. It first introduces the three causal mechanisms – opportunity costs, costly signaling, and transformation of preferences and interests that link economic cooperation to security on the Korean Peninsula. Next, the KIC experience is empirically evaluated, followed by discussion and implication as concluding remarks.

## **Theoretically linking economic ties to security**

### ***Opportunity costs***

The opportunity costs or constraint argument is most frequently discussed in the literature on economic interdependence and war.<sup>8)</sup> Economic ties like trade generate mutual benefits for countries by facilitating the efficient use of limited resources. When two trading partners engage in a militarized conflict, commerce between them is likely to be disrupted. The potential costs of such disruption are expected to be higher among more dependent countries. These economic cut-offs substantively add more cost to the initiation and conduct of war that is costly itself. Political leaders thus become more reluctant to risk a military conflict with countries with which they maintain a high degree of economic interdependence. The constraint effect is particularly more apparent in democratic countries where commercial interests are more represented in the foreign policymaking process.<sup>9)</sup> In today's global economy,

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8) Solomon Polachek, John Robst, and Yuan-Ching Chang, "Liberalism and Interdependence: Extending the Trade-Conflict Model," *Journal of Peace Research*, 1999, pp. 405-422.

disrupted bilateral trade may cause more economic troubles due to its reliance on regional and global supply chains as well as networks of production.

Postulations on trade having a constraint effect date to writings by classical liberals such as Montesquieu, Rousseau, Kant, and Smith. The more recent existing scholarship provides some empirical evidence that the opportunity costs constrain state leaders' conflict behavior.<sup>10)</sup> Copeland develops a modified version of the opportunity costs-based argument, suggesting that expectations of future trade, rather than trade itself, constrain state behavior. He argues that Japan took preemptive action against the U.S. for fear of future trade cut-offs with the United States over strategic resources such as oils.<sup>11)</sup> Other studies find similar evidence in the case of an international capital exchange, arguing that leaders are less likely to engage in militarized conflicts to avoid disruption in economically beneficial transactions and continue to appeal to investors.<sup>12)</sup>

### ***Costly signaling***

The second mechanism linking economic interdependence to security suggests that countries can communicate their resolve more credibly when there is a higher level of economic interdependence between the countries.<sup>13)</sup> This logic is referred to costly signaling or information logic. As a concept developed in a bargaining model of war,<sup>14)</sup> it helps understand why bargaining between countries fails and results in military conflict. Fearon explains that countries have private information on their capabilities and resolve, and they are less likely to share this information with others, especially rivals or enemies.<sup>15)</sup> Instead, they have strategic incentives to exaggerate true capabilities and resolve just as North Korea frequently does to increase its negotiation leverage. These incomplete and private information problems

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9) Michael Mousseau, "Market Prosperity, Democratic Consolidation, and Democratic Peace," *Journal of Conflict Resolution*, 2000, pp. 472-507.

10) Håvard Hegre, John Oneal, and Bruce Russett, "Trade Does Promote Peace: New Simultaneous Estimates of the Reciprocal Effects of Trade and Conflict," *Journal of Peace Research*, 2010, pp. 763-774.

11) Dale Copeland, *Economic Interdependence and War* (Princeton University Press, 2014), pp. 16-20.

12) Margit Bussmann, "Foreign Direct Investment and Militarized International Conflict," *Journal of Peace Research*, 2010, pp. 143-153; Hoon Lee and Sara McLaughlin Mitchell, "Foreign Direct Investment and Territorial Disputes," *Journal of Conflict Resolution*, 2012, pp. 675-703.

13) Erik Gartzke and Quan Li, "War, Peace, and the Invisible Hand: Positive Political Externalities of Economic Globalization," *International Studies Quarterly*, 2003, pp. 561-86; James Morrow, "How Could Trade Affect Conflict?" *Journal of Peace Research*, 1999, pp. 481-489.

14) In a basic setting, two countries compete for a piece of territory. Because a war is costly, they may reach a negotiated settlement that would make them better off.

15) James Fearon, "Rationalist Explanations for War," *International Organization*, 1995, pp. 379-414.

complicate countries' calculations of the costs and benefits of going to war. When a miscalculation on both or either side occurs, they are unable to reach a negotiated settlement and eventually engage in armed conflicts.<sup>16)</sup>

In this context, economic ties can serve as an effective signaling tool. It allows countries to send a costly signal that their resolve to fight is not a bluff. Economic ties afford countries two different ways to make costly signals. First, a country can send costly signals through self-inflicting measures such as imposing economic sanctions against its counterpart. By causing damage to itself, the country can credibly communicate with its counterpart about its true intention. Second, costly signaling is also possible through a country's response to the economic costs imposed by the other.<sup>17)</sup> By enduring economic costs, the message is credibly sent to the other that it is determined not to back down and is willing to escalate and use military force if necessary. This economic signaling logic can be more apparent in today's global economy because it may trigger a potential exodus of foreign investors and cause greater harm to national economies. By choosing a crisis to escalate and enduring a potential capital outflow, countries can signal their true intent and resolve more credibly to their economic partners.<sup>18)</sup>

### *Transformation of preferences and interests*

The last mechanism focuses on the transformative effect of economic interdependence on the likelihood of war through changes in state preferences over conflict and cooperation. While the first two mechanisms assume that actors' preferences and interests are exogenous, this approach posits that they can change over time, affecting their behavior and outcome. It is a sociological process where the two countries have more contacts that are expanded on a larger scale to political, social, and cultural exchanges as economic ties become stronger. A sense of community can emerge as actors share values, norms, and symbols that provide a social identity. Security communities create the assurance that their differences will be resolved peacefully short of war. Mutual understanding and convergence of preferences and interests would make territorial conquest through a military force less of their national interests.<sup>19)</sup>

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16) The information logic is similar to the constraint logic in a way that affects disputants' expected utilities of fighting, eventually facilitating a negotiated settlement. However, its mechanism is different. It focuses on how new information, especially during a military crisis, on military capability may change their chances of winning a war and, more importantly, their political resolve of fighting and not backing down. The constraint logic is based on ex-ante costs, which suggests that countries anticipate potential costs of economic disruption while signaling is possible through ex-post costs that have already been incurred.

17) Allan Dafoe and Nina Kelsey, "Observing the Capitalist Peace Examining Market-Mediated Signaling and Other Mechanisms," *Journal of Peace Research*, 2014, pp. 619-633.

18) Erik Gartzke, Quan Li, and Charles Boehmer, "Investing in the Peace: Economic Interdependence and International Conflict," *International Organization*, 2001, pp. 391-438.

The transformational process is also facilitated by economic ties that generate vested interests in both countries. Although most economic ties form in business communities due to their economic gains, there are other stakeholders including politicians, investors, consumers, journalists, scholars, and the public. With a higher level of interdependence, they are less inclined to have conflicting views with their foreign economic partners because an armed conflict would cause them political, economic, and social costs that they must pay. These actors would constitute a new domestic coalition and exert political pressure on the government to maintain stable and friendly relations with their trading partner countries. In support of this transformative logic, studies show that increased dependence on China leads to increased accommodation of Chinese interests in foreign policy or through voting in international institutions.<sup>20)</sup> Kleinberg and Fordham also find that members of the United States Congress were less supportive of measures hostile to China if their districts became more oriented toward Chinese exports.<sup>21)</sup>

## The case of the Kaesong Industrial Complex

### *Deficient opportunity costs*

The KIC certainly generated economic gains for South Korea. Since its establishment, the number of South Korean companies operating in the Complex grew from 18 in 2005 to 125 in 2015. The primary products manufactured in the Complex include textiles and clothing, chemical products, metals and machinery, electronics, and other kinds of products. According to South Korea's Ministry of Unification, the total production increased from USD 320 million in 2010 to USD 520 million in 2015. Using cheaper North Korean laborers South Korean companies were able to reduce production costs and increase their revenues. According to the International Crisis Group's analysis, these South Korean companies increased their revenues by 8%, fixed assets by 26%, and profit by 11% as compared to firms not operating in the Complex.<sup>22)</sup> Since its shutdown in 2016, the South Korean

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19) Richard Rosecrance and Peter Thompson, "Trade, Foreign Investment, and Security," *Annual Review of Political Science*, 2003, pp. 377–398.

20) Gustavo Flores-Macías and Sarah Kreps, "The Foreign Policy Consequences of Trade: China's Commercial Relations with Africa and Latin America, 1992–2006," *Journal of Politics*, 2013, pp. 357–371; Scott Kastner, "Buying Influence? Assessing the Political Effects of China's International Trade," *Journal of Conflict Resolution*, 2016, pp. 980–1007.

21) Katja Kleinberg and Benjamin Fordham, "The Domestic Politics of Trade and Conflict," *International Studies Quarterly*, 2013, pp. 605–619.

22) International Crisis Group, "The Case for Kaesong: Fostering Korean Peace through Economic Ties," *Asia Report* N°300, 2019, available at <https://www.crisisgroup.org/asia/north-east-asia/korean-peninsula/300-case-kaesong-fostering-korean-peace-through-economic-ties> (accessed

government claimed that the cost of shutdown for the South Korean companies is estimated to be about USD 662 million.<sup>23)</sup>

North Korea also benefited from economic cooperation at the KIC. The benefits include foreign investment in its infrastructure, employment for North Koreans, and hard currency that Pyongyang desperately needs. The KIC establishment came with upgraded transportation networks, infrastructure, and power facilities in the region. North Korean employees increased from 6,013 in 2005 to 54,763 in 2015. North Korea received workers' salaries in hard currency from South Korea. The North Korean government taxed workers' incomes at a high rate and redistributed the remainder to the workers in domestic currency or coupons. The total estimated wages of North Korean workers in the KIC were approximately USD 123 million in 2015.<sup>24)</sup>

Despite the economic gains by both Koreas, the KIC project fell short of its initial aspirations in terms of size and quality. In its original blueprint, the third and final stage of the Complex would host 2,000 companies, employ 350,000 workers, and generate a value of USD 16 billion in its annual production.<sup>25)</sup> The unfortunate reality is that its first-stage development has never been completed. On the South Korean part, the Lee Myung-bak government ultimately abandoned plans to expand the KIC after North Korea conducted nuclear tests in 2006. The lack of investment and expansion led to the KIC accounting for only a fraction of 1% of South Korea's gross domestic product. For North Korea, the KIC similarly took up slightly over 1% of its foreign trade. Although the KIC contributed to its hard currency resources, other sources exceeded the value of payments from the KIC.<sup>26)</sup> As economic sanctions imposed by the United Nations Security Council and the U.S. continued, the Kim Jong-un regime became heavily dependent on China for its importation of

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on August 15, 2021).

- 23) Sang-don Park, "Kaesonggongdan'giöp'yöp'oe "chöngbu, yudongjasan p'ihæaeng shinsok'i chiwönhaeya [Kaesong Industrial District Management Committee argues that the government must promptly assist current assets]," *Yonhap News*, December 14, 2021, available at <https://www.yna.co.kr/view/AKR20211214075900003>(accessed on December 15, 2021).
- 24) The South Korean government claimed that 30% is taxed and that the remaining 70% goes to workers in the form of essential foodstuffs and coupons for purchases. See more details. International Crisis Group, "The Case for Kaesong: Fostering Korean Peace through Economic Ties."
- 25) According to Park's 2004 study, the nine years old and fully developed KIC would have created added values of USD 24.4 billion and 100,000 jobs in South Korea while benefiting North Korea with USD 600 million in wages and corporate income tax with 725,000 jobs. Seoksam Park, "Kaesonggongdan chosöngüi kyöngjejöng hyogwabunsök [Analyzing Economic Effect of Kaesong Industrial Complex]," *Kümyunggyönggyeöng'u [Monetary and Economic Research]*, 2004, pp. 1-52.
- 26) For instance, its income from coal exports to China would be ten times larger than USD 123 million. For more details, see the International Crisis Group's "The Case for Kaesong: Fostering Korean Peace through Economic Ties."

food, fabrics, petroleum, and electronics.

When it is compared to other cases where two disputant countries have economic relations, the magnitude and quality of inter-Korean economic cooperation are undisputedly insignificant or at best rudimentary. The value of cross-strait trade was USD 150.5 billion in 2018, which is a significant increase from USD 5.02 billion in 1998. Between 1991 and 2020, Taiwan's investment in China amounted to USD 188.5 billion.<sup>27)</sup> China and Japan, which have a territorial dispute over Senkaku / Diaoyu Islands, also have a high level of economic ties; they had about USD 300 billion in trade values in 2019, and Japan's foreign direct investment to China was approximately USD 11.3 billion in 2020. It is also worth noting that the inter-Korean economic ties at the KIC are isolated from the global economy, further depressing its opportunity costs, while economic ties across the Strait or in Sino-Japanese relations potentially generate greater costs because of their integration into the regional and global economies.

Overall, deficient economic cooperation in the Complex has not produced enough opportunity costs to constrain security behavior or policy on the Korean Peninsula.<sup>28)</sup> If one reviews inter-Korean relations over the past 20 years, a pacifying effect appears negligible. Low-intense military conflicts have not been deterred. In March 2010, a South Korean navy ship, Cheonan, was sunk with the loss of 46 lives near Baengnyeong Island, south of the de facto maritime border with North Korea in the Yellow Sea. The multinational investigation concluded that the ship was sunk by a North Korean torpedo fired from a submarine. Nine months later, in November 2010, North Korea shelled the island of Yeonpyeong in the disputed maritime border, killing two South Korean citizens and two marines.

Moreover, North Korea continued to develop its nuclear weapons program and missile capability while the KIC was established and operated. North Korea had six nuclear weapon tests in 2006, 2009, 2013, 2016, and 2017. Pyongyang claimed that the largest nuclear test in 2017 was its first thermonuclear weapon. North Korea is believed to possess 20 to 40 nuclear warheads and to have succeeded in miniaturization.<sup>29)</sup> The Kim regime has tested various ranges of missiles including intercontinental ballistic missiles, which can hit any city in the United States. It also developed a cyberwarfare capability over the past decade, disrupting government functions and causing financial losses to South Korea.<sup>30)</sup>

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27) Government of the Republic of China, available at [https://www.taiwan.gov.tw/content\\_6.php](https://www.taiwan.gov.tw/content_6.php) (accessed on August 15, 2021).

28) Nearly 70 years of the absence of war on the Korean Peninsula can be credited to the deterrence provided by the U.S.-South Korea alliance system as well as North Korea's impoverished conditions caused by its international isolation, economic stagnation, and natural disasters.

29) Mary Beth Nikitin, "North Korea's Nuclear Weapons and Missile Programs," *Congressional Research Service In Focus* IF10472, 2021, available at <https://crsreports.congress.gov/product/pdf/IF/IF10472/21> (accessed on Dec 15, 2021).

30) U.S. Department of Defense, "Military and Security Developments Involving the Democratic

### ***Not costly enough signaling***

The KIC served as a signaling tool for both Koreas. North Korea used the stalled operation at the KIC to express its discontent with South Korean governments under President Lee Myung-bak and his successor Park Gun-hye, who were both hard-liners against Pyeongyang. In March 2008, North Korea forced eleven South Korean officials to leave the Inter-Korean Exchange and Cooperation Office in Kaesong. Nine months later, the regime further imposed limitations on the hours and number of South Koreans allowed to pass the border. The following year the North closed its border gate at Kaesong in response to the joint U.S. and South Korean military exercises, leaving hundreds of South Korean workers stranded in the city for days. In April 2013, the regime unilaterally shut down the KIC after the tension over the joint U.S. and South Korean military drills arose again.

The South Korean governments under the conservative presidents also utilized the KIC to send its northern neighbor a strong message about their stance and resolve. They explicitly showed that they would be willing to endure economic disruption and costs inflicted by the North. Sometimes they imposed costs on themselves to send a political message that they would not tolerate North Korea's provocations and accommodate its excessive demands. The South Korean governments, indeed, refused to accept North Korea's demand for wage and land lease increases in 2009 and 2015. After the sinking of the Cheonan naval vessel in May 2010, the Lee Myung-bak government imposed a ban on new investments in the KIC. It was also North Korea's fourth nuclear test and long-range rocket test in early 2016 that eventually motivated President Park Geun-hye to shut down the KIC and withdraw all South Korean nationals from the Complex. It was an eventual outcome of the tit-for-tat approach by the Lee and Park governments.

Although the KIC was the focal point for the two Koreas to express their discontent with each other and show their strong resolve, the tug of war over the KIC did not cause significant economic costs because of its deficient role in both Koreas' economies. Nor did the signaling through the KIC policies and operations yield any concession or compromise on security matters. Rather, the KIC was dependent on the inter-Korean relationship revolving around North Korea's increasing nuclear and missile capability. Mainly reflecting the inter-Korean security environment, the KIC served as a tool to punish its counterpart or further escalate political and security crises. In contrast to what the costly signaling mechanism expects, signaling through the KIC incrementally escalated the tension on the Korean Peninsula and fell short of bringing in policy concessions or behavioral accommodations. Moreover, the constant disruption of the KIC operation eventually led to lost opportunities for both

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People's Republic of Korea," 2017, pp. 1-23, available at <https://media.defense.gov/2018/May/22/2001920587/-1/-1/1/REPORT-TO-CONGRESS-MILITARY-AND-SECURITY-DEVELOPMENTS-INVOLVING-THE-DEMOCRATIC-PEOPLES-REPUBLIC-OF-KOREA-2017.PDF>(accessed on June 10, 2021).

Koreas to develop the Complex into a full-fledged inter-Korean economic and liberal project as initially planned and expected in the early 2000s.

*Stalled transformation of preferences and interests*

The last causal mechanism suggests that the KIC can drive the two countries to change their preferences and interests, decreasing conflicting interests and increasing shared interests. Thanks to the development and operation of the KIC, a network of political parties, bureaucrats, businesses, scholars, research institutes, journalists, and civic groups in South Korea emerged. The Democratic Party of Korea, one of the major political parties, has been the key player who initiated and promoted the idea of economic engagement with North Korea. Another key player is the Corporate Association of Kaesong Industrial Complex housing about 120 South Korean companies. It was formed in 2006 to address issues relevant to the development and operation of the Complex while protecting its business interests and promoting public relations to support the KIC development. This association continuously expressed its concerns when there was a temporary disruption of the KIC operation. Since the complete shutdown in 2016, the group has continued to lobby the South Korean and U.S. governments for inter-Korean dialogue and the eventual reopening of the KIC.<sup>31)</sup>

Despite the creation of a domestic coalition in support of the KIC, there have been few transformative effects in South Korea. Above all, political changes in South Korea greatly rendered the development and operation of the KIC more uncertain and vulnerable to political and security issues. The Sunshine policy era presidents, Kim Dae-jung and Roh Moo-hyun, tried to separate economic cooperation from politics. They believed that the KIC must be a cornerstone for inter-Korean cooperation and eventually would bring about political reconciliation between the two Koreas. However, the successors, presidents Lee Myung-bak and Park Geun-hye, sought to link the KIC to security and political concerns over North Korea's growing nuclear and missile threats. They had a cynical outlook on KIC's potential and promise. Although the number of South Korean companies operating in the Complex increased since President Lee took office in 2008, he halted major plans to expand the KIC and took the reciprocity-based policy toward Pyeongyang. Likewise, a trust-building process on the Korean Peninsula suggested by President Park turned out to be the perpetuation of the hardline stance on Pyeongyang's provocation, which eventually led to a unilateral decision to shut down the KIC in 2016. The Park government further claimed that North Korea had not used USD 560 million in cash from the KIC to pave the way to peace but rather to upgrade its

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31) Kyu-seok Shim, "Kaesong owners fly to Washington to lobby," *Korea JoongAng Daily*, June 10, 2019, available at <https://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3064118> (accessed on August 15, 2021).

nuclear weapons and long-range missiles.<sup>32)</sup>

Moreover, the KIC has not significantly improved South Korea's public support for inter-Korean economic cooperation. Although a majority of South Koreans said in 2019 that it is necessary to economically engage in North Korea for peace and prosperity, reopening the KIC, in particular, has been a more controversial topic.<sup>33)</sup> In 2020, 51% said that the KIC only should be conditionally reopened.<sup>34)</sup> Another survey similarly reports the bifurcation of public opinion with 43.6% in favor of the KIC resumption and 45.8% in opposition to it.<sup>35)</sup> With North Korea's ongoing security threats, denuclearization talks in stalemate, and experiences and challenges of developing and operating KIC, the public confidence in North Korea's commitment to peace has also declined over the two decades from 52.3% in 2000 to 32.9% in 2020.

There is a glimpse of the evidence that the KIC has provided North Korea with an opportunity to taste the principles and institutions of capitalist operation. The studies that interviewed South Korean workers in the Complex report on North Korean workers' behavioral and perspective changes at the KIC. Having experienced capitalism and adjusted to the new working environment, North Korean workers in the Complex recognized their self-interests and developed a new identity that made them desire to stay and work in the KIC.<sup>36)</sup> North Korean officials at the Complex

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- 32) Yoonjung Seo and Anna Fifield, "To punish Kim Jung Un, South Korea shuts down industrial zone in North," *The Washington Post*, February 10, 2016, available at [https://www.washingtonpost.com/world/to-punish-kim-jong-un-south-korea-shuts-down-industrial-zone-in-north/2016/02/10/0237273a-79ba-420b-bcc6-5a749bd71bbf\\_story.html](https://www.washingtonpost.com/world/to-punish-kim-jong-un-south-korea-shuts-down-industrial-zone-in-north/2016/02/10/0237273a-79ba-420b-bcc6-5a749bd71bbf_story.html) (accessed on August 15, 2021).
- 33) Seok-jong Lee, "kungmin 10myōng chung 6myōng t'ep'yōnghwawihae nambukkyōngghyōm p'iryot'e kidaegam [6 out of 10 South Koreans think that inter-Korean economic cooperation is required for peace]," *Asia Today*, January 1, 2019, available at <https://www.asiatoday.co.kr/view.php?key=20181230010018406> (accessed on August 15, 2021).
- 34) Korean Broadcasting System Inter-Korea Relation Department, "2020nyōn kungmin t'ongirūishing chosa [Survey of National Perception on Unification]" *Unification Broadcasting Review*, 2020, available at <https://office.kbs.co.kr/tongil/wp-content/uploads/sites/11/2020/11/%EC%9B%B9%EC%9A%A92020-%EA%B5%AD%EB%AF%BC-%ED%86%B5%EC%9D%BC%EC%9D%98%EC%8B%9D-%EC%A1%B0%EC%82%AC.pdf> (accessed on August 15, 2021).
- 35) Realmeter, "Sōnjejōng kaesōnggongdan chaegadong, och'abōmwi naero p'aengp'aenghage nat'ana [Poll on the preemptive reopening of the Kaesong Industrial Complex: neck and neck within the margin of error]," November 11, 2020, available at <http://www.realmeter.net/%EC%84%A0%EC%9A%A0%9C%EC%A0%81-%EA%B0%9C%EC%84%B1%EA%B3%B5%EB%8B%A8-%EC%9E%AC%EA%B0%80%EB%8F%99-%EC%98%A4%EC%B0%A8%EB%B2%94%EC%9C%84-%EB%82%B4%EB%A1%9C-%ED%8C%BD%ED%8C%BD%ED%95%98%EA%B2%8C-%EB%82%98/?ckattempt=2> (accessed on August 15, 2021).
- 36) Eunmee Jeong, "Kaesōnggongdan puk'an kŭllojaū chōngch'esōng inshikkwa haengdong yangshigūi mek'ōnijūm [Recognition of Identity and Mechanism of Behavior Pattern of North Korean Workers at the Kaesong Industrial Complex]," *North Korean Studies Review*, 2014, pp. 123-146; Yoo-yeon Kim, "Kaesōnggongdan kŭnmu kyōnghōmjaga inshik'an puk'an kŭllojaū t'ŭksōnggwa kŭe ttarūn kwan'gyehyōngsōng chōllyak [The Characteristics of North

also became interested in capitalist tax and accounting systems, learned merit-based incentives through productivity, and acquired know-how in running the industrial complex.<sup>37)</sup>

At the national level, however, it is hard to tell that the KIC significantly contributed to changes in Pyeongyang's preferences and interests in favor of less confrontation and more cooperation with South Korea. Rather, North Korea's foreign policy and behavior largely reflected its power consolidation around the new leader, Kim Jong-un, over the past decade. His Byungjin (Parallel movement) policy in 2013, which pursued a simultaneous development of the military and economy, enhanced North Korea's nuclear capability and kept international economic sanctions in place. It depressed foreign investment and trade through special economic zones such as the KIC.<sup>38)</sup> An international hope for North Korea's market-friendly economic transformation was also dashed as the regime continued its ideological attachment to Juche (self-reliance) and Songun (military-first) embedded in North Korean politics. Its heavy reliance on China for foreign trade and economic cooperation under Kim Jong-un further rendered the inter-Korean economic projects around the KIC less influential and insufficient in transforming the regime's security and economic priorities. Although the North Korean leader expressed his desire to reopen the KIC in his 2019 New Year's address, the regime has not made any concessions that would partially lift economic sanctions by the United Nations Security Council.<sup>39)</sup>

## Conclusion

This study examines the opportunity cost, costly signaling, and transformation of interests and preferences to evaluate the link between inter-Korean economic ties and security on the Korean Peninsula. Using these frameworks, those who favor economic engagement can offer better accounts for the nexus between inter-Korean

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Korean Workers Perceived by South Korean Workers at the Kaesong Industrial Complex and their Relationship Building Strategies],” *Unification and Peace*, 2020, pp. 183-228.

37) Grant Wyeth, “Time to Reopen the Kaesong Industrial Complex? A Conversation with Jin-hyang Kim,” *The Diplomat*, February 27, 2020, available at <https://thediplomat.com/2020/02/time-to-reopen-the-kaesong-industrial-complex-a-conversation-with-jin-hyang-kim/> (accessed on August 15, 2021).

38) North Korea announced in 2018 that it would end the Byungjin policy and prioritize economic development. It was two years after the KIC was shut down. It is reported that the regime wanted to boast itself as nuclear power and use it as a negotiation leverage if necessary.

39) Steve Miller, “Kim's New Year Address Signals He's Willing to Deal or Walk Away,” *Voice of America News*, January 2, 2019, available at <https://www.voanews.com/a/north-korea-leader-gives-2019-speech/4725381.html> (accessed on August 15, 2021).

economic ties and security. As the three processes do not necessarily occur all at once or proceed at the same pace, it would be beneficial for them to monitor which mechanism has been more salient and, accordingly, devise effective policies to reinforce the pacifying effect of economic cooperation. For the same reason, the causal mechanisms would allow the skeptics of the KIC or economic cooperation to engage liberals' peace projects by evaluating the current processes and engaging in discussion of the expected outcomes and prospects. Understanding the clear pathways would prevent a naïve hope and unfounded political claim against economic engagement from dominating the discourse on the peace process on the Korean Peninsula.

The past KIC experience suggests that reopening the KIC would not guarantee its positive influence on inter-Korean security. If one supports the resumption, s/he must consider improving its size and quality to increase the opportunity costs in the long run. It would include implementing the original plan for the second and third phase development of the KIC that would render the KIC three times larger in size and a more high-tech industrial complex. For the much longer term, it would need to implement a grand idea to integrate economic zones, such as former President Moon's proposal to connect the KIC to other cities on the west coast of South and North Korea through industry, logistics, and transportation. Greater opportunity costs would likely constrain the two Koreas' conflict behavior. Greater ex-post costs of economic sanction or disruption will also enable them to send a costly and credible signal during a crisis. More and more domestic players will be involved in economic cooperation, and more vested interests and favorable public opinion will be formed, inviting a higher level of cooperation in the realms of political, economic, and security policies. This should be the vision as well as the blueprint that those liberals must articulate.

Given the closure of the KIC and the stalemate in nuclear negotiations, it is easier said than done to resume and develop the KIC to generate greater opportunity costs. It is clearer than ever before that the KIC cannot be reopened without addressing the security environment on the Korean Peninsula, especially North Korea's nuclear weapons program. However, it is equally important to note that the first and most important condition should be to reach a domestic consensus in South Korea regarding the KIC and its role in the peace process. For this purpose, the KIC resumption should not be expected to be immediately effectual but be taken as part of the peace process. Only when the KIC is further developed into a larger economic cooperation project, its security effect would be significantly realized. It is also important to acknowledge that this security effect is a mid- and long-term process, not an outcome that can be observable in a short time frame.

To keep this liberal project, the South Korean government needs to address the claim that North Korea would use the revenue from the Complex to enhance its nuclear weapons and missile capability. Although it might involve a difficult

negotiation with Pyongyang, which does not want to lose control of its workers, the South Korean government should discuss with its counterpart alternatives such as direct payment to North Korean workers. It should also work closely with other countries, especially the United States, to calibrate the timing of easing international sanctions. As part of the peace process and in response to North Korea's denuclearization commitment, partially lifting economic sanctions would be viable, providing North Korea with breathing space for foreign investment and trade to restart and expand the KIC.

Furthermore, the South Korean government must improve the overall economic efficiency of the KIC. Since the economic gains from the KIC would be one of the few immediate effects of operating the Complex, economic incentives need to grow stronger. It will keep up the momentum until its security effect becomes apparent. The past KIC experience posed several operational and technical problems beyond political uncertainty. They include complicated passages and customs for South Korean workers, restrictions on their use of the internet and cellular phones, insufficient labor supply, and a lack of autonomy for the companies in managing North Korean workers.<sup>40)</sup> Once both Koreas discuss the peace process involving the resumption of the KIC, there would be more room for them to negotiate and resolve these issues.

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40) Jongsu Kim, "Kaesŏnggongdan unyŏng p'yŏnggawa chaegaerŭl wihan kwaje [Evaluation of the Operation of Kaesong Industrial Complex and Challenges to Resume]," *Korean Journal of Area Studies*, 2021, pp. 193–220.

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