

Chapter 3

Expansion of Inter-Korean Exchanges and Cooperation

- I. Inter-Korean Personnel Exchanges
- II. Inter-Korean Trade
- III. Inter-Korean Visits, Communications and Navigation
- IV. Inter-Korean Economic Cooperation Projects
- V. Development of the Gaeseong Industrial Complex
- VI. Inter-Korean Social and Cultural Exchanges and Cooperation
- VII. Building the Foundation for Inter-Korean Exchanges and Cooperation

The background features a light blue gradient with a stylized map of the Korean peninsula in a darker shade of blue. To the left of the map, there are numerous thin, radiating lines that create a sense of movement and expansion. The overall aesthetic is clean and modern.

Expansion of Inter-Korean Exchanges and Cooperation

Expansion of Inter-Korean Exchanges and Cooperation

Inter-Korean exchanges and cooperation have led to a substantial improvement in inter-Korean relations, including laying the foundation for the formation of a Korean national community, fostering the proper atmosphere for the settlement of the North Korean nuclear issue, building military confidence, and easing tensions.

In addition to expanding social and cultural exchanges and raising people's awareness of North Korea, inter-Korean economic cooperation is exerting a positive influence on the overall state of inter-Korean relations. Such exchanges are playing a major role in inducing North Korea to participate in Northeast Asian cooperation.

Despite the suspension of inter-Korean government talks in the second half of 2004, exchanges and cooperation in the economic field have progressed smoothly. The re-connection of roads on the Gyeongui Line and the Donghae Line was completed at the end of November 2004. Moreover, Living Art, one of 15 companies in the model Gaeseong Industrial Complex, produced its first batch of pots there, opening a new chapter in the history of inter-Korean economic cooperation.

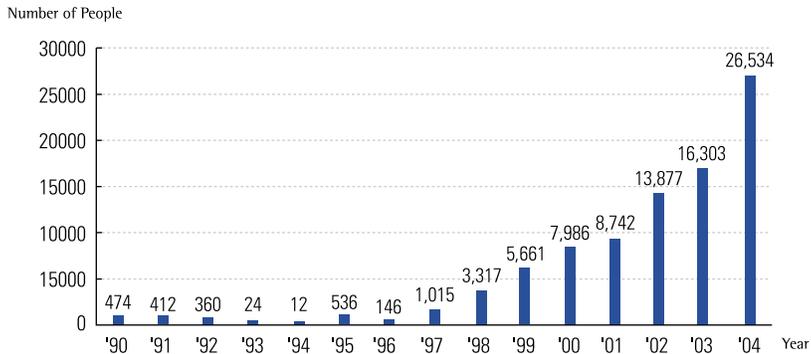
As for the Mt. Geumgang tours, since regular overland tours began in September 2003, the number of tourists in 2004 has increased remarkably, establishing a stable foundation for tourism promotion. In light of these achievements, it can be said that the momentum for inter-Korean exchanges and cooperation was maintained in 2004, despite the temporary suspension of inter-Korean government dialogue.

I. Inter-Korean Personnel Exchanges

1. Inter-Korean Exchanges

In 2004, the number of visitors to North Korea, excluding tourists to Mt. Geumgang was 26,213, the largest number in a single year since visits to North Korea were first approved in 1989. This is a 71.5% increase compared to the total of 15,280 visitors the previous year. The increase is mainly due to a sharp rise in visits for economic purposes, including the construction of the Gaeseong Industrial Complex. The number of North Korean residents visiting South Korea remained at 321, a 218% decline compared to 1,023 visitors the previous year. However, in 2004, the total number of inter-Korean visitors was 26,534, indicating steady growth.

Inter-Korean Personnel Exchange

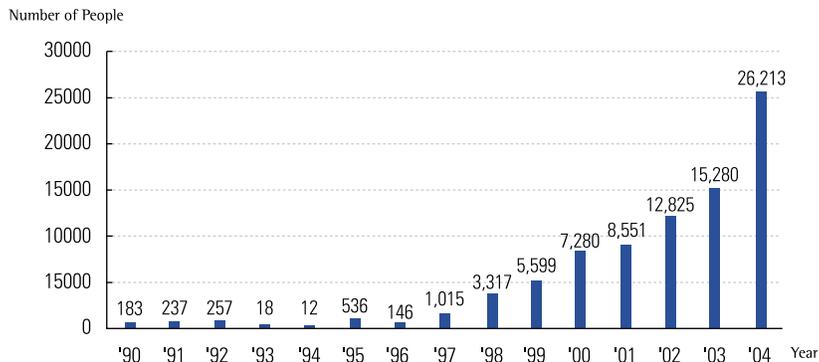


2. Visits to North Korea by Sector

Despite the halt in inter-Korean governmental talks, the first stage construction of 330ha area of the Gaeseong Industrial Complex and its pilot project of 9.3ha proceeded smoothly. This resulted in a sharp growth in the number of people visiting the North for economic purposes compared to other years.

South Koreans visited the Gaeseong Industrial Complex development project to attend various commemorative events, including the ground-breaking ceremonies for factories. On December 15, 2004, 385 South Koreans, including 79 lawmakers, attended a ceremony to celebrate the manufacture of the first products in the Gaeseong Industrial Complex - kitchen pots from the company Living Arts.

Visitors to the North



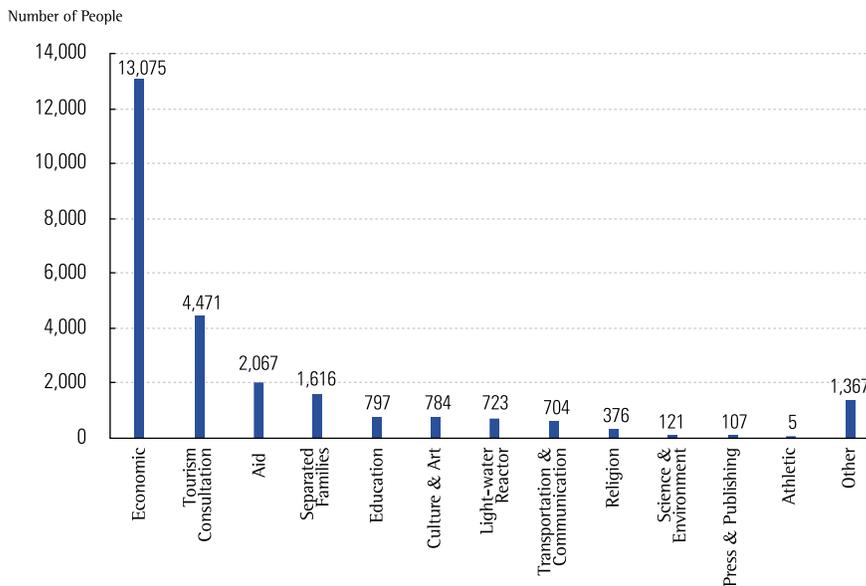
There were also visits to North Korea to provide materials and equipment necessary for road and railroad re-connection and to promote inter-Korean economic cooperation, including an automotive assembly project by Pyeonghwa Motors.

From 1989 through 2004, visitors to North Korea for social and cultural purposes numbered 6,695, of which 2,190 visited in 2004. Compared to the 2,472 visitors in 2003, this is a 12.8% reduction, mainly attributable to the unprecedentedly large number of defectors that entered South Korea in 2004 and the government's ban on condolence delegations on the tenth anniversary of former President Kim Il-sung's death.

In 2004, visits to North Korea in the fields of scientific research and athletics included a North-South joint academic seminar and exhibition for the return of cultural assets plundered by Japan, and a North-South joint seminar and exhibition to celebrate the listing of the Goguryeo tombs as a World Heritage site. In total, 832 South Koreans visited North Korea.

The most important visits to North Korea in the media sector in 2004 included initiatives for the National Writers' Conference, the publication of the Great Dictionary of the Korean People, the production of the "Revival of Goguryeo" by KBS, the production of "Food and Drink of North Korea" by MBC, and the Korean Broadcasting Commission consultations on the broadcasting of the Athens Olympic Games.

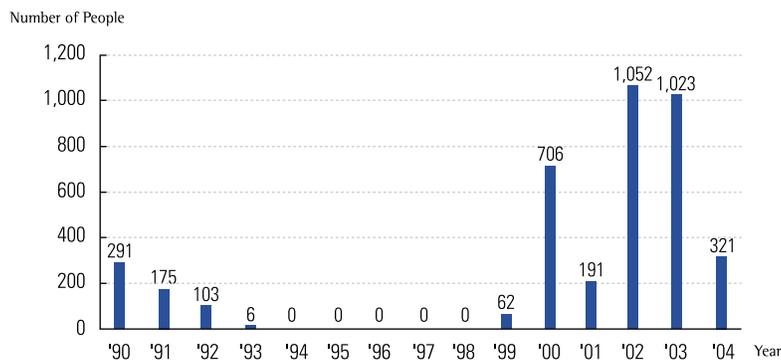
Visitors to the North by Sector



In the area of religion, the level of personnel exchanges in 2004 was similar to other years, despite the issue of condolence visits in July. The most significant visits to North Korea in 2004 included the restoration of the Singye Temple at Mt. Geumgang by the Jogye Order of Korean Buddhism, the Cheontae Order's cooperation project for the restoration of Youngtong Temple in Gaeseong, and the North-South Korean joint prayer meeting by the Presbyterian Church in the Republic of Korea.

As for visits to North Korea in other sectors, including civic organizations in 2004, there were trips to participate in joint events such as the joint Liberation Day (August 15) ceremony, the North-South Student Conference, consultation of exchanges and cooperation projects at the local government level, as in the cases of Gangwon province and the city of Jecheon, the second South-North Farmers' Unification Rally and a North-South Labor Day event.

Inter-Korean Visitors

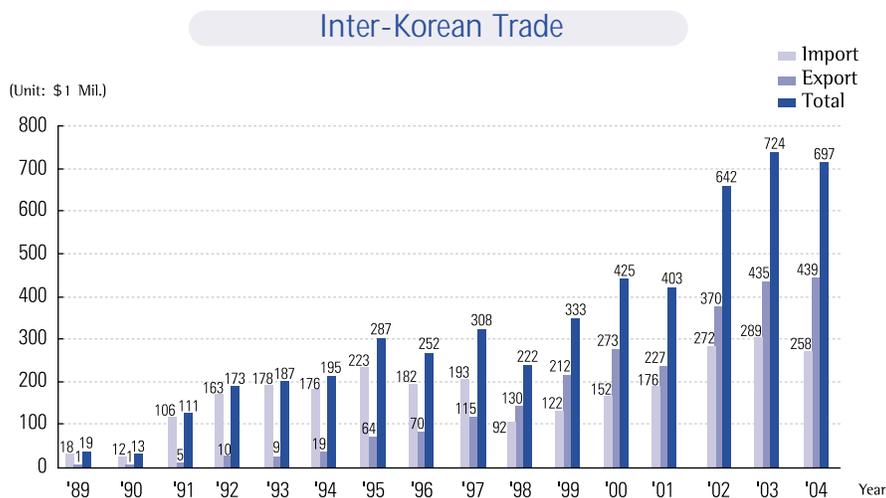


II. Inter-Korean Trade

1. Inter-Korean Trade of Goods

A. Trade Volume

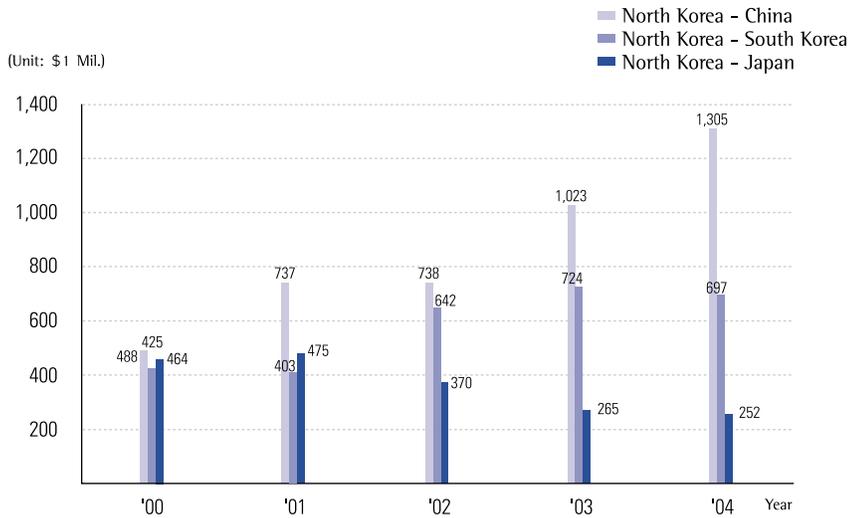
Inter-Korean trade in 2004 remained steady at US\$697 million, a 3.8% drop from the previous year due to sluggish commercial trade while non-commercial trade showed a steady growth in the wake of full-scale development of the Gaeseong Industrial Complex, promotion of the Mt. Geumgang tours project and extended humanitarian support to North Korea, including the Yongcheon disaster assistance.



While goods imported declined by 10.8% compared to the previous year, recording US\$258 million, goods exported increased by 0.9% compared to the previous year, rising to US\$439 million. The decline in imports is mainly due to volume quotas on some agricultural and fishery products designed to protect South Korean producers, and fewer processing deals as a result of a weak demand in South Korea.

As for North Korea's trade with major countries in 2004, trade with China hit US\$1,385 million, a 35.4% increase, while trade with Japan decreased by 4.8% to US\$251 million compared to the previous year.

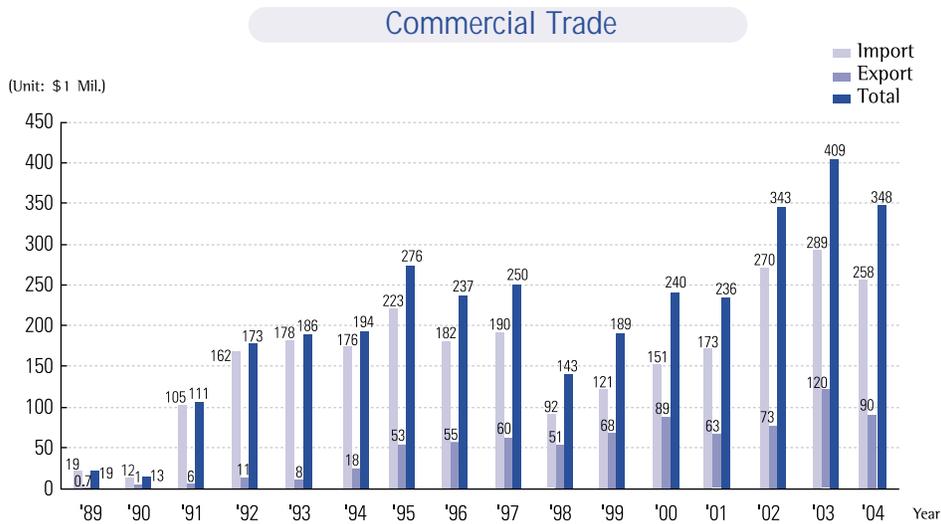
North Korea's Trade Level with 3 Major Trading Partners



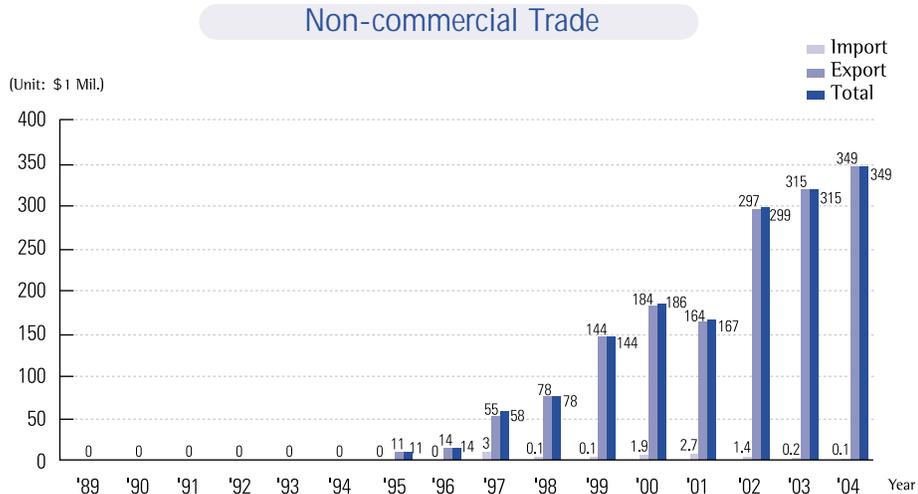
B. Inter-Korean Trade by Category

In 2004, commercial trade (business transactions and commission-based trade) declined by 14.9% to US\$348 million compared to the previous year, accounting for 49.9% of total amount of trade. Goods imported and exported decreased by 10.8% (US\$258 million) and 24.8% (US\$90 million), respectively, compared to the previous year.

In commercial trade, business transactions dwindled to US\$172 million or by 23.2% compared to the previous year, accounting for 24.6% of total trade and 49.4% of the commercial trade amount. Commission-based trade reached US\$176 million, a 4.9% decline compared to the previous year, representing 25.3% of the total trade and 50.6% of the commercial trade amount.



Meanwhile, non-commercial trade rose by 10.7% to US\$349 million compared to the previous year, accounting for 50.1% of total trade. By category, humanitarian support to North Korea amounted to US\$259 million, accounting for 74.0% of the non-commercial trade volume. At the same time, general cooperative projects including construction of the Gaeseong Industrial Complex, the Mt. Geumgang tours and the light-water reactor project recorded US\$49 million, US\$42 million and US\$460,000, accounting for 13.9%, 12.0% and 0.1% of the non-commercial trade volume, respectively.



C. Inter-Korean Trade Balance

As for the trade balance in 2004, nominally, South Korea had a surplus of US\$181 million. However, in terms of the real trade balance excluding non-business goods brought in and out, South Korea had a deficit of US\$168 million. As for the cumulative nominal balance of trade from 1989 through 2004, South Korea had a deficit of US\$235 million. However, the cumulative real trade balance, excluding non-business trade, suffered a much greater loss of US\$1.85 billion.

Although South Korea has a nominal surplus, its real trade balance is negative largely because of the large share of non-commercial trade. Goods taken to North Korea have increased with the full-scale development of the Gaeseong Industrial Complex, promotion of the Mt. Geumgang tours, and the surge in humanitarian assistance to North Korea.

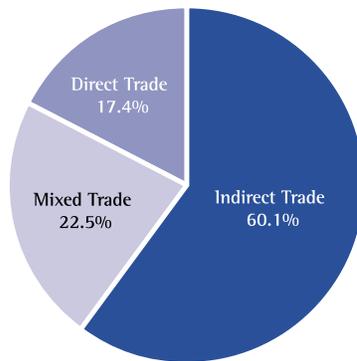
The lopsided real trade balance is mainly attributable to the poor purchasing power of North Korea. Given the foreign currency situation in North Korea, the current trend is likely to persist. However, it is expected to improve gradually when the previously agreed settlement clearing system is implemented.

D. Inter-Korean Trade Structure

In the early years, inter-Korea trade mainly took the form of indirect trade through third countries. Beginning in the mid-1990s, the share of direct trade rose in areas of oriental medicine, agricultural products and some items for processing deals, as a result of direct agreements between the North and South Korean parties. However, there are still many instances of third-party merchant trade in order to lower transaction risks associated with restricted travel and telecommunications.

When the Ministry of Unification and the Korea International Trade Association conducted a joint survey of some 300 inter-Korean trading companies on the status of trade in September 2003, results showed that while the percentage of firms engaged in direct trade via agreements between North and South Korean parties was 17.4%, firms engaged in indirect trade via merchants in third countries represented 60.1%, and trade involving both direct and indirect trade accounted for 22.5%.

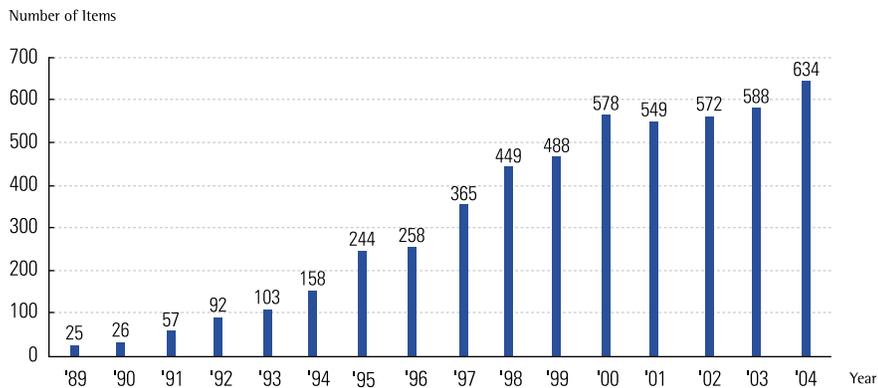
Trade with North Korea by Type



When the environment for inter-Korean direct trade improves, including implementation of institutional mechanisms such as an office for economic cooperation and the agreed-upon settlement clearing system, the share of inter-Korean direct trade is expected to rise gradually.

In 1989, only 25 different goods were traded between the two Koreas. The scale and scope of trade has grown steadily, however, to 572 products in 2002, 588 in 2003, and 634 in 2004. A breakdown of 2004 shows that while the number of items imported increased by 17, to a total of 202, the number of items exported grew by 45, to a total of 575.

Number of Items Traded

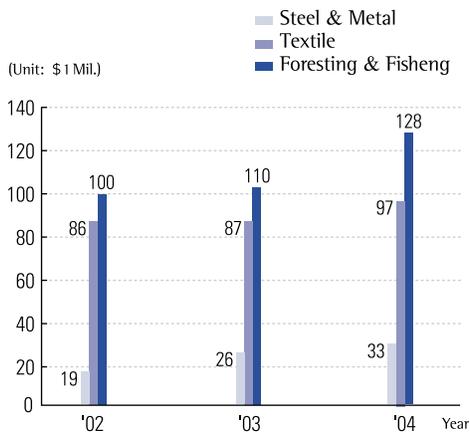


Among items brought from North Korea to South Korea, agricultural, forestry and fishery products represent the largest share, followed by textile goods, and steel and metal products. In 2004, incoming agricultural, forestry and fishery products decreased compared to the previous year, to 39.5%. These are mainly fishery items, including shellfish, dried fish and processed fish products.

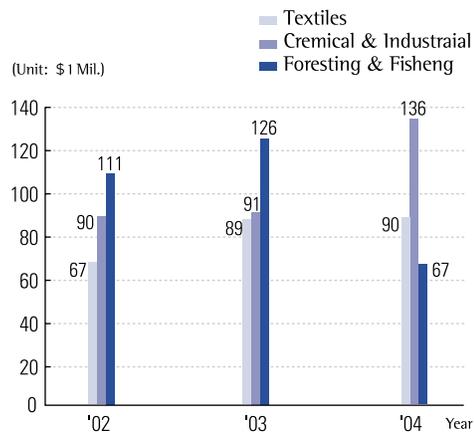
As for goods going to North Korea, chemical products, such as vinyl materials for farming, formed the bulk of trade in the early years. However, the share of textiles in goods going to North Korea has been on the rise with the launch of the processing on commission (POC) trade. Recently, chemical, agricultural, forestry and fishery products have represented a large share due to food, fertilizers and medical supplies that were provided to North Korea.

In 2004, the major products, in the order of share, going to North Korea were: chemicals (31.0%), textiles (20.4%), agricultural, forestry and fishery products (15.2%), machinery (9.8%), mineral products (6.6%) and steel and metal goods (4.9%).

Major Import Items for the Last 3 Years



Major Export Items for the Last 3 Years



2. Processing on Commission Trade

The processing on commission (POC) trade takes place by a South Korean company sending raw materials and semi-processed goods to North Korea to be processed in North Korea. Then, the processed goods are sent back to South Korea, with a certain amount of wages paid to the North Korean counterpart for the processing services. In 2004, the amount traded through POC trade remained at US\$176 million, a 4.9% reduction compared to the previous year, and represented 25.3% of the total trade amount and 50.6% of the business trade. Textiles, which represent over 80% of POC trade and electronics, including television sets and some household commodities are produced under POC and brought to South Korea.



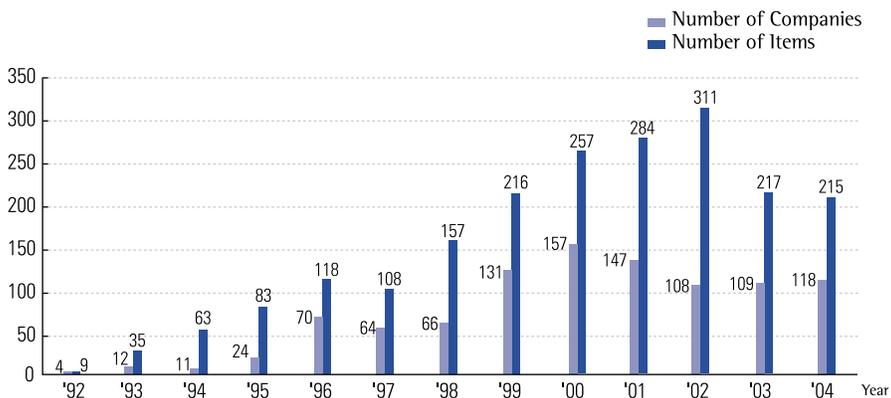
Annual POC Trade



The number of firms engaged in the POC trade, which stood at 118 in 2004, appears to have stabilized gradually over time. However, because this type of trade went through a transition period, some major fluctuations have occurred. For example, the number of firms engaged in this trade plunged from 157 in 2000 to 108 in 2002. Growing interest in full-fledged inter-Korean trade after 2000 led numerous companies to invest in the POC.

However, small companies that brought in less than US\$50,000 in processing trade failed to survive economically and companies with a higher level of trade took the lead, which resulted in a significant increase in the number of goods and the amount traded.

Companies and Items in POC Trade



III. Inter-Korean Visits, Communications and Navigation

1. Visits

A. Establishing a South-North Transit Office and Institutionalizing Overland Passage

Through the first and second rounds of inter-Korean ministerial talks in 2000 and a special envoy's visit to North Korea in 2002, the North and the South forged a dramatic breakthrough



by agreeing to reconnect inter-Korean railroads and roads that had been disconnected for over half a century. This project would bring about increased transfer of materials and equipment necessary for the reconnection work. Moreover, as the Mt. Geumgang tours were started, there was a need for a standing organization to look after affairs concerning entry and exit between the two Koreas. Accordingly, the South Korean government opened a temporary transit

office in February 2003, and later that year, established the Office of North-South Transit, under the Ministry of Unification, on November 20, 2003 to facilitate inter-Korean entry and exit affairs.

The South-North Transit Office is in charge of the operation of inter-Korean railroads and roads, consultations and contacts with North Korea about operating vehicles between the South and the North, addressing emergency situations in inter-Korean transits, approving operation of transportation equipment between the two Koreas, and accepting applications for bringing goods in and out. The Transit Office also performs inter-Korean entry/exit procedures including customs inspections, immigration and quarantines when people travel between the two Koreas either by road or railroad on the Gyeongui and Donghae Lines and when goods are brought in and out.

B. Status of Passage via Inter-Korean Overland Routes

On January 27, 2003, the two Koreas signed the "Provisional Agreement for Military Assurances regarding Passage via Temporary Roads in the Joint Administrative Zone of the

Two Koreas in the East and West Coast Areas.” The new law cleared the way for the Mt. Geumgang tours via overland routes as well as the transportation of materials and equipment for the re-connection of railroads and roads. In addition, personnel and vehicles for various inter-Korean talks, economic cooperation projects, socio-cultural exchanges and cooperation and humanitarian programs are entering and exiting North Korea via roads along the Gyeongui and Donghae Lines.

As for the status of entry/exit between the two Koreas via overland routes, 43,038 people (3,643 people via the Gyeongui Line and 39,395 people via the Donghae Line) including 36,028 tourists to Mt. Geumgang and 4,392 vehicles have traveled between the two Koreas through overland routes during 2004. In 2004, the number of inter-Korean travelers reached 321,088 (24,164 people via the Gyeongui Line and 296,924 people via the Donghae Line) including 268,420 tourists to Mt. Geumgang, which translates to 26,700 visitors per month or 890 visitors a day. A total of 30,899 vehicles (about 2,500 vehicles per month, or 80 vehicles per day) have traveled between the two Koreas.

These figures are based on the passage (both ways) of South Koreans and vehicles via the Gyeongui and Donghae Lines. As for North Korean personnel and vehicles entering South Korea, 80 people and 12 vehicles entered in order to attend the three rounds of inter-Korean talks held in Sokcho and Munsan.

2. Communications

In terms of a South-North communications network, in 2004 two indirect lines were connected by satellite to allow the Gaeseong Industrial Complex Management Committee to go forward with plans for the Gaeseong Industrial Complex. By the end of 2004, a total of 66 lines had been connected between the two Koreas, including 33 direct and 33 indirect lines.

The 2004 agreement for direct optical communications with the Gaeseong Industrial Complex has opened an era of direct optimal communication, offering improved call quality. In addition, the installation of 50 additional lines is planned to offer more convenient communications services for Mt. Geumgang tourists. In contrast, South Korean workers dispatched to the Sinpo light-water reactor site in North Korea depend on international mail services via China.

3. Navigation

In 2004, the total number of sailings between the two Koreas was 2,124 trips, a growth of 5% over the previous year. Among them, the number of sailings from South Korea to North Korea was 946, which increased by 7.8% compared to the previous year. The number from North Korea to South Korea was 1,178, a 2.9% increase from the previous year. In addition, vessels are operating regularly on the Incheon-Nampo, Busan-Najin and Sokcho-Yanghwa maritime routes to transport goods and personnel.

In order to establish a stable maritime transportation system and to initiate cooperation in maritime affairs between the two Koreas, the “Inter-Korean Agreement on Maritime Transportation” and the subsequent implementing agreement reached after four rounds of working-level contacts on inter-Korean cooperation for maritime transportation were adopted in May 2004.



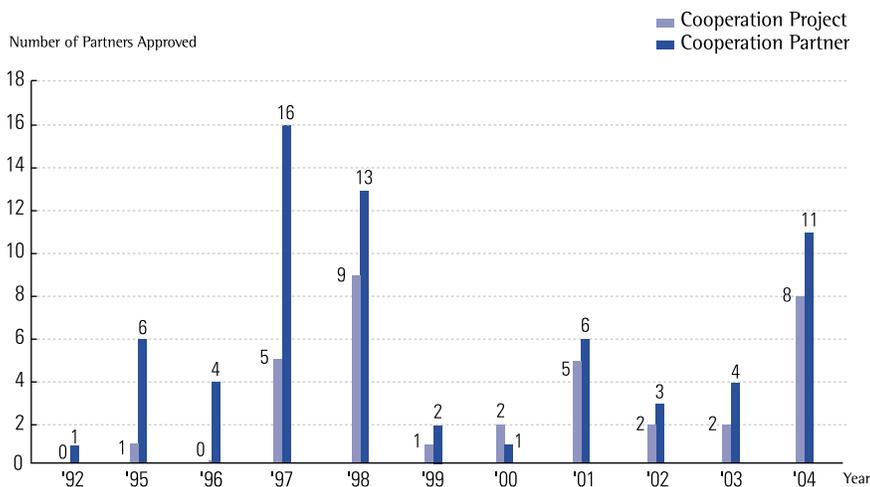
As for flights between the two Koreas, since the first direct flight for the inter-Korean Summit Meeting in 2000, there were 43 flights in 2000, 19 in 2001, 67 in 2002 and 111 in 2003. However, in 2004, the number of flights dropped sharply as a result of stalled inter-Korean relations, which also included suspension of government talks from the second half of the year. Flights in 2004 totaled only 28 and were mainly to transport relief supplies to North Korea.

IV. Inter-Korean Economic Cooperation Projects

1. Status of Economic Cooperation Projects

The year 2004 saw major efforts to push ahead inter-Korean economic cooperation projects in regions other than Gaeseong, as well as full-fledged initiatives for the development of the Gaeseong Industrial Complex. As part of such efforts, eleven economic cooperation partners and eight economic cooperation projects were approved (excluding the Gaeseong Industrial Complex-related projects) in a single year, marking significant growth in the number of approvals compared to 2003. Looking back over the period of 1992-2004, 67 economic cooperation partners and 35 economic cooperation projects have been approved.

Economic Cooperation Partner/Project Approval



Despite efforts by the South Korean government and the private sector to boost inter-Korean economic cooperation, North Korea has not allowed South Korean officials to visit Pyongyang since July 2004. Consequently, inter-Korean economic cooperation initiatives experienced some challenging moments when cooperation projects that had been underway lost momentum and a majority of newly approved projects could not be launched. However, production of some items in the manufacturing sector, which had begun in 2000, continued without interruption.

In the case of Green Cross, since bringing in semi-manufactured urokinase for the first time in July 2001, it continued to bring in semi-manufactured goods worth US\$420,000 by 2004. In addition, since the construction of an automotive assembly plant in Nampo in April 2002, Pyeonghwa Motors has produced 571 automobiles (four models) including “Hwiparam” (Whistle) and “Ppeokkugi” (Cuckoo) and has sold 410 of them by the end of 2004.

The Mt. Geumgang spring water development project by Taechang, which had been stalled due to restrictions on transporting commercial goods via overland routes, entered a new phase as spring water was to be brought overland into South Korea on the Donghae Line. Drawing much attention in North Korea is Andong Daema Textiles, which was approved as a cooperation project in September 2004. The company plans to establish a hemp-product business, complete with an integrated operating system and various production facilities.

In order to build production facilities in Pyongyang and expand its operation for glass products, G-Hanshin Co. Ltd. increased its investment from US\$2.9 million to US\$5.6 million and obtained approval to send materials required for the construction of a new plant to North Korea. Because visits to Pyongyang are now prohibited, however, it has suspended shipment of materials to North Korea.

Samsung Electronics, which gained approval for an economic cooperation project in March 2000, also signed an agreement on five new initiatives for a joint software development project in 2004 and has continued business initiatives. In collaboration with North Korea, Hanabiz.com established “The Hana Program Center” in Dandong, China in 2001, and is pushing ahead joint program development projects, which are going relatively smoothly despite the prohibition against South Korean visitors to North Korea.

Meanwhile, KT, which was approved as a cooperation partner in 2004, has completed a joint project with North Korea on building a voice data system to reinforce a wireless automated speech recognition exchange system and is in the process of seeking a new project.

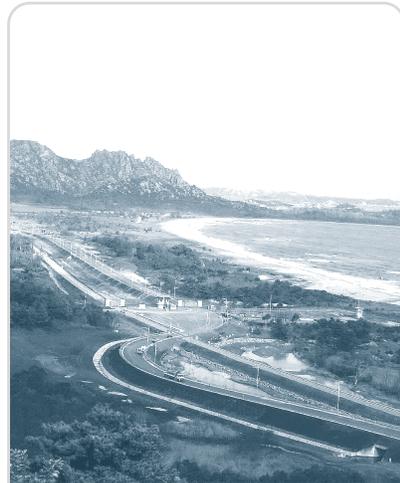
2. Reconnection of Railroads and Roads

During the first round of inter-Korean ministerial talks held shortly after the inter-Korean Summit Meeting in July 2000 and the second round in August 2000, agreement was reached on reconnecting the railroad (Seoul-Sinuiju) and road (Munsan-Gaeseong) on the Gyeongui Line. South Korea began construction work on the Gyeongui Line railroad and road on September 18, 2000, completing the South's portion of the railroad in late December 2002 and the road in late October 2003.

On September 18, 2002, the North and the South held concurrent ground-breaking ceremonies for the re-connection of the railroad and roadway. Since the ceremonies, the two Koreas have made steady progress. An opening ceremony for a temporary road on the Donghae Line was held on February 11, 2003 and a pilot program for the overland Mt. Geumgang tours was launched. During the ninth round of Inter-Korean Economic Cooperation Promotion Committee meetings held in June 2004, in consideration of the progress made, agreement was reached to open the roads on the Gyeongui Line and the Donghae Line in October, and to open railroads in late 2005 after test operations on selected sections of the track.



Railroad & Road on Gyeongui Line



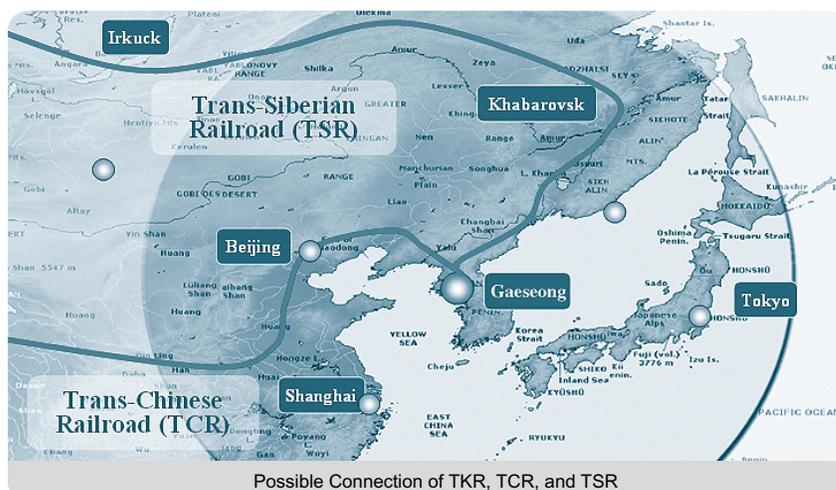
Railroad & Road on Donghae Line

Currently the reconnection work has been completed and preparations for test operations on selected railway sections have proceeded according to the agreed timeline. However, since inter-Korean government talks were halted in July, no formal consultations have taken place. North Korea has announced that when inter-Korean government talks resume, events

celebrating the opening of roads and the test operation of railroads may be held. Against this backdrop, in order to open a temporary road on the Donghae Line and to promote utilization of the completed roads before an official opening between the two Koreas, the South Korean government fully opened the roads to personnel and goods for humanitarian and commercial purposes.

During the fourth Inter-Korean Working-level Meeting on the Reconnection of Railroads and Roads in April 2004, the Basic Agreement on Inter-Korean Railroad Operations was signed. As a result, basic institutional mechanisms necessary since the reconnection of railroads and roads have been established, along with an agreement on motor vehicle operation.

Going forward, the full-scale operation of inter-Korean railroads and roads will mean a reduction in logistics costs and transportation time, which once hindered inter-Korean trade. This will increase trade substantially. In the process, it will naturally create an environment for discussions to ease military tensions and build trust, and will encourage the peaceful use of the Demilitarized Zone, laying the foundation for a peaceful national unification.



Possible Connection of TKR, TCR, and TSR

As part of plans to link the Trans-Korean (TKR) and Trans-Siberian railways (TSR) after inter-Korean railroads reconnection, the South Korean government held the first round of three-way railroad expert meetings of South Korea, North Korea and Russia in Moscow in April 2004. The meeting had been agreed to by the presidents of South Korea and Russia at the APEC conference in October 2003. Technical and practical matters concerning the connection of the TKR-TSR were discussed and participants agreed to hold future meetings.

The ASEM international symposium on the “Iron Silk Road,” organized by the Korea Railroad Research Institute in June 2004, was attended by civilian and government officials from 25 Asian and European countries. Participants, including Park Jong-song, head of the External Railway Cooperation Bureau of the Ministry of Railways of North Korea, discussed possible international cooperation in accordance with the future progress of inter-Korean railroad reconnection.

When the TKR and the Trans-Asian railway are connected, the cheap and abundant natural resources and labor in Russia, China, Mongolia and North Korea can be combined with the technological strength and capital of South Korea and Japan to accelerate the creation of a huge economic bloc similar to the EU.

3. Mt. Geumgang Tours

The Mt. Geumgang tours resulted from a South Korean government policy toward North Korea: “greater interaction and cooperation will create peace.” On April 30, 1998, the South Korean government announced “Actions for Promoting inter-Korean Economic Cooperation”. In June of the same year, the late Hyundai Group Honorary Chairman Chung Ju-yung visited North Korea and reached an agreement with the North’s Asia-Pacific Peace Committee on the Mt. Geumgang tours and development project.

Then, on November 18, the cruise ship Geumgang set sail from Donghae port with 826 people aboard, including separated family members, marking the beginning of the historic Mt. Geumgang tours. However, in 2002, economic difficulties experienced by the tour operator, Hyundai Asan, and a delay in starting overland tours resulted in a sharp decline in the number of tourists. The Mt. Geumgang tour was on the verge of termination.



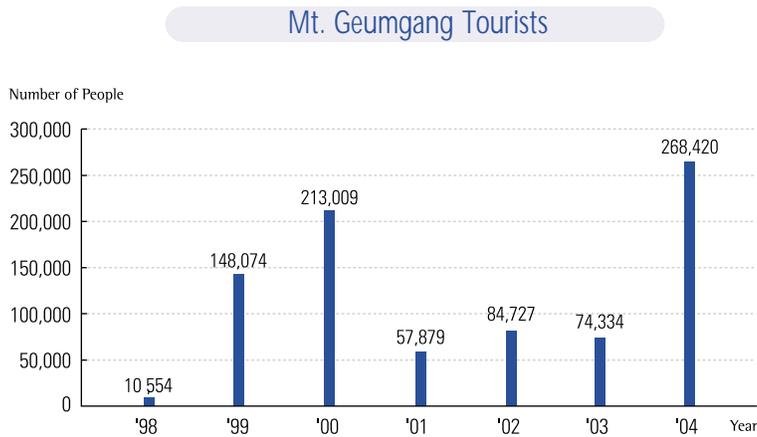
Overland Tours to Mt. Geumgang

Although the South Korean government provided financial support, in an attempt to develop more stable inter-Korean relations, the fundamental solution depended on introducing tours via overland routes as quickly as possible. Accordingly, the reconnection of a temporary road on the Donghae Line was completed on December 11, 2002. Subsequent efforts focused on

fostering an environment for starting the Mt. Geumgang tours via overland routes, which included signing a provisional agreement for military assurances regarding passage via the

temporary roads in the joint administrative zone of the two Koreas in the east and west coast areas on January 27, 2003. The two governments agreed on the resumption of the tours by overland routes at the fifth meeting of the Inter-Korean Economic Cooperation Promotion Committee on May 23, 2003 and, as a result, the tour started again the following September.

With implementation of the overland tours came a variety of tour programs including one-day trips and two-day packages. Efforts were also made to promote tours linking the Mt. Sorak (South) and Mt. Geumgang (North) regions. Consequently, in 2004, the Mt. Geumgang tours were firmly on track with the number of tourists averaging over 20,000 a month and 260,000 per year.



After the overland tours were well established and the number of tourists had soared, the operator, Hyundai Asan, worked to establish a stable growth rate by expanding the lodging, entertainment and public facilities. Consequently, the Mt. Geumgang Hotel opened on July 2, 2004 and construction plans for a family hotel were proposed. In addition, South Korea funded the construction of a world-class golf course. The ground-breaking ceremony on November 19, 2004 was held on the sixth anniversary of the Mt. Geumgang tours.

Meanwhile, for the safety and convenience of tourists, the government utilized the Inter-Korean Cooperation Fund to pave the road between Onjeong Pavilion and Guryong Falls (13.4Km) and assisted with the maintenance of existing roads, including the section between Onjeong Pavilion and the Mt. Geumgang Hotel (7.5Km).

In addition, to raise interest among South Korea's youth about national unification and to give them an accurate understanding of changes in North Korea, Mt. Geumgang programs were

organized during the winter vacation from December 2004 to February 2005. A total of 20,000 middle and high school students (including teachers) were selected to launch the Mt. Geumgang experience.

As they passed through the DMZ and some areas of North Korea, the South Korean students saw the railroads and roads that have been reconnected between the two Koreas. They had the opportunity to better understand North Korea by looking at recent developments in inter-Korean relations and through encounters with North Korean tour guides at Mt. Geumgang.

In a survey conducted of Mt. Geumgang tourists in 2004, 78% of the respondents answered that their negative views of North Korea and their views on national unification had become more positive as a result of visiting Mt. Geumgang, demonstrating the effectiveness of the Mt. Geumgang tours in educating people about national unification. In particular, although inter-Korean relations have been stalled since July 2004, the Mt. Geumgang tours have continued without disruption, reinforcing their role as a peace business, making significant contributions to easing tensions and building trust on the Korean Peninsula.

At the same time, institutional foundations for developing special districts are being fostered. In particular, North Korea announced real estate regulations in October 2004, allowing South Koreans, Koreans living overseas, and foreign companies and individuals to acquire land-use rights and own buildings in North Korea. These regulations have established a legal foundation for boosting investment in the Mt. Geumgang region.

In cooperation with the World Tourism Organization, Hyundai Asan is in the process of developing a comprehensive development plan for the Mt. Geumgang Tourism District. Once the plan is finalized, Hyundai Asan plans to attract investment from South Korean and foreign companies in order to launch a full-scale special district development project, including the construction of hotels, golf courses and ski resorts. The South Korean government is strongly backing the comprehensive development plan for the Mt. Geumgang Tourism District, which envisions sound development and economic viability while conserving the natural environment of Mt. Geumgang.

4. Food Aid for North Korea

The South Korean government agreed in 2004 to provide 400,000 tons of rice on humanitarian grounds to North Korea to ease the food shortage. At the ninth meeting of the Committee on the Promotion of Inter-Korean Economic Cooperation in June 2004, agreement was reached to supply 400,000 tons of rice in the form of a loan. On July 16, the Council on Inter-Korean Exchange and Cooperation passed a resolution to allocate a maximum of US\$124 million from the Inter-Korean Cooperation Fund to purchase the rice.

Details of Agreement on Inter-Korean Food Loan (July 13, 2004)

- Provisions: 400,000 tons of rice (100,000 tons domestically grown, 300,000 tons foreign grown)
- Unit price: US\$300 per ton; Loan amount: US\$124.00 million (maximum)
- Terms of the loan: Repayment over 20 years with a 10-year grace period, interest rate at 1% per annum
- Signatories to the loan: (South) Korea EXIM Bank (North) Joseon Trade Bank,
- Shipment schedule and conditions:
 - ▶ First shipment to leave within two weeks of the date of signing the food loan agreement in the case of overland route transport, and within eight weeks in the case of sea route delivery
 - ▶ Unloading ports: Six ports including Nampo, Haeju, Hongnam, Wonsan, Cheongjin and Songlim
 - ▶ North Korea will pay for unloading and port expenses and demurrage incurred in the unloading areas
- Distribution Transparency Guarantee
 - ▶ Supplier Label: Rice, 40kg, Republic of Korea
 - ▶ Inspections at distribution sites: After every transport of 100,000 tons, at least one inspection of distribution sites is carried out in each of the east and west coast regions and inland areas.

The food loan was delivered by overland route for the first time since rice supplies to North Korea began in 1995. This increased utilization of the roads on the Gyeongui and Donghae Lines, which had been completed after four years of construction, and expanded food transportation routes to inland areas. It also provided the momentum to further promote overland routes for transporting humanitarian aid supplies and traded goods in the future.

Moreover, many North Koreans witnessed these convoys of vehicles transporting food, and they understood that South Korea was supplying rice. Around 360 personnel and 340 trucks traveled back and forth across the eastern and western parts of the DMZ every week for approximately three months during the overland route transport period, and it contributed to reducing military tensions.

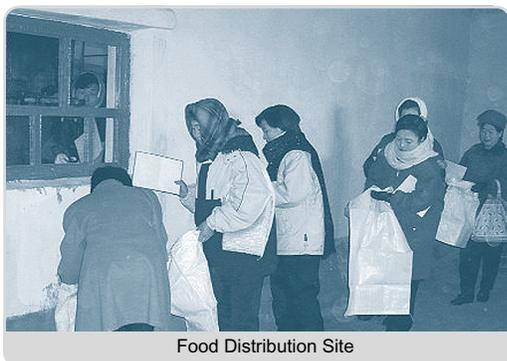


First Delivery of Food Loan to North Korea by Land

Meanwhile, in order to secure transparency in the distribution of food, the South Korean government reached an agreement with North Korea on obligating Pyongyang to notify the South of the detailed process of rice distribution, and to allow South Korean personnel to visit distribution sites in person to witness the distribution process.

Consequently, North Korea notified the South of distribution activities in 10 metropolitan cities/provinces and 194 cities/counties for every 100,000 tons. On-site visits to distribution sites were made twice in October and December 2004 to observe the distribution process and to inspect distribution sites. The remaining third and fourth rounds of inspections were done in January and February 2005. With slight variations across regions, the inspections showed that North Korea distributed the South Korean rice at US\$0.04, and the foreign rice at US\$ 0.03 per kilogram. The distribution took place twice a month and each person was supplied 300 to 380 grams of rice a day.

North Korean residents expressed appreciation to the people of South Korea and responded positively on the quality and taste of the rice. The South Korean government believes that such food provisions in the form of loans have contributed to promoting inter-Korean reconciliation and cooperation, fostering a Korean national community and firmly establishing inter-Korean economic transactions.



Food Distribution Site



Food Distribution Record

V. Development of the Gaeseong Industrial Complex

1. Overview

A. Development Overview

The Gaeseong Industrial Complex development project is the largest economic cooperation plan ever to construct an industrial complex in North Korea, mainly for South Korean companies. The project, which will be initiated in three stages, aims to develop some 66 million m² (26 million m² for the industrial complex and 40 million m² for towns in surrounding areas) around Gaeseong, North Korea.

In stage 1, which is currently being developed, Korea Land Corporation (KOLAND) and Hyundai Asan are working jointly to develop an industrial complex of 3.3 million m². As a model project before the full-scale operation of the industrial complex, a complex of 93,000 m², which will house 15 companies, is being developed.

For the remaining 63 million m², which will be developed in stages 2 and 3, developers and North Korean authorities are continuing discussions. According to the basic framework of the phased development plan, stage 1 aims to create a labor-intensive complex for small and medium enterprises (SMEs) of 3.3 million m². The goals of stages 2 and 3 are to construct a global export base and a combined industrial complex of heavy chemical engineering and industrial facilities, respectively.

Gaeseong Industrial Complex Development Plan

Total Plan

- Area: 66 million m² in total
 - ▶ Industrial complex: 26 million m²; new towns in surrounding areas: 40 million m²
- Phased development in three stages
 - ▶ Phase 1: A labor-intensive SME complex of 3.3 million m²
 - ▶ Phase 2: A global export base
 - ▶ Phase 3: A combined industrial complex of heavy chemical engineering and industrial facilities
 - New towns in surrounding areas will be developed based on future discussions

Stage 1 Development (3.3 million m²)

- Location: Area around Bongdong-ri, Gaeseong
- Period: 2002–2007 (including preliminary work)
- Implementers: Hyundai Asan and Korea Land Corporation
- Project method: Lease land from North Korea for fifty years; after developing industrial complex, sell lots to Korean and foreign companies and manage the complex
 - Develop a model complex of 93,000 m² to accommodate 15 companies

B. Significance of the Gaeseong Project

The Gaeseong Industrial Complex is a unique special economic district in North Korea in which South Korean developers lease land for an industrial complex on a long-term basis from North Korea, take the lead in developing and selling lots in the complex and building internal and external infrastructure, and establish and run an administrative organization as a North Korean company. Meanwhile, South Korean companies make direct investments in plant facilities, technology, raw materials and subsidiary materials and produce goods.

As an unprecedented cooperation project whose structure is completely different from earlier types of inter-Korean economic cooperation, the development of the Gaeseong Industrial Complex holds the following significance.

First, the Gaeseong Industrial Complex promotes the mutual interests of the two Koreas by combining the capital and technology of South Korea with the land and workforce of North Korea. Such an arrangement is expected to help lower the costs for Korean companies, and at the same time, lessen the economic hardship of North Korea.

In addition, the Gaeseong Industrial Complex will encourage improved inter-Korean relations and accelerate the easing of tensions on the Korean Peninsula. The promotion of inter-Korean economic cooperation driven by the Gaeseong Industrial Complex development will contribute to easing military tensions, in bringing stability and peace to the Korean Peninsula, as well as resolving the North Korean nuclear issue.

The Gaeseong Industrial Complex will also be beneficial to North Korea in its efforts to achieve change and stable growth. With the successful development of the Gaeseong Industrial Complex, the North is expected to adopt further economic reforms.

Furthermore, from a mid-to long-term perspective, the Gaeseong Industrial Complex will provide a bridge for achieving the era of Northeast Asia, which is envisioned by the current South Korean administration's Policy of Peace and Prosperity. When the financial center of Seoul and the logistics function of Incheon, which are geographically close, are linked with Pyongyang and Nampo, the Gaeseong Industrial Complex is expected to serve as an outpost for economic cooperation in Northeast Asia.

In short, the Gaeseong Industrial Complex project epitomizes the Policy of Peace and Prosperity supported by the Roh Administration. It is a mutually beneficial, prosperous project for both Koreas as well as a peace project that transcends the Cold War through the economy.

C. Development Status

The Gaeseong Industrial Complex project commenced on August 22, 2000 when Hyundai Asan and the North's Asia-Pacific Peace Committee and the National Economic Cooperation Federation signed an agreement on the development of the Gaeseong Industrial Complex. Following the ground-breaking ceremony for Gaeseong on June 30, 2003, an agreement worth US\$16 million on land-lease fees (for stage 1 development of 3.3 million m² and compensation costs for existing buildings and structures) was signed with North Korea on April 13, 2004. Subsequently, considering the period required to establish the infrastructure and the demands of small and medium-size companies for early sales of lots, it was decided to develop a pilot complex of 93,000 m², out of the 3.3 million m², into which companies could move in first. Developers, who had been approved by the Ministry of Unification on April 23, 2004, commenced construction on the Phase 1 site and the pilot complex.

On June 14, 2004, a total of 15 companies selected for tenancy in the pilot complex signed tenant agreements, and completed the four-step government approval process on cooperation projects. Living Art was the first to begin construction of its factory on September 10, and 11 companies had either commenced or completed factory construction by the end of January 2005. In particular, Living Art's Gaeseong factory held a historic ceremony celebrating the first production and shipment of goods (kitchen pots) from Gaeseong on December 15, 2004.



Opening Ceremony of the Gaeseong Industrial District Management Committee

In addition, the Gaeseong Industrial District Management Committee, the district's administrative organization, celebrated its opening on October 20 and began administrative duties for the industrial complex.

Recognizing that development of the industrial complex can contribute to its economic recovery, North Korea is working to enact institutional mechanisms. Since promulgating the Gaeseong Industrial District Act on November 27, 2002, North Korea has legislated a total of 11 regulations so far: seven laws and regulations including the Provisions on Gaeseong Industrial District Development in 2003 and four regulations including the Provisions on Foreign Currency Management in 2004. Pyongyang also plans to announce the remaining accounting regulations in the near future.

In addition, following the adoption of an agreement on customs, communications and quarantine relevant to the Gaeseong Industrial Complex on December 8, 2002, the two Koreas effectuated four agreements on economic cooperation, including an investment guarantee, the prevention of double taxation, commercial dispute resolution procedures and settlement clearing. Then, on January 29, 2004, the Agreement on Passage and Stays in the Gaeseong Industrial District and the Mt. Geumgang Tourism District was signed, laying the institutional foundation to steadily pursue projects with North Korea.

As described, the Gaeseong Industrial Complex project has made great headway during 2004. A government and civilian-level framework as well as legal and institutional mechanisms were established to initiate the project. Among companies that have commenced construction of factories in the pilot complex, two companies hired North Korean workers and began joint production. Four and a half years after Hyundai Asan and North Korea agreed to develop the Gaeseong Industrial Complex in 2000, the project has finally begun to bear fruit.

2. Stage 1: Development of 3.3 Million Square Meters

A. Pilot Complex Development

(1) Sale of Factory Plots

In order to distribute plots in the pilot complex, the Korea Land Corporation (KOLAND) formed the Plot Sale Screening Committee on April 8, 2004 and finalized the screening criteria and methods. Notices of the plot sale were announced in daily newspapers on May 18, 2004, and applications were received from May 24 through 27. A total of 136 companies submitted applications, of which 15 companies were selected. They signed tenant

agreements with KOLAND on June 14. The lots were leased at US\$45 per square meter, which was in line with the development costs.

(2) Factory Construction and Operation

Tenant companies that were assigned plots in the pilot complex obtained government approval on cooperation projects in a four-step process. By the end of January 2005, 11 companies had commenced or completed the construction of their factories. The remaining four companies had also finalized designs and were preparing for ground-breaking. In particular, Living Art, the first among the tenant companies to commence construction of its factory on September 10, celebrated the completion of its factory and the first output of products in the Gaeseong Industrial Complex on December 15. The 1,000 kitchen pots shipped to the South that day were extremely popular at Lotte Department Stores in Seoul and sold out within a few hours. Soon after, on December 28, SJ Tech, a semiconductor parts manufacturer, also celebrated the completion of its factory and began production.

The industrial district administrative organization maintains authority over factory construction permits and completion inspections, building registrations, approval and registration for the establishment of new companies, and business permits. Accordingly, tenant companies must obtain necessary licenses and permits from this organization.

The minimum monthly wage of North Korean workers employed at the Gaeseong Industrial Complex is US\$50.00 (with a maximum 5% wage increase per year and an additional 15% of the wage paid separately for social insurance). The corporate income tax is 14% of the profits after settling accounts. (The corporate income rate is a preferential rate of 10% for the following fields: infrastructure construction, light and high-tech industries).

As of January 2005, a North Korean workforce placement agency had yet to be selected. Therefore, North Korean workers are recruited for tenant companies through the industrial district administrative organization and Hyundai Asan. The industrial district administrative organization also supervises hiring by companies in the industrial district. As of January 2005, Hyundai Asan (including subcontractors) had hired 1,073 people for site leveling and construction work and KOLAND, Living Art and SJ Tech has employed 14, 269 and 48 workers, respectively. Shinwon Corporation and Samduk Trading had also hired 266 and 12 laborers, respectively. In addition, 28 workers have been employed at the Management Committee and convenience facilities, for a total of 1,710 North Korean workers at the Gaeseong Industrial Complex.

North Korean workers are provided with a basic job orientation offered by the industrial district administrative organization and the tenant companies, and given the technical training required by each company.

(3) Construction of Public Facilities

After obtaining project approval on November 2, 2004, Woori Bank held a branch opening ceremony at the model complex on December 7 and began offering banking services. The bank now offers tenant companies and South Koreans in the Gaeseong Industrial Complex services such as remittances, money exchange and account management.

In addition, Family Mart, YMCA Green Doctors and Arakor obtained project approvals from the government and are running a convenience store, medical facilities and contract food services business, respectively.

B. Main Complex Development

(1) Site-clearing

Regarding Phase 1 development of 3.3 million m², on April 13, 2004, southern developers and North Korea signed an agreement on land use, which stipulates a payment of US\$16 million in total for land lease and the removal of existing buildings and structures. After obtaining government approval, developers began clearing the site on April 23. As of January 2005, 47% of the development project has been completed.

(2) Infrastructure Construction

In order to complete the infrastructure construction by the end of 2006, when the Gaeseong Industrial Complex goes into full operation, the Inter-Korean Cooperation Fund is providing 109.5 billion won as a grant for construction costs of the infrastructure, including water supply facilities, a waste water treatment plant and waste matter disposal facilities. In addition, the cost of electricity and communications facilities, which are part of the external infrastructure, will be provided in the form of a long-term, low-interest loan.

The water supply facility project is to supply 45,000 tons of water daily from the Wolgo Reservoir, located about 24 km north of the Industrial Complex. Initially, Pyongyang had agreed to complete the dam building and tunnel construction work on its own. However, the North requested additional financial support for materials and equipment, so the issue has been under discussion.

Plans to build a waste water treatment plant with a daily capacity of 31,000 tons on the 23,000 m² site in the stage 1 area are underway, with a goal to finalize designs and begin construction in the first half of 2005.

With regard to waste matter disposal facilities, in 2003 it was decided that North Korea

would be in charge of outsourcing waste matter disposal at the Industrial Complex. Accordingly, no site for the facilities had been allocated in the Phase 1 land use plan. However, in May 2004, the North notified the South that it would be difficult to fulfill the obligation and the issue of locating a site of 66,000m² or bigger was raised (17,000 pyong for landfill facilities and 10,000 m² for incineration facilities). The goal is to iron out the site issues and begin a detailed design plan within the first half of 2005, and begin construction in the second half of the year.

Designs for roads, waterworks and sewage systems within the complex were finalized in June 2004 and construction began in August 2004. As of January 2005, 8% of the construction has been completed. Special facilities (bridges, etc.) are in the design process. Plans are underway to commence the construction of special facilities in March 2005 and to complete the construction by December 2006.

(3) Negotiations on Providing Electricity and Communications

In order to supply electricity to the Gaeseong Industrial Complex, the Korea Electric Power Corporation (KEPCO) has already completed work on electric power distribution lines in the South Korean section (about 15 km) on September 30, 2004 and began working on the North Korean section on January 24, 2005. KEPCO finished the project and started supplying electricity in March 2005. It also began working on the North Korean section on January 24, 2005. As for the electricity to be supplied to the Gaeseong Industrial Complex, 15,000kW will be supplied via 22,900V distribution lines in the model complex. In 2007 when 3.3 million m² of the Phase 1 area is developed, 100,000 kW will be supplied via 154,000V power cables.

Supplying electricity to the Gaeseong Industrial Complex holds meaning beyond the level of simply providing power to the tenant companies. It is historically significant that electricity generated by South Korea will be transmitted across the armistice line for the first time since the division of the Korean Peninsula.

Regarding the issue of communications, after several rounds of consultations, the two Koreas signed the Agreement on the Supply of Communications in the Gaeseong Industrial District at the ninth working-level meeting on communications on December 30, 2004.

The agreement stipulates the establishment of a communications network directly linking the Gaeseong Industrial Complex, Gaeseong city and Munsan, while providing phone and fax services first in the model complex. Broadband internet service will be discussed after communication services are provided to the model complex. In addition, a consensus was reached to discuss subsequent agreements on rates and settlements, which are necessary to implement the agreement, in the near future. In particular, it was decided to set the

communications service rate at less than US\$0.5 per minute, which will lessen the tenant companies' burden on communication expenses and contribute significantly to enhancing the international competitiveness of the Gaeseong Industrial Complex while stimulating inter-Korean exchanges.

3. Building the Foundation for the Gaeseong Project Initiatives

A. The Establishment of Administrative Mechanisms

(1) Gaeseong Industrial District Management Committee

The administrative organization responsible for the overall management and operation of the Gaeseong Industrial Complex on site in Gaeseong was established under North Korean law. It is subject to the Gaeseong Industrial District Act and the Provisions on the Founding and Operation of an Administrative Organization for the Gaeseong Industrial District.

The South and the North agreed to name the administrative organization the Gaeseong Industrial District Management Committee (hereafter "Management Committee"). The Management Committee held an opening ceremony in Gaeseong on October 20 and began its official duties.

As for the operational costs of the Management Committee, a loan was extended from the Inter-Korean Cooperation Fund in the amount of 22.5 billion won (of which 4.6 billion won was spent in 2004), including the cost of building the Management Committee offices and its operations. This loan is scheduled to be repaid in installments over ten years (at 1% interest) after a 5-year grace period.

The Management Committee will perform overall administrative and operational functions, including the approval and registration of new companies, construction permits and completion inspections, land use rights and building registration, support of companies' business activities, infrastructure management, issuance of certificates for entrance, environmental protection, and fire safety measures.

It is significant that although the Management Committee is a North Korean company established under North Korean law, it is founded and operated by South Korean developers and performs administrative functions such as approval, registration and permit-related affairs in the territory of North Korea while still being accountable to the authority of South Korea.

(2) Gaeseong Industrial Complex Project Support Office

In an attempt to provide systematic, government-level support for the success of the Gaeseong Industrial Complex project, the South Korean government has established a preparation team for the launching of the Gaeseong Industrial Complex Project Support Office on August 16, 2004. The team has initiated an operational plan for the industrial complex, settlement of issues relevant to importing and exporting of strategic goods, support measures for tenant companies, infrastructure construction plans and preparations for the establishment of the Support Office.

The Support Office will perform the overall general and coordination functions concerning the Gaeseong Industrial Complex Project. It will also be engaged in establishing various institutional mechanisms including personnel management, travel, and customs procedures, providing support to tenant companies, attracting investment and supporting infrastructure construction.

With the launching of the Support Office, a comprehensive support mechanism for the Gaeseong Industrial Complex development has been created at the government level. The Support Office will enable the government to step up its support for tenant companies and developers and increase cross-ministry cooperation.

B. The Establishment of Support Plans

(1) Issues Related to Sending Strategic Goods to the North

With regard to tenant companies in the Gaeseong Industrial Complex taking equipment and materials from South Korea to the North, the South Korean government has made strenuous efforts to resolve the issue of strategic goods while giving comprehensive consideration to the following relevant details: the special nature of the Gaeseong Industrial Complex (ultimately used by South Korean companies and managed by South Korea), the obligation as a signatory to the international multilateral agreement on Export Controls on Dual-use Goods, and the protection of South Korean companies under the U.S. Export Administration Regulations (EAR).

The South Korean government has kept in close contact with the United States to discuss exporting items regulated by the EAR. In August 2004, Unification Minister Chung Dong-young's visit to the U.S. was an important step in clearing the way for sending dual-use

goods subject to the Wassenaar Arrangement and regulated export items under the EAR to the Gaeseong Industrial Complex. The United States recognizes the fundamental significance of the Gaeseong Project and fully supports it. It also shares a common understanding based on the US-ROK trust built over the years. As for taking goods to Gaeseong, consistent efforts are underway to extend the scope of understanding between South Korea and the U.S. through the first US-ROK working-level consultative meeting in September 2004 and an international conference organized by the U.S. Department of Commerce the following month.

(2) Markets and Place of Origin

In exporting products from the Gaeseong Industrial Complex to overseas markets, declaring their place of origin is a critical matter. If their place of origin is recognized as North Korea, goods may face barriers in markets of major countries that levy relatively high tariffs on North Korean goods. Therefore, plans are underway to sell the products in the domestic market in the immediate future or to expand markets to regions with no import restrictions.

Under the Korea-Singapore Free Trade Agreement, which was declared to have been nearing completion by ROK President Rho Moo-hyun and Singapore's Prime Minister Lee Hsien Loong on November 29, 2004, Singapore will treat goods produced in Gaeseong as the same as goods made in South Korea. The agreement also includes products from the Gaeseong Industrial Complex exported to Singapore via South Korea in the list of products receiving preferential duties. The arrangement is highly significant in that it sets a precedent for exploring overseas markets.

To prepare for full-scale production after the main complex is developed, listing products from the Gaeseong Industrial Complex in the preferential duties category in FTAs signed by South Korea may be an effective way to widen overseas markets.

In addition, in an effort to help explore overseas markets for products from the Gaeseong Industrial Complex, the government is seeking diversified plans to secure markets, including a survey of entry restrictions, quota restrictions, tariff rates and GSP rates levied on North Korean products by each country and the promotion and marketing of products from the Gaeseong Industrial Complex.



(3) Financial Support

In order to lessen the financial burden of tenant companies in the pilot complex, the government has decided to extend loans from the Inter-Korean Cooperation Fund to tenant companies that have been approved for cooperation projects. Loans will be extended for about 70% of the total investment required, with the remaining 30% to be funded by the company itself. Just as with other economic cooperation capital, the maturity of the loans is a maximum of eight years (with a 3-year grace period) with the interest rate of 3.3%~4.0%.

However, since private property rights are recognized in Gaeseong and land and buildings can be registered as collateral, assets located in the Gaeseong Industrial Complex are recognized as regular collateral and loans will be extended up to 50% of their value.

As for raising post-acquired collateral ratios (maximum 50% for land and buildings, and maximum 30% for manufacturing facilities) suggested by the tenant companies, the post-acquired collateral ratios are applied for actual construction costs required when loans are extended by the Inter-Korean Cooperation Fund. In addition, for losses incurred in the process of initiating inter-Korean economic cooperation, for which companies are not liable, a loss protection program to compensate up to 90% of the loss – up to a maximum of US\$2 million – has been introduced to lower the risk of investment.

(4) Simplified Entrance and Other Procedures

To further promote the Gaeseong Project, simplifying procedures for travel across the military demarcation line on the Gyeongui Line is crucial. To this end, the government has been continuously working to simplify the procedures.

In an attempt to increase convenience for on-site applications made by businessmen, the tasks that had been administered by the Ministry of Unification – the re-issuance of visitation certificates, change of declared information, and confirmation of visit reports – have been delegated to the South-North Transit Office since November 23.

On December 31, 2004, the procedures for visiting the Gaeseong Industrial Complex were amended as follows to simplify the procedures: 1) the turnaround period for approvals on visits to North Korea has been shortened from ten days to five days; 2) the submission of a personal statement is no longer required for single-time visitors; 3) a North Korean visit report has been replaced with an entry/exit plan. As a result, entry procedures for tenant companies have improved remarkably.

In order to improve transportation for businessmen who frequently travel to and from the Gaeseong Industrial Complex, Hyundai Asan obtained government approval for a shuttle

service on September 9, 2004, and has been operating a shuttle bus five days a week since September 20. The company is also holding discussions with North Korea on increasing the number of the bus trips for the convenience of inter-Korean travelers.

VI. Inter-Korean Social and Cultural Exchanges and Cooperation

1. Overview

Social and cultural exchanges, which are driven by private organizations at various levels, are a process by which South and North Korean citizens who have lived with different value systems and cultural patterns can relieve the social and cultural dichotomies and build a mutual bond. Joint events were organized in both Seoul and Pyongyang in a variety of sectors, with North and South Korean workers, farmers, scholars and students, participating in the events. This contributed to the expansion of contact between South and North Koreans and a cooperative atmosphere was created. Following commemorative events in 2002 and 2003, a ceremony held in 2004 to celebrate the fourth anniversary of the June 15 Joint Declaration inspired active participation by citizens.

However, with the outbreak of sensitive issues between the two Koreas in the second half of 2004, including Seoul's ban on memorial visits for the late North Korean leader Kim Il-sung and large-scale defections to Seoul, social and cultural exchanges and cooperation as well as government talks lapsed into a temporary lull. Nevertheless, private-level exchanges did not come to a complete halt, but continued sporadically. The Korean government views social and cultural exchanges and cooperation as a buffer preventing various crises from escalating into a complete severance in inter-Korean relations.

2. Inter-Korean Social and Cultural Exchanges

A. Inter-Korean Events

The year 2004 marked the establishment of inter-Korean events driven by private organizations. Concurrent Inter-Korean events for Labor Day (May 1) and the June 15 Joint Declaration (cancelled in 2003 due to the SARS epidemic) were held in Pyongyang and Incheon, respectively. In particular, an inter-Korean event for the June 15 Joint Declaration was the first South-North event held in a provincial city, and was open to the general public. Following a festival in 2001, the Farmers' Unification Rally was held at Mt. Geumgang, establishing a framework to make the event permanent.

Meanwhile, the halt to South-North talks had ripple effects on the private-level exchanges. In the end, inter-Korean joint events for Liberation Day (August 15) and National Foundation Day (October 3) were cancelled.

Inter-Korean joint events became more common as different private groups, including religious, labor, farmer, youth and women's groups, steadily pursued events, contributing greatly to fostering the mood for inter-Korean reconciliation and cooperation while demonstrating their commitment to national unification.



B. Academic Exchanges

At the Joint Academic Seminar titled “the Return of Cultural Assets Plundered by Japan” held in Pyongyang in February 2004, the two Koreas shared their awareness on issues concerning the history of the Korean people. Moreover, the two sides came to an agreement on organizing the South-North Association of Historians. In May, a nine-member North Korean delegation attended a conference in Seoul, entitled “Consultative Meeting Requesting Japan to Resolve the Past.” The event attracted attention from the press as the two Koreas made a clear commitment to speak out in one voice to address the issue of Korean women forced into prostitution and forced labor during World War II.

The Chinese government’s distortion of Korean Three Kingdoms’ History in August 2004 sparked even greater interest in the registration of a complex of Goguryeo tombs in North Korea as one of the UNESCO’s World Cultural Heritage sites. An exhibition and seminar commemorating the registration of the tombs as a World Cultural Heritage site were held at Mt. Geumgang in September. The event was successful, and the two sides agreed on a joint project to preserve Goguryeo archaeological sites in the future.

C. Religious Exchanges

Inter-Korean religious exchanges are bearing fruit as the two Koreas are cooperating in the restoration of religious structures as well as allowing contacts between South and North Korean religious organizations.

The restoration of the Singye Temple at Mt. Geumgang, led by the Jogye Order of Korean Buddhists as an inter-Korean cooperation project, proceeded smoothly. The South and the North jointly held a dedication ceremony of its main shrine in November 2004, which was attended by representatives of the Jogye Order and South Korean Buddhists and the Joseon Buddhist Federation from North Korea.

The Cheontae Order's initiative to restore the Youngtong Temple in Gaeseong is also making rapid progress. With the Cheontae Order's support of 400,000 roof tiles and 20 tons of paint, the restoration is nearing completion. A dedication ceremony and an international seminar will be organized in the near future.

Inter-Korean Christian exchanges have also been active. The General Assembly of Presbyterian Churches in Korea initiated an inter-Korean cooperation project to build a 1,320m² greenhouse and a 660m² church in the Daedong River district of Pyongyang. The greenhouse had been completed and, as of December 2004, the first shipment of materials to construct the church (Pyongyang Jeil Church) has been sent. The Annual Conference of the Korean Methodist Churches followed suit with operational support program for the "Pyongyang Seminary," which began in 2001, and continues to focus its efforts on cultivating Christian leaders in North Korea.

The Presbyterian Church held a South-North joint prayer meeting attended by the president of its general assembly at Mt. Geumgang in May 2004. The National Council of Churches in Korea took part in the South-North-German Church Missionary Meeting, organized by a church in Germany in March to discuss inter-Korean missionary affairs. The Catholic Priests' Association for Justice (CPAJ) and the Joseon Catholic Association agreed to hold a joint mass in Pyongyang in July to celebrate the 30th anniversary of CPAJ's founding. Some 150 South Koreans were preparing to visit North Korea, but the visit was cancelled due to the July 8 "memorial visit crisis."

With the supply of materials such as interior furnishings to build the Jeongbaek Church, which is under construction with the support of the North Korean Joseon Orthodox Church and Russia, the Orthodox Metropolis of Korea began exchanges between the Orthodox churches of the two Koreas. An agreement was reached to send a South Korean delegation to the dedication ceremony of the Jeongbaek Church in 2005 and to continue bilateral exchanges.

D. Exchanges in Art and Culture

Inter-Korean exchanges in the fields of art and culture have been centered on inter-Korean

joint exhibitions and joint animation productions. The Korean Council for Reconciliation and Cooperation exhibited the replicas of Goguryeo relics produced by North Korea at the South-North Goguryeo Exhibition in Seoul in 2003 and 2004 from April 9 to June 20. Then, "Reflections of My Country in Flowers," an inter-Korean exhibition commemorating the fourth anniversary of the June 15 Joint Declaration, displayed the work of South and North Korean artists on the theme of flowers that are found in the two Koreas. Exhibitions took place in both Pyongyang and Seoul through the exchange of the artworks.

"Dingga, the Lazy Cat," an animation jointly produced by the two Koreas, aired on EBS in the first half of 2004 received a great response. In fact, its project developer, Hanaro Telecom, reached an agreement with its North Korean partner to produce 15 additional episodes. Also, the National Network Co. Ltd. is making plans to produce animations on a subcontract basis with North Korean personnel.

E. Exchanges in Broadcasting

In June 2004, the Korean Broadcasting System (KBS) and North Korea produced a documentary film "Goguryeo Lives On." In the joint production, the KBS camera crew covered the Goguryeo archaeological sites in the Pyongyang area, while North Korean Joseon Central TV filmed the sites located outside of Pyongyang. It was a landmark achievement. In addition, the Munwha Broadcasting Corporation (MBC) sent a camera crew to Pyongyang in June 2004 to cover the Goguryeo site and broadcast a TV program titled "Living Goguryeo" on June 24. A Seoul Broadcasting System (SBS) crew visited North Korea to report on the South-North academic seminar for the return of cultural assets plundered by Japan, which was held in Pyongyang in February 2004. It also filmed the Great Gangseo Tomb, a historic site of Goguryeo.

Meanwhile, the Korean Broadcasting Commission relayed the scenes of major competitions and matches featuring South and North Korean athletes to the North during the Athens Olympic Games (August 13-29), opening a new chapter in inter-Korean exchanges in broadcasting.

F. South-North Joint Procession at the Athens Olympics

After marching together for the first time at the opening ceremony of the 2000 Sydney Olympic Games, drawing worldwide attention, the South and North Korean teams continued the legacy of joint processions at major international athletic games including the 2002 Busan Asian Games, the 2003 Aomori Winter Asian Games, and the 2003 Daegu Summer Universiade.

At the 28th Athens Olympic Games from August 13 to 29, 2004, the two Koreas entered together at the opening and closing ceremonies, holding the flag of the Korean Peninsula. The joint procession received a storm of applause from the entire world, including over three billion viewers. The number of participants in the joint march was not limited at the Athens Olympic Games, which proved that inter-Korean relations had greatly improved.

VII. Building the Foundation for Inter-Korean Exchanges and Cooperation

1. Streamlining South Korean Laws and Regulations on Inter-Korean Exchanges

The South Korean government has enacted relevant laws and regulations including the Inter-Korean Exchange and Cooperation Act (1990) and laid the foundation for initiating inter-Korean exchanges and cooperation within the legal framework. Since then, those laws have been regularly updated to incorporate changes affecting the environment for inter-Korean exchanges and cooperation. Laws and ordinances, including notices and orders, were also enacted to stipulate details required for application of the main laws and regulations as well as for amending laws and regulations appropriate to situational changes in inter-Korean relations. In particular, the proposed improvements to the Inter-Korean Cooperation Fund loan program were adopted in late January 2004 through the amendments of the Provisions for the Operation and Management of the Inter-Korean Cooperation Fund and the Fund's Guidelines for Inter-Korean Economic Exchanges and Cooperation.

In addition, in order to facilitate the Gaeseong Industrial Complex project, special provisions on approval procedures for visits to the Gaeseong Industrial Complex and other cooperation projects were enacted in July 2004. As a result, the processing period for approving visits to the Gaeseong Industrial Complex (5 days), the period for declaring visits to North Korea by multiple-visit certificate holders (4 days before a visit) and the turnaround period for approvals on cooperation projects relevant to the Gaeseong Industrial Complex (15 days) have been clearly defined and documents required for approval have been notably simplified.

Entry procedures have also been streamlined. The regulation requiring return of the visit certificate each time a visitor returns to South Korea has been lifted. The processing period for approving visits to North Korea was shortened once again, this time from 10 days to 5 days. In addition, in the case of multiple-visit certificate holders, the declaration to visit North Korea can be substituted with the submission of an entry/exit plan.

The government plans to continue to update legal mechanisms concerning inter-Korean exchanges and cooperation in the future to reflect changes in inter-Korean relations, exchanges and the cooperation environment, and progress in the institutional framework between the two Koreas in order to bolster more stable and efficient initiatives in inter-Korean exchanges.

2. Institutionalizing inter-Korean Economic Cooperation Agreements

In order to institutionalize inter-Korean economic cooperation, four agreements on economic cooperation, including the Agreement on Investment Protection, were concluded on December 16, 2000. Since then, the two Koreas have continued discussions, reaching a consensus on follow-up measures. As a result, inter-Korean relations have now surpassed the level of political agreements and are evolving toward a legal and institutional foundation.

During the working-level meetings on an institutional framework for inter-Korean economic cooperation held in Gaeseong from January 27 to 29, 2004, the Agreement on Entry and Stays in the Gaeseong Industrial District and the Mt. Geumgang Tourism District was signed, completing a set of agreements required for the development of the Gaeseong Industrial Complex. Accordingly, it was decided to implement agreements on economic cooperation that had been adopted by the two Koreas previously.

A total of nine agreements on economic cooperation will be formally enacted when notification on mutual implementation is exchanged after Pyongyang completes internal procedures. When the agreements officially take effect, they are expected to bolster inter-Korean economic cooperation initiatives substantially, including the Gaeseong Industrial Complex and the reconnection of railroads and roads.

3. Managing the Inter-Korean Cooperation Fund

A. Raising Funds for the Inter-Korean Cooperation Fund

Under the Inter-Korean Cooperation Fund Act enacted on August 1, 1990, the Inter-Korean Cooperation Fund was first created on March 20, 1991 with a contribution made by the government. Since then it has worked to accelerate inter-Korean exchanges and cooperation, and has played a constructive role in restoring the Korean national community. The Inter-Korean Cooperation Fund is mainly financed by government contributions and investment returns. Contributions to the Fund are also made by some private parties. Since raising US\$34 million with government contributions in 1991, the Inter-Korean Cooperation Fund has raised US\$4.2 billion in total as of December 2004: US\$1.9 billion in government contributions, US\$2 million in private contributions, US\$300 million in investment returns, and US\$1.9 billion in a deposit from the public capital management fund and other sources.

B. Utilizing the Inter-Korean Cooperation Fund

Until 1999, the Inter-Korean Cooperation Fund was mainly used to finance government-level humanitarian support to North Korea, including rice and fertilizers, and activities under Item 5 “supporting the restoration of the Korean national community” of Article 8 of the Inter-Korean Cooperation Fund Act, such as the light-water reactor construction project. However, as exchanges and cooperation in economic, social and cultural sectors were stimulated and exchanges among separated family members were realized, the range of areas supported by the Fund also began to widen.

Currently, the Inter-Korean Cooperation Fund is largely divided into grants and credit assistance to boost inter-Korean exchanges and cooperation and grants and credit assistance to restore the Korean national community. In the case of grants for inter-Korean exchanges and cooperation, US\$29 million has been extended in total by the end of December 2004.* In 2004 alone, US\$3.6 million was provided in total: US\$1 million for personnel exchanges and US\$2.7 million for social and cultural cooperation.

With regards to credit assistance for inter-Korean exchanges and cooperation, US\$121 million was extended in total by the end of December 2004. In 2004, US\$41 million was provided as loans to finance trade and economic cooperation (trade loans: US\$12 million for 64 cases, economic cooperation loans: US\$21 million for 12 cases). This is a significant rise of 153% from the US\$16 million figure in 2003 (trade loans: US\$6.8 million, economic cooperation loans: US\$9.4 million).

As for grants for the restoration of a Korean national community, US\$1 billion was provided by December 2004. In 2004, US\$2.7 million was provided to support the exchanges of separated families and US\$107 million was used for 46 humanitarian support projects.

In laying the groundwork for economic cooperation, 11 projects were carried out in 2004. Their expenditure details include US\$53 million for the reconnection of railroads and roads along the Gyeongui and Donghae Lines, US\$2.1 million for supporting infrastructure construction in the Gaeseong Industrial Complex, and US\$1.3 million for paving roads in the Mt. Geumgang Tourist District. For supporting social and cultural sectors, only one case (US\$54,000) was provided for the joint entrance of South and North Korean teams at the Athens Olympics.

In the case of credit assistance for the restoration of a Korean national community, US\$1.7 billion was spent through December 2004. A total of US\$203 million was spent in five cases in 2004: US\$35 million in a material and equipment loan to North Korea, US\$89 million as part of a food loan (400,000 tons of rice) to North Korea, US\$3.7 million as a loan

* The dollar amount hereinafter has been calculated using the exchange rate \$1= ₩1,146 – an average exchange rate in 2004.

for the Gaeseong Industrial Complex administration, and US\$76 million as a loan for the construction of the light-water reactor project.

As part of further support to promote effective exchanges and cooperation, the government has made steady efforts to improve the Fund support system. In January 2004, through amendments related to Fund-related provisions, including Provisions for the Operation and Management of Inter-Korean Cooperation Fund and Guidelines for Support by the Inter-Korean Cooperation Fund, the loan ceiling was raised from 70-80% to 80-90% of required capital.

Moreover, the share of unsecured loans increased by 10% and loan requirements were eased to extend unsecured loans when the letter of credit guarantee is submitted, and to recognize assets located in North Korea as supplementary collateral to facilitate unsecured loans. As a result, trade capital loans are on a steady rise from US\$340,000 in 2002 and US\$6.9 million in 2003 to US\$12 million in 2004.

