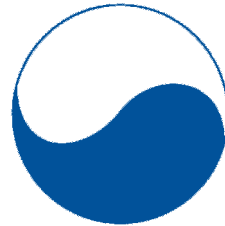

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NORTH KOREA'S ECONOMY AT A CROSSROADS

by Bernhard Seliger

[A] year [2005] of fruitful efforts and a year of great creation and change replete with epochal events and outstanding feats in the history of our Party and the nation. . . .

New Year's editorial published in
Rodong Shinmun [Workers' Newspaper]
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Introduction

The year 2006 will be crucial for the direction of the economic system of the Democratic People's Republic of Korea (DPRK; North Korea). In 2005, policies diverged, with some positive and some negative signs. After four years of a simmering nuclear crisis, the six-party talks came to a preliminary agreement, opening at least theoretically the possibility of nuclear disarmament, a more stable and peaceful Northeast Asia, and economic aid on a massive scale for North Korea. Stalled talks following the general agreement, however, make such a positive assessment look like wishful thinking once again.¹ North Korea's economic cooperation with China, but particularly with South Korea, has increased to an unprecedented level. The development of the Kaesong special industrial zone, close to the South Korean border, slowly picked up its pace although the number of South Korean firms actually producing there remains small. The January trip of North Korea's leader Kim Jong-il to China was shrouded in mystery, but certainly Kim was impressed by China's economic policies, which he publicly admitted. Trips of officials and training of officials and students abroad continued, opening the way for long-term changes in the economic policies of the former hermit state.

Other signs, however, were less encouraging. Humanitarian assistance, the need for which has been reluctantly admitted by North Korea since the mid-1990s, basically stopped at the end of 2005, and all nongovernmental organizations (NGOs) involved in humanitarian activities had to leave the country. Although North Korea's dismissal of the NGOs was officially justified by citing achievements in combating hunger, a bumper crop, and a necessity for long-term development projects rather than humanitarian relief, the fact that humanitarian assistance forced North Korea to open up to foreigners at least partially probably played a major role in closing humanitarian agency offices. Also observed have been additional signs of a tightening of control and closing of the country after its timid opening of the past years; for example, the public distribution system (PDS) once again became the sole legal source for staple foods, especially cereals and rice, possibly because the rampant inflation in semilegal markets had been politically untenable. In addition, controls on North Koreans' travel within the country, which had been tight before the early 1990s but then broke down, were reinstated, making travel more burdensome for, in particular, people searching for food in China as well as for merchants.

What kind of dance will result from this peculiar mixture of steps forward and steps backward? Will it be a reform boogie or will it be a conservative one step forward—two steps backward? There is some probability that 2006 will shed some light on this question. Recently, external pressure has been added to the internal pressures resulting from the country's moribund economy. The closing down of North Korean bank accounts—freezing of assets and severance of

1. Nicholas Eberstadt, in "Son of the Agreed Framework," in the 21 September 2005 *Asian Wall Street Journal* therefore assesses the agreement to be a complete failure, being a "son of the agreed framework" (of 1994) and making the same mistakes, namely, in speaking of the North's right to peaceful use of nuclear power—a point that opens up numerous roads for new demands for nuclear power for North Korea, a country that never pursued nuclear power for its peaceful uses—as well as speaking of the denuclearization of the Korean peninsula, which ultimately can be interpreted by North Korea as a complete withdrawal of the United States, which offers nuclear protection to South Korea.

ties in Macao and Switzerland and worldwide—made North Korea visibly nervous. Not only negative pressure has been added. Large benefits also loom behind the possibility of an agreement with Japan, which has preconditioned any agreement on a solution to the abduction problem. Even larger are the possibilities of full-scale aid from South Korea after the nuclear crisis is solved. Indeed, president Roh Moo-hyun of South Korea, in the euphoria after the six-party agreement in September and before the additional demands of North Korea cooled emotions, quickly ordered his planners to draw up a North-South equivalent of the Marshall Plan of a half century ago. The European Union for the first time included North Korea in its capacity-building program, Asia Invest.

For North Korea, still under the firm control of leader Kim Jong-il, regime survival is the key and must be remembered before one can understand the country's reform steps. This is not a simple equation because internal economic pressure might work just as well against regime survival as external pressure, and vice versa; economic stability could strengthen or weaken the regime. In the remainder of this article, the status of economic reforms until early 2006 is reviewed, then reform options from the point of view of North Korea's leadership are discussed. The final section debates whether full reform (instead of caution and stagnation) is possible and what the role of the international community might be.

Status of Economy and Economic Reform in North Korea

Every discussion about the status of the economy of North Korea or its reforms since 2002 is severely hampered by the lack of reliable macroeconomic data and the difficulty in checking the published data. Fortunately, North Korea's opening after the mid-1990s

in order to gain foreign aid and, to some extent, the monitoring thereof, as well as the increasing ties with China and South Korea, brought much new information from North Korea. Bearing these sources of information and constraints in mind, it seems certain that the price and wage reforms of July 2002 markedly increased private activity in the much discussed and much lauded private markets (*jangmadang*) but did not provide the allocative incentives necessary to induce increased production in agriculture or—more important in North Korea, which is essentially an industrialized country—in industry.²

Trading led to an increased supply of consumer goods in the North, especially in Pyongyang,³ a fact that often led visitors to confirm the dramatic impact the reforms had. Also, catering to a growing foreign community in Pyongyang that consisted of not only aid workers but also greater numbers of Chinese merchants and investors as well as South Koreans led to a modernization of the capital and certain parts of the country frequented by the new visitors.

The first pizzeria in Pyongyang, named Byeolmuri (Galaxy), seemed to herald the change as did the spectacular success of North Korea as a destination for Chinese gamblers—the Casino Pyongyang in the Yanggakdo Hotel in Pyongyang was a showcase—and the installation of the Chosun Development and Investment Fund by London-based fund managers of Anglo-Sino Capital Partners, which planned to raise \$50 million. Most noticeable of all were the sidewalk entrepreneurs, from street photographers to food stalls, everywhere foreign visitors were allowed. What a difference from former times, when North Korea's civil law dictionary defined merchants as a class to be eradicated because they “buy goods from producers at a low price and sell them to consumers at a high price by way of fraud, deceit, and spoils.”⁴

2. Bernhard Seliger, “The July 2002 Reforms in North Korea: Liberman-Style Reforms or Road to Transformation?” *North Korean Review* 1 (Fall 2005): 22–37; Bernhard Seliger, “The North Korean Economy: Nuclear Crisis and Decline, or Peace and Reform in the Last Asian Dynastic Regime?” *Korea's Economy 2004* (Korea Economic Institute) 20 (2004): 77–86.

3. Information available for the provinces is mixed.

4. “North Korea Allows Tentative Stirrings of Profit Motive,” *Korea Herald*, 29 December 2005, p. 3.

Besides trading, a certain amount of foreign investment, in particular from China, is noticeable. Chinese consumer goods and agricultural inputs, which are cheaper than those from other providers like South Korea, are in high demand. Investors from northern Chinese provinces, like Jilin and Liaoning, but also from Zhejiang are reported to be making inroads into North Korean markets. Prominent among them is the Zhejiang Public Trade Company, which opened the Zhejiang commodities market on three floors of central Pyongyang's First Department Store. Other actual or potential investors are looking into the relatively abundant natural resources of North Korea.

Trade has also been accompanied by a greater openness to foreign and, in particular, South Korean culture. Videotapes of South Korean soap operas, though illicit, are flooding North Korea; they are played on cheap, second-hand Chinese video players. Many defectors to South Korea report that they regularly heard foreign radio—South Korea's official Korea Broadcasting System or Radio Free Asia—in North Korea, further undermining the information monopoly of the state. Trading is also profitable; therefore, the teaching of Chinese, the language of North Korea's largest neighbor and the country through which most of North Korea's trade is carried out, has become a profitable business. According to one report, private tutoring for two hours per day, which is illicit but tacitly tolerated, costs 15,000 North Korean *won* per month—a surprising figure given a monthly average salary of 2,000–3,000 *won*.⁵ This price emphasizes one of the most problematic features of North Korea's reforms—hyperinflation.

The training of officials and students abroad goes on at a scale larger than ever, or at least larger than in many decades. Students are sent to various European countries to study business administration, computer sciences, or the English language. Officials are sent to training courses in Switzerland, to stay at international institutions like the United Nations Environment Program, and most of all to study trips to China. The

long-term implications of these eye-opening visits have not yet been explored.

Some indicators seem to show that North Korea is more affluent than it was during the previous decade. Pyongyang is no longer a dark hole at night; automobile and bicycle traffic has increased dramatically, seemingly not suffering from higher energy prices; and there is a greater availability of goods in Pyongyang. According to other reports, even military exercises, including air combat training, which were cut short by the North Korean People's Army because of fuel shortages, increased for the first time in many years during 2005. North Korea's diplomats at the United Nations are reportedly less short of funds than they were before.

Do all these signs indicate that the reform program of 2002 has been successful? Visitors to Pyongyang often seem convinced by their own eyes of the lasting impact of the changes.⁶ The counterintuitive answer to this question is an (almost straightforward) no. Surely, reforms did increase trading activities, the number of goods on sale (but not necessarily consumed), and information disseminated, and they did permit room for the entrepreneurship inherent in all human beings. But the most important task of economic reform, namely increasing production, especially industrial production, has not been achieved and could not be achieved by the reforms of 2002. Although private trading, be it a small-scale street stall or a larger enterprise involving even foreign trade, is profitable for those who engage in it, production is still carried out largely under the control of the economic bureaucracy or one of the power centers (the army or the party), leaving no room for private entrepreneurship. In fact, most factories still seem to be almost moribund. While figures for capacity utilization are not available, defectors regularly speak of 20 percent or even less.

Although there has been a certain amount of investment from abroad, even in extractive industries, the

5. Kwon Jeong-hyun, "Learning Chinese Is Hot in North Korea—Chinese for Money: Private Tutoring Popular," *Daily North Korea*, www.dailynk.com/english/index.php.

6. Rüdiger Frank, "International Aid for North Korea: Sustainable Effects or a Waste of Resources?" *Japan Focus*, 7 December 2005, www.japanfocus.org/article.asp?id=468.

manufacturing sector must be restructured before a large-scale revival can occur. Besides a few prestige projects, like a glass manufacturing plant donated by China, nothing has happened up until now in this crucial sector. In agriculture, the possibility of selling excess products, especially from private plots, in the *jangmadang* provided some incentive for increased effort, but this has been partly or, according to some reports, completely reversed by the reintroduction of the PDS.

The surest sign that the production sector has not experienced any lasting change, despite all reports of the introduction of profitability as a goal of management, is the hyperinflation of the North Korean *won* in the *jangmadang*. When price and wage reform (essentially an increase of prices and wages in which prices rose much faster than wages) was introduced in 2002, one important and officially acknowledged goal was the closing (though not the disappearance) of the gap between North Korea's prices and world market prices. The gap, however, rapidly reopened. This is less clear from the official exchange rate offered to visitors, but it is immediately clear from the data on the *jangmadang* (Table 1),⁷ which provide prices of the one market open to foreigners in Pyongyang. These data, however, are matched by reports from around the country, by visitors, and by defectors and can be said to give a realistic picture of the inflation process that came with the reforms of 2002.

These price increases, which put North Korea into the category of countries with hyperinflation, had implications for the population that cannot be overestimated. The price of 1 kilogram of rice, set at 55 *won* in June 2002, was 1,050 *won* in May 2005. This must be seen in relation to wages, which were ap-

proximately 2,000–3,000 *won*, on average, during the period. Certainly, a calculation of North Korean wages compared with the U.S. dollar does not capture the purchasing power of the *won*. Large parts of the population, between one-quarter and one-third, were fed throughout the period (until December 2005) by the World Food Program (WFP). The PDS never completely ceased to exist, which made possible purchases for staples that were cheaper than they were on private markets. Also, a large amount of foreign currency circulates in the country; it is brought in by traders, foreign aid organizations, and visitors. The distributive implications of hyperinflation were considerable and are one reason for the seemingly backward steps of late 2005.

If there is no additional production combined with a new hyperinflation, then where does the relative abundance of goods, the increase in observable economic activity in Pyongyang, and the confidence of the state that it will be able to survive without further humanitarian assistance come from? The official reason most cited is the bumper crop of 2005; it is perceived as a sign that finally the mass campaigns in agriculture have brought success. This, however, must be disregarded as only a smokescreen. Probably the harvest was better in 2005, but, according to the WFP, it is still far from adequate to bring North Korea to self-sufficiency. Rations for people remain small, far below human needs.

One source of income for North Koreans is asset stripping, that is, the sale of parts from the factories in which they work. Asset stripping was known in Central and Eastern Europe and the Soviet Union, but there it took a different form: in the chaotic environment at the time of the demise of the Soviet Union, managers

Table 1: Euro–North Korean Won Exchange Rate, as Observed in the *Jangmadang*, 2002–06

Year	2002	2003	2004	2005	2006 (March)
1 euro equals	500–700	1,500	2,500	3,200–3,400	3,600

Source: Author's observations.

7. Officially, the North Korean *won* was only slightly devalued (from 155.7 *won* per euro in 2002 to 181.6 *won* per euro in 2004; however, this devaluation had no relation to the a market valuation of the *won*).

separated profitable business entities from the large, moribund state conglomerates, and they became managers of these spontaneously privatized assets. In North Korea, asset stripping has to be seen more literally: North Koreans disassemble their factories part by part and sell them as scrap metal to Chinese buyers of iron, zinc, or bronze, materials in high demand in raw-material-hungry China. Because most North Korean factories are producing far below capacity owing to a lack of raw materials and energy and a breakdown in planning, asset stripping—which has gone on for more than a decade—has become widespread. A recently issued memorandum, “Smuggling Infringes upon the Interests of the Nation and People and Is Helping Enemies for Treason” shows how ubiquitous the problem of asset stripping has become in North Korea.⁸ However long this practice might last, it will come to an end, for it certainly is not a sustainable way to finance consumer goods.

A second, much more important factor is the rising aid from South Korea and the steady aid from China. Both countries supply North Korea with much needed goods and sometimes cash. Because few or no strings are attached to this aid, it is much preferred to the aid from the international community, which is accompanied by the intrusion by foreigners demanding monitoring to see where the goods actually go. Although even defenders of foreign aid admit that complete control is impossible and that a certain amount of aid will disappear to places different from those decided by the donor—be it in private or public hands—this is more common for the unconditional aid provided, especially, by South Korea. Most of the aid from South Korea comes in the form of food aid and fertilizer. By 2004, China and South Korea together were donating more than the WFP and without many strings attached, decreasing the necessity for North Korea to comply with the international rules for aid.

Although total amounts for this aid are extremely difficult to obtain because of the various channels through

which the aid flows, the National Assembly of South Korea allocated an amount equal to \$2.6 billion for inter-Korean cooperation in 2006, more than double the amount for 2005.⁹ Added to this amount is aid that comes via private and semipublic organizations, implicit aid that occurs through the subsidization of businesses related to North Korea (for example, the Mt. Kumgang tourism business through the Korea National Tourism Organization), and implicit aid by South Korean public companies as in the case of companies involved in the Kaesong industrial complex (KIC). The annual trade volume between South Korea and North Korea in 2005 exceeded \$1 billion for the first time in history, 10 times the \$100 million recorded in 1991 and an increase of more than 50 percent compared with 2004.¹⁰ The KIC has an increasing part in this trade but nevertheless accounts for only 16.7 percent.

Hopes for the KIC are high in South Korea. This seems to be the most direct parallel to the Chinese model of economic development as it began in Shenzhen and other special economic zones. In 2005, obstacles to the use of technology—the dual use of several technologies—in the special zone were resolved. KIC even became the place where, in December 2005, for the first time since the Korean War, direct phone lines were installed. However, the parallel to China could be misleading: the scale of production in the KIC is minuscule, and, if it grows at the current pace, no real change in North Korea’s industrial output can be expected from the KIC.

Thus, the July 2002 reforms did bring change to the services and the trading sectors, but they did not increase industrial production. Agricultural production was increased by generous fertilizer aid from South Korea coupled with mass campaigns reminiscent of Maoist China, but there were few signs of a market orientation in North Korea and little promise of long-lasting success. Inflation is rampant in the markets, and asset stripping reduces the probability of increased

8. Lee Hyun-joo, “North Korean People Smuggle Out Metal Scraps Taken Away from Factory Facilities,” *Daily North Korea* (2005).

9. Anthony Faiola, “N. Korea Gains Aid Despite Arms Standoff,” *Washington Post*, 16 November 2005.

10. “South-North Trade to Exceed US\$ 1 Billion in 2005,” press release, Ministry of Unification, Seoul, 23 January 2006, www.unikorea.go.kr/en/EPA/EPA0201R.jsp.

industrial production. More important, both inflation and asset stripping are dangerously undermining the economy in the North. Although the allocative consequences of inflation are of less importance in a situation where, for other reasons, production is already constrained, the distributive consequences are immediate: those holding goods (traders and farmers selling excess production outside of the formal distribution process, for example, from private plots) as well as those holding foreign currency gain, but consumers who do not own foreign currency lose on these markets. A large, new group of urban poor has grown out of the insufficiency of the PDS coupled with inflation in the markets. Because the new urban poor tend to be among the well-educated, their low morale threatens regime survival. At the same time, asset stripping reduces what faith still remains in the economic system. Also, the fact that women have become the entrepreneurial backbone of the society outside of the state-controlled system challenges traditional role models.

In this situation, the reintroduction of the PDS for rice and other staple foods and the ban on selling staples in the *jangmadang* are a rational solution from the point of view of regime survival: the government should end open inflation for the most necessary goods, namely staple foods; broaden cheaper distribution; and bring an additional element of control into society, which had been disassembling since the mid-1990s. One consequence of the revived role of the PDS is that, even in companies that do not produce anything, attendance at work has now become unavoidable: only workers receive rations. This ends much of the uncontrolled business activities and the roaming around of absent workers. Another consequence is again distributive: while the WFP and other humanitarian aid groups focused on the poor and the weak—for example, orphanages and mothers and children—the PDS focuses on those loyal to the regime and certainly on the party elite.

The reintroduction of the PDS plus the cessation of humanitarian assistance can have dangerous consequences, not only from a humanitarian point of view but also for regime survival, although initially the re-

gime appears to benefit from the crackdown in terms of better control. The ouster of international aid agencies ends aid to one-quarter (formerly even one-third) of the population. Furthermore, the allocative effects of the PDS and the ban of grain sales in markets mean that North Korea, at least partly, must resume the work of the humanitarian agencies that used to feed those not able to feed themselves. At the same time, local production—which in any case is not sufficient to feed North Korea—can be expected to decrease. Reports of grain seizures have already appeared, along with reports that the PDS in many regions simply does not work because of a lack of grains and reports of illicit trade. When farmers are forced to produce for the PDS, which means no profit for them at the current prices, they will resort to the time-honored methods of producing secretly for own use or for illicit sales, or simply producing less. Indeed, the reversal of reforms might herald a new famine for North Korea.¹¹ A renewed famine, given the larger amount of information available today, might be much more difficult for the government to control than the famine in the mid-1990s. If that happens, the amount of aid from China and South Korea, how the aid would be used, and the future economic policies of North Korea would determine whether today's reversal of reforms would indeed lead to a new crisis or whether the crisis could be avoided.

Certainly, in the long run, North Korea must offer its population firm incentives: the introduction of private, family-based farms and the introduction of the profit motive into business firms, that is, private rewards for creating profits. Firms are now run like fiefdoms in which managers (as well as workers, as much as they can) extract in the time they are allotted as much as possible, without regard for long-term development—a crucial difference from permanent, private ownership. Although speculation about the long run is interesting and tempting, only the short-term and the medium-term consequences of the current situation in North Korea are addressed here. The short and medium terms are less a problem of economics than they are a problem of political economy although economic consequences of policies always influence choices.

11. Stephen Haggard and Marcus Noland, "A U-Turn on Reforms Could Starve North Korea," *International Herald Tribune*, 22 December 2005, p. 6.

Next Steps: Reform Options

Before we discuss alternative economic policies, we must review the reasons for the reform steps as well as for the withdrawal of some reforms. Reforms became a necessity when, in the early to mid-1990s, the traditional system of socialist central planning broke down. The North Korean government's first answer to the breakdown was spontaneous and uncoordinated; the workers' reaction to the lack of food and work was to abandon their workplaces, roam the country for food, trade through the sale of their remaining valuables or the assets of companies, and—most important—go to China. In China, begging and working would provide for whole families if negative sanctions while in China or during the return to North Korea could be avoided. Over time, trade with China became more important, better organized, and at least partly legalized.

There was also a second answer, namely the opening of the country to external aid. Humanitarian agencies, with the WFP in the lead, fed a large part of the North Korean population during the past decade and also initiated numerous projects directed toward long-term development. Projects included reconstructing and modernizing the farming sector, supplying clean water to reforestation programs, and training personnel in additional skills.

The third answer was the initiation by the government of North Korea of economic policy changes. The state, which was trying to manage both a moribund economy and the transfer of power to a new leader, Kim Jong-il, after the death of his father in 1994, first seemed paralyzed. Observers pointed to the fact that the traditional Confucian period of mourning passed before Kim Jong-il assumed active, public control, which began in 1997–98. A revision of the constitution introduced categories of prices and profits; but only the price and wage reforms of 2002, which were accompanied by new directions for management, made change visible. Throughout this period, private economic activity was also tolerated and in some cases encouraged, most visibly at the new markets.

The reforms neither followed a master plan nor emulated China's (or South Korea's) developmental plan. North Korea's economic policy was driven by the spontaneous forces of its people together with its external environment of hostile relations with capitalist states and, at least initially, alienation from the Chinese model. At the same time, allowing spontaneous movement of people as well as deliberately initiating economic change led not only to intended consequences but also (as all social change does) to unintended consequences: people brought back from China not only food but also information—information about the real economic situation in not only semicapitalist China but also in archrival South Korea. Allowing humanitarian aid also meant media coverage of the situation—including the human rights situation—in North Korea, which had formerly been a mystery to the rest of the world. Large-scale humanitarian aid could also no longer be hidden or labeled “compensation”; the malfunctioning of the economy became obvious and undermined any remaining belief in the ideological system. Establishing markets with semifree prices meant that inflation, which had been repressed, now became visible, as reflected by price increases and, in particular, the free fall of the North Korean *won* compared with the euro and the U.S. dollar. The small quantities of food staples distributed to the public led to further alienation of citizens, particularly in the cities where private plots do not exist.

A host of economic and political measures should guarantee the survival of the system in North Korea. On the one hand, the formerly more-or-less tolerated crossings at the border were stopped, and defectors were hunted down in China.¹² On the other hand, penalties for crossing the border were much reduced, and rampant corruption among border guards reduced the level of enforcement. A foreign currency reform was announced in 2002, and the euro became a new legal tender for use in North Korea although the U.S. dollar as well as the Japanese *yen* are accepted for payment in addition to the euro. Although the government's aim for this reform was probably to regain control over the circulation of foreign currency in North Korea, the reform was never thoroughly

12. China cooperated with North Korea in hunting down defectors; China feared the destabilizing impact of defectors on the North.

implemented and, at least for the normal visitor, both the dollar and the euro as well as the Japanese *yen* are usually accepted.

In sum, the numerous but uncoordinated reform measures relieved some economic burdens and pressures that had been building in the formerly airtight North Korean system, but they built up pressures in other places. Thus, they achieved neither renewed sustainable growth and economic stability for the country nor heightened political stability for its leadership.

Options for North Korea currently are extremely limited. A return to full-scale central planning is certainly impossible. Given the steps backwards discussed above as well as the assiduous affirmations of socialist goals by the country's media, central planning might appear to still be a goal; however, it is impossible for two reasons: Politically it is no longer feasible, because the "survival economy" of the people, largely a subsistence economy, can no longer be confined to state control. Technically, also, it is no longer feasible, because North Korea lacks material preconditions such as cheap energy (in former times, a Soviet gift) and a minimum of exchange on a socialist basis. Fortunately, one can also conclude that the goal of central planning is all but abandoned. After Kim Jong-il's most recent mysterious trip to China, North Korea issued a statement by Kim in which he asserted his most explicit approval of capitalist reforms thus far.

A second option is donor-based survival, namely, a combination of military threats and political advances to lure aid, and maybe even investment, into the country. North Korea has used this strategy successfully during the past decade, with changing focal points like the international donor community (mainly the United States, partly the European Union and other donors) in the mid-1990s and, since 2000, South Korea as well as always closely allied China. However, the nuclear crisis has made this strategy much more complicated. South Korea, the former arch-enemy, can ironically now be called a last resort and

strong pillar of the North Korean political system—South Korea allows North Korea at least partly to overcome the problems mentioned above, namely the unintended side effects caused by opening up to international, monitored aid. Besides political aims, South Korea's calculation of this situation is equally as straightforward as North Korea's: a collapse of North Korea would bring high and uncontrollable costs to the South. South Korean aid also comes at a price, however—one cost is the opening of special economic zones. The North at this time can still easily control the situation—a planned widening of the KIC that will eventually include the employment of hundreds of thousands of North Korean workers—but these plans will certainly have a regime-transforming quality.

President Roh Moo-hyun's idea of a kind of Marshall Plan for North Korea—an initial delivery of 2 million kilowatts of electric power after progress in nuclear dismantlement, costing approximately 7 trillion to 11 trillion South Korean *won* for constructing facilities and creating and transmitting energy; a long-term plan for a comprehensive aid package, including light-water reactors; and a peace proposal—is highly welcome in North Korea although these plans have sparked debate in the South over the wisdom of such generous aid.¹³ North Korea therefore stresses the "one blood and destiny" of both Koreas, against an interfering United States.¹⁴ For now, the strategy seems to be working. Increasingly, North Korea is seen as an important partner instead of a hostile (brother) country.¹⁵

The problem for North Korea is that, in the long run, opening to the South can become even more dangerous for regime survival than an opening to the international community. The possibility of directly comparing living standards and economic and political organizations in both parts of the country will inevitably lead people to what the current leadership of North Korea considers undesirable conclusions. Therefore, rapprochement between the two Koreas is even more limited than opening to other nations; this rapproche-

13. "Debate Brews over Seoul's Expenses for North Korea," *Korea Herald*, 22 September 2005, p. 1.

14. "North Stresses Kinship with South at Meeting," *JoongAng Daily*, 14 December 2005, p. 2.

15. "Warm Feelings Increase for North Korea," *JoongAng Daily*, 23 December 2005, p. 1.

ment works only in the current situation of complete unconditionality, which for now has to some extent been promised by South Korea. How long such a situation will exist in South Korea is highly questionable. A complete and rapid opening appears highly unlikely because it would be a certain recipe for regime change in the North, but a careful further opening is likely. The careful opening would be less a planned and carefully directed process and more a decision to let steam escape to reduce internal pressure. This, however, does not mean that there is no real desire for reform. Certainly, with a guarantee of regime survival, the current North Korean leadership would prefer to be an economically strong country instead of an economically weak one; a liberalized economic environment, however, would present the greatest threat to regime stability. International organizations that seek to be involved in North Korea need to remember this fact: there are positive signs of change in North Korea and an earnest will to learn about development from the experience of others, but there is no will to undertake comprehensive transformation.

Role of the International Community in North Korea's Development

For the time being we must live with a North Korean economic policy that is neither reform oriented nor backwards oriented; it is merely survival oriented. For the international community, this means that strategies of both malign neglect and benign neglect could backfire. If other countries treat North Korea as hostile only and do not offer a way out of the situation (strategy of malign neglect), more tensions will surely follow; and North Korea's military potential, backed by a China that still views North Korea as its close though sometimes annoying ally, could create a lasting zone of instability in Northeast Asia. Many observers therefore favor a strategy of benign neglect. North Korea is not larger than many other poor countries in Africa or Asia, but the attention North Korea gets is certainly out of (economic) proportion. The reason for all this attention is North Korea's military potential, as a trader of weapons as well as a user. Leaving North Korea alone certainly does not work; it would result in Kim Jong-il's stepping up threats and increasing the other time-honored instruments of brinkmanship that Kim has used so well in the past.

When some form of engagement policy is unavoidable, the question of conditionality comes to the fore. North Korea's opposition to conditions related to greater access and monitoring in order to receive aid comes not from the conditions per se, but from the North's lack of trust in international counterparts as well as the potential destabilizing nature of these conditions. To deal with the first problem, international organizations could encourage training as a rational form of engagement while other forms of engagement are off-limits. The necessity for modern training, in the fields of business and economics in particular, is undoubted in North Korea, and training is basically sanctioned from the very center of North Korean politics. Training, inside and outside the country, builds trust and shows clearly the advantages for the people of opening North Korea. In addition, it makes it possible to insist on and teach international rules; for example, rules of transparency in contracts with partners. Training has many advantages for the partner institutions also. Training provides North Korea with personnel able to understand and deal with other nations and, eventually, to trade with other nations. Also, training does not alleviate the burden of reform for North Korea as material aid would. Training prepares the ground for more thorough opening.

Training also can help find the right focus for North Korea. The current emphasis on agriculture, confirmed once again in the 2006 New Year's editorial, cannot solve the long-run problems of the North Korean economy. As an industrialized country without major industries, North Korea must develop its exporting industries, which could easily bring in the money necessary to buy imported food on world markets, for example, from Vietnam and China, instead of farming expensively and inefficiently on the poor home soils. Here, indeed, the focus of humanitarian action has needed correction, but the current North Korean policies also renew this incorrect focus. The KIC could possibly become the seed for export-oriented industries in North Korea.

Although training and other low-key trust-building measures are the only possible way currently available for encouraging reform in North Korea, there is no guarantee that they would work. Therefore, they should not be seen as replacing military and political

preparedness in dealing with North Korea; neither should they be seen as alternatives for the enforcement of international law as far as North Korea is concerned. To the North Korean people, suffering from the economic and human rights situation at home, certainly bolder policy initiatives would seem preferable. To the leadership, continuous crisis has its merits: It justifies the military-first doctrine, it rallies party loyalty around the leadership, and it heightens the threat potential of the North. In such a situation, without leadership change, how larger policy changes are possible is not clear. There is no alternative, however, to the investment in change through training. Training slowly changes the minds; this might permeate the thinking of the leadership of the state, build up trust, and prepare for the possibility of unexpected changes however they are initiated. As such, training is not more expensive but, in reality, cheaper than a more confrontational strategy that would inevitably fail because of the different strategic interests of the surrounding states.

The year 2006 will be an important one for the North Korean economy. North Korea has the potential to move unevenly toward reform, but with the danger of renewed famine looming on the horizon. The rest of the world hopes North Korea's leadership will see the signs, and the international community should encourage it to do so.

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