

Towards a Northeast Asia Security Community: Implications for Korea's Growth and Economic Development

Toward a Northeast Asian Security Community: Implications for the North Korean Economy

by Bradley O. Babson

A Northeast Asia security community that might provide a stable long-term foundation for peace and prosperity in this critically important region is a goal worth pursuing, despite the formidable obstacles that persist. The epicenter of uncertainty is the DPRK's problematic political and economic system that in its current form is geared to isolation and confrontation and not regionalism. For the DPRK to become an integral part of any regional security community, transformative change inside the DPRK will be necessary. Because transformative change is already under way—in an unplanned and unregulated process—the stakes are high as to whether this change will evolve in ways that are compatible or antithetical to enhanced regional cooperation. Engagement with the DPRK with an objective of helping to guide the transformations down a path compatible with regional cooperation and mutual benefit with neighboring countries is a policy worth pursuing, regardless of the priority given to the nuclear proliferation issues that have global, not just regional, significance. This broad agenda of engagement with the DPRK underlies the 19 September 2005 joint agreement negotiated under the auspices of the six-party talks process, which remains valid as a framework to pursue long-term regional security cooperation goals as well as nuclear nonproliferation goals.

This paper explores the implications for the North Korean economy of efforts to build a Northeast Asian security community. The underlying presumption is that, within the context of a regional security architecture, the North Korean economic system could pursue structural reforms that would enable both a large peace dividend to the domestic economy and closer integration with the regional economy and international financial community more broadly. But to maximize the benefits for the DPRK economy that would be possible to achieve would also require difficult changes in the political system and political economy. Resistance to such changes is highly likely and could greatly reduce the potential benefits to the economy of a peace dividend.

These political factors as well as the contours of economic opportunity shape the choices that will need to be made by authorities within the DPRK and by their foreign partners in whatever security and regional economic cooperation arrangements may be considered.

Potential Peace Dividend for the North Korean Economy

There are five broad areas where the North Korean economy could reap the benefits of a peace dividend.

First is a *reduction in the military budget*. Although data are sparse and estimates vary, it is reasonable to believe that the DPRK spends in the neighborhood of 25 percent of its gross national product (GNP) on defense to maintain its conventional forces and deterrence capabilities,¹ and published North Korean annual budget figures put the military share in the 14–15 percent range.² This compares with estimates of about 2.7 percent of gross domestic product (GDP) in South Korea.³ Reducing defense expenditures would allow more resources to be directed to productive economic activities.

Second is the *efficiency gain* that could be achieved through reallocation of resources in the economy and rationalization of pricing with an expanding role for market-based mechanisms. Redeployment of military-owned assets and manpower, integration of the military economy with the people's economy, and price reforms that would more closely reflect market forces could generate significant efficiencies for the North Korean economy. These efficiencies would lift productivity and underpin growth potential.

Third is *stimulation of foreign investment and trade*. A Northeast Asia security community would lower perceptions of risk to investors and trade partners, unleashing potential new capital and trade opportunities and lowering risk premiums for investment. If accompanied by legal and financial sys-

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tem reforms aimed at integrating the DPRK economy with regional and international norms, the DPRK could expect significant new inflows of foreign investment and market openings, principally from South Korea, Japan, and China, but also from the United States, Europe, and Australia.

Fourth is *expanded and better coordinated foreign aid*. Regional security cooperation can also improve the prospects for mobilizing and coordinating development assistance that can support economic reforms and investments that will lead to economic growth and economic integration in the regional economy and international financial system.

Fifth is benefiting from *regional externalities*, where cross-border cooperation can produce benefits to the DPRK economy in, for example, environment, tourism, transport, and energy.

Issues and perspectives related to the challenges to be faced if these potential benefits for the North Korean economy were to be realized, and their implications for discussions of the prospects for a Northeast Asian security framework, are discussed in the following sections.

Reducing Military Expenditures and Redeploying Military Assets and Manpower

Reducing military expenditures and converting to more productive use military assets and manpower are potentially highly significant for the North Korean economy. The estimate of 25 percent of GNP devoted to military use suggests the scope for structural reform is huge in relative terms, even if the DPRK continues to rely on asymmetric strategies to protect its national defense interests. Redeploying such resources would also naturally be a high priority for reducing threat perceptions by other countries in the region, and it can be expected that programs to assist such redeployment, including through retraining and technical assistance for restructuring asset management, would be supported by foreign governments.

Nevertheless, there are important limitations on what can be expected.

First, while the DPRK maintains military forces estimated to be greater one million, soldiers are deployed in agriculture production and in infrastructure construction and maintenance; thus they are contributing to the general economy already.

Second, much of DPRK's military-industrial complex has been experiencing degradation of capital stock for decades, and its conventional military equipment is in poor condition and has little residual value.

Third, some military industries, such as missile production, are foreign exchange earners already for the North Korean economy and could be expected to expand with opportunity for additional investment.

Fourth, some military-owned enterprises, notably in mining, are forming joint ventures with Chinese enterprises or are actively engaged in cross-border trade, but the benefits are accruing to the military, not to the people's economy.

Fifth, corruption in the military, especially along the DPRK-China border, is extracting rents from the people's economy and likely also from the court economy that serves the inner elite circle.

Dilemma of Military-First Politics and the Military Economy

The fragmentation of the North Korean economic and financial system into multiple systems that are neither integrated nor managed under a coherent national policy or regulatory regime militates against redeployment of resources and integrating pricing signals that would lead to large efficiency gains where the role of markets is growing. This fundamental feature of the present economic organization of the DPRK is rooted in the separation of power among the military, the Korean Workers' Party (KWP), and the cabinet. This separation of power reflects the internal political balance that has been struck to maintain support for the regime and has been carefully crafted to maintain Chairman Kim Jong-il's overall control over the country. Military-first politics was adopted as a uniquely North Korean solution to maintaining this balance, by anchoring national cohesion under the constant threats posed by enemies.

If the DPRK were to become part of a Northeast Asian security community, the rationale for this balance of power would become unhinged, as the justification for a military-first politics grounded in the need to maintain national mobilization against highly threatening enemies would be substantially weakened. Thus, a critical choice that would have very significant consequences for the future North Korean economy would be whether a rebalancing of roles among the military, the KWP, and the cabinet would be adopted by the leadership.

If the KWP is given the leading role, as is the case in China and Vietnam, and the military role reduced to subservience to the party, then it is possible to imagine a restructuring of the economic and financial system to reduce fragmentation and bring the national economy under the coherent guidance of the party. (The party is already exercising its dominance over the cabinet.) If such were the case, large economic efficiency gains could be achieved if well-designed economic

policies were put in place to support the system integration process. It would also have consequences for the forms of economic cooperation that the DPRK would pursue with its neighbors, with a closer alignment with policies and institutional arrangements favored by China and weaker alignment with South Korean policies and institutions. This outcome would be highly favorable politically to China, which would actively pursue the goal of fostering a “third jewel in the crown” of successful socialism, rooted in rapid economic growth and stable political control of the Communist Party. For this reason, in such a scenario China would likely make all efforts to support economic restructuring leading to sustained high growth and poverty reduction in the DPRK, buttressed and legitimized by the Northeast Asia security community cooperation arrangements.

If, however, entrenched interests in the North Korean military are unwilling to relinquish the privileges and direct control over enterprises, manpower, and finances they now possess, the prospect of rational integration of the fragmented DPRK economy would be much reduced. Competition for access to new potential sources of income from economic opportunities that might be forthcoming under a Northeast Asian security community could be a source of potential added instability within the DPRK political system and political economy. In this scenario, the military would likely concentrate on rationalizing its use of assets and manpower within its own sphere of control, and a mixture of bargaining with the KWP and cabinet from a position of strength and seeking rents through both accepted and corrupt practices could be expected. Such a situation would pose complications for economic relations with neighboring countries that might be put in a position of making choices among competing North Korean economic partners and contending with unfettered corruption. It is also possible that the military would aggressively expand military industries for overseas sales that are legal under international law and that it would use the umbrella of the Northeast Asia security community to refocus prestige and resources on such military equipment sales as the rationale for maintaining independent power and a place in the regional security system.

Implications for Expanded Investment and Trade

Apart from the issues surrounding the internal structures of the DPRK economic system that would surface in considering the impact of a Northeast Asia security community on the North Korean economy, any peace regime and regional security framework would greatly enhance the prospects for mobilization of investment in the DPRK and expanded trade. Investment quality as well as quantity could be enhanced, as technologies now closed to the DPRK under sanctions and dual-use policies would likely become available. This would open new areas for potential economic development

and productivity gains. Trade with neighboring countries could also be expected to expand significantly if the DPRK were to adopt an outward-oriented economic development strategy that would become politically feasible under the umbrella of a regional security cooperation framework.

Economic Relations with South Korea

Inter-Korean economic relations have expanded significantly since the 2000 summit, despite ups and downs in the nuclear negotiations and bilateral political relations. Establishment of a Northeast Asian security community could be expected to create an environment that would encourage further expansion of South Korean investment in the DPRK and trade at a much larger scale. Plans already on the books for phased expansion of the Kaesong industrial zone and development of other such zones would likely figure prominently in this situation, with South Korean investment creating for North Koreans a large number of industrial jobs that would serve as one mechanism to absorb labor from the reduction of the North Korean military forces.

The mutual political as well as economic benefits from such a coordinated strategy to support the redeployment of North Korean military manpower with high-value investment and jobs could be expected to become a major feature of the bilateral relationship. This would likely be accompanied by sustained economic and humanitarian aid flows from South Korea to the DPRK to support food security and advance South Korean interests. In addition, the inter-Korean economic relationship could expand to embrace joint projects to develop and environmentally protect the Demilitarized Zone (DMZ) and other cross-border shared resources as symbols of commitment to cooperation for activities of mutual benefit and Korean aspirations for eventual unification. The DMZ can be expected to remain, however, as a firewall between the two societies as long as South Korea pursues a policy of gradually leveling the economic gap between the two countries before seeking to achieve political and institutional unification objectives (which could in the end be unattainable for the foreseeable future if the evolution of the political system aligns more tightly with communist China rather than democratic South Korea).

Economic Relations with China

China’s trade with the DPRK has been growing steadily, and the composition of this trade differs significantly from inter-Korean trade. China’s demand for raw materials to feed the construction boom in the northeast provinces is exerting a commercially based incentive for this expansion in economic relations, and government policy aims to reinforce the growth of market mechanisms in the DPRK through cross-border trade and enterprise-based economic

relationships. Aid plays a minor role compared with the inter-Korean economic relationship. Chinese investment in the DPRK has also been growing, but warily. Informal barter trade, smuggling, corruption, and refugee crossings, which have both negative and positive consequences for the North Korean economy, also permeate the China-DPRK relationship.⁴

The China-DPRK economic relationship can be expected to continue to grow with or without the development of a Northeast Asian security community. What would be different is the potential for improving the quantity and quality of Chinese investment in the DPRK that could reinforce economic system restructuring and investments that would produce more domestic value added in North Korean exports to China. Economic growth that is broadly based in the DPRK would reduce pressures on cross-border refugee flows, and China could be expected to pursue a coordinated policy of improving human security within the DPRK while benefiting from trade. A regional security framework would also foster cross-border transport cooperation, notably access to the Najin port in the DPRK, giving landlocked provinces of eastern China long-sought access to the sea. Such expanded port operations would directly benefit the DPRK economy.

Economic Relations with Japan

Japan's participation in a Northeast Asia security community that includes the DPRK would require improvement in bilateral relations. If this occurs, the potential impact on the DPRK economy of Japanese trade, aid, and investment could be substantial. Normalization of relations would be accompanied by a package of financial benefits to the DPRK that, if implemented in the context of the regional security cooperation, would allow the DPRK to accelerate its economic transformation and make investments in industries exporting to the Japanese market as well as open the door to tourism and remittances from Japan that could be significant long-term sources of foreign exchange.

Economic Relations with Russia

Bilateral trade and investment in the DPRK-Russian relationship are minimal at present and would not likely expand much under a regional security cooperation arrangement. What would make a significant impact on the DPRK economy would be Russia's participation in regional energy and transport projects that could move forward after such a framework for cooperation is established. Russia is keenly interested in upgrading the rail connections between South Korea and the Russian network to promote land-based trade with Europe, and the DPRK economy could benefit from this. Recent reports suggest that Russia is already investing in upgrading the rail link of 54 kilometers from Khasan to

the North Korean report of Najin.⁵ Similarly, potential benefits of cross-border gas and oil pipeline projects and trade in power have been discussed for many years and are now actively being pursued by Russia and South Korea. These could reduce the DPRK's dependence on refined petroleum imports from China and improve its energy security through participation in such regional initiatives based on Russian oil and gas reserves. But these projects face many challenges above and beyond the necessary but not sufficient condition of functioning regional security cooperation.⁶

Economic Relations with Countries outside the Northeast Asia Region

Beyond opening prospects for new dynamics in the DPRK's economic relations with neighboring countries, movement toward establishing a Northeast Asia security community would improve the environment for investment and trade with countries outside the region, including the United States, Europe, Australia, and ASEAN. Such expanded economic relations would benefit the DPRK economy through diversification of export markets and sources of technology transfer and investment. Removal of sanctions would contribute to this process as well as to efforts on the part of the DPRK to move toward adopting international accepted standards of transparency and rules-based financial and legal systems in its international economic relations.

Security Cooperation and Foreign Aid

Foreign aid falls into three broad categories: humanitarian, development, and political. Humanitarian and development assistance have well-defined internationally accepted principles and modalities. Political aid is tied to specific objectives of the provider. In the case of the DPRK, the boundaries between political aid and humanitarian and development assistance have been blurred in both bilateral and multilateral forms. Because the DPRK economy is vulnerable in food security, energy security, and financial security, international efforts to entice through aid or force through sanctions to move the DPRK in politically desirable directions have tended to focus on food, energy, and foreign exchange. For these reasons, any future Northeast Asian security community that responds to the needs of the DPRK will have to address all three areas of economic security as well as political and military security perspectives. To have the most benefit for the DPRK economy, aid should be based on internationally accepted best practices and be coherent, transparent, and results oriented. The potential benefit of a regional security cooperation framework is that coordination of aid policies and modalities for delivery would be more likely than at present.

The six-party talks working group on energy and development assistance provides a starting point for regional cooperation and coherence in aid policies linked to political and security issues. But the experience of the working group mechanism also raises caveats. Technical expertise must be integrated in the political aid planning if it is to produce economically rational results and incorporate international best practice principles of humanitarian and development assistance. Also, aid linked to political processes is subject to fits and starts that are not related to an economic logic or practicalities of implementation. Thus an economic aid dimension of a future regional security cooperation arrangement should be designed to produce benefits to the DPRK economy that are aligned with shared security objectives and provided in ways that are operationally efficient and reinforce cooperation in achievement of the desired results.

Foreign aid linked to an economic system reform process and efforts to increase trade and private investment with neighboring countries could result in high economic growth and rapid integration of the DPRK economy in the international system. To achieve this outcome would require a high level of trust and commitment to managed transformative engagement on the part of both the DPRK leadership and the international community. Even if such trust and commitment were to be forthcoming, coordination of aid policies and delivery would be a huge challenge, and mechanisms would need to be put in place to do this, both within the DPRK government and by the international community. A Northeast Asia security cooperation arrangement would be an important, but insufficient, underpinning of such an economic development path for the DPRK. Complementary institutional mechanisms for managing the economic transformation process would be needed.

Potential Regional Externalities

Regional economic cooperation among South Korea, China, Japan, and Russia could spill over into the DPRK economy. Under the auspices of the Tumen River Initiative and the Economic Research Institute for Northeast Asia, numerous studies and workshops exploring the potential benefits of coordinated investments in regional transport, energy, tourism, and environmental management have been conducted since the mid-1990s. A Northeast Asia security community would stimulate renewed efforts to design regional economic cooperation projects that would require long-term commitments and legal and financial frameworks that would bind the interests of participating countries, much the same as has been achieved in Europe. Energy security would be a high priority for all the countries, given the high dependence on foreign energy of South Korea as well as Japan and China's rapidly expanding demand.

Apart from the potential for infrastructure investment in the DPRK that would accompany regionally motivated projects in transport and energy, the DPRK economy could benefit from technology transfers and employment for operation and maintenance as well as from transit fees for freight, oil, and gas that might pass over North Korean territory. Although there are risks associated with such regional economic cooperation ventures, they can contribute to the security architecture by providing incentives for continued cooperation through mutual benefits that come from shared commitments. Deepening economic interdependence can have an important impact on maintenance of regional security.

Lack of trust inside the DPRK has been one major factor inhibiting progress on investments in regional infrastructure, particularly in rail and energy links between South Korea and Russia and China. Overcoming this distrust would be a critical challenge for the DPRK leadership in participating in a Northeast Asia security community. The DPRK's desire for guarantees of its own security will need to be accompanied by DPRK guarantees on the risks faced by investors and neighboring countries if the benefits of regional economic cooperation are going to be realized.

Peaceful Evolution of the North Korean Economy

Ideological as well as pragmatic political economy considerations make the idea of a rapid transformation of the DPRK political and economic system unlikely under a scenario of peaceful negotiated development of a Northeast Asian security community. The *juche* philosophy of self-reliance that has underpinned the North Korean preference for isolation instead of regional collaboration remains an obstacle. However, both the pragmatic economic self-interest and the security enhancement that would be served by participation in a regional security arrangement would be strong incentives to find ideological rationales that would be consistent with a shift to a more outward orientation. Both China and Vietnam have managed to pursue creative ideological reinterpretations of communist dogma to support their successful processes of expanding economic relations with the international community and pursuing development of market economies despite overhangs of past ideological preferences. Expanded trade and investment relations with outside countries has been endorsed by senior North Korean officials in recent years, which suggests that such creative ideological reinterpretation is possible in the DPRK as well.

Within a peaceful managed transformation process, the idea of a peace dividend for the DPRK economy can best be understood not as a one-time, fixed-value economic boost but

instead as a series of sequenced economic dividends that are potentially possible. As the DPRK leadership takes decisions relating to political system and economic system change that can take advantage of new external political and security realities; domestic stakeholder interests; and expanded aid, trade, and investment possibilities with neighboring countries and the international community more widely, it will also be necessary to build new financial and economic institutional capacities to implement these decisions and take advantage of opportunities. Even under the most optimistic scenario, this will be difficult and will take time.

If the DPRK moves down this path of incremental sequenced economic dividends from a peaceful evolution process, the involvement of the international financial institutions (IFIs) and UN development agencies could potentially be of significant help to the DPRK. Joining the IFIs in particular would help accelerate integration into the global internal financial system as well as the Northeast Asia regional economy.⁷ Objective policy advice and technical assistance for capacity building can facilitate and accelerate the reform agenda and process. In addition to mobilizing financial resources through their own mechanisms, the IFIs and UN development agencies can mobilize finance for catalytic investments from their resources and leverage the resources that can be made available by other donors through aid coordination mechanisms and application of best practice economic development principles that are now well established in the international community. Establishment of transparent and well-designed IFI and UN programs of assistance for the DPRK would also support confidence building and lower risk perceptions by private investors and trading partners and contribute to the realization of the economic dividends for the DPRK.

Conclusions

If the goals of the DPRK are maintaining its national sovereignty and pursuing economic development, it would be greatly in the DPRK's interests to reform its political and economic system to improve productivity and attract foreign capital and to build export-oriented economic relations with all of its neighboring countries. Each provides different opportunities and potential, and, by expanding and diversifying its external economic relationships, the DPRK could pursue a policy of regional integration while protecting its national identity and interests without becoming overly dependent on any of its principal neighbors. A Northeast Asia regional security cooperation architecture could be designed to provide a crucial underpinning for such a vision of the DPRK's future and support for the necessary transition from an inward-oriented economic system to an outward-oriented one. It is hard to imagine how a regional security cooperation arrangement could in fact succeed unless the DPRK is

willing to undertake the critical transformations required to participate and benefit from genuine regionalism.

The commitments and actions that would be required are daunting, however, and in the current environment hardly plausible. Thus the process of moving international dialogue and engagement toward the creation of a Northeast Asian security community should consider how to shape incentives and mechanisms that would encourage the DPRK to develop the courage, trust, and commitment to take bold steps and make the necessary policy and system adjustments in its own long-term national interest.

A Northeast Asian security community would necessarily embrace a much broader scope of objectives than dealing with the DPRK's issues, critical as they are, and to some extent the DPRK tail should not wag the Northeast Asia dog given the larger security concerns at stake. But a regional security solution that does not resolve the fundamental misalignment of the DPRK political and economic system with the rest of the region and address the DPRK's long-term viability as a sovereign nation is not likely to be satisfying to the countries of the region, not the least of which is the DPRK itself.

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Endnotes

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