

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

Features of a Peace Dividend for the Two Koreas

by Paul Chamberlin

Introduction

Can you imagine peace on the Korean peninsula? As difficult as it may be, this goal to end hostilities between the southern Republic of Korea (ROK) and the northern Democratic People's Republic of Korea (DPRK) has been a stated goal of the "six parties"—China, Japan, North Korea, South Korea, Russia, and the United States—since September 2005.¹ The potential for peace on the Korean peninsula implies the subsequent emergence of a "peace dividend" for the two Koreas, which is the subject of this paper.

Peace Dividend

Imagining a peace mechanism and peace dividend for a persistent, unresolved war that some believe ended over a half century ago requires us to define certain terms and make certain assumptions. Let us define a peace dividend as "an amount of money taken from a defense budget and appropriated elsewhere in times of peace when less money is required for defense than in times of hostility or war."²

This paper rests on three major assumptions: One, North Korea will become a verifiable nonnuclear weapons state as a result of the six-party process. Two, the six-party process will produce a peace mechanism that will include arms control and confidence-building measures to eliminate Korean security concerns about inter-Korean aggression. Inevitably, the peace mechanism should include verification procedures to assure compliance with the terms of the agreement. Historically, developing verification procedures with North Korea has been problematic. Three, the peace mechanism will resolve the so-called Korea question that emerged in the late 1940s regarding who among Koreans would govern Koreans. This question became more acute after southern and northern Koreans declared the existence of the ROK and DPRK in August and September 1948, respectively.

To resolve the Korea question by force, the North Korean People's Army (KPA) invaded South Korea in June 1950, launching the Korean War and a strong international response that assured the survival of South Korea. An armistice agreement ended Korean War combat operations in July 1953. In the intervening half century, however, no progress has been achieved in resolving the fundamental Korea question. Thus, Koreans have harbored anxiety about when a second Korean War might break out to achieve unification by force. Resolution of this Korea question is the last impediment to ending the armistice agreement.³

What remains to be determined is how much the assumed peace mechanism will assuage Korean concerns about foreign aggression by surrounding powers—China, Russia, Japan, and the United States—and thus inspire their willingness to divert significant funds for a peace dividend.

A peace dividend ought to promote prosperity. This goal is as easy to envision for South Korea as it is difficult to anticipate for North Korea unless Pyongyang first revises its socialist system, governing principles, and national priorities. The chairman of North Korea's National Defense Committee, Kim Jong-il, promised to transform North Korea into a "strong and prosperous country" in the late 1990s. Today, North Korea's military strength is arguable, but its poverty is not. Estimated per capita income in 2007 was a relatively meager \$1,700 compared with South Korea's \$25,000.⁴ Can North Korea's power elite afford to implement changes that will make North Korea prosperous?

Summary of Key Findings

- Both Koreas face significant social needs that could benefit from a peace dividend.
- Seoul will find it easier to apply a peace dividend than Pyongyang unless it first implements reforms to alleviate major systemic shortcomings and a vicious circle.

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- Foreign entities can greatly help Pyongyang if it agrees to implement major reforms.
- The size of a peace dividend will reflect how much confidence Koreans place in it to assuage security concerns that date from long before national division in 1945.

In examining the features of a peace dividend for the two Koreas, national needs that might benefit from a peace dividend are reviewed first. Then the next section addresses potential features of such a dividend, some additional thoughts to help manage expectations, and implications for U.S. Forces Korea (USFK).

National Needs

Like other countries, each Korea shares with the other a primary need to assure its national survival. This is nothing that Koreans take for granted. Throughout Korea's 4,000-year history, the surrounding powers have sought to control the Korean homeland, as the Korean peninsula is the strategic crossroads of East Asia. Koreans count 930 invasions or attacks, mostly from Japan and continental powers (primarily China). Mathematically, this averages to approximately one notable act of foreign aggression every five years. Some years were much worse than others.

Tokyo's wars to control the Korean peninsula in the late nineteenth and early twentieth centuries had the most traumatic

consequences for modern Koreans. Japan's aggression led to the end of unified Korea's sovereignty in 1910 and the beginning of harsh colonization. Liberation in 1945 ended unified Korea for the first time since the seventh century. Tragically, it also produced the two competing Koreas that exist today.

The two Koreas pursued different strategies to assure their national security and achieve other national goals. Seoul looked outward; Pyongyang looked inward.

Recognizing its relatively small national power compared with such traditional threats as China and Japan, Seoul has nurtured its alliance with the United States to deter foreign aggression.⁵ Seoul also embraced democracy, market economics, and trade. This strategy ultimately enabled South Korea to transform itself from one of the world's poorest nations in the 1950s to a modern, prosperous democracy.

North Korea in contrast accepted authoritarian socialist principles while developing its problematic *juche* philosophy and a military-first policy to avoid having to rely on traditional threats for its national security.

These different strategies produced vastly different needs. Before reviewing them, let's consider some basic demographic information in *Figures 1, 2, and 3*.⁶

Figure 1: ROK & DPRK Fertility Rates

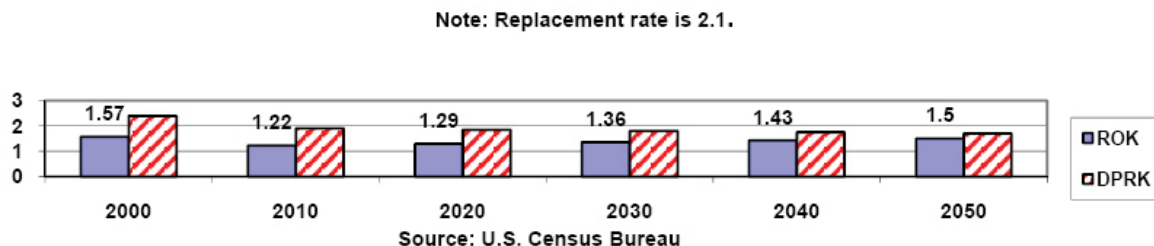


Figure 2: ROK & DPRK Lifespans

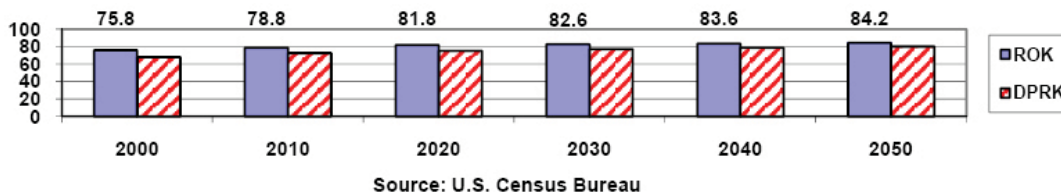
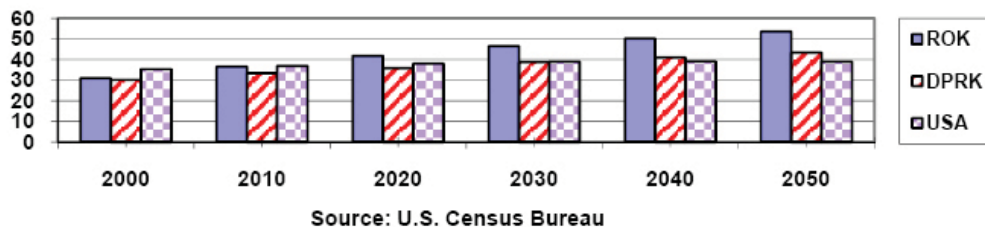


Figure 3: Median Ages - ROK, DPRK, USA



Needs of the ROK

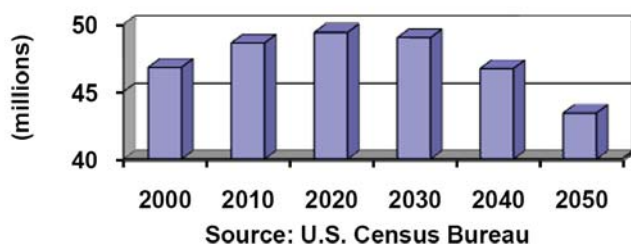
South Korea is a democratic, advanced industrial country and member of the Organization for Economic Cooperation and Development (OECD). Its gross domestic product (GDP) regularly numbers among the top dozen in the world. Having made the transition from the agricultural age to the industrial age in the late twentieth century, South Korea is now in transition to becoming a knowledge age society.⁷

South Koreans manage their social system in accordance with proven democratic and market economy concepts. In such an open, dynamic society, a lack of consensus on certain national spending priorities is quite natural. The question of how much to spend on a social safety net, including elder care, for example, is not unique to South Koreans. Another likely topic for debate is a reduction in military spending.

Social safety net. Seoul has a “minimal social safety net” for its people.⁸ Although the government budget for the social safety net increased from 19.9 percent of the budget in 2002 to 27.9 percent in 2006, it still features an “underdeveloped social insurance system, an antiquated social welfare service sector, and extremely low levels of public social expenditure relative to that of other OECD countries.”⁹ In 2007, Seoul spent a relatively small 6 percent of GDP on public social spending; the OECD average was 21 percent.¹⁰ In part, the ROK budget allocation reflects Korea’s Confucian traditions that expect family members to take care of one another, especially of the elderly.

The problem is that modernization has profoundly transformed traditional large, extended families living in rural areas to nuclear families living in urban areas. South Koreans are not having enough babies to replace themselves and to care for the elders, who are living longer than in traditional times. Moreover, the median age is rapidly rising, producing a declining population (*Figure 4*) and potential workforce problems.¹¹

Figure 4: Total Population



Elder care. Elder care is becoming a major concern for South Koreans. By 2050, more than one in three Koreans (38 percent) will be classified as “elderly,” making Korea’s

population one of the oldest on earth. Korea’s low fertility rate means that each elder will have far fewer adult children to act as caregivers than was historically the case. To fill the gap, Koreans are building private-sector elder-care facilities, which are likely to be increasingly expensive to use. Koreans will probably struggle financially to care for their parents in these private facilities. This struggle is expected to degrade individual savings and national financial resources.¹² Consequently, we should expect the electorate to insist on more government spending to offset elder-care costs while businesses seek to cope with an aging workforce.¹³

Military force structure. Seoul spends about 2.7 percent of GDP on its military,¹⁴ which comprised 681,000 personnel in 2005.¹⁵ Mindful of demographic trend projections and the usefulness of technology to achieve important combat force multipliers, the government developed the “Defense Reform 2020” plan in 2005. One of its key goals is to transform a 681,000 “manpower-intensive and conventional force structure into a technology-intensive and qualitatively advanced force structure,” comprising about 500,000 personnel.¹⁶ A peace mechanism will prompt a reassessment of forces to protect Korea in a new security environment.

A peace mechanism will likely prompt a national debate among South Koreans on how much to reduce defense spending and apply to the social safety net.

Needs of the DPRK

North Koreans, in contrast, face chronic problems that stem from a siege mentality, dysfunctional socialist principles, a unique *juche* ideology, and a military-first policy, all of which combine to impede healthy national development and prosperity. North Korea is one of the world’s most centrally directed and least open economies. Its core principles are an anachronism in the modern, highly interdependent world. The North Korean system does not work for the common good. Thus, North Korea has many more needs than South Korea.

Perpetuating *juche* is likely to be one of these needs. *Juche* constitutes one of North Korea’s epic myths regarding its place in the universe. It also provides the fundamental legitimacy of the Kim Il-sung dynasty. Although *juche* is literally defined as “self-reliance,” in practice it is a governing philosophy and core of a type of state religion. As a governing philosophy, it comprises three parts: leader, party, and people. The leader controls the people through the party. *Juche* highlights the primacy of the Korean Workers’ Party (KWP) over any other institution below the leader. Principal organizations within the KWP are the Central Committee and its Organization Guidance Bureau. The military is

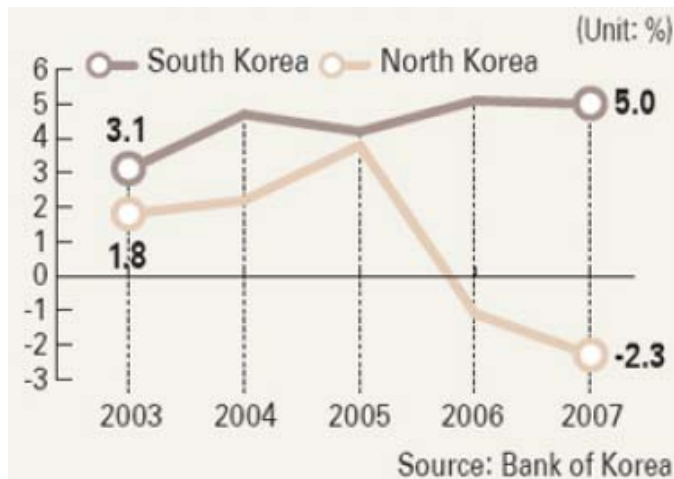
subordinate to this structure. As a religion, *juche* comprises a trinity with the late Kim Il-sung as the infallible father and now “eternal president” under the 1998 constitution, Kim Jong-il as the infallible son, and the *juche* ideology as the “holy spirit.”¹⁷

A modern hermit kingdom, North Korea does not routinely provide verifiable information about political, social, and economic topics that most other countries provide to the United Nations and other international organizations. Thus, foreigners rely on a range of other sources with varying degrees of accuracy.

One trustworthy source is the [South] Korea Institute for International Economic Policy (KIEP), which has reported comprehensively on North Korean political-economic topics. KIEP published its most recent development report on North Korea in July 2004. Although much has probably changed on the fringes since then, interim reporting by the *Economist* magazine and other credible observers indicates that the core findings of KIEP’s 2004 report are reasonably reliable for the purposes of this paper.

On balance, significant shortcomings in North Korea’s social system, infrastructure, and major economic sectors imply that the fundamental system does not work. The military-first policy has produced lopsided emphasis on military spending and heavy industry, which prevents healthy economic development (see *Figure 5*). Rampant malnutrition and poor economic performance drive the point further home.

Figure 5: Rates of Economic Growth for North and South Korea



Some of many needs that could benefit from a peace dividend are social security and welfare, national infrastructure, agriculture, civilian¹⁸ and defense industry, and military forces that could be subject to a reduction in force.

Social security and welfare services. The North Korean system is not meeting its constitutional responsibilities to assure “. . .the rights and duties of citizens are based on the collectivist principle, ‘One for all and all for one.’”¹⁹ For example, the socialist government does not provide all citizens with adequate food, medical care, employment, and “other social security systems.”²⁰

The implied equality of the collectivist principle is skewed by the existence of a highly stratified social system. The government has put each citizen into 1 of about 50 different groups based on that person’s socioeconomic class background, that is, *songbun*. Some students at North Korea’s Kim Il-sung University humorously divide these many groups into three larger categories that they call tomatoes, apples, and grapes. Tomatoes, which are red (communist) to the core, make up about 30 percent of the population. Apples are red only on the outside but are considered to be relatively loyal, despite the need for “ideological improvement.” Apples make up about 40 percent of the population. At the bottom of the barrel are the “grapes,” which are considered to be “hopeless.” Education, employment, and social services are provided in consideration of one’s *songbun*.²¹ Upward mobility is not the norm.

Food shortages are a chronic problem. Resolving the food shortage has been a top priority throughout North Korea’s history.²² The scope of the problem came to a head in the mid-1990s when up to about one million North Koreans reportedly died of famine and malnutrition.²³ The United Nations and others provided extensive assistance, but problems persist. In 2008, North Korea’s “agricultural sector contracted 9.6 percent.”²⁴

North Korea continues “to suffer chronic food insecurity, high malnutrition rates and economic problems, and remains reliant on external food assistance to meet the needs of its 23 million people,” according to the UN World Food Program in September 2008.²⁵ Earlier in 2008, Yoonok Chang, Stephan Haggard, and Marcus Noland conducted a survey of 1,300 North Koreans and concluded that about “23 percent of men and 37 percent of women say family members died of hunger.”²⁶

Those with particular dietary requirements—for example, the elderly, pregnant and nursing women, and young children—are especially vulnerable to food shortages and malnutrition.²⁷ A UN assessment found “stunting rates at 37 percent, underweight at 23 percent and wasting at 7 percent among children under 6. Maternal [anemia] was around 35 percent.”²⁸ Declining economic performance since 2005 suggests that these problems probably persist.

In October 2008, the well-known observers of North Korea's political economy Stephen Haggard and Marcus Noiland concluded, "North Korea has experienced an intensification of long-standing problems of malnutrition and hunger-related deaths. Moreover, the lack of fertilizer and the consequent possibility of a weak fall harvest in 2008, continuing constraints on commercial imports, and the vacillating policy response of the government will carry the emergency into 2009 if not beyond."²⁹

Medical care is wholly inadequate. In early 2007 the World Health Organization reported: "The economic downturn has led to the erosion of DPR Korea's extensive health-care infrastructure. There are serious shortages of essential drugs and vaccines as well as essential medical diagnostic equipment and surgical supplies."³⁰ Blaming all of these problems exclusively on the economic downturn may be too simplistic an explanation for what appears to be systemic shortcomings.

Since December 2007, the Canadian government warns travelers to North Korea: "Medical facilities are primitive. Hospitals often lack heat and medicine and suffer from frequent power outages."³¹

These views complement KIEP's bleak assessment in 2004: North Korea's "medical security system . . . has been all but demolished, because of the collapse of the supply system for medical equipment and drugs as well as the doctor-district assignment system. . . ."³² Associated problems include inadequate medical resources, inadequate funding, and a highly bureaucratic, nationalized medical system that cannot meet local needs nationwide.³³

The public assistance system, including food distribution, falls short of meeting public needs. Two problems are that the system provides assistance on a preferential basis and it depends on government funding, which is problematic.³⁴ Extensive malnutrition among nonelite North Koreans eloquently demonstrates systemic shortfalls in the public assistance system.

Employment and wages are problematic. As noted, per capita income is estimated at only \$1,700, which is less than 7 percent of South Korea's per capita income.

Infrastructure. Problems persist in the national infrastructure as well as in such sectors as agriculture, manufacturing, and defense industries.

Electricity production and distribution are inadequate (*Figure 6*). Frequent, extended blackouts are common.³⁵ North Korea uses a roughly equal mix of thermal and hydroelectric plants to generate electricity, but this diversification has

failed to meet national needs. Some reasons for this poor performance are lack of fuel for thermal plants and antiquated hydroelectric plants that had an operational rate of only 20 percent in 2004. Many of the hydroelectric plants were built before 1945, and some have been non-operational since 1996.³⁶ Moreover, the transmission grid is antiquated and inefficient.³⁷ Associated problems include the lack of energy product markets and "suppressed / latent demand for energy services."³⁸

Figure 6: North Korea at Night



Railroads require significant attention, as they are North Korea's primary transportation system and also connect to the Chinese and Russian railroad systems, which is important for trade. North Korea's railways span the country with about 5,235 kilometers (3,253 miles) of track.³⁹ More than 80 percent of North Korea's trains are electrified, which is problematic given North Korea's electricity problems. The rail system moves 90 percent of North Korea's freight and 60 percent of the population; however, trains operate at low speeds because of aged locomotives and low-quality track.⁴⁰

Roads and highways also require attention. Most of North Korea's roads were built during the period of Japanese colonization (1910–45). The Japanese destroyed or seriously damaged many of the roads when they left in 1945. Others were damaged during the Korean War. Although Kim Il-sung⁴¹ talked about the importance of building a good road infrastructure,⁴² less than 3 percent of North Korea's 25,554 kilometers of roads were paved in 1996. This reluctance to improve roads reflects KPA concerns about an aggressor using an improved road infrastructure to wage war against North Korea.⁴³ Virtually no roads cross the Demilitarized Zone (DMZ).

North Korean ports cannot efficiently handle modern ships. North Korea has 8 trade ports, 40 fishery ports, and 5 pelag-

ic marine base harbors. Most port facilities are old, with a usage rate of only 3 percent in 2004. By comparison, the usage rate of railroads was 90 percent and that of roads was 7 percent. The ports need to be modernized (and deepened) to accommodate large transport vessels and their cargo, which is often in containers.⁴⁴

Agriculture. The agriculture sector is rife with difficulties, as demonstrated by its chronic inability to feed the population. Between 1991 and 2004, the average annual yield was approximately 3.5 million tons, which is well below the estimated annual requirement of about 6.25 million tons.⁴⁵ In 2008, North Korea remained unable to overcome its historic inability to feed its people. The “. . . [UN Food and Agricultural Organization] projected that the country will suffer a cereals deficit of 1.66 million [metric tons] in 2008—the largest deficit since 2001.”⁴⁶

The core of the problem does not seem to be the weather, as North Koreans routinely claim. North Korea’s chronic failure seems to be rooted in the inadequacy of socialist and *juche* concepts to meet national needs, especially in light of the amount and quality of arable land, the climate, the need for fertilizer, energy shortages that affect the use of farm and food distribution equipment, and few incentives for farmers to be more efficient. Collectivization and centralized planning ignore the efficacy of modern agricultural methods.

Industrial sector. The industrial sector, with its emphasis on heavy and defense industries to achieve self-reliance per the *juche* ideology, reveals more systemic shortcomings. Kim Jong-il officially came to power in 1998 and launched a new policy to build a great and prosperous country (*Kang-sungdaeguk*). The policy called for investments in “agriculture, coal mining, electricity, rail transport and metals.”⁴⁷ Just as problems persist in the agriculture, electricity, and transportation sectors, they are also evident in heavy and chemical industries.

In the civilian sector of the country, North Korea’s fundamental problem is its very structure, which reflects socialist and *juche* ideological shortcomings. Heavy and chemical industries constitute the heart of the sector, but they are not competitive. Compounding the problem is an undeveloped light-industry sector. KIEP diagnosed North Korea’s industrial problem in 2004:

It is not just a certain industry or sector that has fallen behind, but the entire industrial cycle is riddled with problems. The problems include the dual structure of military and civilian industries, the relationship between heavy and light industries, and the relationship between upstream and downstream industries. For ex-

ample, because of a shortage of raw and subsidiary materials, the textile industry is failing to achieve regular production. In addition, the chemical fiber factories that require vast amounts of electricity to inefficiently produce vinylon have lowered their utilization rates because of the stagnant coal sector and the resulting energy shortage. Meanwhile, the mining sector, which is suffering from worsened mining conditions and a lack of equipment and materials, is unlikely to see a recovery in the short term. In addition, the food and necessities shortage is making it difficult to recruit labor in the mining sector and has caused production to fall even lower. Because the economy’s problems are interconnected in this way, it is difficult to improve the situation simply by focusing human resources on a certain sector. Even if the energy situation is improved, the raw materials shortage would continue in the textile industry if the synthetic fiber factories fail to reform their inefficient production system.⁴⁸

In September 2008, the *Economist* magazine confirmed the accuracy of KIEP’s 2004 assessment. It reported: “The factories of the command economy have ground to a halt: fuel and other inputs are too expensive to run them, and workers often go unpaid. Frequently, it is not just a factory’s output that its managers have sold on the black market but all its plant and equipment too, leaving a shell.”⁴⁹

These assessments inspire no confidence that North Korea’s socialist and *juche* concepts can guide the development of a productive industrial sector.

It is in the defense industrial sector that the emphasis that *juche* places on self-reliance is particularly evident: “. . . [N]o other country of equivalent size [had] such an extensive and complete defense production capability,” according to the U.S. Defense Intelligence Agency in 1991.⁵⁰ Since then, North Korea has developed a variety of long-range ballistic missiles, a nuclear device that it tested in October 2006, and presumably some nuclear warheads.

The defense budget has routinely been estimated to comprise 20–30 percent of the total government budget. In 2004, North Korea’s defense industry appeared to comprise more than 50 percent of the total economy and about 30 percent of North Korea’s total annual production.⁵¹ Military expenditures were estimated at more than 30 percent of gross national income.⁵²

This single-minded military focus has come at a high price. North Korea remains a poor country with per capita income of only about \$1,700, which is well short of South Korea's \$25,000.⁵³ North Korea's poor economic performance and relative poverty belie the government's notion that heavy industrial development improves other industries and the quality of life for ordinary people.⁵⁴

North Korea is in a vicious circle with its persistent commitment to the defense sector while it ignores or does not comprehend the consequences for the overall economy and the implications for national security. The extent to which bureaucratic politics affect the government's lopsided priorities is presumably quite high, given the military-first policy.

Military reduction in force. The KPA—which includes the air force and navy—is the world's fourth-largest force, with approximately 1.2 million active-duty personnel.⁵⁵ It also has approximately 7.7 million reserves.⁵⁶ To deploy and sustain this force, Pyongyang may spend about 25 percent of its GDP.⁵⁷

Theoretically, a peace dividend would see a dramatic reduction in this force. After World War II, for example, the United States slashed defense spending from \$90 billion in 1945 to \$10 billion in 1947.⁵⁸ By 1947, it had reduced its 12-million-strong force to about 1 million men and women.⁵⁹ The demobilized soldiers, sailors, airmen, and marines encountered essentially no difficulties in finding jobs in different industries that were surging to meet postwar needs.

North Korea's situation is dramatically different owing to a weak economy that cannot absorb so many job seekers. Thus, improving the general economy should be the top priority before reducing the force.

Systemic reforms. Kim Jong-il launched some economic reforms in July 2002. The goal was to adjust certain aspects of North Korea's socialist system, not to abandon it. Key measures pertained to the rationing system and approval for citizens to establish markets and other trading centers.⁶⁰

Five years later, however, Kim Jong-il expressed concern about some of the measures. On 26 August 2007, he announced, ". . . markets have become anti-socialist, Western-style markets." By the end of 2007, authorities were cracking down on many aspects of how North Koreans were implementing the 2002 reforms. The apparent objective was to "control the development of a market economy."⁶¹

Thus, North Korea's system, governing principles, and practices require major reform before the government can seriously consider implementing the measures that one nor-

mally associates with a peace dividend—including, for example, a major military reduction in force.

Potential Features of a Peace Dividend

A peace dividend could help each Korea address a number of national needs. The two countries could not do so equally, however, because of profound differences in their political, social, and economic systems.

Another key factor affecting a potential peace dividend is the extent to which a peace mechanism will assuage Korean concerns about future attacks from traditional aggressors, especially China and Japan. Because of Pyongyang's propaganda, some North Koreans might also worry about U.S. aggression, which makes it important for the United States to ameliorate North Korean anxieties as circumstances warrant.

Korea has been the victim of foreign aggression throughout history except for a respite when it was under Chinese suzerainty from the mid-seventeenth to late nineteenth centuries. Dependence on Chinese protection weakened Korea's ability to maintain appropriate defense forces and thus left it vulnerable to Japanese aggression in the late nineteenth and early twentieth centuries. The consequences for such a lack of preparedness included the end of Korea's 1,200-year history as a unified sovereign state in 1910, brutal colonization from 1910 to 1945, and lingering bitter national division since then. Koreans have yet to realize their historic status as a unified sovereign state from Mount Halla in South Korea's Cheju Province to Mount Baekdu on the North Korea-China border.

Therefore, one should not expect Koreans to place their future security at risk if the assumed Korean peninsula peace mechanism is implemented. South Koreans will probably continue the ROK-U.S. alliance and host USFK to deter foreign aggression. North Korea will probably concur—based on a conversation between North Korea's Chairman Kim Jong-il, and ROK President Kim Dae-jung, during the first inter-Korea summit in June 2000—with an adjustment of USFK's mission to include a regional balance of power role.⁶²

These likely developments imply a new role and mission for USFK to help maintain a balance of power in the post-peace mechanism period. Adjusting USFK's ability to deter other aggression in East Asia would help maintain regional security over the long term. U.S. military units should remain garrisoned south of the Han River to avoid worrying Chinese national security planners. The withdrawal of USFK, in contrast, would likely alarm U.S. allies and oth-

ers who worry that China might try to expand its influence in the region with military pressure or overt force.

Another way to assure North Koreans that they need not fear U.S. aggression would be for Washington to steadily improve relations with Pyongyang on a patient, transparent, verifiable, and mutually beneficial basis. Then, when conditions warrant, Washington and Seoul should consider expanding the ROK-U.S. mutual defense treaty to include North Korea. Essential conditions for this major step would include North Korea becoming a confirmed nonnuclear weapons state and resolution of the Korea question, perhaps through each Korea's diplomatic recognition of each other as sovereign, reunified Korean states.⁶³

Potential features of a peace dividend for South Korea and North Korea are discussed below in the sections on the ROK and the DPRK. Then two sections provide some additional thoughts to help manage expectations and implications for USFK.

Republic of Korea (South Korea)

We should expect South Koreans to seek a modest peace dividend and apply it to improve the social safety welfare net, including elder care, if the envisioned peace mechanism and the ROK-U.S. alliance assure South Koreans that the ROK's national security is not at imminent risk. The funding for this peace dividend quite possibly could come primarily from economic gains attributable to increased foreign investor confidence and such related factors addressed by Dr. Deok-Ryong Yoon at an October conference in Washington D.C.

Other economic benefits are expected as South Koreans expand their economic presence in North Korea to build closer relationships, take advantage of the low-cost labor market, and help North Koreans learn how a market economy works. Such goals would probably be somewhat independent of Pyongyang's ability to establish a favorable business environment.

How much Seoul would reduce military spending is difficult to predict, however, given concerns about traditional aggressors among South Korea's neighboring countries.

Koreans terribly miscalculated their security environment in the late nineteenth century and consequently lost their country, which remains divided. They are not likely to repeat this mistake. The biennial white paper issued by the Ministry of National Defense routinely details the military capabilities and trends of China, Japan, Russia, the United States, and of course North Korea. ROK security planners consider the military capabilities of neighboring countries when crafting force structure and acquisition plans.

"Defense Reform 2020: The Way Ahead" calls for cutting the ROK military manpower by approximately 25 percent, from 681,000 personnel in 2005 to about 500,000 in 2020. The envisioned force will be more mobile and dependent on technology than the current force. But because that technology is expensive, Seoul has envisioned increasing the defense portion of the annual government budget by 6.2 percent during the 15-year period 2005–20. Defense spending was forecast to peak at 3 percent of GDP in 2015 and level off at 2.3 percent in 2020, assuming the reforms are accomplished as planned.⁶⁴

Seoul's per capita income is the second-highest among the five Northeast Asia countries, but its military spending as a percentage of GDP is second-lowest among this group (*Figure 7*). In descending order, Northeast Asian-country military spending as a percentage of GDP is North Korea, estimated 25 percent (ongoing); China, 4.3 percent in 2006; Russia, 3.9 percent in 2005; ROK, 2.7 percent in 2007;⁶⁵ and Japan, 0.8 percent in 2006. Washington spent an estimated 4.06 percent in 2005. By comparison, the average allocated by OECD countries was about 1.8 percent of GDP.⁶⁶

North Korea has quantitative advantages over the ROK in several areas, aside from whatever nuclear weapons North Korea might have in its arsenal (*Table 1*).

So how much will Seoul cut its defense budget? Much depends on how it assesses its security environment and the arms control measures of the envisioned peace mechanism.

Given North Korea's quantitative advantages, the peace mechanism's arms control measures would probably call for the two Koreas to achieve rough parity in measurable

Figure 7: Estimated Military Spending as a Percentage of GDP

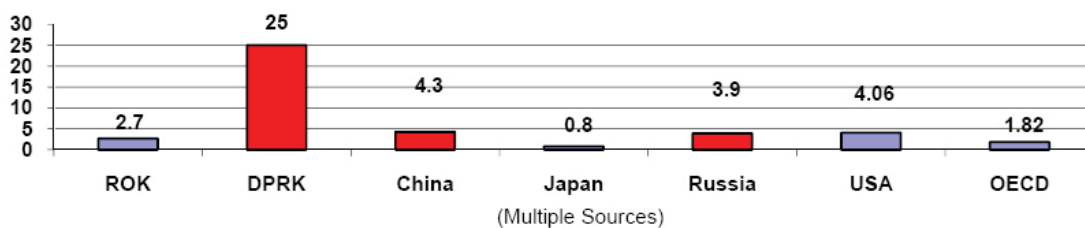


Table 1: Selected ROK and DPRK Military Resources (as of December 2006)

		ROK	DPRK
Overall military manpower		>674,000	>1,170,000
Army	Main battle tanks	2,300	3,700
	Armored vehicles	2,500	2,100
	Field Artillery (cannons, e.g.)	5,100	8,500
	Multiple launch rocket systems	200	4,800
Navy	Naval warships	120	420
Air Force	Fighter aircraft	500	820
Source: ROK 2006 Defense White Paper			

resources. Such a call would not yield a significant peace dividend to South Korea, but it could for North Korea as it cuts forces to achieve rough parity with the ROK.

There is a temptation to assume that a credible peace mechanism will prompt Seoul to cut its defense spending to approximate the OECD average. Although some South Koreans might welcome such a significant budget cut, we should expect decision makers to weigh the implications of such a cut for Korea’s national security in their historically dangerous neighborhood.

If a credible peace mechanism were implemented in 2009, for example, planning for a peace dividend would probably focus on the 2011 budget year, at the earliest. Let’s assume that South Korea’s GDP had grown to about \$1.5 trillion (PPP) in 2011, its defense spending was 2.9 percent of GDP per the “Defense Reform 2020” program, and the OECD average hovered around 1.9 percent. Under this scenario, Seoul would cut its military spending by 1 percent of GDP and gain a \$14.7 billion peace dividend. But what would the security implications be?

Such a cut would prevent the timely achievement of the modern military envisioned by “Defense Reform 2020.” Given the aging of the Korean population and the corresponding reduction in the pool of young adults to serve in the military, one questions the feasibility of suspending the defense reform program.

More likely, South Korea will reassess its security environment, perhaps along the lines of the U.S. bottom-up review in the immediate post-Cold War years. Two key factors affecting the ROK reassessment will be the state of the ROK-U.S. mutual defense treaty and ROK confidence in the U.S. ability to help it defend against external aggression. Another will be the military capabilities and trends of surrounding countries. Political factors will affect the reassessment,

given previously mentioned concerns regarding the social safety net and elder care.

One other possible factor affecting South Korea’s future military and a peace dividend is the tantalizing prospect that the two Koreas might form some sort of a confederation after resolving the Korea question and ending inter-Korea hostilities. Planning to establish a confederated military would require significant decisions on command and control, force structure, training, and zones of operations, to name just a few variables. Such planning would take a long time and therefore seems infeasible in the coming five years, for example.

Thus, Seoul’s defense spending is relatively justifiable over the years required to achieve the goals of “Defense Reform 2020.” Sufficient consensus seems to exist in the Ministry of National Defense, Blue House, and National Assembly to transform the manpower-intensive military into a more modern force to meet current and future defense requirements. Therefore, Seoul seems unlikely to seek significant cuts in military spending prior to achieving the “Defense Reform 2020” goals. The primary source of funds for a South Korean peace dividend will probably be the indirect economic benefits of a peace mechanism.

Democratic People’s Republic of Korea (North Korea)

A number of potential features of a peace dividend for North Korea come to mind if Pyongyang can divert a significant portion of its extensive defense spending to fund peacetime activities. In addition to Pyongyang’s substantially cutting the size of its active-duty military forces to achieve rough parity with South Korea, for example, we might also imagine its dramatically cutting the funds for its defense industry, military operations, and research and development and applying the savings to the production of consumer goods and services for domestic and export purposes. Coupling such actions with such other initiatives as inter-Korea eco-

conomic projects and other special economic zones or free-trade zones for foreign enterprises and newly privatized or quasi-public North Korean firms could provide employment opportunities for newly discharged military personnel. One can even envision international financial institutions (IFIs) and other foreign entities providing substantial grants and loans and growing foreign direct investment.

All this and more is imaginable if the North Korean government were to implement a range of structural reforms and practices to attract foreign business, investments, and loans. And that is the rub. Not only has Pyongyang been unable to reform its socialist, *juche* system for its own good; its system also does not inspire confidence among foreigners that they can profitably do business there, even if all foreign economic sanctions were lifted. From a foreign perspective, the North Korean system is like a cracked pot. A Korean proverb reminds us: Putting water in a cracked pot is hopeless.

Foreigners are therefore not likely to provide significant economic assistance or invest in North Korea unless Pyongyang implements a range of major reforms that will inspire confidence among foreigners that they can profitably invest in North Korea and expect reasonable economic development from loans and grant aid. The burden is on Pyongyang to create such favorable foreign perceptions and help launch a virtuous circle. But North Koreans cannot do it alone. Foreign assistance is needed.

Therefore, the primary features of a peace dividend for North Korea should include internal and foreign initiatives. Both are needed to help North Korea break out of the vicious circle created by its siege mentality, dysfunctional ideologies, unfamiliarity with proven politico-economic concepts, and fear of change.

Some measures are suggested below, but not sequentially. The most important internal component for North Korea is its willingness to implement major structural and ideological reforms. Although this would be a difficult decision for Pyongyang, certain prerequisites will include its confidence in the new security environment and its ability to govern in a reformed DPRK.

The primary features of a peace dividend for North Korea, therefore, should include mutually complementary internal and foreign measures.

Suggested foreign measures to help start a virtuous circle. Foreign entities should look for opportunities to improve relations with and assist North Korea, provided they are confident that North Korea's reform efforts are sincere and likely to bear fruit. Examples include:

- End economic sanctions. Presumably the United Nations will lift the sanctions it imposed after North Korea's several ballistic missile tests in July 2006 and nuclear test in October 2006. Other countries should also lift their sanctions against North Korea commensurate with their assessment of North Korea's confidence-building measures. The United States should be especially alert to opportunities to reciprocate sincere North Korean initiatives. One bellwether will be Pyongyang's approach to implementing ideological and structural reforms.
- Normalize relations. The United States should seek to develop a friendly relationship with Pyongyang as it has with Seoul, mindful that the Korean peninsula is strategically important. Of course, this will take time, but every moment patiently spent over time in changing North Korean perceptions to regard the United States as a friend will be time well spent.

Americans should keep three principles in mind as they deal with North Koreans: transactions should be transparent, verifiable, and mutually beneficial.

Additionally, Washington should carefully coordinate with Seoul to develop various U.S. and allied approaches to North Korea to strengthen the alliance and ensure that Pyongyang does not play Washington off against Seoul.

Normalizing U.S.-DPRK diplomatic relations is an appropriate goal, but it should be done on mutually respectful terms, as Koreans have bad memories of unequal relationships. As the North Korean view of what constitutes normal relations is not clear, significant effort should be dedicated to ensuring that Americans and North Koreans have common understandings.

Developing a range of personal and institutional relationships is a necessary prerequisite for normalizing relations. At the same time, Americans should be cautious that North Koreans don't try to manipulate them.

The United States should provide practical assistance to help North Korea apply for membership in the International Monetary Fund (IMF) and other IFIs provided North Korea no longer qualifies for inclusion on Washington's list of states supporting terrorism.⁶⁷

Washington should also be willing to help North Koreans learn proven economic and governance principles and practices to help it implement the major reforms that will be essential to take advantage of a peace dividend and create a system that works.

To help build confidence and achieve important national interests, some measures could be initiated before a six-party peace mechanism is concluded if conditions warrant. For example, the United States and North Korea should normalize relations with each other in consideration of long-standing statements of such intent, resolution of the Korea question and the nuclear issue, and the confidence that will come from a patient series of transparent, verifiable, and mutually beneficial transactions. Waiting for a six-party peace mechanism is not necessary, but close coordination with Seoul is.

The United States and Seoul should also consider expanding the ROK-U.S. security alliance to include North Korea should circumstances warrant. Key prerequisites would include North Korea's status as a verified nonnuclear weapons state, resolution of the Korea question, and steady improvement in U.S.-DPRK relations (in full coordination with Seoul).

The United States should expand its national interests to include the peaceful unification of Korea on terms mutually agreeable to Koreans, recognizing this will likely be a lengthy process. Washington should then develop a national strategy and policies for the long term while also coordinating with Seoul for a peaceful bilateral alliance approach. A peacefully unified Korea—particularly one aligned with the United States—would best serve the interests of maintaining peace and promoting prosperity, given the likelihood of increased trade throughout Eurasia. USFK units should remain south of the Han River.

In addition, other countries should also seek to improve and ultimately normalize relations with Pyongyang along the lines outlined above.

- Encourage other foreign entities to develop relations with Pyongyang. The IMF and other IFIs should welcome North Korea's application for membership per the existing standards for all members. The IFIs should provide education and training to North Koreans to help them modernize their system in addition to advancing financial assistance as circumstances warrant.

Foreign businesspeople should consider investing in North Korea as they gain confidence that North Korea is sincere about transforming its system into something that is more functional and less threatening than the current system.

Russia, Japan, and China should consider helping North Korea rehabilitate infrastructure facilities that they helped build—power plants in the case of Russia and Japan, for example. A likely prerequisite for Japanese support will be resolution of the North Korean abductee issue.

On a final note, foreigners should exercise caution to avoid enabling dysfunctional practices and North Korean manipulation to gain some perceived advantage over others. North Korea has a long history of playing off one foreign actor against another.

Suggested internal measures to help start a virtuous circle. Initiatives that Pyongyang should implement to gain a peace dividend include:

- Replace or revise anachronistic core principles, including *juche*, to reflect proven concepts. Because the North Korean system demonstrably does not work, Pyongyang should consider studying other socialist countries that have implemented major reforms to improve their economies and build new governing legitimacy. IFIs and other foreign entities are additional resources to help North Koreans think about ways to reform their system. Although foreigners might want North Korea to become a democracy and market economy, this is not likely to happen in the near term.

Juche requires major reform. North Korea's strict concept of self-reliance in an interdependent world is a prescription for its continuing isolation and poverty. *Juche's* call for socializing the Korean peninsula would conflict with the likely intent of a six-party peace mechanism, and its anti-American components would hinder U.S.-DPRK rapprochement. Another by-product of *juche* and hindrance to U.S.-DPRK rapprochement is Pyongyang's failure to respect human rights: the North Korean regime cruelly imprisons domestic critics,⁶⁸ creates disincentives for creating a productive workforce, and greatly degrades foreign respect for the government.

North Korea should reach out to foreign entities for assistance in crafting ways to reform this dysfunctional ideology and its practices. Changing *juche* will be as difficult for North Koreans while the Kim Il-sung family rules as changing Maoism was for the Chinese while Madam Mao and the Gang of Four ruled. But where there's a will, there's a way.

North Korea's military-first policy also requires reform so that North Koreans can begin to develop an economy that will meet national needs.

Other major reforms, with particular attention to the agricultural and industrial sectors and the overall business climate, are needed to create a functional economy. North Korea should implement a range of reforms regarding industrial and economic affairs to establish a proper balance between civilian and defense industries and heavy and light industries. It should also consider establishing special eco-

conomic zones and free-trade zones that will induce foreign investment. It may be particularly difficult for North Koreans to overcome their fear of foreigners, but doing so is a prerequisite for progress.

- Develop a new, growth-oriented, transparent business climate that rewards foreign expectations for a reasonable return on investment. Foreigners—especially in the private sector—are not likely to provide financial assistance or invest in North Korea unless they believe they can do so safely and profitably. Expecting a foreign firm to invest with no hope for a reasonable return on investment is unreasonable. In developing a new business climate, North Koreans should give attention to such important topics as adhering to the rule of law, protecting intellectual property rights, facilitating the repatriation of funds, and permitting foreign employers to pay North Korean workers directly. South Koreans may be a particularly good resource to help North Koreans with these difficult reforms. Additional resources are IFIs and friendly countries, which at this point (after a credible peace mechanism, for example) should include the United States.

With such reforms in place, a restructured economy poised to move in a positive direction, and a virtuous circle coming into sight, North Korea can start to implement a range of measures to achieve normal attributes of a peace dividend.

If a credible peace mechanism were implemented in 2009 and Pyongyang were to implement needed reforms and cut its military spending in 2011 to match South Korea's spending as a percentage of GDP,⁶⁹ it could achieve a significant peace dividend of more than \$8 billion. In the North Korean case, however, demobilizing troops into an economy that cannot profitably put them to work can be problematic. Therefore, this estimate depends wholly on economic liberalization featuring enough reforms to provide gainful employment for the huge number of discharged military personnel under the envisioned reduction in force.⁷⁰

An \$8 billion peace dividend could be exceptionally useful for rebuilding North Korea's national infrastructure and improving the social welfare system. Indirect benefits stemming from more workers in a reformed economy could contribute further to expanding North Korea's GDP.

Managing Expectations

So many variables attend this discussion of a peace dividend for North Korea that we should keep some possible scenarios in mind.

One scenario is the complete implementation of a peace mechanism that inspires North Korea to launch a virtuous circle to dramatically cut military spending, embrace foreign investment, enthusiastically apply for membership to the IMF and other IFIs, and subsequently demonstrate the requisite transparency to inspire IFIs and others to advance loans and promote development projects.

A second scenario envisions a peace mechanism that inspires only partial confidence by Pyongyang and, thus, a reduced peace dividend. One stimulant for this scenario could be a six-party peace mechanism that would not assure Pyongyang of its long-term security and would thus discourage it from implementing major reforms to build a functioning system.

A final scenario for consideration would emerge if the six parties fail to establish a plausible peace mechanism but the United States and the DPRK were to normalize relations. Although we should not expect a peace dividend if there is no peace mechanism, there is some value to contemplating how a new North Korean leader (individual or group) who is less paranoid than current incumbents could be positively influenced under such a scenario.

Implications for USFK

U.S. military planning would naturally be affected by a credible inter-Korea peace mechanism, which would include the assumed resolution of the long-standing Korea question and the North Korean nuclear weapons program.

Seoul and Washington would be wise to continue USFK to help contribute to regional peace and stability. USFK units should be stationed in South Korea to avoid alarming Korea's neighbors.

USFK roles and missions should be adjusted to help guarantee the security of both Koreas and assure other Asian nations that the United States is well positioned to honor its treaty obligations and contribute to maintaining regional peace.

Opponents of USFK who call for its dissolution should consider the implications of such a decision for the ability of the United States to achieve its national interests in the East Asia-Pacific region. Dissolution of USFK would certainly affect U.S. alliances with South Korea and Japan, U.S. Forces Japan, and the perceptions of other regional states of the dependability of the United States should hostilities break out again in the region.

Conclusions

Thinking about a peace dividend on the Korean peninsula merits serious consideration regardless of how difficult it may be to imagine an intra-Korea peace mechanism brokered by the countries participating in the six-party talks. It merits consideration if only to help us ponder the future state of the strategically important Korean peninsula and the interim measures to patiently achieve a peace mechanism over time.

We should not expect an inter-Korea peace mechanism to assuage Korean fears of foreign aggression unless the mechanism specifically addresses them. Why? Because the Korean peninsula is the strategic crossroads of East Asia, and Koreans believe they have been the victims of almost 1,000 acts of aggression throughout their 4,000-year history. When the East Asia security architecture—including Korea as a protectorate of declining China—collapsed in the late nineteenth century, Korea was wholly unprepared to cope with rising Japan. As a result, it was no match for Imperial Japan's modern, aggressive military. Korea became a Japanese colony from 1910 to 1945 and a victim of great-power politics upon its liberation.

Koreans—north and south of the DMZ—are likely to keep this history in mind as they resolve to no longer threaten one another with a military attack. Their challenge will be to develop a modern, economically viable military force and alliances that can defeat foreign aggression if deterrence fails.

South Korea has a robust electorate that is fully capable of debating how to apply a peace dividend. Because South Korea has a relatively modest social safety net and growing elder-care needs, South Koreans are likely to debate ways to reallocate some defense spending to these and other areas. Commitments to achieving military modernization per the “Defense Reform 2020” plan imply that major cuts in military spending are unlikely until the modernization is complete. Funds for a peace dividend will probably come from expected economic benefits following the end of inter-Korea tension, resolution of the North Korean nuclear issue, and the Korea question.

North Korea's decisions are more difficult to anticipate. The leadership's siege mentality may be understandable, but it seriously inhibits the country's healthy development.

Economic growth depends on the wise application of proven principles and the development of mutually beneficial trading relationships with other countries. To grow, Pyongyang needs to develop policies and practices that will enable it to interact successfully with foreigners, to both facilitate exports and attract foreign investment. Whether North Ko-

rea will have the courage to undertake the broad range of needed reforms remains to be determined, but if it were to do so, a peace dividend of at least \$8 billion seems feasible in the first year it is implemented.

History teaches us that only the DPRK leadership can chart its course, and foreign efforts to pressure the leadership to act contrary to its perceived self-interest will fail. If the North Korean leadership wants to put North Korea on a course to prosperity, Pyongyang would be wise to move away from its demonstrably unsuccessful socialist model to one that can work.

Building confidence among North Koreans that they don't have to fear foreign aggression and can therefore reallocate some funds from defense spending to other peacetime priorities is as essential as it is difficult, given Korea's troubled history at the strategic crossroads of East Asia.

Foreign entities, including the United States, therefore need to play an important role that inspires and enables North Koreans to reform their highly authoritarian socialist system. Foreign entities should begin now to improve relations with North Korea—on a transparent, verifiable, mutually beneficial basis—and not wait for a peace mechanism to be implemented. Starting now is important because building confidence takes a long time.

Mr. Paul Chamberlin is the President of Korea-U.S. Consulting, Incorporated.

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