

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

A Peace Dividend for North Korea? The Political Economy of Military Spending, Conflict Resolution, and Reform

by Bernhard Seliger

The West as a whole in the early 1990s became obsessed with a "peace dividend" that would be spent over and over again on any number of soft-hearted and sometimes soft-headed causes. Politicians forget that the only real peace dividend is peace.

—Margaret Thatcher
Statecraft, p. 40

Among the most striking and menacing features of the Democratic People's Republic of Korea (North Korea) is the extreme worship of the military and militarization. Not only is North Korea a totalitarian state, but it is a state where the military, uniquely in the world, officially has the upper hand in all functions and issues. This is the principle enshrined in its *songun* policy. There have been a number of explanations and speculation of and around this military-first policy, among them the guerrilla tradition of Kim Il-sung,¹ which after the generational change has been more formalized as "military first"; the fact that Kim Jong-il did not have the military credentials of his father, the alleged liberator of Korea from Japanese colonization; or the expectation that military-first could lead to a modernization process of the economy while political control had to be guarded by a strong military. By the numbers, North Korea has one of the largest armies in the world and, given the tiny GDP, also probably the largest share of military expenditure compared with GDP, although no exact figures are known. It is no wonder then that the idea that peace might bring enormous benefits to North Korea through conversion of military spending to civilian purposes is one of the issues thought to be an attractive feature of denuclearization and the creation of a security order for Northeast Asia. In addition, the insistence of North Korea on nonaggression guarantees in some phases of the story of confrontation with the United States and South Korea seems to corroborate this idea: peace seems to bring a large dividend to North Korea.²

The concept of a peace dividend, referring to the possible long-term benefits of lower military spending, became popular during the last years of the Cold War. While there are indications that there has been a peace dividend, certainly for the Eastern European states freed from the burden of maintaining large armies plus hosting sometimes considerable numbers of Soviet troops, the peace dividend in the West did not materialize immediately; plus, military spending saw a large reversal in the post-11 September 2001 world.

For North Korea, for the reasons mentioned above, the concept of a peace dividend seems particularly relevant. At the same time, a larger concept of a peace dividend could include the end of spending on certain prestige goods and a better allocation of resources when military dominance in North Korea ends. Therefore, the creation of a stable security environment and lasting peace in Northeast Asia is accompanied by expectations of higher growth that would at the same time lower the internal and external burden of adjustment in North Korea. From a political economy point of view, however, the military-first policy and military spending should not be seen as entirely related to the external security threat for North Korea; instead, they are equally importantly dominated by domestic policy considerations, in particular, regime survival. In this sense, the hope for a peace dividend might be premature as long as the fundamental use of security crises for regime survival in North Korea does not stop.

Certainly, the size of the peace dividend is also related to the concrete form a security order for Northeast Asia will take. Today it is most likely that it is an extension of the six-party talks,³ in its most ambitious form as a counterpart to the Organization for Security and Co-Operation in Europe (OSCE).⁴ For the purpose of this paper, a stable security and peace order in Northeast Asia is understood as an arrangement, most likely in the form of a successful conclusion of

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the six-party talks, whereby North Korea is denuclearized and in one or the other form receives credible security guarantees against outside aggression.⁵

This paper looks into the peace dividend for North Korea from an economic point of view and from a political economy point of view as well. Integrating both views not only makes policy analyses more realistic but also allows for more realistic negotiations with North Korea. The remainder of this paper is organized as follows: In the second part, the North Korean expectations during the current state of the six-party talks are discussed. The third section deals with the European experience with a peace dividend and the implications of the Northeast Asian military buildup and its potential demise after achieving a state of peace in Northeast Asia. The fourth section discusses the same problem from a political economy point of view; this is followed by some conclusions in the fifth and final section.

Current Stage of Six-Party Talks and Prospects of Benefits for North Korea

In early October 2008, after North Korea agreed on a verification system for its nuclear program and the George W. Bush administration finally announced that North Korea had been taken off the list of terror-sponsoring states, one of the most contentious issues had been resolved, from the North Korean point of view. North Korea’s leadership not only

psychologically feels itself threatened and surrounded but also literally blames the encroachment of the United States and its allies for the bad performance of the North Korean economy. In this belief, unfortunately, it is not alone.

A number of foreign observers also seems to share the belief that the sanctions of the United States and the hostility of the international community are among the reasons for the bad state of the North Korean economy. This is, however, wrong since the reasons can be found exclusively in the mismanagement and dysfunctionality of the North Korean economic system.⁶ Also, the reforms of July 2002 only marginally altered this fact because no basic decision for economic transformation has been taken.⁷ Moreover, the often-heard conclusion is wrong that a lifting of sanctions or a peaceful resolution of the nuclear issue will automatically bring prosperity to North Korea. While it might bring, in the most fortunate circumstances, a massive inflow of aid (in particular, there are prospects of Japanese reparation payments although they are by no means legally binding and politically secured), it does not alter the state of the North Korean economy and the lack of human capital development.

The lifting of sanctions can, therefore, only be the beginning of serious efforts to change North Korea, which will require much more than the possibility of free exchanges and trade: these efforts will require North Korean products

Figure 1: ROK & DPRK Fertility Rates

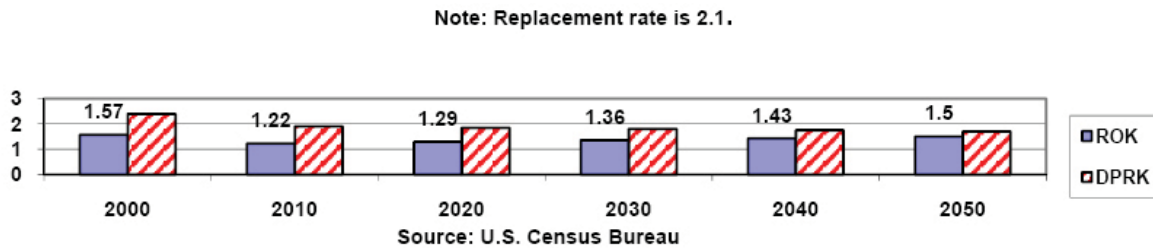


Figure 2: ROK & DPRK Lifespans

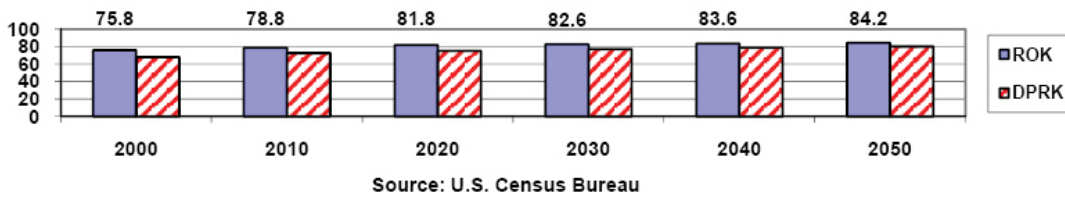
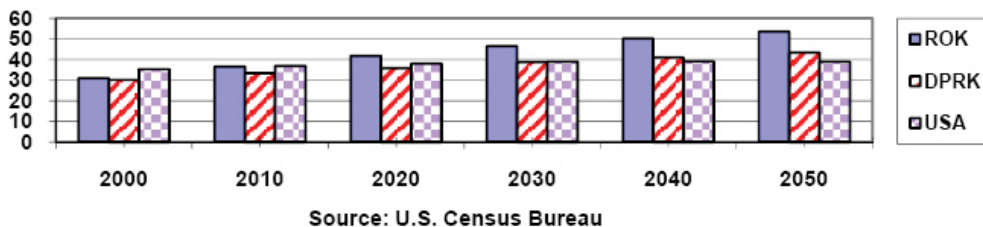


Figure 3: Median Ages - ROK, DPRK, USA



to be competitive, North Korea to provide a legally and financially safe environment for trade, and North Korea to tackle its problem of old debt, on which it defaulted a long time ago. All these issues are often forgotten in the debate about the impact of peace on North Korea's economy.

It is important to point out these misconceptions, however, because they are determining to some extent the pattern of negotiations between North Korea and the other members of the six-party talks. If no economic benefits materialize from the new status of North Korea's no longer being considered as sponsoring terror, the North Koreans could well misunderstand this as another conspiracy against their state. Such a misunderstanding would mean that North Korea again, like before, would probably claim that, if not legally then at least by its actions and intentions, the United States violated the "spirit of reconciliation" and therefore that North Korea would not take any new steps without new incentives.

This can be seen in the way the North Koreans perceived the financial sanctions and, in particular, the freezing of \$25 million in Banco Delta Asia. The freeze, not being a defined sanction but the result of a warning by the U.S. Department of the Treasury, was solved after protracted negotiations in which North Korea insisted on the involvement of North American institutions. This, the North Koreans believed, would whitewash their country in the eyes of the financial community. That did not happen. Still, North Korea's external financial transactions are extremely limited.⁸ The lack of understanding of market mechanisms compared with the intervention of the state is behind this case. Equally, the lifting of sanctions will lead to the expectation that trade flows will begin by political decision rather than economic decision.⁹ This would be in line with the immediate benefits—like heavy oil and food shipments—that North Korea was granted after it entered the first and second stages of the six-party talks.

North Korea is currently, according to the consensus view of aid organizations working in the country, once again facing enormous difficulties in feeding its population, and some even think the country is at the brink of another famine.¹⁰ The possible benefits from the six-party talks therefore can play an important role as incentives for North Korea to cooperate in the talks. In 2009, when the originally agreed food aid and heavy oil shipments are finished, this will be even more true. First, the dependence of North Korea on external aid seems to be auspicious because it gives everybody who is promising aid a certain leverage. At second glance, it is less easy.

Aid is an important goal for North Korea, but only to a certain extent. When in 2008 a tourist was shot at Mt. Kumgang and South Korea unilaterally stopped the Mt. Kum-

gang tourism business and required a joint investigation, North Korea not only rejected the investigation but even stepped up confrontation by requiring a South Korean apology for its alleged violation of North Korean territory. Thus, pride and self-assurance (also with a view to the domestic population, which no longer can be fully be shielded from international news) are more important than aid, although certainly the business generated at Mt. Kumgang was an important foreign-currency earner for North Korea. Even more important than pride is defense against any threat to the regime; this is highest in the hierarchy of goals of North Korea. As an answer to leaflets with anti-Kim Jong-il propaganda that have been carried within its borders by balloons, North Korea threatened the complete closure of the Kaesong industrial complex, although it would itself be hurt most by this action. By late 2008 the Kaesong tour business had been stopped although it had been another cash cow for North Korea. But the anti-Kim propaganda entering the country seemed to be so dangerous that the threat had to be taken seriously, and the result was the closing of the quite successful inter-Korean industrial complex.

From these initial considerations, we can draw two conclusions about the possibility of the peace dividend: First, the peace dividend has to be tangible and materialize not as a potential long-term benefit, but soon. Second, the peace dividend has to fit in the hierarchy of goals of North Korea: aid and stabilization as well as pride (either as an intrinsic value or as an instrument to uphold the regime) and, ultimately, regime survival. The next section will look at the peace dividend, and the fourth part discusses how it fits into the North Korean hierarchy of goals.

Military-Industrial Complex and the Possibility of a Peace Dividend

The European Experience—Elusive Peace Dividend and the Real Dividend of Lasting Peace in Europe

The idea of the peace dividend, which was widely discussed in the final days of the Cold War, can be shown simply by the following figures. During the peak of military expenditure in the Cold War—1987—more than \$1 trillion (in constant 1994 U.S. dollars) was spent worldwide; but after this peak it continuously sank, and in 1995 it was only \$700 billion, a reduction of 30 percent.¹¹ This has been not the result of a planned and uniform reduction, but it began slowly in the last years of the Cold War and accelerated when it was rather forced upon the former Warsaw Pact states during the first phase of their economic and political transformation. In some states, like the German Democratic Republic (East Germany) during the last year of the GDR's existence, the reduction was an explicit policy (the first and last defense minister of East Germany, Rainer Eppelmann, a former

dissident and pastor, was symbolically called minister for defense and disarmament); in other countries, like the late Soviet Union, reductions in military expenditures were the result of economic forces. In NATO states also military expenditures sank. As a share of world GDP, military expenditures sank from 3.7 percent in 1990 to 2.4 percent in 1995. At that time, military spending in absolute terms bottomed out, stayed for some years at a similar level, and after 2001 strongly increased. In relative terms, in 2007 military expenditures stood at 2.5 percent of GDP owing to the strong increase of world GDP in the first years of this decade.

The peace dividend includes not only capital but also the reduction of military personnel, which at least theoretically was available as a factor of peaceful production. The example of Germany (*Table 1*) shows that this effect is quite considerable for some countries. This dividend was unequally distributed, however, and also was dependent on the available jobs for dismissed military personnel.

There are considerable long-term effects of lower military spending; they include higher per capita output as a result of improved capital formation and resource allocation.¹² Although it is undeniable that the peace dividend led to a reduction of spending of capital and the use of labor, the expectations for the peace dividend as a solution for budgetary problems—especially as Western European welfare states coped with the 1993 recession, the effects of ballooning welfare spending, and the aging of their societies—were vastly excessive and consequently led to disappointment. The recession with its record-high unemployment, the civil war in the former Yugoslavia requiring the modernization of Western European armies, and finally the post-9/11 developments made the peace dividend elusive.

Where has the peace dividend gone? As Margaret Thatcher in the quote preceding this article pointed out, the real peace dividend is peace itself, and the beneficial effects of peace on European economic development are so overwhelming that they cannot be stressed enough. The end of the Cold War led to the reintegration of Europe, with the first enlargement

of the European Union in 1995 (Sweden, Finland, Austria), then a second round in 2004 (Estonia, Latvia, Lithuania, Poland, the Czech and Slovak Republics, and Hungary as well as Slovenia), and a third in 2007 (Bulgaria and Romania). The economic effects of an enlarged Europe rightly should be counted as a peace dividend because economic integration became possible only after the end of military and ideological confrontation. This again leads to questions for Northeast Asia: What will a peace order look like? What are the potential benefits of economic integration? Can such an order be achieved with the end of military aggression alone, or does it require also some form of systemic convergence, as was strongly and uniformly the case in Europe?

From Military-First toward a Peaceful State—What Can North Korea Expect?

“Military first” is not a mere slogan, but indeed the military in North Korea probably accounts for a larger share of the GDP than in any other country of the world. Adding up military expenditure always has been difficult, and in many countries military expenditure has been hidden under various budgetary titles, but the following comparison in *Table 2* shows, even allowing for large inaccuracies, that the military’s share of GDP is larger in North Korea than anywhere else in the world.¹³ *Ceteris paribus*, this would also mean a larger peace dividend able to be reaped than anywhere else in the world.

The same is true in the comparison of armed personnel, where North Korea has the world’s fourth-largest army in absolute terms, and relative to its total population its army easily beats the competitors, with almost 5 percent of its population enlisted in the military.¹⁴ Additionally, there are reportedly reserve troops making up another 4.7 million, and consequently, “as a result of the steady increase in military manpower and weaponry, North Korea has essentially become one huge armed camp.”¹⁵ If active and reserve troops are counted together, almost one in four North Koreans qualify as military personnel.

Table 1: Reduction of Military Forces in Germany, 1989–2010

Personnel	1989	1991	1994–95	1999	2006	2010
		1st reduction				
		2nd reduction				
		3rd reduction				
		4th reduction				
Professional soldiers	270,000	—	211,000	200,000	200,000	195,000
Conscripts	218,000	—	155,000	135,000	85,000	55,000
Total	495,000	487,000	370,000	335,000	285,000	250,000

Source: “Annual Report 2005/2006” (Bonn: Bonn International Center for Conversion, 2006), 30, www.biRecc.de/publications/jahresbericht/2006/bicc_annual_report_2005_2006.pdf.

Table 2: Military Spending, Selected Countries

Country	Military expenditure (percentage of GDP)	Budget period
North Korea	31.3-40	Estimate
China	4.3	2006
United States	4.3	2005 est.
Russia	3.9	2005
South Korea	2.7	2006
Germany	1.5	2005 est.
Japan	0.8	2006

Note: For North Korea estimates vary widely, between 31.3 percent, as estimated by Wayne Snow (2003) of Globalsecurity.org and 40 percent, as estimated by Gen. Leon J. LaPorte, US Forces Korea commander, reported in Washington Times (August 3, 2004).

Source: For data on North Korea: “North Korea pumps money into military”, The Washington Times, August 3, 2004, <http://www.washingtontimes.com/news/2004/aug/03/20040803-122618-7502r/>; Snow, Wayne (2003), “North Korea: Armed and dangerous”, The Atlanta Journal-Constitution July 27, 2003, <http://www.globalsecurity.org/org/news/2003/030727-nk.htm>; for other countries: “Rank order: military expenditures”, The CIA World Factbook (Washington, D.C.: Central Intelligence Agency, 2008), <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2034rank.html>.

Table 3: Active-Duty Military Personnel, Selected Countries, 2005

Rank (no. of troops)	Nation	No. of active-duty troops	Population of country (billions)	Troops/population
1	People’s Republic of China	2,255,000	1.330	0.0016
2	United States	1,474,000	0.303	0.0048
3	India	1,325,000	1.147	0.0011
4	North Korea	1,106,000	0.023	0.0480

Source: “The Military Balance”, International Institute for Strategic Studies (2005); population data from CIA World Factbook, 1 October 2008.

Table 4: Military Spending, Selected Countries and World

Jurisdiction	Military expenditure (billions of U.S. dollars)	Budget period
World	1,100.00	2004 est.
United States	623.00	2004 est.
People’s Republic of China	65.00	2008 budget
Russia	50.00	Est.
Japan	41.75	2007
Germany	35.10	2003
South Korea	21.10	2003 est.
North Korea	5.00	FY 2002

Source: “Worldwide Military Expenditures,” GlobalSecurity.org, 1 October 2008, www.globalsecurity.org/military/world/spending.htm.

To put this figure in perspective, in terms of absolute spending it has to be understood that North Korea spends only a fraction of what South Korea or the United States spends on the military, as **Table 4** shows. In terms of its own GDP, however, this fraction is much higher than in any other country. This might also explain the continued sense of threat the North Korean leaders experience despite living in an overly militarized country.

The military burden and its flip side, the possible peace dividend, make up much more than military expenditure alone.

One of the most closely linked sectors is the military-industrial complex. In all socialist states heavy industry had been a focus area of economic development, originally for a political reason but later closely linked to the quest for military dominance.¹⁶ North Korea, together with the Czech Republic and East Germany, had been until the early 1990s one of the most industrialized countries in the Eastern bloc. The share of manufacturing in total GDP in North Korea declined from approximately 45 percent to almost half of that from 1990 to 1997–98, although it has been estimated to be recovering for some time now.¹⁷ The decline is en-

tirely due to the stopping of production in companies lacking energy and other inputs. Although the nominal share of industrial employment has stayed high, men who were still enlisted in companies as workers (their entitlement to housing and food through the public distribution system is linked to such employment) began to look for other jobs and possibilities for securing food, especially in mountainous areas where farming is carried out on hillside land.¹⁸ In the recent increase of production, the output of the Kaesong industrial complex plays an especially important role.

Among the industries directly related to the military are the arms factories, many of which are located in the eastern cities of the country. According to one source, in 1990 North Korea had approximately 134 arms factories, many of them completely or partially concealed underground. These facilities could produce ground service arms, ammunition, armored vehicles, naval craft, aircraft (spares and subassemblies), missiles, electronics, and possibly chemical-related materials. In addition, some 115 nonmilitary factories had a dedicated wartime matériel production mission.¹⁹ Of these, however, not all are entirely devoted to equipping the North Korean army; an important goal of their production is sales abroad. Among these sales, missile sales have received the highest attention, while sales of conventional arms have also, according to estimates, contributed to foreign currency earnings. It is not clear how much a security protocol for Northeast Asia (if it does not explicitly cover these issues) would curb North Korean arms exports.²⁰ Important resources now going to the arms industry would no doubt be freed for peaceful use if North Korea would seriously consider a reduction of its overblown military.

In fact, a large part of the old industries has already been dismantled. Throughout the 1990s and during this decade, the capacity utilization of factories in North Korea has been estimated to be not more than 10 to 30 percent. Although the military-industrial complex was certainly on a priority list for energy and raw materials, in particular, by being an export-earning enterprise, it could not escape from the downturn of the entire economy. Outdated machines and other equipment were taken en masse to China as scrap metal when early in this decade prices for raw materials in China soared. In the border region and beyond, mining businesses, like the largest iron ore mine in Musan, were monopolized by Chinese companies and consequently were no longer able to supply the military and heavy industry. North Korean soldiers have always had second jobs—farmers in uniform. But now, for soldiers, farming and securing their means of survival through business or by force (stealing from farmers, for example) seems to be a preoccupation of parts of the military.

External Aspects of the Peace Dividend

Among the most intriguing aspects of the peace dividend for North Korea are the potential effects of peace on the external relations of North Korea, namely sanctions, trade, aid, and reparations, as well as the potential effects of membership in international organizations. Sanctions against North Korea have existed ever since the Korean War but have been reinforced during the nuclear crisis, in particular in 2006 through Resolution 1716 passed by the UN Security Council.²¹ Sanctions have been related to the sponsoring of terror, the Trading with the Enemy Act, the fact that North Korea as a nonmarket state does not enjoy the same status as market economies, and North Korea's status as a proliferator of weapons, in particular, missiles. During 2008, two of the sanctions were lifted: On 26 June 2008, President George W. Bush signed proclamation 8271, terminating most of the restrictions under the Trading with the Enemy Act. And in October 2008, North Korea was removed from the list of terror-sponsoring states.²² Some of the sanctions already had only a symbolic meaning: for example, the Trading with the Enemy Act did provide for a limited range of sanctions (like the approval of imports on a case-by-case basis, a freezing of selected assets, and the prohibition of direct financial transactions with the United States), but more important for exports, from the point of view of North Korean companies, are the tariffs imposed for being a nonmarket economy.²³

The removal of North Korea from the list of terror-sponsoring states is especially relevant because the list is an effective blockade to any attempts by North Korea to become a member state of any international institutions. However, it is only a necessary but not a sufficient condition. Other conditions, in particular those regarding transparency, changes in economic management toward a market economy, and the advance payment of a quarter of the allotted funds for the International Monetary Fund (IMF membership is a prerequisite to join the Asian Development Bank, which has been one of the stated goals of North Korea) seem unlikely to be fulfilled in the near future.

For inter-Korean cooperation, successful denuclearization could open complete new ways of cooperation. Under the Kim Dae-jung and Roh Moo-hyun administrations, the link between the nuclear issue and inter-Korean cooperation existed, but it was weak. In fact, North Korea exploited the situation by sometimes playing closer to South Korea, sometimes closer to the United States for a maximum of aid. Regarding humanitarian aid, South Korea explicitly or implicitly (when the pressure from its allies was too great) rejected a link to denuclearization. However, all this has changed under the Lee Myung-bak government, which made reciprocity and the restoration of a close alliance with

the United States its mantra and explicitly linked aid for impoverished North Korea to a successful continuation of the denuclearization process.

Smart acronyms and slogans for a long time have accompanied policymaking in South Korea—from the “miracle of the Han River” (the Korean economic rise in the 1960s through 1980s) to DJnomics, the economic policy of the Kim Dae-jung administration after the Asian crisis, and the Sunshine Policy for its Nordpolitik. The government of Lee Myung-bak equally reduced its goal for North Korea to a simple formula: “MB doctrine” (named after the initials of President Lee); also “Denuclearization–Opening–3000” is Lee’s vision for North Korea. The MB doctrine relates economic North-South cooperation with the six-party talks so that denuclearization and further cooperation enhance each other. If appropriate steps are taken to denuclearize North Korea, the per capita income of North Korea should, with the help of large economic cooperation projects, reach \$3,000, far from the current near-starvation levels. Throughout 2008, however, North Korea continuously snubbed all offers for cooperation, and even when South Korea almost begged to be allowed to send food aid to the North, which once again is on the brink of famine, the North declined, citing its discontent with President Lee Myung-bak’s government. For the North, the United States has become a handy substitute for the aid given by the previous two South Korean administrations, leading to fears that South Korea may become isolated.

The Denuclearization–Opening–3000 policy has been much criticized and even ridiculed by experts, predictably by those with close ties to the previous administration. First, they argue, it is unrealistic, given the state of the North Korean economy. Second, without cooperation from the North it could not be achieved anyway. The critics maintain the mantra of the two previous administrations, that rapprochement means not raising any issues that might irk the North; quite simply, denuclearization and rapprochement cannot be pursued simultaneously. Surprisingly, North Korea itself made the offer public in the North, but immediately added derogatory comments on the true nature of the Lee Myung-bak administration. Nevertheless, the publication of the offer was quite unexpected. The current average official income of North Koreans is just \$1 or \$2 per month, according to market rates. This is due to the astronomical depreciation of the domestic currency, which now trades at 3,000 *won* or more per dollar.

Even the most optimistic valuation of real income in North Korea, taking into account purchasing power parities rather than market rates, would mean that the current level is maybe one-fourth of the \$3,000 level that Lee Myung-bak is offering to the North. Therefore, \$3,000 seems an almost

impossibly attractive offer—either typical propaganda that people in North Korea are so used to, or an offer by an incredibly rich country, by the standards of North Koreans. By now, most North Koreans know that South Korea is not the impoverished country the North Korean propaganda machine often touted, but rather the rich brother. At least the rapprochement during the past few years conveyed a clearer picture of reality to ordinary citizens in North Korea. People quickly began to talk about the “\$3,000 per capita” offer, so much, in fact, that the party had to finally intervene.

But party intervention cannot stop gossip and amazement. Even some foreign diplomats in North Korea thought that the publication of the offer was some ingenious North Korean move to prepare the ground for renewed cooperation with South Korea. This seems far-fetched, but one thing is clear: North Koreans now see South Korea in a totally different light than their propaganda wants them to see it, namely, more than ever as a cure for an ailing economy on the brink of famine. Thus, denuclearization and rapprochement, or opening, might suddenly no longer be two competing concepts, but rather a virtuous circle: By making the North such an irresistible offer, the South Koreans have forced the North Korean leaders to either kill off their people’s hope or else accept. Nobody is in a better position to make such an offer than the Lee Myung-Bak government, as it is firmly grounded in its alliance with the United States and therefore not likely to be accused of blindness vis-à-vis the nature of North Korea’s political system.

Renewed inter-Korean cooperation could thus be the real winner of denuclearization. It has to be pointed out, though, that the concept of opening is a prerequisite for achieving its ambitious goal—and that is where the interests of North Korea’s leaders might differ most from South Korea’s. Overall, for inter-Korean cooperation the prospect of denuclearization holds great attraction. Plans for the extension have already been made—the second phase of the Kaesong industrial complex (which already has assumed an importance reaching beyond its narrow borders), the plans of the last summit meeting of October 2007, and, from the new government, the plans for a Russian-Korean energy connection.

As for trade, a successful and stable security order for Northeast Asia also has potential benefits. First, the lifting of sanctions will lead to the judicial precondition for free (or freer) trade, although an additional problem for trade with the United States is the status of the North as a nonmarket country. Second, the lifting of sanctions, if all political sanctions are included, means easier access to certain technology goods. Given the current economic state of North Korea, this would be especially important in

the Kaesong industrial complex, where technology imports could enhance productivity. In terms of exports, those originating in Kaesong would no longer be a political problem for trade with the United States. The question remains, however: What goods would pay for the imports from abroad? In this sense, again, the lifting of sanctions is necessary, but it is not sufficient. Competitive goods will be produced only in a market environment, that is, opening has to follow denuclearization. The Kaesong industrial complex principally provides such an environment, but more opening is necessary to benefit the whole country.

The most far-reaching expectations of North Korea with regard to a successful completion of the six-party talks are related to aid inflows. These comprise, besides aid from China and South Korea, inflows from the European Union and other international actors especially, in addition to the possibility of funding through international agencies. The EU, for example, has long considered official development aid (ODA) as a way to alleviate poverty in North Korea. When the EU established relations with North Korea, it set out its strategies on relations in a country strategy paper (CSP).²⁴ Technical assistance was an important part of this strategy, and a total of €35 million was set aside through 2006 for EU technical assistance projects, making the EU a substantial donor of technical assistance to the DPRK. The EC-DPRK CSP and the EU's National Indicative Program (NIP) for the DPRK set out the framework and objectives for technical assistance projects in North Korea. The CSP and NIP, if ever implemented, will provide for training in market economic principles and projects designed to support and promote sustainable management and the efficient use of natural resources and energy in the DPRK, the development of a reliable and sustainable transport sector, rural development as well as institutional support and capacity building. The admission of a nuclear weapons program by North Korea stopped ODA, however; and the EU froze the money earmarked for technical assistance.

Instead, humanitarian projects alone have been allowed, executed by a multitude of bilateral and multilateral donors and implementing organizations and coordinated on the European side by ECHO, the EU's office for humanitarian aid. When the 1995 floods, a result of environmental degradation brought upon the North by its dysfunctional economic system as well as famine, brought North Korea to the brink of collapse, the North opened its doors to international aid. The EU, via its food aid and food security programs, has provided significant aid since 1997. Food aid to the needy was originally the focus of the program, but soon it shifted to structural food assistance, in particular, the provision of inputs and technical assistance. ECHO assistance had already started in 1995, targeting the improvement of access

to safe water and sanitation and providing drugs and medicines to health institutions.²⁵

The focus of the two food programs shows that the EU's aid was not designed simply to bring food to North Korea, with the negative side effect of possibly making people dependent on the food. This happened only in the first years of the crisis, when there was an immediate need for feeding millions of undernourished people left stranded by their regime. Instead, the EU saw the necessity for structural assistance, such as capacity building and training to broaden the domestic North Korean food supply. Although it has been frequently pointed out that North Korea is not an agricultural country and that North Korea should rather focus on the rehabilitation of industrial production, earning by exports the money necessary to import food, the rehabilitation of agriculture nevertheless offers abundant potential for improvement and possibly could lead to self-sufficiency in food production after a household responsibility system (in other words, privatization) of agriculture begins.

In the current circumstances of collective farming, such improvements are not likely. Nevertheless, the eviction of most foreign aid workers in December 2005, which in particular affected the European nongovernmental organizations, shows that it was not the shift to development assistance that bothered North Korea, but rather it was the fact that aid workers were in the country at all. Also, substitution effects had set in: the unconditional aid of South Korea was much more attractive from the point of view of North Korea, as no stringent monitoring requirements were attached and the flow of information as they dealt with South Koreans, who were at that time accepting every control placed upon them by the North, could be much more effectively controlled.

The possibility of renewed South Korean aid under successful denuclearization has already been discussed. As for other foreign aid, it depends on the concrete final documents of a denuclearization process and the possible promises made to make North Korea accept denuclearization. One very attractive prize is the possibility of reparations that Japan might pay North Korea for actions during the colonial period, although in the meantime other important issues, most of all the question of abducted Japanese, have to be resolved. China might act anti-cyclically, however, because its aid is merely designed to help North Korea survive and has no specific development goal other than stabilizing North Korea enough to prevent regime instability and the prospect of a united Korea with U.S. troops at China's border. Thus, larger shipments by other partners in the six-party talks might lead China to the thought that its own contributions are less necessary.

The Political Economy of the Peace Dividend for North Korea

The demise of the military buildup, the lifting of sanctions, the opening of trade and aid, and inter-Korean cooperation have been discussed earlier as potential effects of denuclearization. What is the feasibility of denuclearization? *Ceteris paribus*, the factors mentioned above allow for a shift to civilian production and, consequently, more growth. Also, a reduction of mandatory military service would be a precondition for better education of young people, who currently enter the army at ages 17–20 and stay until they are 26 years old. The external dimension, as shown above, is particularly important for reaping a peace dividend.

North Korea's leadership benefits, however, from conflict: If it is accepted that within the North regime survival is highest in the hierarchy of goals, then conflict with the outside is one means to foster regime stability. Conflict, in the limited way it has been simmering throughout the last two decades, benefits the leader vis-à-vis his subordinates, benefits the military vis-à-vis other state entities, and benefits the leadership vis-à-vis the population. The leader, Kim Jong-il, gains through conflict because he is able to apply emergency rules that his subordinates must obey, and because he can rely on the discipline related to a conflict situation more than he could in an environment of peace. Kim Jong-il's ability to gather information through, for example, the Internet, which is restricted for most of his subordinates, allows him to issue commands in an authoritative manner, and these commands are certain to elicit admiration among his subordinates.

Kim Jong-il's entourage and the country's military gain through conflict, not only in the form of additional prestige but also in particular in the form of additional resources allocated in the name of priorities in times of conflict. The militarization of the language and everyday life is to some extent independent of a real military threat. But it is not easy to uphold this illusion when information about external affairs can no longer be completely controlled by the state and when the external security situation improves. If the military threat were to disappear, people would probably demand a larger share of goods for consumption or even more openness.

In addition, in general, benefits accrue to the leadership, not the population, since conflict and militarization (justified by conflict) are a means to control the population. This can be directly observed in Pyongyang almost every day. Thousands, sometimes tens of thousands, of people, most of them students but also the elderly, are training in the central Kim Il-sung square and other places (for example, near the Cultural Palace) for political demonstrations. Often, these take place on the birthday of an important person such as one of

the leaders or on some other national holiday; sometimes they are related to events like the first nuclear test.

From an economic point of view, this can only be described as wasteful. Pupils who attend these practices skip millions of school hours as they drill, sometimes until the early morning hours. And, although it is true that companies are idle, the central planning (at least on the national level) of the socialist state always needs new labor (labor hoarding) even if that labor is used at infrequent intervals. This seems to be the exact problem: thousands and tens of thousands of people can roam the city and possibly bond together. Through military action and exercise, though, these elements are firmly under control. This is perhaps the best explanation of why months of exercises preceded the founding day of the state on 9 September 2008, which was a rather sober party, lasting less than two hours and without the leader in attendance.

There is a second related reason why conflict stabilizes the regime. As in other socialist regimes, the emerging Kim regime in the 1940s was based first on its superiority as an economic system. Kim Il-sung essentially promised three things: a tiled roof (versus the widespread use of straw roofs), a silk traditional garment to wear, and meat soup to eat every day. For the poor farmers and workers of North Korea, this promise indeed was a promise of unknown luxury. For some time after the Korean War, North Korea seemed to make great progress in fulfilling these promises, but beginning in the late 1970s the economic situation turned worse again. Soon Kim Il-sung's legitimacy was enhanced by a military claim, namely, the single-handed victory Kim allegedly achieved in the fight against the Japanese army and the U.S. army.²⁶ The economic promises failed spectacularly in the 1990s, and the specious military victories are now a distant memory. In this situation, conflict allows Kim Jong-il, who suffers from a lack of legitimacy because he inherited his position, to prove himself as an equally important military commander. His depiction of himself as one of the three "great generals of Paektusan" is related to the countless victories he has claimed in countering sinister U.S. and international designs on North Korea. Without conflict, this would not have been possible.

What would denuclearization and an environment of peace in Northeast Asia mean for regime stability in North Korea? First, there would be no more reason to keep the whole nation on alert. Hungry people would ask about the benefits of peace. Although to some extent additional aid could be distributed, the real benefits of peace would materialize only through opening. China's and Vietnam's openings began with thousands of students who were abroad. In the case of Korea, this seems impossible: the attraction of South Korea would be too great to allow young, unmarried, and

unattached people to leave the country en masse. Also, what kind of border regime should North Korea chose in a peaceful Northeast Asia? Any relaxation of the tight control toward the South would lead to an unwanted exodus. Finally, what would happen to the resources freed from military use in the absence of any change of the economic system? The resources would be put to an equally wasteful use outside the military: maybe even more monuments to the leader (and maybe his successor, whoever this might be) would be built; maybe the defunct public distribution system would be revived? As long as there is no better allocation of resources in North Korea, the peace dividend might evaporate in the wasteland of socialist planning.

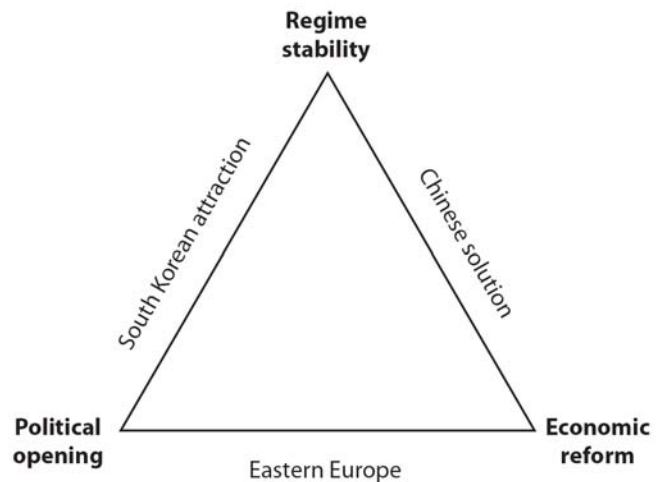
This result in North Korea is not the consequence of an adherence to any form of socialist creed or ideology. The North Korean leadership, if it ever was ideological, changed its mind a long time ago. Today it would prefer to follow the Chinese model and adopt a modern market economy if the problem of regime stability did not enter into the question. The attraction of South Korea is the real reason that North Korea cannot reform and prefers conflict to peaceful cooperation. Thus, one conclusion is straightforward: a peace regime for Northeast Asia is, all in all, a necessary but not a sufficient precondition for a peace dividend. And, again, such a peace dividend is, on the one hand, wanted by North Korea's leadership but is, on the other hand, feared because it might interfere with regime stability. Regime change, as occurred in Eastern Europe, is the real trigger for creating and actively using an emerging peace order.²⁷

Impossibility of North Korean Reform and Implications for Negotiating Peace in Northeast Asia

One way to understand the potentially dangerous implications for the North Korean leadership of a Northeast Asia peace and security order is to think about the forces determining North Korea's economic policy between opening and reestablishment of state control in the last decade. North Korea has been torn between the forces of opening to the outside world—forces that include not only the hungry population but also the technocratic young elite now in leading positions in party and government—and forces of conservatism, among them the military. Economic reform is welcome to some extent, and on the issue of economic reform North Korea moved during the past decade; but at the same time the moves were timid and inconclusive. Political opening (in the form of a Northeast Asian peace order), although promising a peace dividend, cannot be carried out simultaneously with maintaining the traditional order of the regime. The reason is that they form an impossible relation with the third, and most important, goal of the North's leadership: survival. Two out of three goals might be reached, but it seems impossible to achieve them all simultaneously.

The Chinese solution was achieved without political opening (it was, at most, a tightly controlled opening). The Eastern European experience was a simultaneous and chaotic process of economic and political transformation, resulting in a change of political leadership early in the phase. For North Korea, the attraction of the South poses the additional challenge of regime stability, denying it policy options that China and Vietnam used to achieve opening without political reform (*Figure 1*).

Figure 1: The Triangle Facing North Korea



Source: Author's concept.

Understanding the North Korean leadership's perception of threat allows us to draw up an appropriate incentive structure for negotiations with North Korea. Negotiations with North Korea will be successful insofar as they accept the goal of regime survival as the ultimate goal of the North Korean leadership. This, however, severely limits the negotiating options because it would mean accepting the fact that under the current circumstances North Korea is not interested in lasting peace in Northeast Asia. This has nothing to do with militarization for ideological reasons. In fact, there is some genuine interest in overcoming the history of confrontation with the United States, which is perceived as the largest external threat to regime stability. At the same time, however, the internal threat to regime stability is thought to be just as pressing and requiring of as much attention; for this reason the external threat might even be welcome to the North's leadership.

Can the North Korean incentive structure be altered? Probably not completely, but there are two possibilities for those negotiating with North Korea: First, on a short-term basis North Korea is flexible as long as it expects immediate benefits from flexibility and as long as it expects no major threats from concessions it makes. Negotiators can offer (and have offered) a variety of incentives for desired behavior on the part of North Korea, but this will not have

lasting effects. It can nevertheless be an appropriate strategy if one expects major political changes in the near or at least not-too-far future.²⁸

Second, and more fundamentally, there could be an attempt to interest at least certain parts of the leadership in opening and reform. One reason is that the Chinese military was remarkably calm throughout two and a half decades of transition, and it benefited enormously from economic change, first in the form of military enterprises and later through the ability of the strong new China to finance vastly increased military expenditures. North Korea's military, however, currently perceives peace and opening as threatening. Engaging the military might be difficult, but it is not impossible.²⁹ Although remunerating the military for its role in protecting a rogue state might be repellent, this could prove to be a better strategy than isolation. Such support, in terms of a certain division of labor in the six-party talks, could largely be a role in which the Chinese side could be active, with tacit support from the other members of six-party talks.

The analysis above depicts the possibility of a peace dividend for North Korea in somber and sober but, it is hoped, not unfair words. There still is a chance that North Korea under the current leadership or new leadership will recognize the enormous benefits of peace, not in the form of a readily spendable peace dividend but in the form of a chance for a complete reversal of the decades-old patterns of confrontation and economic disintegration in Northeast Asia.

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Endnotes

¹ Adrian Buzo, *The Guerilla Dynasty: Politics and Leadership in North Korea* (Boulder, Colo.: Westview Press, 1999).

² See Homer T. Hodge, "North Korea's Military Strategy," *Parameters* (Spring 2003): 68–71, for a discussion of the relation of the goals of "national reunification" (the official foremost goal of North Korea), regime survival, and defense against aggression led by genuine fear of a U.S. attack. Ken E. Gause, in "North Korean Civil-Military Trends: Military-First Politics to a Point," Strategic Studies Institute of the Army, 2006, <http://libweb.uoregon.edu/ec/e-asia/read/PUB728.pdf>, on pages 5–10 discusses the change of the role of the military after the introduction of the *songun* policy and its relation to the Korean Workers' Party and points out that it cannot simply be understood as military dominance in civilian affairs.

³ Charles L. Pritchard, *Failed Diplomacy* (Washington D.C.: Brookings Institution Press, 2007), 176–84.

⁴ Exchange of ideas on the possibility of an OSCE-style organization for Northeast Asia has been lively for some time, in, for example, the two OSCE-Korea conferences in 2001 and 2005.

⁵ Other benefits North Korea could get, among them aid by the other parties in the six-party talks, outside aid (for example, in the form of official development assistance from the European Union or assistance from international institutions), or, possibly, reparations by Japan, would be part of the peace dividend discussed here.

⁶ Bernhard Seliger, "The North Korean Economy: Nuclear Crisis and Decline, or Peace and Reform in the Last Asian Dynastic Regime?" *Korea's Economy 2004* 20 (2004): 77–86.

⁷ Bernhard Seliger, "The July 2002 Reforms in North Korea—Liberian Style Reforms or Road to Transformation?" *North Korea Review* 1 (Fall 2005): 22–37.

⁸ In the words of one with personal knowledgeable of the situation, "it took North Korea extremely long to thoroughly destroy its financial reputation and will take as long to regain it."

⁹ Similarly, in capacity-building projects of the Hanns-Seidel-Foundation concerning international trade, the North Korean side always stresses to Europe the importance of good political relations, not the quality of its goods, as the precondition for trade.

¹⁰ Until now, the World Food Program, which conducted the most far-reaching survey of living conditions in North Korea in recent months, did not find a full-fledged famine but did find alarming signs of malnutrition (for example, skipping of meals, collection of wild herbs, and, in particular, increased cases of diarrhea in hospitals).

¹¹ Bonn International Center for Conversion, Annual Conversion Survey, <http://www.bicc.de/publications/survey/1997/content.php>.

¹² See Malcolm Knight, Norman Loayza, and Delano Villanueva, "The Peace Dividend, Military Spending Cuts and Economic Growth," World Bank Policy Research Working Paper no. 1577 (Washington, D.C.: World Bank, 1996). Knight et al. also point out that Germany and Japan in the post-World War II period were also examples of a peace dividend because military spending in these states was curbed while their external security was guaranteed by the Allied forces.

¹³ See, for example, Dick K. Nanto and Emma Chanlett-Avery, *The North Korean Economy: Leverage and Policy Analysis*, Report no. RL32493 (Washington, D.C.: Congressional Research Service, 2008), which cites an estimate from the online *Chinese People's Daily* of 12 April 2005 that puts North Korea's military expenditure at only \$2.3 billion, or 15.9 percent of GDP.

¹⁴ Again, the figures have to be taken cautiously. Data for North Korea's population and data for its military might be overestimations; however, the overwhelming evidence for the militarization of North Korea is undisputed.

¹⁵ Kim Jing-wun, "Korea, Democratic People's Republic of, Armed Forces," in *The Encyclopedia of the Cold War*, ed. Spencer C. Tucker (Santa Barbara: ABC-Clio, 2008), 2:733–34.

¹⁶ The political reason was the early Soviet Union's lack of a proletariat necessary for the transformation toward socialism. Accelerated industrial growth spurred by the "price scissors" of agricultural and

industrial products was supposed to create the industrial economy lacking in post-feudal Russia in the 1920s.

¹⁷ See Nanto and Chanlett-Avery, *The North Korean Economy*, 14; with data from the Bank of Korea.

¹⁸ In mountainous areas, private, unofficial farming is allowed. This, together with over-exploitation caused by energy shortages, has led to complete deforestation in many areas of North Korea.

¹⁹ Andrea Matles Savada, ed., *North Korea: A Country Study* (Washington D.C.: Federal Research Division, Library of Congress, 1994), <http://lcweb2.loc.gov/frd/cs/kptoc.html#kp0034>.

²⁰ Recently, during a Parliamentary inspection, a South Korean lawmaker, without providing evidence, estimated North Korea's annual arms sales to be a modest \$13 million.

²¹ For an overview of sanctions and their relation to aid, see Bernhard Seliger, Thomas T. Park, and Hyung Suk Kim, "Economic Sanctions, North Korean Famine, and Humanitarian Assistance," in *Economic Sanctions against a Nuclear North Korea: An Analysis of United States and United Nations Actions since 1950*, ed. Suk Hi Kim and Seemon Chang (Jefferson, N.C.: McFarland, 2007), 127–48. For a timeline of sanctions, see Peterson Institute (without year), <http://www.peterson-institute.org/research/topics/sanctions/nk.cfm#chronology>.

²² Japan, however, extended its existing sanctions.

²³ For an in-depth analysis of the impact of the lifting of economic sanctions, see Lim Soo-ho, *The Alleviation of U.S. Economic Sanctions against North Korea and Its Implication for Inter-Korean Economic Cooperation*, SERI Issue Report no. 6 (Seoul: Samsung Economic Research Institute, 2008).

²⁴ "The EC—Democratic People's Republic of Korea (DPRK) Country Strategy Paper 2001–2004," European Commission, External Relations, 2002, http://ec.europa.eu/external_relations/korea_north/docs/01_04_en.pdf.

²⁵ "Democratic People's Republic of Korea (North Korea)," European Commission, External Relations, 12 January 2009, http://ec.europa.eu/comm/external_relations/north_korea/intro/index.htm.

²⁶ Both claims were complete inventions and were used to foster the Kim regime.

²⁷ Regime change does not necessarily mean different personnel although this would be probable, but it does mean different policies and hierarchies followed by the regime.

²⁸ The question of the health of the leader and the unresolved succession immediately comes to mind.

²⁹ In talks with European politicians the desire for closer contacts with European militaries and police forces has occasionally been expressed.

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