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CONTENTS

"PEACE IN OUR TIME" AT WHAT COST? POSSIBLE FINANCIAL AND LEGAL IMPLICATIONS OF DENUCLEARIZING NORTH KOREA

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CONTENTS

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I. Introduction

On 21 June 2005 the flag of the Socialist Republic of Vietnam flew outside of Blair House, across the street from the White House. Standing still on a windless day, the single-star banner heralded how far Vietnam and its prime minister, Phan Van Khai, who would meet President Bush that day, had come only a decade after the United States normalized relations with Vietnam. Khai's U.S. visit would include stops at Boeing, Microsoft, Nike, the New York Stock Exchange, and Harvard. Khai arrived in Washington with a set mission: to establish a framework for a long-term relationship with the United States and to obtain U.S. support for recognizing Vietnam as a market economy in the run-up to Vietnam's bid to join the World Trade Organization (WTO).

Recent progress at the six-party talks begs the question of whether it is conceivable that in the next few years a North Korean flag will fly in front of Blair House. Is it plausible that the number two official from the DPRK will stay at Blair House before meeting a U.S. president to seek support for North Korea's economic reforms and to lay the framework for a long-term relationship with the United States? From the vantage point of 2007, such a scenario appears barely plausible.[1] But part of the U.S. strategy of negotiating with North Korea assumes as much; that is, that North Korea will ultimately only relinquish its nuclear weapons in exchange for a normalized relationship with the United States.

This paper seeks to question this assumption, while it remains agnostic as to whether North Korea will give up its nuclear weapons. Instead, this paper argues that North Korea's ultimate goal during the remainder of the Bush administration may be to gain access to the international financial system rather than denuclearize. It further contends that North Korean leaders are well aware that the state of the North Korean economy demands that North Korea must reform its economy to survive. These assumptions, in turn, have important implications for North Korea's willingness to forgo nuclear weapons and substantially engage countries beyond China and South Korea as well as for negotiations with the United States. This paper will examine those implications.

In making its arguments, this paper accepts at face value assurances by lead U.S. negotiator and assistant secretary of state, Christopher R. Hill, that North Korea intends to disable the Yongbyon reactor and declare all of its nuclear programs by the end of 2007 and that, with a great deal of good fortune, this actually can occur as early as February 2008. It also accepts in good faith statements by the DPRK Foreign Ministry that North Korea will meet its phase 2 obligations to declare and disable only

1. This is particularly true given allegations that North Korea had provided technical or technological support to a nascent Syrian nuclear weapons program.

when the United States removes the DPRK from the U.S. list of state sponsors of terrorism and from the strictures of the Trading with the Enemy Act (TWEA) and that the United States has agreed to these conditions.

This paper will first examine the barren state of the North Korean economy and the reasons North Korea must reform its economy. It will then review the procedures by which the United States will remove North Korea from the list of state sponsors of terrorism and the TWEA, the resulting impact on existing U.S. sanctions against the DPRK, and North Korea's possible entry into the international financial system. This paper will then tackle what leverage the United States, after the removal of sanctions, will have in negotiating with North Korea to induce North Korea to give up its nuclear weapons. It will also look at the process for North Korea to become a member of international financial institutions (IFIs) and will discuss whether Vietnam can serve as a model for North Korea in normalizing relations with the United States. Finally, it will conclude with policy options for the United States.

II. North Korean Economy—Illicit and Otherwise—in Decline

An uncharitable observer could describe the North Korean economy as a basket economy where the people ate the contents of the baskets, then burned them for fuel. At times, North Korea's laundry list of disasters, natural and man-made, since 1990 appears only to rival ancient Egypt's in frequency. The August 2007 flood that washed away 11 percent of North Korea's cropland is the just the latest installment in the epic travails that began with the withdrawal of Soviet support and peaked with the famine in the late 1990s. With a gross national income of little more than $21 billion (only 40 percent of its 1990 level), the North Korean economy is less than 8 percent the size of Boston's and shrinking, declining again in 2006 after years of sub par growth following the July 2002 economic reforms.

The illicit activities that many hawkish observers contend are propping up the regime are also declining, forcing North Korea to look toward alternative revenue streams. North Korean illicit activities appear to be sagging. Although its arms sales averaged $500 million a year in the late 1980s, the sales of armaments and related services declined to $250 million between 1998 and 2001 and further since then (Haggard and Noland 2007, 5). With obsolete technology dating back to the era of Soviet cooperation and UN resolutions 1695 and 1718 in place, North Korea is believed to be finding fewer buyers, including Syria and Iran and perhaps other countries flush with oil revenues. North Korean sales of opiates, heroin, and methamphetamine are also estimated to be falling. High estimates range from $70 million to $200 million worth of annual drug sales originating in North Korea, but lower projections suggest only $17 million to $35 million in sales in 2006 (Haggard and Noland 2007, 8).

Tough Japanese sanctions, tighter controls on goods entering China, and concerns over the domestic impact of drug sales inside North Korea may account for the downward trends. North Korea must also exit the business of counterfeiting U.S. super notes if it intends to gain access to the international financial system. Regardless, its income from the sale of super notes is meager, with Stephan Haggard and Marcus Noland (2007) estimating that from 1989 through 2005, North Korea earned only \$1.25 million a year from the sale of counterfeit U.S. currency worth \$50 million. Even assuming that the actual figure of counterfeit super notes sold was \$500 million over 16 years, this would amount to a mere \$12.5 million per year. This may help explain North Korea's willingness in the past year to pass anticounterfeiting laws, to allegedly hold accountable the wrongdoers, and to consider turning over evidence of the counterfeiting operations to U.S. officials.

In short, the North Korean economy, though functional, is stuck in a poverty trap that will likely prevent future growth without substantial economic reforms and greater opening to the international community (or so the logic goes). Since the advent of Kim Dae-jung's Sunshine Policy, South Korea has continued to place the bet that North Korea wants to reform but is waiting for the right international environment to embark on grand reforms or at least greater openness to the international community. Many neoconservative officials in the Bush administration through 2006 may have dismissed the Sunshine Policy as nothing more than the tale they claimed it was based on: Hans Christian Andersen's "Emperor's New Clothes."

In contrast, the September 2007 Bush administration approach to negotiating with North Korea rests on the assumptions that (1) North Korea now believes that it can trust the Bush administration to seriously negotiate with it (or to at least grant it significant concessions) and (2) it is in the interest of North Korea to disable Yongbyon and declare its nuclear programs in exchange for what the United States has to offer because of the international access this makes possible.

A review of North Korea's financial conditions and negotiating history suggests that North Korea will demand access to the international financial system to proceed on a course toward denuclearization. Although North Korea can continue to expect grants and concessions from China and South Korea, its other revenue streams are not enough to make North Korea self-sufficient or capable of sustained economic growth. Presuming that North Korea has no desire to become a vassal economic state of China or South Korea and understands that its illicit activities will have to decline if it is to ever enter the international financial arena with U.S. support, South Korea may well be correct in its anticipation of North Korean reform.

III. Doing Business with North Korea: Legal Trade Today

At present, the trade relationship between the United States and North Korea is largely nonexistent. Because of restrictions associated with TWEA and the designation of North Korea as a supporter of terrorism, North Korea cannot receive any funds or assistance from IFIs. The United States is legally obligated to vote against such funding; and without U.S. support, the IFIs cannot provide the funds. If North Korea declares and disables in compliance with its phase 2 commitments and as a quid pro quo the United States removes the DRPK from the terrorism list and TWEA, this could soon rapidly change. Before describing the implications of removing North Korea from the reach of these statutes, this article will describe in some detail the current state of sanctions, including the terrorism list, the TWEA, and other U.S. statutes that permit the United States continued leverage in negotiating with North Korea.

Since President Bill Clinton's 16 June 2000 announcement of a relaxation of sanctions against North Korea, some trade between the two countries has become technically legal. Although the trade of all dual-use items is barred, U.S. companies may import goods from North Korea provided that licensing requirements meant to ensure compliance with U.S. nonproliferation regulations are met. Moreover, exports of "purely" civilian goods, excluding certain luxury items, are allowed with a license. Items for export listed on the U.S. Commerce Control List are no longer automatically denied, but they are reviewed case by case.[2] Travel to North Korea by U.S. citizens and the establishment of telecommunications between the United States and North Korea are also not prohibited. In addition, transactions with individual North Koreans are allowed if they do not amount to donations to a U.S. person and do not further terrorist acts. North Koreans may also invest in U.S. property, and assets of North Koreans who immigrated to the United States and have U.S. residency are not blocked after June 2000. Following the North Korean ballistic missile tests in July 2006, the United States forbade U.S. ownership and operation of North Korean vessels.

IV. Removing North Korea from the Terrorism List

Export Administration Act

On 20 January 1988 the United States added North Korea to its list of state sponsors of terrorism. The addition of the DPRK followed the 29 November 1987 destruction of Korean Air flight 858 by North Korean operatives, which occurred four years after

2. Medical and emergency aid donations are permitted by this list, as recently evidenced by the $8 million worth of aid for flood relief flown directly from Charlotte, North Carolina, to North Korea (the first nonstop flight between the United States and North Korea since the Korean War) by Donald Graham's Samaritan's Purse.

North Korean agents exploded a bomb in the mausoleum of the founder of modern Burma in 1983 in an attempt to assassinate the South Korean president, Chun Doo-hwan. Although the assassination attempt failed, 17 died, including four members of the South Korean cabinet. North Korea is "not known to have sponsored any terrorist acts since the bombing of a Korean Airlines Flight in 1987," according to the State Department's *2006 Country Reports on Terrorism* (DOS 2007).

As a result of North Korea being labeled a terrorist sponsor, the U.S. Export Administration Act ([EAA]; 50 App. U.S.C.A. §2405 [2004]) gives the U.S. president the ability to severely circumscribe exports to North Korea. The EAA allows the president to control exports of U.S. goods and technology through licensing, particularly of dual-use items. Donations of medicine and medical supplies and some food exports are excluded from the act. According to the text of the act, controls may be imposed to achieve an intended foreign policy purpose as long as the proposed controls are compatible with U.S. foreign policy objectives. If North Korea is no longer listed as a state sponsor of terrorism, U.S. exporters could export more freely to North Korea without a license, one of the prime reasons North Korea seeks its removal from the list.

Thus, the designation of North Korea as a supporter of terrorism requires that the export of many goods and technology from the United States be conditioned on the receipt of a license. The process can be cumbersome, and review is on a case-by-case basis. Further, the EAA mandates that the secretary of state notify the Committee on Foreign Affairs in the House of Representatives and the Committee on Banking, Housing, and Urban Affairs in the Senate at least 30 days before issuing any license.

The North Koreans are well aware that few other countries in the world must have every item that they import from the United States vetted by the executive and legislative branches, and they realize that ending the EAA restrictions will end a major impediment for U.S. and multinational corporations with a nexus to business in the United States from exporting to North Korea. Although only one country has been removed from the terrorism list without a change in regime (Libya, for denuclearization no less), the process for removal from the terrorism list can occur quite quickly. To remove the terrorism designation, the secretary of state must inform the following individuals of the intent to remove North Korea from the list: Speaker of the House (currently Nancy Pelosi); chairman of the Senate Committee on Banking, Housing, and Urban Affairs (Christopher Dodd); and the chairman of the Senate Foreign Relations Committee (Joseph Biden). The notification must occur 45 days before the proposed rescission will take effect and certify that (1) North Korea has not provided any support for international terrorism in the preceding six months, and (2) North Korea has provided assurances that it will not support terrorism in the future.

Unless both houses of Congress vote against the removal, North Korea would be removed from the list in 45 days, and commercial license-free exports to North Korea would be permitted. Because it is unlikely that either house of Congress would block the removal of the designation if North Korea declares and disables, the removal could take place promptly and largely through executive action. This explains both the appeal of the removal to the North Koreans and the power of the repeal as a Bush administration inducement. Given North Korean distrust and the significance of the North Koreans declaring all of their nuclear programs, North Korea will likely demand that notice be given 45 days prior to the target date for its disablement and declaration.

Arms Export Control Act

The terrorism list designation also implicates the Arms Export Control Act ([ECA]; 22 U.S.C. §2780 [1968]). Because North Korea is designated as a terrorist sponsor, no U.S. exports to North Korea of arms and munitions are permissible.[3] The process for rescission of the terrorism designation is similar to the process under the EAA, but it requires that the 45-day notice from the secretary of state go to only the Speaker of the House and the Foreign Relations Committee chairman, and it spells out the process for denial by Congress: a joint resolution blocking the repeal to be passed by both houses of Congress. If North Korea were removed from the terrorism list and the separate list of states not cooperating with the United States in the war on terror, U.S. exporters could in theory export arms and munitions to North Korea. This is improbable any time in the near future, but removal of the North Koreans from the reach of the statute does have implications for the expedited sale of dual-use technology to South Korea's Kaesong industrial complex that should not be underestimated.

ECA Amendments

The Antiterrorism and Effective Death Penalty Act of 1996 (P.L. 104-132; also called the Antiterrorism Act) amendments to the ECA explain why termination of the terrorism designation would offer two primary benefits for the DPRK: It would put an end to penalties for engaging in financial transactions with the DPRK and also put an end to the congressional mandate to vote against loans by IFIs to North Korea. Section 321 of the ECA makes it a crime for a U.S. person to engage in any financial transaction with the North Korean government.[4] Removal of the terrorism sanction will permit

3. This is subject to a presidential waiver for sales in the national interest.

4. The secretary of the treasury, in consultation with the secretary of state, may waive the application of the provision. In the case of Banco Delta Asia (BDA), it is unclear whether the transfer via the Federal Reserve of North Korean assets from the Macau bank required a waiver from the Treasury Department and the State Department or whether, because the Federal Reserve is not a U.S. person, no waiver was required.

U.S. financial institutions to more readily engage in financial transactions with North Korea and theoretically offer benefits for both sides. For North Korea, removal of the ban on financial transactions would reduce the chances of North Korea being held hostage to a BDA-like crackdown on a single financial institution, leading to North Korea being shut out of the financial system again. For the United States, it could mean greater North Korean integration into and dependence on a U.S. financial system governed by international norms that North Korea would be forced to obey.

Foreign Assistance

The Antiterrorism Act also amended the Foreign Assistance Act (FAA) to bar assistance from the U.S. government to the North Korean government, meaning that every time the United States seeks to give aid to North Korea, it has to seek congressional authorization after the president requests a waiver 15 days before providing the assistance. The requirement for and power of the presidential waiver was most recently demonstrated on 11 September 2007 when President Bush requested a waiver to supply heavy fuel oil worth $25 million to the North Koreans.

The implications of setting aside the terrorism label could be profound: In terms of foreign assistance, the Bush administration could quickly provide incentives such as heavy fuel, infrastructure development, and energy-capacity assistance to North Korea without congressional approval, thus allowing the United States to accelerate promises made to the North Koreans to denuclearize. In practice, this could increase North Korean demands for further rewards and perhaps the Bush administration's willingness to use them during phase 3 of the nuclear negotiations.

Entrée to IFIs

Removal of the terrorism designation will permit the U.S. Department of the Treasury to support engagement of North Korea by the IFIs—the ultimate incentive—should the Bush administration choose to do so. At present, the ECA amendments to the International Financial Institutions Act require the secretary of the treasury to "instruct the United States executive director of each international financial institution to use the voice and vote of the United States to oppose any loan or other use of the funds of the respective institution to or for a country for which the Secretary of State has made a determination" that is a state sponsor of terror.[5] At present, the United States legally must block any aid from the Inter-American Bank, the Asian Development Bank, the European Bank for Reconstruction and Development (IBRD), the African Development Bank, and the African Development Fund, and, more broadly, the World Bank and International Monetary Fund (IMF).

5. See the *Anti-Terrorism and Effective Death Penalty Act of 1996,* P.L. 104-132 §327.

V. Ending Sanctions Mandated by the Trading with the Enemy Act

As a condition of declaring its nuclear facilities and programs and disabling Yongbyon, North Korea also expects the United States to end the prohibitions associated with the Trading with the Enemy Act ([TWEA]; 12 U.S.C.A. §95a. et. seq. (2007)]. Removal from TWEA will have far-reaching consequences for North Korean financial transactions and the sanctions currently administered by the Office of Foreign Assets Control (OFAC) at the U.S. Department of the Treasury. Under TWEA, President Harry Truman declared a national emergency on 16 December 1950 owing to the Korean War, leading the Treasury Department to promulgate rules banning financial transactions involving or on behalf of North Korea. Specifically, the act permits the president to regulate and prohibit any transaction in foreign exchange; transfers of credits through or to any banking institution; and any payment, conveyance, transfer, assignment, or delivery of property or interest to an account in the United States.

The Clinton administration lifted a number of the sanctions imposed under the TWEA, but a number remain. OFAC regulations currently:

- Ban any imports from North Korea without OFAC approval;
- Require any depository institutions handling letters of credit involving imports from North Korea to seek OFAC approval;
- Prohibit U.S. persons from owning, leasing, operating, or insuring North Korean vessels;
- Retain the freeze on accounts and assets frozen before 16 June 2000; and
- Require almost all exports be licensed and approved.

In addition, Treasury regulations currently prohibit, unless specifically approved by the secretary of treasury, any financial transactions with North Korea, including all foreign exchange transfers of credit and “all payments between, by, through, or to any banking institution or banking institutions wheresoever located, with respect to any property subject to the jurisdiction of the United States.”[6] Treasury regulations also forbid any U.S. financial institution from holding or transferring any North Korean funds unless they are held in an interest-bearing account in a domestic bank (a means to enforce asset freezes).

6. “Transactions Involving Designated Foreign Countries or Their Nationals,” 31 CFR 500.201(a)(1) (2006).

All of these financial prohibitions and other restrictions can be removed at once by the deletion of North Korea from a schedule attached to the Treasury regulations. For North Korea to meets its 13 February 2007 phase 2 commitments, it has demanded that the United States end all TWEA sanctions; North Korea then expects an end to financial bars and restrictions and all of the OFAC-monitored licensing requirements. Once accomplished, North Korea will be able to:

- Export to and import from the United States without OFAC approval for most commercial goods;
- Use U.S. financial institutions to hold North Korean accounts and transfer North Korean funds;
- Allow U.S. businesspeople and companies to own North Korean vessels; and
- Unfreeze North Korean asset accounts frozen between the beginning of the Korean War and June 2000.

These actions will go a long way in helping North Korea achieve its goals of avoiding any repetition of the BDA fiasco and gaining perpetual access to the U.S. financial system. They could also lead to the holding of North Korean assets by U.S. financial institutions, which will then acquire a vested interest in the maintenance of North Korean participation in the U.S. financial system.

VI. Retaining U.S. Leverage

If North Korea disables Yongbyon and fully declares its nuclear program in exchange for removal from the terrorism list and an end to all TWEA sanctions, it will have struck a very hard bargain. Although North Korea would retain its nuclear weapons and plutonium stockpile, the United States would have opened the U.S. financial system to North Korea, removed most restrictions on commercial exports and imports to North Korea, unfrozen most North Korean assets frozen under TWEA, and unblocked the statutory bar on direct U.S. assistance and U.S. support for IFI assistance to North Korea. Why would North Korea then give up its nuclear weapons? And what leverage would the United States still retain after the sanctions list and TWEA sanctions go by the wayside?

The list of possible demands North Korea might make before it actually gives up its nuclear programs might seem almost endless: termination of UN resolutions 1695 and 1718, security guarantees, an armistice and end to the Korean War, a light-water reactor (LWR) or two, establishment of North Korean accounts at U.S. banks, and U.S. government facilitation of North Korean financial transactions.

A careful review of relevant legislation reveals that the United States is giving up less than it appears at first glance. The Treasury Department has the authority to impose U.S. restrictions as long as a state of war exists between the United States and North Korea. Under the EAA, even without the terrorism sponsor designation, the executive branch can readily reimpose the limitations on exports. In fact, section 2405(a)(1) of the EAA permits the president to impose export limits "to the extent necessary to further significantly the foreign policy of the United States or to fulfill its declared international obligations." In plain English, if North Korea decided not to denuclearize, President Bush or his successor could rapidly reimpose the export and financial controls if that were thought to be in the foreign policy interest of the United States. Second, under the ECA, the executive still has the discretion to block arms sales specifically to countries that are not cooperating with administration efforts to combat terrorism and more generally under other statutes and regulations. Third, while removal from the terrorism list no longer obligates the United States to vote against IFI support for North Korea, it does not require the secretary of the treasury to support it.

The Bush administration or any subsequent administration can also impose additional sanctions under the International Religious Freedom Act of 1998 ([IRFA]; 22 U.S.C.A. §6401 et seq.) and the Trafficking Victims Protection Act of 2000 ([Trafficking Act]; Division A of P.L. 106-386). These sanctions fall short, however, of the possibilities under TWEA or the terrorism list. Given North Korea's atrocious record when it comes to religious tolerance, the executive branch under IRFA has the authority to limit development assistance to North Korea, direct U.S. executive directors of IFIs to vote against loans to North Korea, require specific licenses for the export of goods or technology to any government agency responsible for the violations of human rights laws, and limit the loans of U.S. financial institutions to $10 million in any 12-month period. IRFA, however, has its limits. It expresses a preference for the U.S. government to negotiate an end to religious discrimination and ties the imposition of sanctions to specific violations of and violators of religious freedom.

The sanctions under the Trafficking Act are even more limited and are specifically tied to the trafficking of women and children, making its application particularly difficult. While some human rights activists can argue that horrendous conditions inside North Korea lead to the trafficking of women and children to China and that North Korean guards or low-level officials are complicit in the trafficking, such arguments may not live up to legal scrutiny. If they do, the act allows the president to withhold "nonhumanitarian, nontrade-related assistance" and to order U.S. executive directors to block IFI loans. But, like IRFA, the statute lacks the teeth of TWEA and the terrorism designation.

VII. The Bush Administration and the Age of Aquarius

Why should the Bush administration risk such a gamble? In exchange for shutting down a reactor that has outlived its shelf life and a declaration of nuclear programs without disclosure of their location, why should the United States remove all sanctions on North Korea and open the U.S. financial system to the North Korean government? With John Bolton and Bob Joseph gone, did President Bush awaken one morning humming the lyrics to the song "The Age of Aquarius" from the Broadway hippie musical *Hair*? Hardly. In contrast, the knee-jerk reaction of many longtime Bush critics is a simple one: having botched the war in Iraq, the administration needs a foreign policy victory, any foreign policy victory, and if it's with North Korea, so be it. Such a simplistic description not only minimizes the importance of key personnel departures from the Bush administration and their impact on the process, it also sells short the efforts of Assistant Secretary Christopher Hill and masks more complex explanations.

In making his case to the administration, Assistant Secretary Hill has (apparently) argued effectively that the ability to foreclose the North Korean capacity to manufacture more nuclear weapons outweighs any hypothetical North Korean gains of face when TWEA and the terrorism designation sanctions are removed. Second, engagement proponents can contend that whatever the United States gives up now, it can always take back again. In late 2007, one senses that in the interest of national security, the administration can live with a nuclear North Korea that has capped its production capabilities and does not proliferate, that is, an Agreed Framework redux.

In this paper, it is posited that the Bush administration believes or at least hopes that North Korea, in order to secure its economic and security interests, (a) desires to gradually reform and open its economy; (b) will negotiate until the UN sanctions are removed, and (c) has the will and ability to interface with IFIs. The assumption is made that North Korea seeks to extract maximal resources from the IFIs to allow it to reform and build its economy and will negotiate not only to maximize its gains with an administration facing a running clock but also to increase its own regime stability and national security. Finally, it is also assumed that North Korea will give up its nuclear weapons, if at all, only after it gains access to IFI funds.

VIII. North Korea and International Financial Institutions: North Korea Goes Global

Assume for the moment that North Korea disables Yongbyon and declares its nuclear programs and that the United States removes North Korea from the list of state sponsors of terror and abolishes the TWEA sanctions by February 2008. Assume further that North Korea demands that the United States and Japan proactively support North Korean engagement with the IMF as a first step toward receiving financial assistance from the IMF and other IFIs as a condition of complete denuclearization. Finally, assume that the Bush administration acquiesces to the demand to permit technical assistance, joint macroeconomic game planning, and possibly the establishment of a World Bank trust fund in a good faith effort to accelerate denuclearization and in the long-term hope that greater international financial interaction with North Korea will in fact undermine the Kim Jong-il regime and the pyramid of power and patronage he has built.

This section briefly describes what the process would entail for North Korea to ultimately obtain aid from IFIs. Regardless of whether the North seeks an economic big bang to attract a flood of capital and expertise to remake its economy while reducing social transformation costs or engages in fakery aimed at attracting as much foreign currency and expertise to support the regime as it can, North Korea would need massive official development assistance and foreign direct investment (FDI) as well as technical advice and assistance to develop an economic growth plan, to use the foreign assistance rationally, and to resolve payment of its external debts if it seriously desires to obtain IFI financial support. The North must also build management capacity, create a banking system, and revamp its legal systems to ultimately garner donor support. This would be preceded by a joint DPRK-IFI program to design a macroeconomic framework for the country's economy.

Such a program assumes that North Korea is sufficiently willing to abide by international norms to begin a serious dialogue with the IFIs. There is some precedent. In 1997, the DPRK sent an inquiry to the Asia Development Bank seeking to learn more about membership. In September of the same year, the IMF deployed a fact-finding mission to North Korea, which reported to the IMF's executive board. And in February 1998 the World Bank sent its own exploratory mission to North Korea.[7]

To join an IFI, North Korea requires support of 85 percent of the IFI's shareholders, meaning it must have U.S. support. North Korea would have to first join the IMF before joining the World Bank (although applications for both could be submitted at the same time). Based on past precedent, North Korea could then apply to join the Asian Development Bank. At the World Bank, North Korea would have to first become a member of the IBRD, which, in turn, could lead to membership in the World Bank's International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA).

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7. Critics, however, can point to the lack of follow-through on the part of North Korea during these earlier efforts and its refusal to participate as a "special guest" in the IMF–World Bank annual meetings in 2000.

Babson (2006, 20) divided up the process of becoming a member in the World Bank into four stages:

> Phase 1: Education, training, economic assessment, and dialogue on development strategies;
>
> Phase 2: Creation of a special trust fund to pay for training, technical assistance, sectoral and institutional assessments, and pre-investment studies;
>
> Phase 3: Membership in the IMF, IBRD, and IDA, the beginning of IDA assistance and establishment of a DPRK consultative group; IFC and MIGA membership might follow;
>
> Phase 4: Receipt of IBRD loans and support to join the WTO.

According to Babson, phase 1 might last a year and the second phase (which could overlap with phase 3) might take more than three to four years. This means that in an ideal scenario North Korea could only graduate from phase 1 at the beginning of a post-Bush administration and ultimately receive (at the earliest) IDA and IBRD assistance well into the successor administration's first or even second term.

The fruits of a relationship with an IFI could be acquired by North Korea before formal membership. The boards of directors of the IFIs could agree to provide assistance to North Korea, including (1) technical assistance and training in advance of the application process and to comply with membership's technical and legal conditions, (2) postconflict recovery and economic reconstruction planning, and (3) assistance via trust funds set up by donor nations and administered by the World Bank.

If immediate funds are North Korea's priority, conditioning denuclearization on the establishment of a U.S.-backed trust fund at the World Bank could make a strong negotiating tactic as North Korea could receive funds faster. The World Bank has established special trust funds for nonmembers of the World Bank, as in the cases of the West Bank and Gaza, Bosnia, Kosovo, and East Timor, and could do so in the case of North Korea. The World Bank executive board would initiate the project. Donor nations would then pool resources and disburse them, typically on a grant basis. South Korea could be expected to play a large role. Generally, a trustee is appointed by the bank, and a council of donors approves distribution of the funds. Although some analysts contend that North Korea would have to first show a willingness to revamp its economy and open up, a United States, in tandem with Japanese acquiescence, committed to the establishment of a trust fund by the World Bank could speed the process if denuclearization negotiations proceeded rapidly.

IX. The Vietnam Model: Applicable or Not?

In January 2007, Vietnam, once a pariah state vis-à-vis the United States, entered the WTO. Vietnam's accession was made possible only by congressional approval of the United States granting permanent normal trade relations (PNTR) status to Vietnam. Vietnam's entrance into the WTO was the culmination of 13 years of improving relations between the United States and the socialist republic, which began with President Clinton's decision to end the U.S. trade embargo on Vietnam in February 1994. Similarly, if the Bush administration removes the terrorist-state designation and ends TWEA sanctions against North Korea, it would unblock many of the existing restrictions on trade with North Korea. Can North Korea follow the Vietnamese path to normalization of relations with the United States?

Vietnam Policy during the George H. W. Bush Administration and Lessons for North Korea

North Korean officials may recoil at the comparison between the DPRK and Vietnam and point out the vast differences between the two countries, but they can learn significant lessons from the Southeast Asian state's burgeoning relationship with the United States. The primary lesson: easing of trade restrictions is the forerunner to a political relationship to be developed over successive U.S. administrations.

North Korean officials should start by looking back to 1991 (U.S.-Vietnam Trade Council 2007). In that year, the United States discussed a specific "road map" for normalization of relations with Vietnam. The parties agreed to open a U.S. office in Vietnam to investigate prisoner-of-war and missing-in-action cases in exchange for U.S. humanitarian aid. Similarly, if denuclearization talks proceed and are not sunk by reported North Korean proliferation of missile or nuclear technology to Syria, the United States and North Korea, pursuant to the 13 February 2007 agreement, will begin discussing a road map for normalization. Establishing a U.S. office for humanitarian assistance or for POW and MIA issues could be a first step. In 1991 the State Department also granted permission more frequently to Vietnamese officials at the United Nations to travel outside of New York. This parallels the State Department's decision to permit the North Korean permanent representative and deputy permanent representative to the United Nations to travel with their families to Washington, D.C., for a weekend vacation in September 2007.

In 1992, the United States ramped up humanitarian aid to Vietnam. It also agreed to permit direct telecommunications between the United States and Vietnam, to allow U.S. commercial sales for humanitarian reasons to Vietnam, and to remove limitations on Vietnam-based projects of U.S. nongovernmental organizations (NGOs). By December 1992, the United States removed a number of restrictions on U.S. companies operating in Vietnam. To a limited extent, the United States has already permitted humanitarian-focused NGOs to operate in North Korea during the famine and commercial sales and grants for humanitarian reasons to North Korea. Establishment of direct telephone links may be a long way off, however, owing not only to North Korea's technological deficiencies but also to concerns in Pyongyang about exposure to ideological pollution from the outside. Should denuclearization talks proceed, the United States and South Korea could offer to develop North Korea's communications infrastructure and establish telecom links on a limited basis.

Vietnam Policy during the Clinton Administration and Lessons for North Korea

President Clinton accelerated the movement toward reversing the U.S. economic isolation of Vietnam. On 2 July 1993, the Clinton administration announced that it would not continue to oppose IFI aid to Vietnam. Progress on POW and MIA issues made the decision politically viable, as it did the decision to station U.S. consular officials in Hanoi. In September 2003, the United States permitted U.S. companies to submit bids on IFI-supported projects in Vietnam. By February 1994, Clinton announced an end to the U.S. trade embargo on Vietnam. The announcement followed by a week a Senate vote on broad authorizing legislation that attached a call for an end to the embargo.

North Korea can also glean certain lessons from 1993. Instead of using progress on POW and MIA issues as leverage to prod the United States, North Korea can use progressive denuclearization (or even progress on POW and MIA issues) as a means of encouraging the United States to not oppose IFI aid. Second, although at the outset the executive branch can remove North Korea from the terrorism list or end the TWEA sanctions, congressional support of administration policy will be essential to improved North Korean relations with Washington.

In January 1995, the United States and Vietnam agreed to open liaison offices in Hanoi and Washington the following month and to resolve outstanding diplomatic and property claims. The Treasury Department in March 1995 unblocked accounts held by Vietnamese nationals and the government of Vietnam. Removal of the TWEA sanctions could go a long way toward unfreezing accounts by North Korea blocked before June 2000. North Korea could also demand the establishment of liaison offices and the resolution of diplomatic and property claims[8] as a condition of denuclearization because Pyongyang cannot expect the United States to establish full-fledged diplomatic relations with it once its nuclear leverage is exhausted.

8. The 1981 U.S.-Iranian Claims Tribunal is one such model.

In July 1995, Clinton released plans to establish full diplomatic relations, with embassies opening in Hanoi and Washington in August 1995. The first U.S. ambassador arrived in Hanoi to assume his post in April 1997. This rapid-fire normalization survived several congressional efforts to block economic and political normalization, including attempts to tie normalization to greater movement on POW issues and improvements in Vietnam's human rights record. Numerous trips to Vietnam by members of the U.S. Congress who came back from Vietnam convinced that Vietnam was committed to pursuing POW and MIA claims in turn strengthened support for normalization. In all likelihood, dozens of members of Congress will have to visit North Korea and come back to Washington convinced that North Korea is seriously committed to denuclearization and economic reform before they are willing to support normalization—another important lesson for the North Koreans.

Removal of the trade embargo between the United States and North Korea will not be enough to jump-start U.S. FDI into North Korea, given the decrepit state of the DPRK economy. Several steps will be necessary, including a waiver of the Jackson-Vanik amendment, as demonstrated by the case of Vietnam. In 1997, the United States signed an agreement with Vietnam on copyright protection and announced that the U.S. Trade and Development Agency would operate in Vietnam. These announcements were followed by administration consultations with Congress about granting a presidential waiver of the Jackson-Vanik amendment. The amendment, which bars loans or other financial support from the Overseas Private Investment Corporation (OPIC) and the Export-Import (Ex-Im) Bank to U.S. businesses operating in nonmarket economies, stood as a major impediment to U.S. FDI into Vietnam. In March 1998, Clinton granted the waiver, making possible a $2.3 million OPIC loan to Caterpillar in Vietnam in November 1999. The Ex-Im Bank soon followed suit, signing two agreements on project finance with the State Bank of Vietnam in December 1999.

At present, many U.S. businesses are unlikely to enter the North Korean market, to the extent it exists, without some type of political risk insurance. U.S. financial institutions will also be very hesitant to fund U.S. FDI on their own. Financing and support from both OPIC and the Ex-Im Bank will be crucial to providing private sector actors with enough confidence to enter North Korea; they will want to see their investments protected from the cost of possible nationalization or other North Korean government actions. The U.S. executive branch will need to consult with Congress and then grant an annual Jackson-Vanik waiver for North Korea and come to an agreement with North Korea on OPIC and Ex-Im Bank support for U.S. investments in North Korea. This is additional leverage for the United States.

Vietnam Policy during the George W. Bush Administration and Lessons for North Korea

Negotiating and signing a bilateral trade agreement (BTA), as in the case of Vietnam, may be another U.S. lever and could force reform onto North Korea. In December 2001, five years after exchanging ambassadors, the United States and Vietnam entered into a BTA. It required Congress to grant conditional normal trade relations (NTR) status to Vietnam. Under the terms of the 2001 agreement, the United States slashed U.S. tariffs on Vietnamese imports, and Vietnam agreed to NTR for U.S. exports, reduced tariffs, increased access for U.S. banks and telecommunications providers, and newly imposed intellectual property rights protections. A prerequisite of maintaining NTR was an annual waiver of Jackson-Vanik, which can be blocked by a congressional disapproval motion. In the instance of Vietnam, the waivers survived congressional opposition each year, despite efforts to tie the waiver to progress on POWs, greater market access, or human rights. Vested business interests supporting improved U.S.-Vietnam ties and a perception in Congress that Vietnam was continuing on the path to reform made this possible. As a result, U.S.-Vietnamese merchandise flows in 2006 amounted to $9.4 billion, up from $222.7 million in 1994. These are important lessons for North Korea.

Improvements in U.S.-Vietnamese ties led to improved political and economic relations, but less emphasis was placed on human rights issues, despite some efforts in Congress to enlarge the role of human rights in the relationship. Either a new maturity in the relationship or changed political dynamics in Washington has caused this to change and has led to changes in both Vietnam's behavior and Vietnam's entry into the WTO. North Korea might receive a similar pass on its atrocious human rights practices for as long as it has a nuclear weapons program, but not much longer.

Events in the U.S.-Vietnam relationship since 2004 may be instructive. In 2004, the State Department named Vietnam as a "country of particular concern" (CPC) because of Vietnam's treatment of certain Protestant and Buddhist groups. To avoid sanctions, Vietnam negotiated an agreement with the United States to improve religious freedom, particularly for groups in the central highlands. In November 2006, the United States removed the CPC label. The removal preceded by days President Bush's trip to Hanoi for an Asia-Pacific Economic Cooperation summit and Bush's pronouncements of U.S. support for Vietnam's entry into the WTO. Vietnamese efforts—at the behest of the U.S. Treasury—to curtail Vietnamese banking activities with North Korea probably did not hurt either. Perhaps, like Vietnam, North Korea can establish an economic and political relationship with the United States, but absent a sincere commitment to market reform and demonstrable progress in its human rights policies, North Korea will experience important limits to improved relations with the United States.

X. U.S. Policy Options and Conclusion

The significance of the Bush administration's willingness to remove the terrorist-state designation and TWEA should not be understated. If the negotiations with North Korea are successful, the Bush administration will have given up much more than the Clinton administration ever did under the Agreed Framework. During the Clinton administration, the United States retained the bulk of its sanctions against North Korea, while North Korea agreed to freeze Yongbyon and not process any more plutonium in exchange for heavy fuel oil and an LWR paid for primarily by the South Koreans and Japanese. In contrast, under Bush, the United States will remove most of its sanctions against North Korea while North Korea agrees to disable Yongbyon, not process any more plutonium, and declares its nuclear programs; but the North can retain 10 bombs worth of fissile plutonium.

In exchange for only a declaration and disablement, the United States will make significant concessions. These include allowing U.S. companies to export and import many commercial goods to and from North Korea without licenses, opening the U.S. financial system to North Korea, removing the U.S. statutory bar to voting for IFI funds for North Korea (likely resulting in North Korean demands for IFI support prior to denuclearization), and unfreezing North Korean accounts in the United States. This will be in exchange for a virtual return to the Agreed Framework, and it requires only a 45-day notice to Congress in the case of a terrorism designation and an executive order in the case of TWEA.

Once the sanctions are gone, the North Koreans will have little reason to give up their nuclear weapons absent a long-term strategy and a willingness on the part of the United States to use the (dis)incentives at its disposal. To avoid this dilemma, the United States should consider the following:

- Highlight to the North Koreans the theoretical benefits of removal of the sanctions, but not the realities. While the removal of sanctions will make it possible to export and import many goods without licenses, tariffs, other regulations, and the lack of a Jackson-Vanik waiver will make this cost-prohibitive.

- Tie the 45-day notice period for the removal of the terrorist label to North Korea's complete declaration and disablement.

- Make clear that EAA sanctions can be reimposed by law to achieve stated U.S. foreign policy objectives. Because the United States considers denuclearization of North Korea an important foreign policy objective, North Korean failure to denuclearize could result in reimposition.

- Permit legitimate North Korean entities to use the U.S. financial system if North Korea verifiably ceases its counterfeiting activities and the North Korean government complies with international anti–money laundering requirements. The United States government should not, however, facilitate financial transactions by North Korea or North Korean entities.

- Make clear to the North Koreans that U.S. support at the IFIs depends upon North Korea giving up nuclear weapons. U.S. support for technical assistance could precede denuclearization and should be used as an effective tool to prod the North Koreans to give up their nuclear weapons and open up their economy. U.S. support of a World Bank trust fund should occur simultaneously with the final stages of denuclearization. The United States should seek to play up the benefits of the IFIs and permit the IFIs to send assessment teams at the earliest possibility.

- Delay U.S. support for overturning UN sanctions resolutions 1695 and 1718 until the last stages of denuclearization negotiations.

- Address North Korean human rights violations only after North Korea denuclearizes and North Korea's threat as a proliferator is neutralized.

- If North Korea honors its phase 2 commitments, learn from the lessons of U.S. normalization with Vietnam; then, in phase 3:

    — Provide a specific road map for normalization;

    — Permit the more frequent travel of North Korean officials outside of New York and encourage U.S. congressional officials to visit North Korea in order to garner greater congressional support for engagement with North Korea;

    — Agree to establish, following denuclearization, an international telecommunications network, preferably funded by the South Koreans, between the United States and North Korea; and

    — Establish a tribunal similar to the U.S.-Iran Claims Tribunal to resolve the status of assets and property unfrozen by the removal of TWEA restrictions.

North Korea of course is not Vietnam. It did not unify the two halves of what it claimed to be one country. It did not drive U.S. troops from its borders. In contrast to Vietnam, North Korea lacks any type of religious freedom, let alone freedom of movement. Instead of witnessing 8 percent growth for nearly 20 years, North Korea has suffered through an economic free fall followed by stagnant growth. And North Korea lacks any type of relationship with the United States while the U.S.-Vietnam relationship continues to blossom. But North Korea's plutonium stockpile has the possibility of providing an existential threat to U.S. citizens while Vietnam poses no such danger. Accordingly, the United States must deal with North Korea to neutralize the threat of proliferation. Reversing nearly six years of possibility, the Bush administration appears ready to wager almost all U.S. sanctions to return to an Agreed Framework–like cap on North Korea's plutonium production. It is a bet the United States cannot afford to lose.

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