

# 동북아 평화 증진과 북한 개발을 위한 국제협력

International Cooperation  
for Enhancing Peace in Northeast Asia  
and North Korea's Development

2013. 11. 19 (화)  
콘래드 서울 (여의도)

November 19, 2013  
Conrad Hotel, Seoul, Korea

주최

 한국수출입은행  
THE EXPORT-IMPORT BANK OF KOREA



경남대학교 극동문제연구소  
The Institute for Far Eastern Studies

후원



통일부  
MINISTRY OF UNIFICATION



기획재정부  
MINISTRY OF STRATEGY  
AND FINANCE



북한대학원대학교  
University of North Korean Studies

# 프로그램

9:30~9:50

## 개회식

개회사	<b>김용환</b> (한국수출입은행 은행장)
축사	<b>강창희</b> (국회의장) <b>류길재</b> (통일부 장관)
환영사	<b>박재규</b> (경남대학교 총장)

10:10~12:00

## Session I

### 북한 개발협력에 대한 동북아 국가들의 시각과 전략

사회	<b>송민순</b> (전 외교통상부 장관)
발표	<ul style="list-style-type: none"><li>• 북한 개발협력에 대한 중국의 시각과 전략 <b>자오후지</b> (중국공산당 중앙당교 정법부 교수)</li><li>• 북한 개발협력에 대한 일본의 시각과 전략 <b>이소자키 아츠히토</b> (게이오대학교 교수)</li><li>• 북한 개발협력에 대한 러시아의 시각과 전략 <b>게오르기 틀로라야</b> (러시아과학원 원장)</li><li>• 북한 개발협력에 대한 미국의 시각과 전략 <b>멜 거토프</b> (포트랜드주립대학 명예교수)</li></ul>
토론	<b>이호철</b> (인천대학교 교수) <b>박영준</b> (국방대학교 교수) <b>김석환</b> (한국외국어대학교 교수) <b>사하시 료</b> (가나가와대학교 교수)

12:00~14:00

## 오찬

오찬연설	<b>롤프 마파엘</b> (주한독일대사)
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# Program

9:30~9:50

## Opening Session

Opening Remarks

**KIM Yong Hwan** (Chairman & President of The Export-Import Bank of Korea)

Congratulatory Speech

**KANG Chang-Hee** (Speaker of the National Assembly)

**RYOO Kihl-jae** (Minister of Unification)

Welcoming Remarks

**PARK Jae Kyu** (President of Kyungnam University)

10:10~12:00

## Session I *Northeast Asian Perspectives and Strategies on Development Cooperation for North Korea*

Moderator

**SONG Minsoon** (Former Minister of Foreign Affairs and Trade)

Presenters

- Chinese Perspective and Strategies for North Korean Development Cooperation  
**ZHAO Huji** (Professor, Central Party School of the Communist Party of China)
- Japanese Perspective and Strategy for North Korean Development Cooperation  
**ISOZAKI Atsuhito** (Professor, Keio University)
- Russian Perspective and Strategy for North Korean Development Cooperation  
**Georgy TOLORAYA** (Department Chief, Russkiy Mir Foundation)
- US Perspective and Strategy for North Korean Development Cooperation  
**Mel GURTOV** (Professor Emeritus, Portland State University)

Discussants

**LEE Hochul** (Professor, University of Incheon)

**PARK Young-Jun** (Professor, Korea National Defense University)

**KIM Seok-Hwan** (Professor, Hankuk University of Foreign Studies)

**SAHASHI Ryo** (Professor, Kanagawa University)

12:00~14:00

## Luncheon

Luncheon Speech

**Rolf MAFTEL** (Ambassador of Germany to the ROK)

# 프로그램

14:00~15:50

## Session II 북한의 경제개발 평가와 국제 개입 전략

사회

**최완규** (북한대학원대학교 총장)

발표

- 김정은 시대 북한의 경제발전계획: 글로벌 관점과 대응  
**스콧 스나이더** (미국외교협회 선임연구원)
- 개성공단의 국제화와 북한의 경제특구: 주변국들의 역할  
**트로이 스탠가론** (한미경제연구소 의회통상국장)
- 북한의 경제 기반 개발: 한-중-러 삼각협력  
**타기르 쿠지야토브** (러시아극동대학 교수)
- 김정은 정권 이후 북한에 대해 중국의 변화된 태도 고찰  
**사이먼 쉐** (홍콩중문대학교 교수)

토론

**양문수** (북한대학원대학교 교수)  
**임을출** (경남대학교 교수)  
**나희승** (철도기술연구원 연구위원)  
**임강택** (통일연구원 선임연구위원)

15:50~16:10

## Coffee break

16:10~18:00

## Session III 북한과 동북아 국가들 간의 협력 증진: 국제개발기구들의 역할

사회

**라스 안드레 리히터** (프리드리히 나우만재단 한국사무소 대표)

발표

- 미얀마의 경제체제 전환에서 국제금융기구의 개입: 그 중요성과 북한에 대한 함의  
**브래들리 밥슨** (아시아지역 컨설턴트)
- 베트남 체제 전환 사례를 통해 본 국제협력의 필요성  
**디팍 미쉬라** (세계은행 수석 이코노미스트)
- 동유럽 체제전환 사례와 경제개발협력 경험  
**피로스카 나기** (유럽부흥개발은행 국가전략정책 소장)
- 광역두만계획(GTI)을 통한 지역협력의 증진  
**장도환** (UNDP GTI 사무국 자문관)
- 국제개발협력에 대한 중국의 참여: 북한에 대한 함의  
**저우 타이동** (아시아재단 프로그램 자문관)

토론

**장형수** (한양대학교 교수)  
**최창용** (KDI 국제정책대학원 교수)  
**윤덕룡** (대외경제정책연구원 선임연구위원)  
**김병로** (서울대학교 교수)

# Program

14:00~15:50

## Session II *Assessment of North Korea's Economic Development and International Intervention Strategies*

Moderator

**CHOI Wan-Kyu** (President, University of North Korean Studies)

Presenters

- North Korea's Economic Development Plan in the Kim Jong Un Era: Global Perspective and Response  
**Scott SNYDER** (Senior Fellow, Council on Foreign Relations)
- Internationalization of the Kaesong Industrial Complex and North Korea's SEZs: The Role of Neighboring Countries  
**Troy STANGARONE** (Senior Director, Korea Economic Institute of America)
- Development of North Korea's Infrastructure: Trilateral Korea-China-Russia Cooperation  
**Tagir KHUZIYATOV** (Professor, Far Eastern Federal University)
- Explaining China's Shifting Attitude toward DPRK since Kim Jong-un  
**Simon SHEN** (Professor, Chinese University of Hong Kong)

Discussants

**YANG Moon-Soo** (Professor, University of North Korean Studies)

**LIM Eul-Chul** (Professor, Kyungnam University)

**NA Hee Seung** (Senior Research Associate, Korea Railroad Research Institute)

**LIM Kang-Taeg** (Senior Research Fellow, Korea Institute for National Unification)

15:50~16:10

**Coffee break**

16:10~18:00

## Session III *Promoting Cooperation between North Korea and the Nations of Northeast Asia: The Role of International Development Agencies*

Moderator

**Lars-André RICHTER** (Resident Representative, Friedrich Naumann Foundation for Freedom)

Presenters

- International Financial Institutions in Myanmar's transition: potential Implications for The DPRK  
**Bradley O. BABSON** (Consultant on Asian affairs)
- Vietnam's Economic Transition: Well Begun, Not Yet Done  
**Deepak MISHRA** (Lead Economist, World Bank)
- The Experience of Systemic Transition and Economic Development in Eastern Europe  
**Piroska NAGY** (Director of Country Strategy and Policy, Office of the Chief Economist, EBRD)
- Promoting Regional Cooperation under GTI (Greater Tumen Initiative) Framework  
**CHANG Dohwan** (Program Advisor, UNDP GTI Secretariat)
- Engaging China in International Development Cooperation: Implications for North Korea  
**ZHOU Taidong** (Program Officer, The Asia Foundation)

Discussants

**ZANG Hyoungsoo** (Professor, Hanyang University)

**CHOI Changyong** (Professor, KDI School of Public Policy and Management)

**YOON Deok Ryong** (Senior Research Fellow, Korea Institute for International Economic Policy)

**Philo KIM** (Professor, Seoul National University)

## Opening Remarks

Kim Yong Hwan  
Chairman & President  
of the Export-Import Bank of Korea

Good Morning.

Honorable Speaker Kang Chang-Hee, Minister Ryoo Kihl-jae, our co-organizer President Park Jae Kyu of Kyungnam University, Your Excellencies Ambassadors to the Republic of Korea,

Distinguished Guests and Ladies and Gentlemen,

I would like to extend my warmest welcome to you all for taking the time to be here today, to be a part of this conference on International Cooperation for Enhancing Peace in Northeast Asia and North Korea's Development.

It is my privilege and honor to have this remarkable opportunity to jointly host the international conference with the Institute for Far Eastern Studies of Kyungnam University.

The maintenance of peace in Northeast Asia remains volatile amid lingering tensions with North Korea. The international community has unremittingly made demands to North Korea to denuclearize and open up but it continues to tread the path of isolation, resulting in escalation of mistrust and conflict.

Nevertheless, it is crucial that the international community continue to embark on this effort to build trust with North Korea, and encourage it to become partners with the rest of the world.

It is significant in this regard that various economic changes can be detected in North Korea. For example, Pyongyang has newly designated 14 Special Economic Zones and took steps to induce more foreign investment to the country.

If countries of Northeast Asia work together to promote North Korea's development, if North Korea responds positively to such efforts, I believe we can not only hope for peace and prosperity in the region but also for the dawning of a new Eurasian era.

At this critical juncture, it is timely and meaningful indeed that experts from international financial institutions and renowned academics at home and abroad have gathered here today to discuss the vital issue of "International Cooperation for Enhancing Peace in Northeast Asia and North Korea's Development".

Ladies and Gentlemen,

As the official export credit agency of South Korea, Korea Eximbank has been providing export credits to facilitate trade, overseas investment, and the development of natural resources abroad for nearly 40 years. In addition, we are also providing aid to developing countries through the Economic Development Cooperation Fund (EDCF) and promoting exchanges and cooperation with North Korea through the Inter-Korean Cooperation Fund (IKCF). We have been using these and other tools to implement a wide range of government policies.

One such policy is to promote regional development in Northeast Asia. To do so, our bank has signed Reciprocal Risk Participation Agreement with China Eximbank and established a framework for financial cooperation in the amount of USD 2.5 billion with Russian banks including Vnesheconombank. In August this year, the Northeast Asia EXIM Banks Association was launched to strengthen cooperation among the export credit agencies of Greater Tumen Initiative member states including China, Russia, and Mongolia.

In relation to North Korea, we have provided over KRW 5.99 trillion or USD 5.61 billion since we were entrusted with the operation of IKCF in 1991. The bulk of that Fund went to humanitarian assistance in the form of rice and fertilizer as well as going to loans and insurance coverage for companies operating in the Kaesong Industrial Complex.

In addition, we support the government's initiatives on North Korea by hosting annual international seminars and inter-Korean advisory committees consisting of experts from various fields to gain insights and policy recommendations.

Many such seminars and meetings in the past have already yielded substantial insights into the complicated nature of inter-Korean relations, and I am confident that your valuable inputs during today's conference will be tremendously helpful in guiding our bank's future policy.

In concluding, I would like to once again thank all of you for being a part of our conference today.

We ask for your continued interest in, and cooperation with Korea Eximbank as we pursue our mission to promote economic cooperation among Northeast Asian countries and establish the foundation for the unification of the two Koreas.

Thank you.

## Welcoming Remarks

Park Jae Kyu  
President of Kyungnam University  
Former Minister of Unification

Honorable Kang Chang-Hee, Minister Ryoo Kihl-jae, Chairman Kim Yong Hwan, distinguished participants and guests, ladies and gentlemen.

It is my pleasure to welcome you all to today's conference on International Cooperation for Enhancing Peace in Northeast Asia and North Korea's Development, jointly organized by the IFES of Kyungnam University and the Export-Import Bank of Korea.

I'd like to sincerely thank our co-organizer, the Export-Import Bank of Korea, for their strenuous efforts and generous support. I'd also like to thank our sponsors, the Ministry of Unification, Ministry of Strategy and Finance, and the University of North Korean Studies. Finally, let me thank the hard working faculty and staff at IFES for their hard work in organizing today's event.

When we talk about enhancing peace in Northeast Asia, it means we are well aware of how elusive peace and stability in the region can be and has been, particularly of late. Recently, tensions have risen, and disputes have intensified due to a number of developments in various issue areas.

To enhance peace in the region, actors will have to overcome numerous obstacles. One of those is the denuclearization of the Korean Peninsula and the problem of North Korea.

Over the last twelve months, North Korea rather provocatively launched a long-range rocket and conducted a third nuclear test.

Looking at the country, there are many grave and pressing issues of international concern. But so far, our past efforts have failed to curb North Korea's nuclear ambitions, induce its reform and opening, or prompt it to address its human rights issues. If North Korea desires to integrate into the international community, resuscitate its economy, and improve the well-being of its people, then denuclearization, reform and opening, and improving human rights are the steps the regime ultimately must take. This is inevitable.

However, although efforts have been made to lead North Korea down that path, they have largely failed.

What we must truly recognize is that peaceful resolution to the nuclear issue—and therefore enhancing peace in the region—will require recognizing North Korea's security concerns and solving the dilemma of the country's development.

To do that, past strategies of engagement and pressure need to be reassessed, taking into account the current reality from different perspectives. Alternatives need to be explored.

One such alternative is to take development assistance to North Korea seriously. Today, at this conference, we hope to examine what that means, and what alternatives might look like with respect to various actors' involvement, including the governments of Northeast Asia and international organizations, in particular international financial institutions. To date, IFIs have a track record of effectiveness in economies such as Vietnam, Cambodia, and more recently Myanmar. They have been able to slowly build confidence and improve transparency in these challenging environments through dialogues, technical assistance, and even such endeavors as micro-finance programs, among other activities. Such commitment to engagement has led to tangible outcomes that have promoted stability in those countries and enhanced peace in their surrounding region.

North Korea is none of these countries. It poses its own challenging environment. The region's history, geopolitics, and identity have made it so. But there is no challenge that can't be met if there is willingness and flexibility on the part of the region's leaderships. Of course, timing itself is always an issue. Yet these factors might more swiftly align if alternatives are conceived, scrutinized, refined, prepared, and close at hand when the windows of opportunity open.

With this in mind, let me conclude by saying thank you all once again for taking the time to be here today to listen, to speak, and to contribute in the search for alternatives. I welcome and look forward to your participation in what I know will be productive discussions leading to meaningful outcomes.

Thank you.

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## Session II

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## ***Northeast Asian Perspectives and Strategies on Development Cooperation for North Korea***

Chinese Perspective and Strategies for North Korean Development Cooperation

**ZHAO Huji** (Professor, Central Party School of the Communist Party of China)

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**KIM Seok-Hwan** (Professor, Hankuk University of Foreign Studies)

**SAHASHI Ryo** (Professor, Kanagawa University)



Presentation

# Chinese Perspective and Strategies for North Korean Development Cooperation

**ZHAO Huji** |

(Professor, Central Party School of the Communist Party of China)



## 북한 개발협력에 대한 중국의 시각과 전략: 북한이 중국 개혁개방 정책의 길을 따를 것인가

북한에 대한 중국의 경제정책은 상호이익과 시장원리, 산업협력과 정부의 지도로 요약할 수 있다. 중국은 1978년 개혁 이후에 시장경제시스템을 도입하였다. 그러나 북한은 여전히 계획경제시스템을 고수하면서 시장요소를 도입하고자 시도하고 있다. 북한이 개혁개방을 실행하는 동안,

그러한 움직임은 핵 개발과 선군정치와 함께 이루어지고 있다. 이러한 상황에서 대대적인 북중 경제협력은 사실상 효과적으로 실행되기 어렵다. 이 글은 중국의 개혁개방 과정에서 나타난 주요 경험들을 분석함으로써 북한의 개혁개방에 대한 가능성을 논해보고자 한다.

## **Compared With China, Whether North Korea Could Continue to Follow the Policy of Reform and Opening Up**

China's economic policies on North Korea can be summarized as mutual benefit, market principles, enterprises participation and government's guidance. China has initially established the market economic system since the reform in 1978. However, North Korea still adheres to the planned economic system; while trying to introduce market factors. While North Korea is carrying out the policy of reform

and opening up, it is also engaged in nuclear development and the songun politics. In such situation, large-scale economic cooperation between China and North Korea is difficult to promote effectively. This paper mainly discusses the possibility of North Korea's reform and opening up on the basis of analyzing the main experience in the process of China's reform and opening up.

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**National security, the transformation of value concept  
and China's reform and opening up**

The 10th national congress of CCP in 1973 held the concept that we Chinese were still in the period of imperialism and proletarian revolution, in which we must adhere to chairman Mao's instruction that mainly means 'protecting people against wars and famine, digging deep holes, widely accumulation and never seeking hegemony'. Meanwhile, we must stay alert and prepare for wars of aggression that imperialist countries might launch, especially the surprise attacks from imperialists in the Soviet Union. The heroic PLA (the people's liberation army) and the militia must be ready to annihilate enemies. In the 14th national congress of CCP in 1992, China's foreign strategies changed completely, which claimed to peaceful coexistence instead of strategic rivalry. In this congress, members agreed the following policies. China is willing to develop friendly relations and cooperation with all countries on the basis of the five principles of peaceful co-existence. The differences in social systems and ideologies should not become obstacles to the development of national relations. We never impose our own social system and ideology on other country, and vice versa. We need to respect the diversity of the world, for all countries have their rights to choose their own social systems, development strategies and the ways of life.

With the collapse of the cold-war structure, great changes have taken place in China's international environment. China's foreign strategies have changed from "two and a half", which means we need to be against Soviet union and United States with 100% energy and with 50% power to deal with local threats, to the strategy that includes coexist peacefully, complementing each other and developing commonly. In China, the political value goal has changed completely since Deng Xiaoping became the power center after Mao Zedong. Then followed the new situation of reform and opening up. As shown in the figure below, Deng's political values are different from Mao's.

political values between Deng and Mao

Mao	Deng
Idealism	Realism
Rationalism	Factualism
Nationalism	Corporatism

Before taking power, considering the reality Mao pointed out the way of the China's revolution form. After getting power and consolidating the new regime roughly, Mao was gradually in favour of the idealism, which was used to transform China. Idealism inevitably leads to the second value concept rationalism and another one nationalism. In Mao's mind, values such as marxism are much more important than substantive values in governance such as safety and welfare. When the interest conflicts among state, the collectives and the individuals occurred, the later two ones must obey the national interest.

In Deng's political values, reality weights more than ideal. In terms of the future of a country, the ideal is indeed significant, but the reality is more important. That is to say that safety and welfare and such governance effect are more important than ideal. With the famous

“cat theory”, Deng expounded such value. Deng believes that government, collectives, individuals are of same importance and value maximization can be only achieved by cooperating closely with each other.

With the transformation of the basic ideas and the deepening of reform and opening, great changes have taken place in the relationships between state and society, government and enterprises and central and local governments in China. Before China's reform and opening-up, the members of the society had no right to choose. Their options were concentrated in the hands of the state. All individuals have to obey the arrangements of the state passively. After the reform and opening up, choosing right completely returns to the national's hands. Before the reform and opening up, the enterprise was just production organization rather than management organization. The business operations were in the hands of the government. After the reform and opening up, management right has returned back to the enterprise, which has become the principal part of the micro-economic activity. Before the reform and opening up, the local governments were just the transmission system of the central power. However, after it, the local government has also taken the role of the representative of local interests besides the former role. These changes in the power (right) relationship bring huge behavior driving force to individuals, enterprises and local governments.

These changes have brought huge behavior driving force to individuals, enterprises and local governments. And the driving force combined with large amounts of imported capital, technology, and market, which have produced tremendous productivity and brought a strong impetus to the modernization of China.

China's experience shows the followings. Firstly, the socialist countries' reform and opening up must make the national security as the fundamental prerequisite. The external pressure and threats will only strengthen the internal control capability, the ability of mobilization and resisting. With the collapse of the cold war, China got rid of the threat to national security. With the weakening of the external security threats, domestic problems, especially the legitimacy pressure of the ruling group, gradually become the main force of behavior and make the policy goal turn to economic construction. Secondly, the transformation of value is the basic condition for economic reform. With the concept of value changing from idealism, rationalism and nationalism to realism, pragmatism and corporatism, China has gradually begun reform and opening up. Thirdly, in the socialist countries, reform and opening up are the dependent relation and they must go on simultaneously. The lack of any one has no meaning. Reform can only solve the social vigor problems and opening up can only solve the problems of production elements.

### **North Korea's Three Survival Strategies and Their Conflicts**

North Korea's nuclear development is a typical asymmetric strategy. Asymmetry means that the national strength between the conflicting countries differs in a big way. Asymmetric strategy means that a party, which is in a disadvantage situation and against powerful enemy, takes a strategy to avoid enemies of high-tech weapons and to attack the weaknesses in order to grasp the strategic initiative. Firstly, North Korea's nuclear development is a weak country's positive and active asymmetric suppression strategy. After the collapse of the cold war, due to various reasons North Korea has been isolated. In order to get rid of this crisis, North Korea chose nuclear development. In January of 1991, Soviet Foreign Minister Eduard Shevardnadze has

visited Pyongyang to inform of the establishment of diplomatic relations with South Korea. North Korea's Foreign Minister Jin Yongnan said that if the Soviet Union would betray North Korea, North Korea would develop their own strategic weapons and support Japan to make territorial disputes with Soviet. On September 15th in 1990, the Korean Central News said that If the Soviet Union and South Korea would establish diplomatic relations, the system of North Korea, the Soviet Union, China would face the threat. North Korea could not depend on friendly neighbors; she has no choice except having its own special weapons. Since then, the nuclear development has become the main means to suppress the national security and system threat from the United States. As long as it could not exclude the national security and the system threat, North Korea would not abandon its nuclear development.

In 1991 and 1992, the Soviet Union and China successively established diplomatic ties with South Korea. North Korea believed that the system of North Korea, the Soviet Union, and China has already changed and North Korea could not rely on existing friendly neighbors to protect its own safety. North Korea believed that the result of the disintegration of the cold war was not peace and relaxation, but aggression and war. The so-called new order that the United States wanted to establish was actually the hegemonic order that the United States was the world's "emperor" and could command all the other countries. It is also actually the power order that the United States can conquer other countries by power. After the cold war, the stage of the political and military counter between the capitalism and socialism is moved to the Korean Peninsula. With the Cold War disintegration as a starting point, counterweight structures between North Korea and the United States replace the counterweight structure between Soviet and the United States and the structures between the west and the east. On the domestic side, North Korea believes that Marx Lenin's biggest flaw is not found the status and role of the military in the socialist revolution and construction. Su Dong lessons prove that losing the army cannot suppress the counter— revolutionaries and unable to defend the revolution would lose everything.

According to the above logic, mortal extreme conflicts, which are between imperialism and socialism, and between revolutionists and counter-revolutionists in the domestic, is the basic environment of the socialist revolution and construction. Therefore, the military power is the core of political power. Army is the core of the socialist revolution and construction, and the military is the first national affairs. The Sungun Policy is the basic political way of socialism. In a word, with the disintegration of the socialist camp and the reinforce of the US-Korea alliance, North Korea chose asymmetric strategy as the survival strategy— the nuclear development and the Sungun system.

Since the late 1980s, North Korea's economy has begun to decline in all directions. It has stuck in a structured and comprehensive economic crises since the mid 1990s. These crisis breed the crisis of legitimacy inevitably. Firstly, the potential crisis of legitimacy. For the masses, the long-term, comprehensive and structural economic crises mean the shortage of the necessities, which lead to the sharp decline of the quality of life, even threat to survival. Second, the formation of the "second economy" and potential political crisis. From a macro perspective, "the second economy" refers to the economic activities outside the system, such as "underground economy", "informal economy" and "illegal economy". Since the late 1980s, North Korea has begun to appear obvious signs of "second economy". It spread out the whole society in 1990s and damaged the original economic order and social order seriously, weakening political

control ability severely and brewing the potential political crisis.

The paralysis in food rationing system and the impact of the social order. Food rationing system became one of the important variables in stipulating social order of North Korea. Different treatments were based on different grades and status, which became a kind of social order. However, serious shortage of food crumbled this order. After 1990s, North Korea has to delegate the central government's power in food distribution to provinces and counties. Then they are asked to solve food supply independently. The central government constantly minimizes food supplies, even formed such a pattern“government, foreign support, each unit and Individuals averagely supplying of three months' food.” The food supplies relying on one's own efforts not only led to weaken the authority of the central government, but also led to the gap between the regions and local protectionism.

The black marketization of farmers' market and the impact of the social order. Farmers' markets began in the late 80's. External markets started when the manufacturers directly sold their products outside the plan. In the late 80's, the government had to permit farmers market, and the market opened every ten days. After 1990's, with the scarcity aggravating, normal farmers' market gradually became black marketization. Its performance is in the following areas. One is the transactions illegally. The trading varieties not only include their own production of agricultural products, but gradually expand to the government banned varieties. For example, food, medicine, household appliances, and even a production stolen from the industrial and mining enterprises. Along with the universality of this phenomenon, the government management and control of the market in fact become purely nominal. The second is the transaction price illegally. Farmers' market price is out of the state's regulation and determined by the relation between supply and demand. Market price is several times, hundred, even thousand times, higher than the national price. The third is the source of trading items illegally. In the farmers' markets, traded goods mainly come from some kinds of agricultural products grown by farmers, various living supplies smuggled from China, the production goods stolen from industrial and mining enterprises, and the shortage of materials obtained by the authorities. According to a survey by South Korea's Ministry of unification, 60% of food needed by the North Korean residents and 70% of other necessities are coming from the farmers' market.

“The second economy” has played a positive role in alleviating the problems of serious shortage in various substances. At the same time, “second economic” has played the “safety valve” function in easing the discontent emotion due to material extremely scarce shortage of various substances in the objective. On the other hand, the “second economic” disrupts the existing political order. Such as weakening the authority of the central government, weakening the central government's control on the lower bodies of the party and government organs, weakening control ability of Party and government organs to cadres at all levels, and weakening control ability of state to general residents.

“Relying on one's own efforts” weakens the control ability of central to lower organs. Power is the relationship between control and be controlled. A party in control could control others' thought or actions by their own resources. The amount of resources by a party in control and the degree of a party be controlled dependent on these resources decide the extent of compliance. The long-term shortage economy, especially the disappear of socialist economic circle at the beginning of the 90's, made the Korean high centralization of the original central planning system in a state of paralysis. The central government was unable to meet the local needs, so

they had to put down a series of power to the provinces and counties. In fact, provinces and counties, especially counties, become the basic and independent economic units. Because of seriously insufficient of raw material supplied by the central government, each county must collect raw materials by itself. Therefore, it gradually formed a new pattern in which counties independently develop economic activities including foreign trade, “earn foreign exchange activities” and others even could be income, wages for each unit. This pattern was the results of the weakening in the central planning system, which in turn further weakened the function of central planning and the control ability of central to the lower organs. This is mainly manifested in three aspects. Firstly, it weakened the ability of the central government to extract resources and to redistribute resources. Secondly, it weakened the legitimacy foundation of the central government. And thirdly, it strengthened the local government influence.

“Second Economy” and the decline of political control ability. The extending of “Second Economy” led the “political attenuation”. In fact, “Second Economy” was changing the original relationship between country and society. The original system didn’t contain an independent civil society. From politics, economy and culture to each family’s basic life, all affairs were designed and arranged by central government. With the spreading of “Second Economy”, fundamental changes had happened in the pattern, it meant that society was began spun off from the country, formed the relatively independent part. In terms of personal family, everyone’s life was reponsible by oneself, and can no longer rely on country. The gradually formed social part which free in the country didn’t care state’s political life, their interests mainly focused on how to run your own life. This situation was desroying the integration pattern of state and society with the character of “all things politicalize”, and then weaked the ability of country’s political control.

The decline of political control ability from central government to leading cadres of all levels. “Second economy” had created new informal source of income for public servants, and weaked the dependence relationship of public servants to higher organ and superior director, then disturbed the existing political order. In foreign trade activities, more and more people became “upstart” by way of obtaining illegal income from Lower level amount, cheating, taking kickbacks, fiddling expenses and so on. Among these people with relevant departments’ relevant personnel and their superior department heads, gradually formed a stable Interest relations system with bribery, cooperation, symbiosis. This system directly destroyed the original official control system. Kim Jong-il had to point out in the aritical named “*Socialism is Science*” that “Some staff of the party violate people’s interests, preserve the interest of a few privileged class, this behavior will certainly be punished by revolted by people”, “Lack regular anti-corruption movement may lead some cadres who lack of preparation become corruption metamorphic, so that they will become a privileged class that free to the people.”

In the late 1990s, North Korea chose “Sungun Policy” in the situation of internal and external troubles. Modern military as a special group, has the following several characteristics: command obedience system with highly unified; Strict hierarchical system; Strict discipline; Advanced means of information communication; team spirit. Army is an organization with the highest organizational level, the stongest mobility and legal monopolize force. Army own three advantages, compare with civil groups on politic: highly organized, highly integrated; monopolize force. Military service for special purpose, namely protecting people's life safety and property, defending territory and country. These characteristics of army make soldiers, especially officers

group is different from other social group at the orientation of consciousness: the mission of the army is more vital and comprehensive than civil groups' purpose or goals. Civil social groups pursue for the interests of group, but army see the peace of state and people as its basic mission, and this mission is directly related to the country and the nation's prosperity and decline success or failure. The war or fighting that related to national destiny can not complete only depend on individual ability and intelligence. So, Solidarity and cooperation has a special value for military; rapidness and preciseness are crucial for military. Troops need high efficiency to finish the task quickly and accurately, and the system guarantee of the high efficiency is the strict hierarchy system. Troop's hierarchy system specify the authority, responsibility and the function of all levels. The top-down command obedience is existed in the relationship between higher and lower. Because of the army should to complete the task in urgent situation, therefore, this command obedience relationship is more rigorous than any civil group. Army not only complete its special mission by force during the war, but also shoulder its mission in a peaceful environment. In a peaceful environment, military manage and use force legally, and rely on monopolizing force to achieve its special mission. Therefore, both in wartime and peacetime, strict discipline is the life of the military organizations.

In North Korea, these features of army get further extend and expand, make North Korea's military own some special particularity: the army's ideologicalization. As Kim jong-il said: "the power of guns come from the idea and belief, A gun without thoughts is weaker than a stick. The army without keeping the faith for socialist cause cannot protect socialism", "political superiority is the essential advantage of revolutionary armed forces, it's the source of invincible position", "the battle is not only a military confrontation with the enemy, but also the confrontation of ideas. In the construction of our military, I advocated ideological theory. A military strike is limited, but thought hit is infinite, its power is stronger than the atomic bomb". Absolute loyalty to the leader. As Kim jong-il said: "Building army into absolute loyalty to the leader and the party's army is the general assignment of army building", "Our army is a military that is determined to support and defend the leader, a military will firm obey party's commands and instructions. The army is our party's biggest glory and pride."

Due to long-term shortage economy, especially extremely serious economic crisis since the 1990s, political legitimacy foundation faces a serious threat. Long-term shortage economy, especially the severe economic crisis since the 1990s, led to the spread of the "second economy" which destroyed the original rationing system, and then disturbed the existing economic order. This situation caused the weakening of politics control capability, and implied a potential political crisis; after the collapse of the cold war, especially after the outbreak of the nuclear crisis, North Korea fell into a very serious national security crisis. Under this pattern, the so-called "Sungun Policy" is just a survival strategy which uses the special features of the army to get rid of the crisis both inside and outside.

The army is the last barrier for the country's security, under certain conditions; it is also the most dangerous destructive force. Kim Jong-Il had moved the central power from the ruling party to the military. On the one hand, this was the performance of Kim Jong-Il's stable regime, but on the other hand, it was the performance of his fragile regime. The army as the direct carrier power means that other political systems had lost normal function and unable to meet the needs of the rule. In addition, the military can only assume the functions of the regime's consolidation, and can't bear the function of the economic and social development, so

the army cannot penetrate into all areas of society effectively. The army was the center of Kim Jong-Il regime, but the dominant force of economic development can only be the ruling party and the government. This kind of power structure can cause disharmony between each subject of power, even conflict, which lead to a more profound political crisis.

Economic survival strategy. From China's experience, the economic reforms of the socialist state can be observed from the perspective of the redistribution of power. First, the redistribution of power between state and individuals. Before the reform, the private lives of the masses shall be the responsibility of the country, and the masses whose rights of choice were given to the country and became the country's accessories. After the reform, the masses themselves are responsible for their own lives which means the autonomy and right to choose of the masses began to return to their own hands in the private sphere. Second, the redistribution of power between government and enterprises. Before the reform, the enterprise was simply the production organization, without any autonomy and the right to operate. After the reform, the enterprise began to become a management organization, and the subject of the microscopic economic activities. Third, the redistribution of power between the central and local. The central government began to disperse economic planning and the responsibility of its implementation to local governments which mean that, in terms of economic activity, local government became the representative of the local interests, decided local affairs in a considerable range, and its authorities were attained to large-scale.

Can “Sungun Policy”, “7.1Measures” and other new economic measures, nuclear development--three big survival strategies make North Korea out of the crisis? The “Sungun Policy” is merely a crisis management regime during special periods of time, and it's not the political system which North Korea claimed during the period of the socialist revolution and socialist construction. The “extreme conflict” is the logical starting point of the “Sungun Policy”. That is to say, the threats of system and security from the domestic and foreign reactionary forces are the main contradiction of North Korea. Under such logical pre-conditions, it is impossible for North Korea to open up in order to improve its economic situation. And besides, the all-round opening up to the outside world may directly impair the supreme status of the military and the military-centered politics.

“7.1 measures” contain the fundamental restrictive factors. Currently, Korea's military industry (direct and indirect) accounts for too large proportion in the total economy. Therefore, the success of North Korea's economic reform depends on the transformation of military industries into civilian ones. Otherwise, the macroeconomic level can't adapt to the reform in structure. And the civilian transformation of the military industries should take national security as an essential condition. This is unlikely, however, owing to the ideology North Korea insisted on and the hostile international environment that faces Pyongyang, which is the basic restrictive factor of North Korea's reform.

The development of nuclear directly barriers the opening up policy and the import of capital and technology, which lead to the ineffectiveness and discontinuity of the implementation of “measures of 7.1”. On the other hand, once North Korea gives up the nuclear development, the “Sungun Policy” will lose its legitimacy. Because the “Sungun Policy” presupposes the existence of a certain “tension relationship” and “external pressure”. From the perspective of Development economics, modern technology, financial and institutional changes are the most important factors to the development of economy of the late- developing countries. In the aspect of modern

technology, developing human resources of domestic and introducing the technology from abroad are the key. In the aspect of capital, it need introduce a lot of money from abroad in a short term. In the aspect of institutional change, it is a crucial point to form a competitive economic and a stable macroeconomic pattern. Political stability and comprehensive opening to the outside world are a fundamental political premise to introduce lots of technology and money in short time. However, in North Korea, “extreme conflict” is the logical starting point to the “Sungun Policy”.

The threats from domestic and foreign reactionary forces of domestic and foreign reactionary are the country’s principal ones. Under this logic, North Korea could abandon neither its nuclear program nor opening to the outside world. In addition, Opening up maybe directly shakes the supremacy of military, and then it would shake the “Sungun Policy”. The “Sungun Policy” and nuclear development make the obstacles to the opening up and directly barrier the introduction of capital and technology, which lead to some reform measures not to be promoted effectively and continuously. On the other hand, once North Korea gives up the nuclear, the “Sungun Policy” will lose its legitimacy. Because the “Sungun Policy” presupposes the existence of a certain “tension relationship” and “external pressure”.

### **The Dilemma of Kim Jong-un and His Potential Tendency**

In order to get rid of survive the crisis, Kim Jong-un regime has tried to carry out the reform and opening up. However, the results repeat the vicious cycles between the reform and rigidity. The reason is that Kim's reform does not change the basic values conceptions, but the pursuit of economic benefits in short time. Does Kim Jong-un could get out of this vicious cycle? The possibilities are open, everything is possible. Kim Jong-un keeps balance between his father's behest and the reform, which is the only way to get rid of the current predicament. Deng Xiaoping used “three to seven” to evaluate the demerits and merits of Mao Zedong, and depended on this opportunity to start and promote the ideological emancipation and the reform. Can Kim Jong-un walk out the crisis? Firstly, it would depend on the basic recognize and judgment of the situation. Secondly, it also depends on him and his ruling team whether they have the ability to control the complex political situation and political skills.

As mentioned above, the reform and opening up of socialist system is complementary interdependence. Without the opening up of reform or the reform, it could not bring lasting effect. And the change of basic values is the premise of reform and opening up. On the other hand, local and limited opening up also may lead to a comprehensive one. China's reform and opening up neither go hand in hand, nor in full swing at start time. The 14 SARs which achieve success bring fully open, and the opening up of 14 SARs also come from the success of Shen Zhen. If the opening up of Rajin and Sinuiju area can gain success, it may be spread to more areas. From the experience of China, North Korea's partially open and limited reform may lead to reform and opening up in a deeper level. The international community should give it actively guiding and support.

The differences between Kim Jong-un and Kim Jong-il. There are at least three differences between Kim Jong-un and his father-- Kim Jong-il. First, as a national leader, Kim Jong-un is very young. Young means inexperience and lack of authority. On the other hand, young means that his political philosophy is still uncertain and has great plasticity compared to his father.

Second, Kim Jong-un have a study abroad experience. Kim Jong-un has been studied in the most advanced countries at least three years and has evolved in all aspects by himself. Third, it is different of the ruling environment between Kim Jong-un and Kim Jong-il. Former is under the shadow of his father who ruled for nearly 20 years after gaining independence status, while Kim Jong-un became independent leader at first. The fourth is that Kim Jong-un regime withstands greater external pressures than Kim Jon-il era. In the wave of democratization African democracies have happened misfortune, non-democratic leaders experienced a tragic ending. Increasing development gap between the developed countries is increasly huge, especially development between North and South Korea, which increasingly becomes a challenge and threat. These pressures are also likely to strengthen the cohesion of the privileged class, but there may be privileged internal differentiation. Currently, Kim Jong-un regime has at least two internal structural imbalances. Firstly, there are imbalances between communist party, state and military. The peculiar phenomenon that the disappearance of the Politburo Standing Committee and Jang Ri, Kim Kyung-hee and other private parties became generals overnight, illustrate how difficult it coordinated military and political relations. After the 3th party convention, the DPRK only uses a large number of young cadres in important positions and forms a new generation led by Kim Jong-un in order to replace the older pattern. According to a new generation of political elite, it is required to get supports from the older generation. How North Korea's new generation to get the older generation of stable support is still unknown.

Third, it is Kim Jong-un's dilemma. Under the above situation, Kim Jong-un faces a dilemma. Firstly, he could rely on the reform and opening up to get rid of the crisis and to prove his political capacity and gain the political legitimacy in order to seek long-term governance and the prosperity and unity of country. If choosing this strategy, Kim Jong-un would face a deep crisis, which comes from the resistance of privileged class due to the change of basic political ideas and institutions and the loss of the original political legitimacy. The second is that he can refuse reform and still maintain the existing ideas and institutions to obtain the support of the privileged class and use the existing political legitimacy to consolidate his dominance. If choosing this strategy, he would face rising social discontent which comes from the poor rule performance and the crisis of weakening of legitimacy. These two value targets between inheriting his father's behest and consolidating his dominance not only have part of the consistent, but also have conflicts. Kim Jong-un either chooses one, or a compromise between the two value targets.

Kim Jong-il regime had tried to reform and opening up to get rid of the crisis of survival. However, the result was a vicious circle of repeated reform and rigidity. Investigating its reason, Kim Jong-il's reform did not make the change of the basic value idea as the guidance and only pursued the short-term economic benefits. Could Kim Jong-un start out this vicious circle? The possibilities are open, and everything is possible. Kim Jong-un need to keep balance between the reform and opening up and the legacy he inherited from his father. This is the only way for him to get rid of dilemma. Deng Xiaoping evaluated Mao Zedong by the standard of three points fault and seven points merit, and taken this opportunity to start and promote the emancipation of the mind and reform and opening up. Kim Jong-un could come out of the crisis depending on his basic cognition, judgment of the situation and his teams who have the political ability of managing complex situations and political skills.

As mentioned above, Reform and opening up in socialist systems are interdependent relationship. Opening up without the reform or reform without the opening up could not bring lasting effect and changing the basic value idea is the basic premise of reform and opening up. On the other hand, local and limited open may also lead to opening up and reform in the round. China's reform and opening up is not at the same time or spreading out in the round. Fully open is brought by the success of 14 SEZs which are brought by the success of the Special Economic Zones of Shenzhen. If partially opening up of Najin and Sinuiju could be successful, it is likely to spread to more areas. From the Chinese experience, partially opening up and limited reform in North Korea are likely to trigger a deeper one. The international community should actively guide and support them.

Presentation

# Japanese Perspective and Strategy for North Korean Development Cooperation

**ISOZAKI Atsuhito** |  
(Professor, Keio University)



## 북한개발협력에 대한 일본의 시각

일본은 북한에 대해 높은 관심을 가지고 있다. 일본 내각부에서 매년 실행하는 “외교 여론조사”에 따르면, 북한에 대한 일본인의 관심은 납치, 핵, 미사일 문제로 집중되어있다. 납치문제는 지난 10년 동안 일본 관심의 초점이 되어왔고 현재도 가장 중요한 현안으로 여겨지고 있다. 일본인의 90%가 납치문제에 관심을 가지고 있다고 대답한 반면 겨우 10%가 북한과 무역 등의 경제 교류에 관심이 있다고 표명했다. 따라서 일본과 북한의 관계를 고려할 때, 일본의 주요 관심사인 납치문제도 함께 염두에 두면서 접근 할 필요가 있다.

이 논문은 북한과 일본의 경제협력 가능성에 초점을 맞추고 있다. 일본과 북한 관계의 최근 동향에 대한 간단한 검토를 목적으로 한다. 북한과 일본정부가 평양선언을 채택한지도 벌써 십일 년이라는 시간이 지나 현재는 양국의 정권 교체로 많은 상황이 변화했다. 그 시간 동안, 북한은 반복된 핵 및 미사일 시험을 시행하였고 ‘완전한 핵 보유 국가’가 되었다. 평양선언 서명 이후 초기

조건은 크게 변경되었지만, 향후 일본의 대북정책을 수립해 나가는 과정에 있어 장기적인 기반이 되어 영향을 미칠 것이다. 평양선언은 일본과 북한의 정상회담에서 교환된 유일한 문서이다. 핵확산금지조약 (NPT), 한국과의 상호불가침조약의 포기, 한국전쟁 휴전협정의 무효를 선언하며 북한은 많은 협정과 협의를 위반해 왔다. 그러나, 북한은 아직도 평양선언의 유효성을 내세우고 있는 모습을 보이고 있다.

일본의 관점에서, 쉽게 북한에 대한 경제제재를 줄일 수는 없을 것이다. 그렇지만 최종 목표가 납치문제의 해결이라면, 그 목표를 달성할 수 있는 수단을 조금 더 유연하게 생각해야 할 필요가 있다고 생각한다. 그 방법이 아무리 조금 비합리적일지라도 최종 목적을 위해서는 유연성이 필요할 것이다. 북한의 슬로건인 병행노선에 따라, 이미 김정은 정권의 중점인 경제강국 건설을 위한 움직임을 보이기 시작했다. 이러한 상황은 일본에게 향후 북한과의 협상과 긴 교착관계를 타개할 수 있는 좋은 기회가 될 것이다.

## Japanese Perspective and Strategy for North Korean Development Cooperation

Japanese society has taken great interest in North Korea. According to the “public opinion poll on diplomacy,” which is conducted every year by the Japanese Cabinet Office, Japanese people’s interest in North Korea is concentrated on the abduction, nuclear, and the missile issues. The abduction issue, which has been the focus of attention for more than ten years, continues to be the most prominent subject. Ninety percent of Japanese people expressed interest in this issue, whereas only near ten percent had any interest in “economic exchanges such as trade”. Therefore, when we consider the relationship between Japan and North Korea, it is essential to always keep in mind the abduction issue, which for many years has been a matter of national concern.

This article focuses on the possibility of Japan’s economic cooperation with North Korea and offers a brief examination of recent trends in the relationship between Japan and North Korea. Eleven years have already passed since the Japan-DPRK Pyongyang Declaration, and the administrations of both countries have changed. During that time, North Korea repeatedly carried out nuclear and missile tests, becoming a “full-fledged nuclear power.” Although the initial conditions have largely

changed since the declaration signing, they will likely be used in the long term as the basis for the creation of future policies with North Korea, considering it is the only document that was exchanged at the Japan–North Korea summit meeting. North Korea has discarded many agreements as null and void, such as the withdrawal from the Non-Proliferation Treaty (NPT), the abandonment of the non-aggression agreement with South Korea, and the nullification of the “cease-fire agreement” of the Korean War; however, it continues to hold up the validity of the Japan-DPRK Pyongyang Declaration.

From Japan’s point of view, it cannot easily reduce the economic sanctions on North Korea. However, if the end goal is a resolution of the abduction issue, it is essential to continue to think flexibly, even if the means to achieve that goal seem unreasonable. By using the “Parallel Pursuit” as a slogan, Kim Jong Un’s administration has started to put emphasis on “constructing an economically strong nation.” This state of affairs can be considered as a good opportunity for Japan to seriously explore negotiations in its long-stagnant relationship with North Korea.

## 1 Introduction

Japanese society has taken great interest in North Korea. In just the last two or three years, significant changes have occurred in the internal affairs of North Korea, such as the formalization of a successor to Kim Jong Il, his death, and the beginning of the Kim Jong Un administration. The issues that accompanied these changes, for example, nuclear tests as well as a long-range ballistic missile launch (which North Korea claims was the “launching of an artificial satellite”) have been treated as front-page news by every Japanese newspaper. According to the “public opinion poll on diplomacy,” which is conducted every year by the Japanese Cabinet Office, Japanese people’s interest in North Korea is concentrated on the abduction issue, the nuclear issue, and the missile issue. The abduction issue, which has been the focus of attention for more than ten years, continues to be the most prominent subject. Ninety percent of Japanese people expressed interest in this issue, whereas only near ten percent had any interest in “economic exchanges such as trade”.<sup>1)</sup> Therefore, when we consider the relationship between Japan and North Korea, it is essential to always keep in mind the abduction issue, which for many years has been a matter of national concern.

Given the long-standing abduction issue, Japan’s role is naturally limited even when economic cooperation with North Korea is discussed at the six-party talks. Trade between Japan and North Korea has been at a standstill since 2010 for both imports and exports. However, when we consider the scale of Japan’s economic cooperation with South Korea, which accompanied the normalization of diplomatic relations between the two countries in 1965, we see a preliminary calculation that anticipates economic cooperation to the tune of USD 10 billion if diplomatic relations are normalized between Japan and North Korea.<sup>2)</sup> In other words, Japan continues to be an appealing presence that could potentially offer North Korea a great deal of financial assistance. However, the problem is that this is only a potential appeal; it would be difficult for this to be actualized without a striking improvement in relations such as the normalization of diplomatic ties between Japan and North Korea.

It has been a year and a half since the beginning of the Kim Jong Un administration, and in this paper I will examine the status of the relationship between Japan and North Korea and how it might develop, as suggested by the “work” (로작) of First Chairman of the National Defense Commission (NDC), Kim Jong Un.

## 2 The Present Relationship between Japan and North Korea

In recent years, successive Japanese administrations have raised the abduction issue, which is an infringement of sovereignty by North Korea, as an important concern. However, only the administration of Junichiro Koizumi actually recovered any of these victims. When Chairman of NDC Kim Jong Il acknowledged and apologized for the abduction issue to Prime Minister Koizumi, this was undoubtedly a major decision on the part of North Korea, which nevertheless led to a worsening of the ties between the two countries because of a backlash in Japanese

1) Japanese Cabinet Office’s homepage for the “Gaikoni Kansuru Yorochosa [public opinion poll on diplomacy]” <http://www8.cao.go.jp/survey/index-gai.html> (Last accessed on September 20, 2013). Before 2006, it was published as the Gekkan Yorochosa [Monthly public opinion poll] by the public relations group of the Office of the Prime Minister (Ministry of Finance’s Printing Department).

2) In August 2002, North Korea reportedly demanded “over 10,000,000,000 dollars.” See Yoichi Funabashi, *Za Peninsura Kuesuchon: Chosenhanto Dainiji Kakukiki* [The Peninsula Question: A Chronicle of the Second Korean Nuclear Crisis]. Tokyo: Asahi Shimbun Shuppan, 2006, pp.35-36.

public opinion. Officials in both countries had not anticipated such a reaction, which was attributed not only to the announcement that the eight victims including Ms. Megumi Yokota (who is now a symbol of the abduction issue) had already “passed away” but also the response by North Korea, which was seen as insincere.

Accordingly, North Korea continues to have concerns that any progress in the abduction issue might lead to more opposition from Japanese public opinion. In other words, if the abduction victims who were already announced as “dead” were sent home, the North Korean government would assumedly face repercussions among the Japanese to the effect of “just as we expected, North Korea has been lying.” North Korea assumes that this backlash would outweigh the welcoming feeling caused by the return of the abduction victims. Within this context, the minister in charge of the abduction issue under the administration of the Democratic Party, Jin Matsubara, made a statement in an interview with all of Japan’s news companies, in which he appealed to the public, saying that “even if North Korea admitted that ‘the abduction victims that they announced were dead were actually still alive’, the people would receive this as an effort to be accepted by the international community and appreciate it.” This statement was meaningful in terms of looking toward a realistic solution.<sup>3)</sup> In other words, to seek sincere attitudes on the part of North Korea for the resolution of this issue, it also becomes essential to make efforts to assuage that country’s concerns. Moreover, a stable Japanese government is indispensable if this protracted dispute is to be resolved. Unfortunately, in recent years there has been a change in prime ministers almost every year, creating a situation that likely makes North Korea distrustful. In that sense, the beginning of the second Abe administration offers a favorable environment that might not present itself so often.

It appears that the situation in North Korea is changing somewhat for the better as compared with the past, which is due to the new Kim Jong Un administration that began at the end of 2011 with the death of Chairman of NDC Kim Jong Il. It is clear that First Chairman Kim Jong Un was not of an age to directly take part in the abduction issue when it occurred in the late 70s. In the current environment, section-chief level officials of the Japanese and North Korean governments held preliminary talks in Beijing on August 29 to 31, 2012. The meetings ended with both sides agreeing that they would henceforth “discuss items of high interest to both parties” as part of their agendas. On November 15 and 16, the department directors of the Japanese and North Korean governments held a talks in Ulan Bator, Mongolia, at which they exchanged ideas regarding the abduction issue and agreed to “continue to have talks in the future as well in order to further investigate this matter.” However, this series of meetings has been suspended since North Korea announced that it would launch long-range ballistic missiles.

It is hard to believe that last year’s talks were held despite North Korea’s having only the short-term goal towards the gradual lifting of economic sanctions. Until North Korea shows a sincere response to the abduction issue, their relationship with Japan cannot be easily improved. Moreover, even assuming that a portion of the economic sanctions are lifted, the impact on North Korea’s economy will not be sufficient enough. However, if the new Kim Jong Un administration is serious about seeking economic development, it would inevitably need to

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3) The following type of message was repeated on September 17, 2002, in the “talk by the cabinet minister in charge of the abduction issue at the 10th anniversary of the summit meeting between Japan and North Korea.” “If North Korea states that the people announced as dead are actually alive, I will accept this in a forward facing manner without criticism even though they changed their original claim. Moreover, in the case that a development is obtained whereby a consensus can be reached by the people involved that the development is considered as a ‘certain progress’ on this abduction issue, I think we can take measures in order to improve relations with North Korea and offer humanitarian aid. I am continuously hoping that the new administration of North Korea will work out new policies on the abduction issue.”

improve relations with Japan because of its potential financial appeal. Moreover, improved relations between North Korea and Japan would have a secondary effect of rectifying North Korea's path towards the overdependence on China, which was only deepened by the deterioration of North-South Korea relations since the advent of the Lee Myung-bak administration.

### 3 The “Parallel Pursuit of Economic Development and Nuclear Armament”

To this end, although we know that the ultimate goal of Kim Jong Un's government is to maintain its own existence, it is important to determine whether or not it will place a priority on present economic development. However, the Kim Jong Un administration started over a year and half ago, and little information has come out about its intentions. Therefore, we are unable to investigate the regime based on policy patterns, and moreover, there is insufficient information related to First Chairman Kim Jong Un. In the past, we possessed the capability to gather information about Chairman of NDC Kim Jong Il from a variety of sources. We had access to details from the so-called royal family (his eldest son, Kim Jongnam; his sister-in-law, Song Hyerang; and his nephew, Lee Hanyoung), from close associates (Hwang Jangyeop and Shin Kyungwan), from the South Korean husband and wife (Shin Sang-ok and Choi Eunhee) who were kidnapped to take part in the production of a film, and from his chef (Kenji Fujimoto). Thus, it was possible to cross-check all of this information and get close to the power structure. There was also published evidence that Chairman of NDC Kim Jong Il had conversations with foreign persons of importance. The material available on First Chairman Kim Jong Un, however, is limited to the time he spent studying abroad in Bern, Switzerland, and to what his “chef” has said. In other words, there is no information except facts from his youth. The regime has not revealed any confusion in the published announcements of its hard-line policy and the meetings held by every governmental organization from the beginning of 2013 to around March. Moreover, there are no rumors about an attempted coup d'état or sickness of a new leader, like those seen after the death of Chairman Kim Il Sung. Rather, policy is executed under the unilateral leadership of First Chairman Kim Jong Un, and North Korea appears to be domestically stable on the surface.<sup>4)</sup> However, currently there is zero evidence whether First Chairman Kim Jong Un makes policy alone, in much the same way as Chairman of NDC Kim Jong Il did, or whether elements of group leadership are being strengthened. In this type of situation, it is a major premise that verification is difficult.

In these circumstances, the “work” such as speeches, conversations, and essays that have been published under First Chairman Kim Jong Un's name are useful for the understanding the internal logic of North Korea where “words” (말씀) and “instructions” (교시) of the supreme leader are seen as absolutes. They are deemed to be one small clue that is possible to verify. When I take a look at the approximately 30 works of First Chairman Kim Jong Un that have been published since last year, the contrast between his ideology and that of NDC Chairman Kim Jong Il is striking. The difference between Kim Jong Un and his predecessor suggests that Kim Jong Un is a pragmatically oriented leader. For example, the term “Songun Idea” was not

4) The stability of the Kim Jong Un regime can be seen in my article “Kimujon'untaiseino Kochikukatei: 2008nen-2011nen [The process of constructing Kim Jong Un regime: 2008-2011],” in Hiroko Imamura's work, Higashijia Bundankokka: Chutai Nanbokuchosenno Kyoseiwa Kanoka [The Divided States in East Asia: Is coexistence of a Taiwan, China, and North and South Korea possible?], Tokyo: Hara Shobo, 2013, pp.131-178.

used even once in the multiple speeches, essays, and conversations that First Chairman Kim Jong Un made available to the public last year.<sup>5)</sup> This is in spite of the Songun Idea being a “guideline for leadership of the nation” equal to the “Juche Idea” following the constitutional reform that took place in April 2009. Moreover, the terminology related to the “Kim Il Sung

5) My article “2012nenno Kimujon’un Rosakukensho [Review of the ‘works’ of Kim Jong Un in 2012]” Kokusai Josei [Bulletin on the International Affairs], No. 83, pp.11-23.

The frequency of references regarding the primary important terms in Kim Jong Un’s “works” in 2012 is as follows:

	(1)	(2)	(3)	(4)	(4)	(6)	(7)	(8)	(12)
Date Published	4/15	4/19	5/9	6/6	6/12	8/3	8/25	10/13	12/21
Format	Speech 연설	Talk 담화	Talk 담화	Speech 연설	Article 논문	Talk 담화	Speech 연설	Letter 서환	Speech 연설
Date	4/15	4/6	4/27	6/6	4/20	7/26	8/25	10/12	12/21
Main theme	Parade ceremony 열병식	General secretary 총비서	Territory management 국토관리	Children's Union 소년단	Eternal leader 영원한 수령	Patriotism 애국주의	Songun day 선군절	Revolution ary school 혁명학원	Kwangmy ongson 광명성발사
Number of characters	5160	12388	14265	3147	11388	8100	1562	9594	2150
Kim Il Song 김일성	17	26	1	7	50	0	2	6	2
The Great leader 수령님	3	33	17	0	88	7	0	6	4
Kim Il Song's People 김일성민족	3	0	0	0	1	0	0	0	0
Kim Jong Il 김정일	17	18	2	7	15	37	7	9	2
The General 장군님	4	84	23	0	25	56	2	7	9
Kim Jong Il's Korea 김정일조선	1	0	0	1	1	0	0	1	2
The Great commanders-in-chief 대원수님들	1	0	0	0	0	0	0	7	0
The commander-in-chief 대원수님	1	0	0	14	0	0	5	7	0
Last instructions 유훈	1	3	7	0	5	1	0	1	3
Kim Il Sung-Kim Jong Il doctrine 김일성-김정일주의	1	13	0	0	3	0	0	0	0
Patriotism 애국주의	0	0	0	0	0	48	0	2	0
Strong solidarity 일심단결	1	11	0	0	3	1	0	0	0
Juche 주체	8	7	3	0	47	0	1	6	3
Juche Idea 주체사상	0	0	1	0	11	0	0	0	0
Songun 선군	11	8	2	5	8	8	8	16	1
Songun plitics 선군정치	1	1	0	0	3	0	0	0	0
Songun Idea 선군사상	0	0	0	0	0	0	0	0	0
Socialism 사회주의	8	15	11	6	52	20	0	4	0
Autonomy 자주	7	5	0	0	49	0	0	1	1
Strong and prosperous nation 강성국가	5	7	12	2	6	7	1	0	3
Strong and prosperous nation 강성대국	0	0	0	0	0	0	0	0	0
Socialist wealth and prosperity 사회주의부귀영화	1	0	0	0	0	0	0	0	0
Life of the people 인민생활	4	8	3	0	4	0	0	0	0
The United States 미국	0	0	0	0	0	0	4	0	0
American empire 미제	0	0	0	0	0	0	0	0	0
Imperialism 제국주의	4	2	0	0	13	1	0	0	0
Imperialist 제국주의자	2	2	0	0	2	0	0	0	0
Unification (with South Korea) (남측과의) 통일	3	1	0	0	11	3	4	2	0

and Kim Jong Il doctrine” that appeared after the death of Kim Jong Il has scarcely been used. Many references have been made to the “improvement in the lives of citizens” and the issue of food for the people, although they do not seem to have been able to come up with effective strategies. Occasional inspections of economic institutions have been implemented without notice, and it appears that Kim Jong Un is making efforts to grasp the issues that his country faces.

Currently, the remarks surrounding the “Parallel Pursuit of Economic Development and Nuclear Armament” (경제건설과 핵무력건설을 병진시키나갈데 대한 로선) presented on March 31, 2013 needs to be emphasized. At the Central Committee’s general meeting of Worker’s Party of Korea, First Chairman Kim Jong Un established the “Parallel Pursuit of Economic Development and Nuclear Armament” as a “new strategic path.” Moreover, his explanation of why his country should proceed with nuclear development is critical.<sup>6)</sup> He states “a lesson from the Middle Eastern countries” in the background of nuclear development. In April, Rodong Shinmun newspaper published an explanatory article about the situation in Libya, asserting that the Libyan government was toppled as a result of its abandonment of nuclear development. It seems that North Korea’s dependence on nuclear weapons as a deterrent was reinforced by witnessing the Libian situation.<sup>7)</sup>

When the “Parallel Pursuit” was announced, it could not be determined whether it was centered on the “economic development” or the “nuclear armament.” However, Kim Jong Un’s works clarified this in the summer. August 25 marks the day when NDC Chairman Kim Jong Il began the “Songun Revolutionary Leadership” when he was 18. This year, it was declared a national holiday called Songun Day. On this day, First Chairman Kim Jong Un made public a speech in which he made only one reference—to “nuclear weapons.” The speech emphasized the importance of the “Parallel Pursuit of Economic Development and Nuclear Armament.” Despite the fact that this speech commemorated “Songun Day,” its contents leaned toward the “economic development.”<sup>8)</sup> There was no reference to “nuclear weapons” in either of the speeches presented by Choe Ryong-hae—director of General Political Bureau of Korean People’s Army, on the 60th anniversary of the Korean Armistice Agreement—or Premier Pak Pong-ju—on the North Korea’s 65th anniversary. Thus, although policies that emphasize economy might give way to a return of hard-line policies against the South Korea and the United States in the long run, it is clear that First Chairman Kim Jong Un has taken a stance that emphasizes economic development, as can be seen in the increase of his “field instructions” (현지지도) in the economic institutions since May of this year.

However, there are no references to Japan in the works of First Chairman Kim Jong Un, and they contain no definitive direction for the overall foreign policy of North Korea. The North Korean media has brought up issues such as comfort women, and the regime holds fast to its position of requesting a “settlement for the past” from Japan pertaining to the period of colonial rule. However, it has refrained from stating that the abduction issue is “resolved.”

6) “조선로동당 중앙위원회 2013년3월전원회의에 관한 보도 [Report Related to a Worker’s Party of Korea Central Committee All-member Meeting in March 2013]” *Rodong Shinmun*, April 1, 2013.

7) For example, Chae Ilchul “유혹과 압력따위는 우리에게 절대로 통할수 없다[Types of pressure and temptation will definitely not work on us]” *Rodong Shinmun* April 6, 2013

8) However, documents for domestic use have not neglected the “construction of nuclear weapons.” Kim Changmyung, “우리 당이 제시한 새로운 병진로선은 우리 혁명의 최고리익으로부터 항구적으로 틀어쥐고 나가야 할 전략적로선 [The new policy of Parallel Pursuit that has been presented by our party is the strategy path that should be permanently seized for our revolution’s largest gain]” *Kulloja [Worker]* ( *근로자* ) 2013, Vol. 6, pp.21-23.

#### 4 The Lesson of 2002<sup>9)</sup>

It was in 2002 that North Korea, having been attracted by Japan's economic potential, attempted to develop the relationship between the two countries in a single stroke. The first summit meeting in history took place on September 17, 2002; however, it was a process that started in the fall of 2001 that made this meeting a reality. First, secret contacts were made in locations such as Dalian; next, two Red Cross meetings took place in Beijing; and then a foreign ministers' meeting in Brunei, and a meeting with the directors of the Ministry of Foreign Affairs in Pyongyang were held. At the summit, Kim Jong Il himself acknowledged the abduction issue, apologized, and signed the Japan-DPRK Pyongyang Declaration. This event was actual proof that the most powerful means of compelling a dictatorship like North Korea to make a policy shift is by direct negotiations with the supreme leader. On the other hand, the worsening of the relationship between the two countries due to North Korea's response and the unanticipated reaction of the Japanese public is also part of the lesson of 2002.

The only document that was agreed upon at the Japan-North Korea summit was the "Japan-DPRK Pyongyang Declaration." Not only does this document state that "with respect to the outstanding issues of concern related to the lives and security of Japanese nationals, the DPRK side confirmed that it would take appropriate measures so that these regrettable incidents, that took place under the abnormal bilateral relationship would never happen in the future," it specifies that after the normalization of diplomatic relations, Japan will "provide economic co-operation including grant aids, long-term loans with low interest rates and such assistance as humanitarian assistance through international organizations" for North Korea, and also that the "specific scales and contents of the economic cooperation will be sincerely discussed."<sup>10)</sup> This document officially confirmed that, for the first time, Japan's handling of its past colonial rule would not be in the form of "reparations" but rather "economic co-operation."

What could have been behind this personal acknowledgement of the mistakes of his own country by the "Great Leader Comrade"? Starting from July 1 which was just before the summit meeting took place, North Korea had been implementing "Economic Management Reform Measures," which can be considered as the North Korean version of reform measures. Following this, on September 12, the North Korean city of Shinuiju was established as the Special Administrative Region. This area has more autonomy than a special economic zone in China. Shinuiju, a city that borders North Korea and China, was granted autonomy similar to that of Hong Kong or Macao. This move was groundbreaking. However, Yang Bin, who was appointed as the area's first secretary, was arrested by the Chinese Ministry of Public Security in less than a month, and the plan for the special economic zone came to a standstill. However, this is an opinion based on hindsight, and the fact that North Korea had tried to establish a special ward that contained capitalist elements at that point was regarded as important in and of itself. During

9) My article "Nicchokankeiwo Kangaeru Shikaku: Kitachosen Kokunaijijotono Rendo [A point of view to consider the relationship between North Korea and Japan: Working with internal affairs in North Korea]" *Kaikakusya* [Reformer], November 2007, pp.18-21. Also, as a coherent analysis of Koizumi's visit to North Korea, see the *Yomiuri Shimbun* Government Department. *Gaikowo Kenkanishita Otoko: Koizumi Gaiko 2000nichino Shinjitsu* [A man who made diplomacy into a fight: The reality of Koizumi's 2,000 days diplomacy], Tokyo: Shinchosha, 2006, first chapter.

10) The actual text of the Japan-DPRK Pyongyang Declaration is the following:

"Both sides shared the recognition that, providing economic co-operation after the normalization by the Japanese side to the DPRK side, including grant aids, long-term loans with low interest rates and such assistances as humanitarian assistance through international organizations, over a period of time deemed appropriate by both sides, and providing other loans and credits by such financial institutions as the Japan Bank for International Co-operation with a view to supporting private economic activities, would be consistent with the spirit of this Declaration, and decided that they would sincerely discuss the specific scales and contents of the economic co-operation in the normalization talks." "Both sides, pursuant to the basic principle that when the bilateral relationship is normalized both Japan and the DPRK would mutually waive all their property and claims and those of their nationals that had arisen from causes which occurred before August 15, 1945, decided that they would discuss this issue of property and claims concretely in the normalization talks."

this same time period, two special economic wards were also legislated: Kaesong Industrial Region and Mount Kumgang Tourist Region. Also in 2002, NDC Chairman Kim Jong Il celebrated his sixtieth birthday, and the year was recognized as an important one for the North Korean economy.

In retrospect, we can see that the Japan–North Korea summit meeting occurred in the midst of bold new policies that North Korea had initiated with a view of moving toward reform and liberalization. To be able to execute new economic policies, it is essential to have enormous amounts of capital and access to the technologies of advanced nations, because of which Japan was seen as a favorable target by North Korea. This demonstrates that because of North Korea’s extreme centralization of power, the Japan–North Korea relationship is directly influenced by the internal affairs of North Korea. Moreover, the North Korea–US relationship severely worsened after President George W. Bush criticized North Korea by calling it a country in the “Axis of Evil” in his State of the Union address in January 2002. Therefore, the current state of Japan–US relations was evidently used as an opening to improve the relationship between North Korea and the US and to break the deadlock in other international relations. Just as North Korea had explored the normalization of diplomatic relations with Japan in the beginning of the 1990s to escape from its international isolation that was worsened by the end of the Cold War, North Korea has strengthened its “utilitarian” orientation since 2000 and has improved its relations with China, South Korea, the United States, and the European Union nations; It can be said that the Japan–North Korea summit took place within this context. In that sense, the circumstance of that era partially resembles the current situation. In other words, North Korea’s relationship with South Korea and the United States has remained stagnant, even though First Chairman Kim Jong Un initiated the “Parallel Pursuit of Economic Development and Nuclear Armament” at the end of March 2013, and toned down his country’s hard-line stance and got up to speed on direct instructions for economy-related institutions.

## 5 The Abe Administration’s Policies toward North Korea

Although each Japanese administration since that of Koizumi has had a slightly different response to North Korea, there is basically no clear difference between the Liberal Democratic Party (LDP) and the Democratic Party.<sup>11)</sup> However, North Korea’s criticism of the first Abe administration was a very noticeably strong one, which was because Prime Minister Shinzo Abe is the first “abduction-issue prime minister” who was elected on the platform emphasizing the “abduction issue” by raising it with great passion.<sup>12)</sup> By taking a hard-line stance toward North Korea, the first Abe administration earned the support of Japan’s citizens. Therefore, this administration inevitably strengthened sanctions against North Korea and could not make substantial progress on the abduction issue. Prime Minister Abe’s extraordinary interest in this matter is indicated by the establishment of the Headquarters for the Abduction Issue, an

11) For example, campaign promises for the election for House of Councilors in July 2013 were as follows:

Liberal Democratic Party: “Resolution of the North Korean Issue” ...We will devote all of our energy to the complete resolution of the abduction issue and an early resolution of the nuclear and missile issues by sticking to the policy of “dialogue and pressure.” (“Sangiin Senkyo Koyaku [House of Councilors’ election campaign promises 2013].” Liberal Democratic Party Headquarters, 2013, p. 28)

Democratic Party: “Abduction, Nuclear Weapons, and Missiles”... We will give all our power to resolving the abduction issue, which is a serious infringement of sovereignty and human rights. We will guarantee the safety of the region by working with the international community, starting with the United States and South Korea, in coping with North Korea’s nuclear missile development and deployment.” (“Manifesto: Kurashiwomamoru Chikaraninaru [Manifesto: Being dependable to protect lives].” Democratic Party Headquarters, 2013, p.21)

12) “Democratic People’s Republic of Korea, Ministry of Foreign Affairs Memorandum: Abe—The strife of the feeling of abduction will only lead to self-destruction.” July 19, 2007.

organization that along with the Ministry of Foreign Affairs is engaged in the Japanese government's diplomacy on this issue with North Korea.

With these credentials, Abe made his way back to the position of prime minister after a period of five years and expressed the following view in a general policy speech given on January 28, 2013. "Above all else is the resolution of the abduction issue. My mission will not be finished until the day arrives that the families of all the abductees are able to hold their relatives in their arms. Under a policy of 'dialogue and pressure' with North Korea, I will do my utmost to achieve the three points of ensuring the safety and the immediate return to Japan of all the abductees, obtaining a full accounting concerning the abductions, and realizing the handover of the perpetrators of the abductions."<sup>13)</sup> It was different from the previous administrations in that there was no reference to the Japan-DPRK Pyongyang Declaration in the general policy speech.<sup>14)</sup>

As a result of half a year of "Abenomics," during which some stock prices rose by 150%, the second Abe administration has maintained a high approval rating of over 60% and the LDP was anticipated to receive an overwhelming victory in the House of Councilors election at the end of July. In the midst of this, it was announced unexpectedly that Special Adviser to the Cabinet Isao Iijima would make a visit to North Korea. Special Adviser Isao Iijima was in Pyongyang from May 14 to 17, during which he had several discussions with Song Ilho, the ambassador in charge of the DPRK-Japan talks of the Ministry of Foreign Affairs. Additionally, he saw Kim Yongil, the secretary and international department chief of the Worker's Party of Korea, and Kim Yongnam, the Chairman of Presidium of the Supreme People's Assembly. Isao Iijima requested (1) the prompt return of all abduction victims, (2) a serious probe into the truth about the abductions, and (3) the handing over of the perpetrators. In response, the North Korean side promised that they would convey the Japanese government's requests to First Chairman Kim Jong Un. The fact that Kim Yongnam, who is number two in rank in the regime, albeit formally, appeared at this meeting in addition to the party secretary seems to give us a glimpse of North Korea's intentions that it was attempting to cut off Japan's retreat and being full-swing intergovernmental. It is still premature to evaluate Iijima's visit to North Korea, but based on what was reported about the visit in the Rodong Shinmun, we can confirm that contact between Japan and North Korea is proceeding with the approval of First Chairman Kim Jong Un.

This policy of "negotiations and dialogue" did not result in a resounding backlash of public opinion. However, if these events had taken place under an administration of the Democratic Party, which has been considered to be too appeasing to other Asian countries, there might have been a backlash. Thus, it seems to reflect the tendency of Japan's citizens to be more readily convinced about such policies under Abe, who is seen as the most conservative prime minister of the LDP in recent years. An editorial in the Asahi Shimbun newspaper regarding Special

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13) "Prime Minister Abe's General Policy Speech at the 183rd National Diet" Prime Minister's Official Homepage [http://www.kantei.go.jp/jp/96\\_abe/statement2/20130128syosin.html](http://www.kantei.go.jp/jp/96_abe/statement2/20130128syosin.html) (Last accessed on September 20, 2013). In the administrative policy speech that was given on February 28, 2013, he stated the following: ("Prime Minister Abe's General Policy Speech at the 183rd National Diet" Prime Minister's Official Homepage [http://www.kantei.go.jp/jp/96\\_abe/statement2/20130128syosin.html](http://www.kantei.go.jp/jp/96_abe/statement2/20130128syosin.html) (Last accessed on September 20, 2013))

"The nuclear test that North Korea conducted absolutely cannot be tolerated. It clearly violates UN Security Council Resolutions and Japan strenuously protests and condemns it. If North Korea seeks peace and prosperity, it should be made to understand that taking this kind of provocative action will not yield any benefits. We will pursue a resolute response in cooperation with relevant countries, notably the United States and the Republic of Korea as well as China and Russia. Regarding the abduction issue, my mission will not be complete until the day comes that the families of all the abductees are able to embrace their relatives with their own hands. Under the policy of "dialogue and pressure" with North Korea, I will do my utmost to achieve the three points of ensuring the safety and the immediate return to Japan of all the abductees, obtaining a full accounting concerning the abductions, and realizing the handover of the perpetrators of the abductions. We strongly urge North Korea to take concrete actions towards the comprehensive resolution of the outstanding issues of concern, including the abduction, nuclear, and missile issues."

14) On occasions other than speeches, there has been a reference to the Pyongyang Declaration: "Prime Minister Abe, 'There will be more dialogue about the abduction issue hereafter'; if it's not resolved, there will be pressure," Asahi Shimbun, May 20, 2013.

Adviser Iijima's visit to North Korea was published under the title "Toward a Continuation of the 'Dialogue and Pressure,'" and stated that "breaking the deadlock in this situation cannot be done without dialogue."<sup>15)</sup> While an editorial in the Mainichi Shimbun newspaper raised several points of concern, it also stated that "in order to break the deadlock in the stalemate situation of the abduction issue, a dialogue with North Korea is indispensable."<sup>16)</sup> An editorial in the Nikkei Shimbun newspaper expressed the necessity of "not disturbing efforts at international cooperation" but observed that "dialogue cannot be lacking."<sup>17)</sup> Hence, the general opinion is that dialogue is essential, but it must be carried out carefully. Moreover, the voices of abduction victims' families requesting negotiations and not just sanctions have begun to grow stronger.

On May 20, at a House of Councilors' Audit Committee meeting, Prime Minister Abe stated, "It is not impossible that there are more abduction victims than the ones we currently recognize. When I am talking about a resolution of the abduction issue, I mean the return of all of the victims, including these people as well." The Japanese government officially recognizes 17 abduction victims. In addition, the citizen's group "Investigation Commission on Missing Japanese Probably Related to N. Korea" compiled the names of approximately 470 people who are "particular missing persons suspected of being abducted." The exchanges with North Korea have not been made public, but there are rumors about a possible plan to "move" the situation forward by returning victims who have not been officially requested by Japan. Such a case should be considered as "progress" and not a "resolution" of the abduction issue. Of course, it is necessary to aim for a complete "resolution" by returning all the surviving victims to their homes, but there is no doubt that North Korea is closely observing how Japanese society reacts to the "progress" made in this process. This close observation stems from a lesson that North Korea learned in 2002, which was that their concessions might not necessarily bring about the desired results. Nevertheless, if Japan acknowledges "progress" as one step toward a "resolution," it is possible that later, North Korea will only release a small amount of information at a time and then use further negotiations to their advantage. It is precisely because the abduction issue is an urgent problem with lives at stake that these "progresses" become a big dilemma for the Japanese side.

## 6 Conclusion

This article focused on the possibility of Japan's economic cooperation with North Korea and offered a brief examination of recent trends in the relationship between Japan and North Korea. Eleven years have already passed since the Japan-DPRK Pyongyang Declaration, and the administrations of both countries have changed. During that time, North Korea repeatedly carried out nuclear and missile tests, becoming a "full-fledged nuclear power." Although the initial conditions have largely changed since the declaration signing, they will likely be used in the long term as the basis for the creation of future policies with North Korea, considering it is the only document that was exchanged at the Japan-North Korea summit meeting. North Korea has discarded many agreements as null and void, such as the withdrawal from the Treaty on the

15) "Shasetsu: Iijimashihocho Taiwato Atsuryoku'no Keizokuwo [Editorial: Iijima's visit to North Korea. Toward a Continuation of 'Dialogue and Pressure']" Asahi Shimbun, May 19, 2013.

16) "Shasetsu: Iijimashinocho Kenenwo Harashitehoshii [Editorial: Iijima's visit to North Korea. We would like the concerns to be dispelled]" Mainichi Shimbun, May 21, 2013.

17) "Shasetsu: Rachikaiketsueno Taiwawa Juyodaga [Editorial: Although dialogues are important for the resolution of the abduction issue]" Nikkei Shimbun, May 21, 2013.

Non-Proliferation of Nuclear Weapons (NPT), the abandonment of the non-aggression pact with South Korea, and the nullification of the “Korean Armistice Agreement”; however, it continues to hold up the validity of the Japan-DPRK Pyongyang Declaration.<sup>18)</sup>

From Japan’s point of view, it cannot easily reduce the economic sanctions on North Korea. However, if the end goal is a resolution of the abduction issue, it is essential to continue to think flexibly, even if the means to achieve that goal seem unreasonable. By using the “Parallel Pursuit” as a slogan, Kim Jong Un’s administration has started to put emphasis on “constructing an economically strong nation.” This state of affairs can be considered as a good opportunity for Japan to seriously explore negotiations in its long-stagnant relationship with North Korea.

\*As of September 20, 2013. This article is an unfinished manuscript, so please refrain from citations.

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<sup>18)</sup> However, it is also true that there is already a large gap between the declaration and the actual circumstances, indicated by incidents such as the violation of the “moratorium on missile launches.”

Presentation

# Russian Perspective and Strategy for North Korean Development Cooperation

**Georgy TOLORAYA** |

(Department Chief, Russkiy Mir Foundation)



## 북한개발협력에 대한 러시아의 시각과 전략

러시아는 북한의 현안들에 관해 날카롭게 지켜보고 있다. 그 이유는 북한의 상황이 이웃 국가들의 안보에도 영향을 미치기 때문이다. 2013년의 김정은 리더십의 예상치 못한 위기 행동과 발언들은, 러시아 전문가 커뮤니티의 향후 한반도의 다양한 시나리오를 연구하는 움직임으로 이어지고 있다. 이는 러시아의 비전은 북한을 반대하는 국가들의 입장과 상충되어있기 때문이다. 북한정권과 공존하는 전략적 결정을 미국, 한국 또는 일본이 선택하지는 않을 것이다. 한국과 북한에게 아직 한국 전쟁은 끝나지 않은 전쟁으로, 최악의 위기의 가능성이 높지는 않지만 아직 존재하고 있다. 따라서 양국의 접근방식의 변화는 중요하다. 장기적으로 북한의 미래는 경제 및 사회발전과 정치적 안정의 양쪽 측면에 달려있다. 대부분의 러시아 북한 전문가들은 '북한붕괴파'에 속하지 않지만, 앞으로의 향후 상황은 김정은이 경제개발과 리더십 능력 발휘에 따라 북한과 주변 상황의 맞는 새로운 리더십을 세우고, 정권과 국가경제의 현대화로 나아가는 방향에 따라 영향을 받을 것이다. 그리고 그 결과로 적들과의 잠정 협정을 확립해야 할 것이다. 그렇다면 향후 동북아시아의 미래와 러시아의 전략적 비전에 적합한 전망은 무엇일까?

한반도 정세의 안정화와 북한 발전의 열쇠는 북한에게 체제전복에 대한 우려를 완화시키고 대신 경제에 집중할 수 있도록 허용하는 환경을 만드는 것이다. 이러한 안보태세는 다자적으로 해결해야 한다. 러시아는 여전히 6자회담을 타협의 기준으로 여기고 있으며 기회가 있을 때마다 한반도의 문제는 다자적 회담이라는 메커니즘을 통해 해결해야 한다는 점을 상기시키고 있다. 그리고 이 입장은 다시 한 번 2013년 봄에 긴장상태가 진정되며 강조되었다. 러시아의 외무장관 세르게이 라브로프는 다자간 접근방식의 필요성을 역설하며 동북아시아의 평화와 안보를 위한 다자적 워킹그룹을 만들어야 한다고 제안했다. 즉, 러시아가 의장국이 되어 6자 회담을 되살리는 형식을 제시한 것이다. 그러나 미국, 일본과 한국은 이러한 접근이 북한의 비핵화를 가져오지 못하기 때문에 이 제안에 대해 우려는 표하는 입장이다. 그러므로 우리는 조용히 비핵화가 먼 미래의 목표인 점을 간주하면서 더 실행 가능한 일인 북한의 핵 잠재력을 억제하는 '리스크 관리'에 치중해야 한다. 따라서 앞으로의 과제는 이러한 현실 속에서 어떻게 평화와 발전을 촉진시킬 수 있는지 고민해보는 것이어야 한다.

## RUSSIAN PERSPECTIVE AND STRATEGY FOR NORTH KOREAN DEVELOPMENT

Russia keenly watches the developments in North Korea as it is crucial for the security of its neighborhood. The unexpected crisis of 2013, initiated in a decisive degree by Kim Jong Un's leadership's actions and rhetoric, has prompted Russian expert community to study various scenarios of development of situation in Korean peninsula. It should be understood that the Russian vision remains at odds with that of North Korea's opponents: the strategic decision to co-exist with this regime has never been taken in USA, ROK or Japan. In the eyes of both South and North Korea the Korean War is not over. Although the possibility of a crisis is not high, it is still "on the table." To avoid it the change in both sides' approaches is crucial. In the long-term the future depends much on where North Korea will move both in terms of economic and social developments and political stability. Although serious Russian experts do not belong to "collapsist" school, it is clear that progress in the situation in and around North Korea would largely depend on Kim Jong Un's ability both to develop economy and modernize the regime by injecting new blood in the leadership and, as a result, agree on modus vivendi with his foes. What are the prospects for such a development, which fits well into Russia strategic vision of the future of Northeast Asia?

The key to development of North Korea and stabilization of political situation in Korean Peninsula is creating security arrangements relieving North Korean concern about possible subversion and permitting it to concentrate on economy instead. Such security arrangements should be multilateral. Russia still keeps reminding at every occasion that it wants the Six-party talks to be the major instrument to help solve the Korean problem on a compromise basis. That position was again stressed as the Spring 2013 tensions in Korea subsided: Foreign minister Sergei Lavrov confirmed the need for multilateral approach, suggesting that the work should be started from the reviving the Working Group on peace and security mechanism in Northeast Asia, chaired by Russia in the Six-party talks format. However US, Japan and South Korea so far remain lukewarm to this proposal, as it does not bring North Korea's denuclearization any closer. Therefore we should silently presume that denuclearization is the aim for the distant future, and the more viable task is to rein in the DPRK nuclear potential—to "manage the risks." So the task is to explore the option how peace and development could be provided under current realities.

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### **Political Dilemmas**

The initial fears that after the sudden transfer of power to Kim Jong Un in 2011 he might not be able to be in control and could fall prey to intra-faction struggle have subsided – by the end of 2012 he has firmly established his governance system. Initially there were many hopes the young Western-educated leader might change the course of his country to a more pragmatic one—he gave such hopes thanks to PR-actions, aimed at increasing popularity with the somewhat skeptical population of the country («local governance», the appearance in public with a young wife, going to concerts and attractions). However many of these actions backfired (like publicizing former basketball star Denis Rodman's visit, which raised eyebrows not only on North Korea)

Kim's authority recognition came not without resistance, as the governance vertical was streamlined. The purge in of the military, started in summer 2012, still continues which makes it difficult for the military to play any political role now. Military and special services now have defined place in the state—internal and external security, but not solution of political and economic issues.<sup>1)</sup> This is a change in comparison with the “arduous march” period: in this era military establishment has become overwhelming. As Marcus Noland puts it “some kind of dual authority emerged” which may lead to a substitution of the national goals with that of the military.<sup>2)</sup> Nowadays party structures are entrusted to lead the administration of the state, and the Cabinet of Ministers of the economy.<sup>3)</sup> However Kim Jong Un does not question the viability of Songun policy, although he tries to combine it with economic development (Pyonjing).

Initially Kim went as far as to mention “a new economic management system in our own style.” In what was interpreted by optimists as a shift in national strategy Kim Jong Un declared

1) North Korean leader Kim Jong-un wrests economic control from military  
<http://www.guardian.co.uk/world/2012/jul/20/north-korean-economic-military>

2) [www.piee.com/blogs/nk/?p=11871&utm\\_source=feedburner&utm\\_medium=email&utm\\_campaign=Feed%3A+nkwitness+\(PIIE+|+North+Korea%3A+Witness+to+Transformation\)](http://www.piee.com/blogs/nk/?p=11871&utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+nkwitness+(PIIE+|+North+Korea%3A+Witness+to+Transformation))

3) <http://www.dailynk.com/english/read.php?catald=nk00400&num=9509>

that the rise in living standards will be the most important task: “The building of an economic giant is the most important task that comes to the fore in the present stage of building a thriving socialist country.”, he said in 2013.<sup>4)</sup>

The problem is, however, there are doubts if he has got political will and ability to implement his obvious desire to modernize the country. The greatest dilemma is that any movement in this direction endangers the political power structure—and that, in turn, in a situation of strong international pressure and foreign subversive activities can easily lead to the collapse of the regime and to either the country being absorbed by South Korea or be taken under control by China.

Therefore the initial push for changes has stalled by the end of 2012 and the question about possible changes in the DPRK remains open. In 2013 the hardline policies dominated both in internal politics, where repressions were on the increase, and in external policies, where the inflammatory rhetoric and provocations were abound. The closing of borders to defectors and smugglers, repressions against the opposition, the direction of the inspections, strengthening the fight against the «hostile ideology» show more of an attempt to «tighten the screws», than about liberalization. However, is this the answer to the country’s long-term need?

Can Kim-Junior leave things as is, like the old part of the leadership wants? Geopolitical position of the country—the factor of South Korea, the strategic goal of which remains the absorption of the North and of China, which wants to control the regime—does not allow experiments that endanger the security of the regime. The obvious recipe is conservation - the leadership of the DPRK—or the large part of it at least—hopes to renovate the totalitarian-monarchical political system and without any major changes to keep it for decades.

However the penetration of information from the outside and the development of market relations has made it increasingly difficult. The population has long lost faith in socialist ideals and perceives propaganda just as «white noise», learned to circumvent the prohibitions with the help of bribes. So far the regime keeps its stability simply because the authorities have for the first time left the population much alone- to pursue their economic interests and personal life, rather than participate in collective efforts, as long as the system is not challenged.

The most vivid testimony is the emergence of a “middle class” (initially in Pyongyang) which discovers new consumerism for itself not quite in line with communist egalitarian standards. The authorities try not to notice that and not to “regulate” new phenomena. Is it possible that younger part of leadership see this emerging class of owners and successful people as a new base for the regime? And wants to count on their loyalty rather than “sit on the bayonets.” It could be reasonable, as this new class has something to lose in case of a calamity and is afraid that in case of regime change or unification they would lose their social status and position and might be repressed. They do fear that any unrest may result in “conquering” of their country by South Korea which is seen as hostile, and this does not encourage any demands for changes, directed at the “political class”.

At the same time any criticism of the authorities is still not tolerated, and the people, which were given some breathing space, just do not feel the acute need and are afraid to challenge the existing order of things, as the repressive system of North Korea has the traditional feudal and then harsh colonial system as its direct predecessors and the population simply is not aware of

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4) <http://www.kcna.co.jp/index-e.htm>

any other form of government.

However it is also noticeable that the younger generation do question the viability of the existing system and wants it improved. So without bringing the system in line with new requirements the regime can experience serious internal challenges in addition to external ones.

In fact, in order to maintain the DPRK as an independent state, the elite has to offer a new «national idea». And it should not be just survival by means of strengthening military defense capability.

It is relatively easy to refuse from imported ideas of communism: the word has already disappeared in 2009 from the Constitution of the DPRK, and the last portraits of Marx and Lenin were gone from Pyongyang streets. The term «our style socialism» is elastic. Kimilsung-Kimjongirsim more and more resembles the religious teachings (remember, that Confucius was a real person), there may be different interpretations of « heritage».

In the summer of 2012 the slogan of «Kim Jong Il patriotism» was coined- meaning, that Kim Jong Il, as a disciple of Messiah (Kim Il Sung) interpreted his teaching in this way. The basis of formation of a modernized ideology can be a Korean nationalism, based on Confucian ideas about the primacy of the state and hierarchy. A slogan of «a powerful country, unending prosperity» appeared as a «creative development» of the earlier idea of a «strong and prosperous nation» with an emphasis on the growth of living standards. Kim Jong Un underlined in the 2013 New Year speech: “In the same manner as we demonstrated the dignity and might of Songun Korea through the manufacture and launch of the Juche-based application satellite, the entire Party, the whole country and all the people should wage an all-out struggle this year to effect a turnaround in building an economic giant and improving the people’s standard of living.”<sup>5)</sup>

### **Economic reforms?**

The economic reality of the DPRK for a long time already is not Stalinism as was often presumed in the past and even now. Semi-paralyzed public sector exists side by side with quasi-market «grey» and «marketized international» sector with the participation of economic entities, belonging to the administrative, regional, party bodies, security services and the military, as well as joint ventures, free economic zones, which in the last year have received a new development. A semi-state oligarchic economy is emerging, which in principle can become the backbone of the regime in the future.

As Peter Ward notes the market economy is multilayered: “At the lower level, slash-and-burn agriculture on mountain sides, underground drug factories and making garments and sweets are the jobs done by the adult women who predominate among lower and middle-class breadwinners.” These activities are now universal and cannot be rooted out. On the upper level there are generally two groups- traditional party and military/special services nomenclatura, including their offsprings, relatives and friends, and a comparatively new one of self-made capitalists.

Many of them, Pater Ward notes, “usually formally work for what are ostensibly state organizations, but in actual fact they have taken these over. For the privilege, they pay kick-backs to the state …The donju (Korean for "money masters", i.e., the rich) run many of the

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5) <http://www.kcna.co.jp/index-e.htm>

formerly state-run restaurants, buses and even sometimes mines. The state does not have the resources to run these operations, so many of them were allowed to close and then subsequently privatized by officials or private entrepreneurs... [Another] group is those working in what are known in Korean as waehwaporu, (literally "foreign currency earning") organizations. These used to be state export companies that have gradually seen much of their organization and profits fall into the hands of private investors and officials (often the same)".<sup>6)</sup>

So far the state do not dare to recognize and legalize this economic reality. An attempt was made in summer 2012, when reforms in agriculture - «measures on June 28» were introduced. They so far has not been either denounced or fully implemented, but the process is going on. The discussion of possible changes centers on withdrawal of distribution system, (in fact paralyzed since 1990-s), sharp growth of wages, to ensure the «consumer basket» at market prices, the transition to settlements between enterprises directly in cash, the decentralization of economic management, the acquisition of a greater independence of the enterprises. It initially (in 2012) caused a surge in inflation expectations, the growth in demand for foreign currency and food. However in 2013 the consumer prices and exchange rates are relatively stable and the rise in prices is related mostly not to the basic commodities, but to the “high-end” (for North Korea) products and services which is a testimony to the growing purchasing power of North Korean middle class.

Obviously, the dispute between «conservatives» (calling to struggle with the capitalist methods, limiting of market mechanisms) and «radicals» (which recognize that the reforms must «have a smell of capitalism») is far from over. Not long ago the cadres which have reputation as reformists (Prime Minister Park Bon Ju) were brought back to the helm, North Koreans are sending exchange students to study economics in West European countries. The General Bureau for State Economic Development was upgraded to become the State Economic Development Commission,<sup>7)</sup> which might be the sign of recognizing the need to work out a more realistic development strategy.

However the lack of economic knowledge among the North Korean orthodox scholars (trained by old political economy of socialism textbooks and having no access to other theories) hinders the appearance of a sound economic strategy. The North Korean economists offer such ideas as control over prices, limiting of the market trade, “de-dollarization”, prohibition of private participation in the foreign trade activities, creation of import-substitution production etc. There are little alternative ideas – of course North Koreans would not listen to foreign experts opinions and only the trial-and-error method, under constant influence of ideological dogmas, remains. They frown on “Chinese way”- both because it is anathema openly imitate “big counties” to the real Jucheists and because the “opening of the country”, inherent to the classic Chinese way represents the mortal danger to the regime.

So what we would probably see in the medium term is just passivity of state to the new market requirements- simply tolerating them without making and formulating any strategies for reforms.

Sooner or later, however, Kim Jong Un will still have to make a decision on legalization of already functioning market economy and the creation of the appropriate legal framework. It is necessary to withdraw from the shadows private traders and enterprises, optimize the operation of

6) 'Money-masters' hold lifeline for North Korea, Peter Ward - <http://www.atimes.com/atimes/Korea/NJ19Dg01.html>

7) <http://www.kcna.co.jp/index-e.htm>

state-owned corporations and state-owned companies, and introduce a normal system of payments, improve the financial system, create a tax system.

The sorrowful development is, however, that Kim Jong Un got engrossed in large-scale wasteful projects like Masik ski resort, dophinarium, water parks, etc.—obviously to demonstrate the success of his policy of improving “peoples livelihood”—in fact as a substitute to development of economic infrastructure and reindustrialization of the country. However it is better than pouring the scarce resources on arms only. The problem is that these kind of demonstrative measures should not distract from really pressing tasks of creating possibilities for real-sector economic development, as in a primitive economy like North Korea service sector can only play a supplementary role as generator of the demand and funds.

### **Foreign economic factor**

It should be admitted, that any meaningful transformation and modernization of the economy can be successful only in the case of financial investments, which has nowhere to come except from abroad. The external political factors—bringing the country out of isolation—is the decisive condition to make it happen, regardless of North Korea's desire or ability to introduce systematic changes into the system of attracting the foreign capital.

Recently North Korea got back to the idea of creating free economic zones to attract foreign investment. The Economic Development Association was created in order to “help foreign businesses and entities to get a better knowledge of special economic zones in the DPRK and to make investments in them.”<sup>8)</sup> It was previously reported that economic officials in provincial areas of North Korea had been ordered to formulate plans for the designation of two candidate cities for development, and that legal and systemic modifications were being investigated, in order to try and ensure interest from foreign capital. A conference on SEZ development was held in Pyongyang in October 2013.<sup>9)</sup> It was officially announced by Yoon Yong Suk, the head of this Association about issuance of a directive to economic officials in the country's nine provinces, calling upon them to designate potential sites for development in a similar manner to Rason Special Economic Zone. It was found out that the workers Party Central Committee meeting in March 2013 (interestingly, in the midst of confrontation with US and South Korea) decided that special economic zones should be established in each province, and tourist areas, too, in order to invigorate the tourist industry, and bring about greater diversity in international trade.”<sup>10)</sup>

It is planned that the profit derived from joint ventures would be shared 50-50; however, foreign companies would only have to cover the cost of land use and wages. The crucial issue is whether the provinces have any autonomy in designing the zones or whether they are effectively managed from the top.<sup>11)</sup>

There are not a few examples of the new joint ventures. For example, recently a consortium consisting of Jurong Consultants and OKP Holdings of Singapore, P&T Architects & Engineers Ltd. of Hong Kong, China agreed with the DPRK' on collaboration in building the Kaesong Hi-Tech Industrial Park and Highway Toll Road from Capital Airport to Pyongyang City.<sup>12)</sup>

8) <http://www.kcna.co.jp/index-e.htm>

9) <http://www.kcna.co.jp/index-e.htm>

10) <http://www.dailynk.com/english/read.php?cataId=nk00400&num=11089>

11) <http://www.dailynk.com/english/read.php?cataId=nk01500&num=11032>

Such a concentrated effort is another attempt to break the deadlock of the country's extremely low investment attractiveness, although it possesses several comparative advantages – mineral resources, logistic geoposition, low-cost labor, qualified technicians... Since 1990 several zones were attempted, like the Rason Special Economic Zone, the Hwangguempeong and Wihwa Island areas, Keumgangsan International Tourist Area,(not to speak of Kaesong Industrial complex). However there is no surprise that none was successful, not only because of political risks, but also due to the failure of North Korean authorities to establish an attractive investment climate and provide guarantees. The problems is systematic and lies in inability of North Korean policymakers of the higher echelon to understand how international business operates and what it needs for being attracted to invest. The low- and middle level officials, exposed to foreign businessmen might be more knowledgeable, but the North Korea reality is such they cannot challenge their superiors.

Therefore it is very interesting whether this new attempt of FEZs—apparently at the instructions of the young leader—would help overcome this systematic problem and present the real possibility for the foreign investment. However a combination of political factors (continuing hostility with the outside world due to nuclear problem) and economic sanctions, which makes it impossible to normally conduct financial operations with North Korea makes it doubtful whether large foreign investment would actually flow into North Korea before these problems are solved. With one possible exception—China.

China is the largest donor to the DPRK, including in terms of investments, its expansion is called even «economic colonization» of the DPRK. However a theoretical normalization of the international ties of the DPRK and its relations with South Korea would make Seoul the biggest donor. Assistance from international organizations is also possible in case political issues are solved.

In order to achieve it Pyongyang has to come out of isolation and at least partially ease the standoff with the outside world. North Koreans react to «hostile actions» (maneuvers in South Korea, its measures for the development of a missile capability, etc) very emotionally. But so far only verbally, by all channels showing interest in a direct dialogue with the United States.

In contrast to other «rogue States» (for example, Myanmar), whatever North Korea would do in the field of demilitarization, democratization and the improvement of the situation with human rights, Pyongyang all the same will not be accepted by opponents as an equal partner, simply because the calculation is on the unification of Korea, and not on conservation of North Korea as an independent state. Something radically new should happen in the world that the political elite of the USA and ROK would agree to co-exist with such odious regime, as the North Korean. Or the regime should be deeply transformed.

In both cases only national reconciliation with the South is the realistic chance for the survival of the DPRK. Joining hands with ROK is also important to find the «equalizer» to release from dependence on China. The President Park Geun Hye strategies of Trustpolitik, Alignment and Evolution, if seriously implemented, could contribute to such a development. Especially the idea of simultaneous, not sequential implementation of the three phases of trust-building (humanitarian assistance, exchanges, implementation of the “Vision Korea” on the way to economic community is worth noting. I believe, in fact the spirit of this approach is a

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12) <http://www.kcna.co.jp/index-e.htm>

descendant of “Sunshine and Engagement” policies of liberal administrations. However “Dynamic Alignment” concept,<sup>13)</sup> linking cooperation to political and security factors—and in fact presuming that North Korea is to be “contained” before it can count on benefits from cooperation—could cause suspicion of the Pyongyang elite that the real aim of the policy, as was the case with the past policies, is just preparation for the absorption of North Korea. Especially the demand for prior denuclearization is a total non-starter and if it would be insisted upon, no progress in inter-Korean relations would be feasible.

I believe it is in the interest of both countries to restore without conditions dialogue at the government level, resume trade and investment cooperation, tourism projects, begin realization of multilateral projects, mitigate the territorial dispute in the Yellow sea (perhaps on the basis of the principal outcomes of the inter-Korean summit in October 2007.).

### **The Russian position and possible role in North Korean development**

For Russia stability and prevention of a conflict at its Eastern frontier, which could lead to tectonic changes in geopolitical situation (a possible inter-Korean conflict having crucial importance for US-China confrontation) is the utmost priority in its Korean policy. Therefore all other consideration and priorities should be considered secondary to this agenda.<sup>14)</sup>

Unfortunately it is questionable whether the goal of the denuclearization of the DPRK is attainable for the moment. So any diplomatic process is only a tool to hedge the risks, stop North Korean improvement it arsenal and prevent nuclear proliferation.

Potential reforms in the neighboring country is a chance for Moscow to improve its positions in North-East Asia, strengthen the role of the Russian business in regional projects, important from the geo-economic and geopolitical points of view (such as a gas pipeline to South Korea via the territory of the DPRK, and the TRANS-Korean railway with TRANS-Siberian (see later). The reforms would contribute to implementation of these projects, and they, in turn - to the stabilization of the economic situation in the DPRK.

Russia is prepared to make real contribution for bringing such a prospect closer. For example, settlement in 2012 of the debt of the DPRK through writing off of 90% with the transfer of 10% (\$1.1 billion) into an investment fund allows for the mobilization of these investment resources, for example, through co-investment in North Korea.

In 2012-2013 the relations suffered a temporary setback, because Russia had to support, at least partly, Western criticism of North Korean nuclear tests and rocket launches, as well as provocative rhetoric and behavior. Moscow was very critical on the Pyongyang’s position after the nuclear test and also expressed concern with the decisions of the March WPK Plenum, which legally confirmed the status of DPRK as a nuclear power, pointing out it blocks the way for the resumption of the Six-Party Talks. Foreign Ministry called it a “fragrant contempt” by Pyongyang of the UN Security Council decisions, which was “categorically unacceptable to Russia”

Further developments, including inflammatory military rhetoric of Kim Jong Il’s regime and demonstratively provocative PR actions, like moving missiles to the firing positions and declaring the “war-like state”, and “all-about nuclear war” were resented by Russian establishment and

13) Park Geun Hye/. A new kind of Kora: building trust between Seoul and Pyongyang”- Foreign Affairs’, September/October 2012, pp.15-16

14) See Vladimir Putin.” Russia and the Changing World “, Moscow news, accessed May 1, 2012, <http://mn.ru/politics/20120227/312306749.html>.

most of population alike. However experts did not take this situation seriously, understanding, there was no need for US or South Korea to go to war in Korea, while North Korea had no possibility or capability to start a conflict, despite military hysteria. At the same time Moscow expressed negative attitude to “all statements and actions, which lead to escalation of tensions” and once again called on the partners of the six-party process “to avoid the events being carried beyond the limits of the political and diplomatic framework”

The results of the early 2013 events cooled down the relations and resulted in several problems. First, Russia was increasingly frustrated with the erratic behavior of Pyongyang after the advent of Kim Jong Un and North Korea’s lack of desire to inform Moscow, not to say seek advice, on its policies. This was amply demonstrated in the toughening of the tone of Russian official statements on Korean issue. Unofficially the attitude was even more critical even in those parts of Russia’s establishment, which used to be supportive of North Korea. And North Koreans themselves demonstrated without fail their dissatisfaction with what they called “betrayal” of Russia- this was noticeable in the cooling of official relations and contacts in the last months as well as in the tone of North Korean propaganda comments on Russia.

Second, Russia still cannot afford to be straightforward to Pyongyang, as it is anxious not to let the crisis on its borders escalate, much less allow a conflict or the collapse of North Korea and its absorption by the South. Russia believes such a scenario would mean a drastic change in the geopolitics in the Far East and deteriorate its security positions in this far-away area. Therefore Moscow consistently calls for political and diplomatic solution to the existing problems on a multilateral basis, implying Russia’s active participation in the process. The fear of being side-lined is a long-standing concern, making Moscow’s position dubious, as it has to keep the channels of communication with North Korea opened and not give Pyongyang pretext to ignore Moscow. Here the sorrowful experience of 1990s is relevant. Then Moscow supported US and West in general on North Korea nuclear issue, resulting in cooling of relations with DPRK. By doing so Russia effectively marginalized itself in the process of Korean settlement, including vital nuclear issues and economic projects: not only North Korea, but also Western powers ignored Russia, saying in had “no influence” on Pyongyang. This lesson is not forgotten. Third, Moscow tends to let China be the spearhead on the discussions on the Korean situation and take the negative consequences of “defending” DPRK and usually passively supports the wording of the international resolutions on Korea, agreed in a tough tug of war between China and US. When China is not present at the discussion (p.e. during G-8 meetings) Moscow becomes even more passive on Korean issue and does not try to challenge much the consensus. For example, in the discussions with the USA on Korea (p.e. during Lavrov-Kerry talks in April 2013) , Russia publicly tried to smoothen the differences and give the impression of similarity of views- which is a sharp contrast with, for example, Syria.

Russia was relieved when the acute phase of the crisis was over due to the change of Pyongyang’s aggressive approaches and welcomed certain rapprochement between North and South, however difficult it progressed. Russian experts sincerely hope the dialogue between North and South will restart and this would be a long-lasting “peace offensive” phase in Korean affairs.

Stabilization and development in North Korea are especially important from the point of view of Russian geo-economic and geopolitical interests in East Asia. Moscow also sees involvement of North Korea into international cooperation as a factor in economic progress of DPRK. Both

goals are served well by trilateral projects linking Russia and both Korea. They are the long-term policy goals of Russia in East Asia that are important for trust-building process in the regional and strengthening of Russian positions in Asia and the Pacific, as well as development of Russian Far East.

The earliest and the most advanced project is the one of connecting Transkorean railroad with Transsib for transit cargoes from Korea and the Pacific to Russia and Europe. The issue was hotly debated in early 2000-s. After Kim Jong Il visited Russia by train in 2001 and discussed the railroad project with President Vladimir Putin he became a proponent on it and personally overrode the resistance of the military as to the route and parameters of the project. However, Kim Dae Jung government, reportedly under pressure from the US, dragged its feet in promoting the project. So Russia had to unilaterally invest into the “pilot” project linking its border with Rajin port in North Korea.

The joint Russia-DPRK joint venture “Rasoncontrans” was created in 2009 as the work at the Khasan-Rajin route started in October 2008, when the agreement was signed between Ministry of Railroads of DORK and Russian “RZhD” state company. As a result 54 km of railroad were rebuilt, 18 bridges and 3 tunnels were constructed. Also the universal terminal in Rajin port is being constructed. 4 mln tons of cargo could pass this terminal. According to “RZhD” President Vladimir Yakunin 5,5 bln roubles (about US\$ 170 mln) are invested into the railroad, 3.5 bln roubles (US\$110) are invested into reconstruction of the port.<sup>15)</sup> The first test run of the trains was undertaken in October 2011<sup>16)</sup> and in September 2013 the railroad was officially opened.<sup>17)</sup>

However the actual commercial operation is still to come. This is related to political reasons, as South Korea refused to send containers to Rajin for transit, as was initially expected. At the moment of writing the problems are solved and the coal exports are planned but the project no longer involves South Korea who actually opted out of it, thus undermining the whole concept of trilateral cooperation.

Chinese competition over Rajin area, hindering Russian efforts, is also a factor. Russia hoped that Park Geun Hye government would agree to be more active and this issue was discussed during the summits in September 2013 in St Petersburg and November 2013 in Seoul.

The power line connecting Russian Far East, where the excessive electricity generation capacity for export exists, with South Korea as an export market was discussed for many years and in 2009 a number of agreements between Russian “Inter RAO UES” and South Korean KEPCO was signed.<sup>18)</sup> The 500kV line through North Korea was discussed and in 2008 “Inter RAO UES” and Ministry of Energy and Coal of DPRK signed a memorandum, providing for land allocation for the line to be paid for by energy supplies.<sup>19)</sup> However due to deterioration of relations between North and South this project was also shelved, although Russia shows its commitment to the project (for example, it was discussed during the summit meeting in Seoul in March 2012 and again mentioned in September 2012 meeting in Vladivostok).

15) <http://www.regnum.ru/news/society/1710650.html>

16) Russia to open railway track to North Korea, *ABC-CBNnews.com*, accessed October 25, 2011, <http://rp3.abs-cbnnews.com/global-filipino/world/09/15/11/russia-open-railway-track-north-korea>

17) [http://www.ng.ru/world/2013-09-23/8\\_kndr.html](http://www.ng.ru/world/2013-09-23/8_kndr.html)

18) “Inter Rao UES and Korean KEPCO signed memorandum of understanding”, East Energetic company, accessed May 10, 2012, <http://www.eastern-ec.ru/news/podpisanie-memoranduma-o-vzaimoponimanii-50.html>

19) “Technical requirements for feasibility studies for construction LEP for electricity supply to Korean peninsula` countries are signed”, East Energetic company, May 10, 2012, <http://www.eastern-ec.ru/news/vostochnaja-jenergeticheskaja-kompanija-.html>

The most widely discussed trilateral project with DPRK participation is the gas pipeline to supply Russian natural gas from Sakhalin to ROK through the territory of the North. The idea is as old as Russia-ROK relations themselves, and already in 1990-s North Koreans showed their readiness to participate: testifying in Russian Parliament the North Korean ambassador informed, that his government is prepared to allocate land for the gas pipeline.<sup>20)</sup>

In May 2003 Russian “Gazprom” state company and South Korean KOGAS signed the Cooperation agreement, providing for gas pipeline construction. In 2006 the Russia-ROK Intergovernmental agreement was concluded and in 2008 and 2010 other relevant agreements between Russia and ROK were signed. In 2010 the Final report on the variants of gas supply from Vladivostok to Korea was prepared. In July 2011 “Gazprom” delegation headed by its vice-president visited Pyongyang and presented to the North Korean side detailed plan of the construction of the pipeline to South Korea, which was in general accepted.<sup>21)</sup>

After the August 2011 Medvedev-Kim Jong Il summit meeting active consultation started, and DPRK showed very positive attitude. In September 2011 “Gazprom” president Alexey Miller met the DPRK Minister of oil industry Kim Hui Yong and “Kogas” president Choo Gang Soo and the “roadmap” was signed for construction of the pipeline. The investment was prognosed at US\$ 2.5 bln, the volume at 12 bln cubic meters per year.<sup>22)</sup> The Russia- North Korean Working group was established and relevant MOU was signed, while Russian side strived for conclusion of the intergovernmental agreement with DPRK on cooperation in gas industry. “Gasprom” will fully finance the construction of the pipeline in DPRK territory.<sup>23)</sup>

However the reluctance of South Korean side to find a compromise on prices and terms of delivery endangered the whole project. South Korean attitude that Russia needs the project more (for geopolitical reasons) than ROK does could only lead to switch of “Gazprom” (which is commercial company) to more profitable LPG supplies to ROK, and ROK could end up paying 10-15% more for Russian gas. In October 2013 it was reported that Gazprom has decided to shelve the project or built the underwater pipeline via Japanese sea. However Russian Premier Medvedev said that :the idea of the gas pipeline to South Korea through the territory of DORK remains on the table, but the condition is continuation of the talks for solving political problems related to North Korea.”<sup>24)</sup> This is a diplomatic way of demanding from South Korea of changing its position of de-facto boycotting the project.

Russia also put forward the idea of modernizing the industrial and infrastructure objects once created with Soviet assistance, which still remain the backbone of North Korean heavy industry. Russia wants coordination with South Korea as a possible market and probably investor into such projects, but again this demand falls on to deaf ears.

Another idea (welcomed, by the way by some South Korean businessmen) is trilateral cooperation on Russian soil. For example, use of North Korean workforce at the industrial objects of South Korean companies in Russia (Samsung, Hyundai, LG etc) could be considered. This would be beneficial for South Korean companies, as they can use a homogenous and disciplined workforce speaking the same language (the workers could also reside at the quarters,

20) «Изучение Сибири в РК» Центр изучения Сибири университета Пэчже, РК, г. Тэчжон, 2-й том, 1998 г., с. 226. “Siberia studies in Republic of Korea”, Center of Siberian studies, Paeje University, Taejon, Vol. 2, 1998, p.228

21) “Peaceful gaz to Korea”, *Moscow news*, accessed July 27, 2011, [http://www.mn.ru/newspaper\\_firstpage/20110722/303445035.html](http://www.mn.ru/newspaper_firstpage/20110722/303445035.html)

22) “Attack of the East”, *Rossiskaya gazeta*, accessed May 6, 2012, <http://www.rg.ru/2012/04/17/gazoprovod.html>

23) “Pyongyang and Seoul’s interests will guarantee the success of the project”, *Kommersant*, accessed May 10, 2012, <http://www.kommersant.ru/doc/1827381>

24) <http://www.isn.ru/88620.html>

built near the plants) for very competitive salary. North Korea will receive a new income source. At the same time the workers would be trained by South Koreans that would be beneficial for future inter-Korean projects. Another idea is investment by North Korea in Russia using South Korean financing in different forms (equity, credits, joint ventures).

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The key to development of North Korea and stabilization of political situation in Korean Peninsula is creating security arrangements relieving North Korean concern about possible subversion of the regime and permitting it to concentrate on economy instead. Such security arrangements should be multilateral. Russia still keeps reminding at every occasion that it wants the Six-party talks to be the major instrument to help solve the Korean problem on a compromise basis. That position was again stressed as the Spring 2013 tensions in Korea subsided: Foreign minister Sergei Lavrov confirmed the need for multilateral approach, suggesting that the work should be started from the reviving the Working Group on peace and security mechanism in North East Asia, chaired by Russia in the Six-party talks format as a first step towards resuming the full-fledged talks. However US, Japan and South Korea so far remain lukewarm to this proposal, as it does not bring North Korea's denuclearization any closer.

At this point of time, when DPRK officially declared itself to be a nuclear power (including it into the new version of its Constitution) denuclearization of Korea under the current rules of the game seem to be unattainable, especially in the wake of "Libyan and Syrian lessons." Therefore we should silently presume that denuclearization is the aim for the distant future, and the more viable task is to rein in the DPRK nuclear potential—to "manage the risks." So the task is to explore the option how peace and development could be provided under current realities.



Presentation

# US Perspective and Strategy for North Korean Development Cooperation

**Mei GURTOV** |

(Professor Emeritus, Portland State University)



## 북한개발협력에 대한 미국의 시각과 전략

2013년은 한국전쟁 휴전협정 60주년이자 북한과 미국이 적이 된지 60년이 되는 해이다. 최근 조지 W. 부시 행정부와 오바마 행정부 시기를 비교해본 결과 미국과 북한의 상호작용 패턴은 거의 바뀌지 않았다. 기존의 협상을 깨뜨리는 형태로 한 쪽이 상대방을 비난하거나 다른 한쪽이 또 상대방을 비난하는 패턴, 북한 미사일과 핵실험 그리고 무력공격을 포함하는 위협 대 역위협 패턴, 북한에 제재를 가하고 미국이 북한비핵화를 요구하는 패턴, 북한이 대화를 다시 시작하고자 접근하자 미국은 핵무기 프로그램을 포기하는 것을 증명하지 않는다면 그 제안을 거절하는 것과 같은 패턴이 반복되었다. 그러한 역사를 짚어보는 것은 제재도 아니고, 조건부적인 대화도

적대적인 관계를 해소하지 못한다는 점을 잘 보여주고 있다. 이 논문에서는 북한과 미국간의 차이점을 한국의 적극적인 참여와 함께 점진적으로 좁혀 나갈 수 있는 방법들을 고찰해 보았다. 특별히 김대중 정부의 햇볕정책 또는 포용전략을 회복시켜야 할 때라고 믿는다. 그러나 그러한 전략은 현재의 상황에 맞게 확장하고 수정되어야 할 필요가 있다. 국내의 어려운 문제가 한창인 현재에도 오바마 대통령은 이란의 리더십에게 핵 대화를 제안하였고 이렇듯 어려운 상황에 당면해 있을 때에도 외교적 돌파구가 마련될 수 있다는 가능성을 확인시켜 주었다.

## The US Perspective and Strategy for North Korean Development Cooperation

The year 2013 marks the sixtieth anniversary not only of the Korean War armistice but also the sixtieth year in which the United States and North Korea remain enemies. In recent years, covering the George W. Bush and Barack Obama presidencies, the pattern of US-DPRK interaction has changed very little: accusations by one side or the other that existing agreements have been broken; threats and counter-threats, including North Korean missile and nuclear-weapon tests and armed attacks; punishing sanctions on the North and US demands that Pyongyang denuclearize; North Korean overtures to restart talks; and US refusal unless and until the North takes verifiable to end its nuclear-weapon program. A quick summation of this history

would suggest that neither sanctions nor conditional talks will end the hostile relationship. In this paper I explore ways in which the United States, with the active involvement of the ROK in most instances, might gradually bridge their differences. Specifically, I believe the time is ripe for reinstating Kim Dae-jung's Sunshine or engagement strategy, but expanding and modifying it to fit with current circumstances. The very fact that Obama, in the midst of difficult domestic problems, was able to reach out to the Iranian leadership and put nuclear talks on a new footing suggests that diplomatic breakthroughs are always possible even in the most trying circumstances.

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It might appear that there is no way to break this pattern, but in this paper I want to explore ways in which the United States, with the active involvement of the ROK in most instances, might gradually bridge their differences. Specifically, I believe the time is ripe for reinstating Kim Dae-jung's Sunshine or engagement strategy, but expanding and modifying it to fit with current circumstances. The very fact that Obama, in the midst of difficult domestic problems, was able to reach out to the Iranian leadership and put nuclear talks on a new footing suggests that diplomatic breakthroughs are always possible even in the most trying circumstances.

### **The Strategy of Engagement**

Kim Dae-jung left us with a legacy that involves a formula for peace when dealing with North Korea. His formula was defined by three ideas: “peaceful coexistence, peaceful exchange, and peaceful unification.” Concerned that confrontational policies toward North Korea would only strengthen hardliners there and undermine the “moderates,” Kim urged “reconciliation and cooperation within the same national community.” The North should be reassured that the South had no intention to absorb it. To the contrary, South Korea would aid in rebuilding the North's economy, which would also contribute to creating a strong Northeast Asia regional economy. Face-saving gestures to the North should be undertaken, Kim urged, such as sending a distinguished emissary to Pyongyang and even urging that the North's leader be invited to the United States. These steps would promote Korea's eventual unification—a prospect, Kim cautioned, that should take place gradually in three stages, starting with a two-state confederation.<sup>2)</sup> Kim believed that favorable conditions were needed for this engagement strategy to be successful, including a positive political will in Seoul for gradual unification, international support, and the absence of political or military steps that could cause a reversal of the process. He also believed that implementing a “cooperative security system” to include the two Koreas, the United States, China, Russia, and Japan—the “two-plus-four” approach that would later gain currency in the Six Party Talks—was essential to promoting regional stability.<sup>3)</sup>

Fundamental to Kim Dae-jung's engagement strategy was the challenging, even radical view that improving North Korea's security is in the best interest of South Korea's security. Rather than seek regime change or regime destruction, engagement embraces the idea of common

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1) On the Obama administration's record, see John Delury, “The Disappointments of Disengagement: Assessing Obama's North Korea Policy,” *Asian Perspective*, vol. 37, No. 2 (2013), 149-182.

2) Speech in Jerusalem, July 1, 1993, in Kim Dae-jung, *Unification, Democracy, and Peace* (Seoul: Kim Dae-jung Peace Foundation Press, 1994), pp. 118-124; speech in Washington, DC, May 1994, in Kim Dae-jung, *Korea and Asia: A Collection of Essays, Speeches, and Discussions* (Seoul: Kim Dae-jung Peace Foundation Press, 1994), pp. 18-19.

3) See the comprehensive study by Chung-in Moon, *The Sunshine Policy: In Defense of Engagement as a Path to Peace in Korea* (Seoul: Yonsei University Press, 2012), pp. 26-28.

security—not because of any positive regard for the North Korean regime, but because a strategy that isolates and places constant pressure on such a regime risks a dangerous reaction and risk of military escalation. North Korea, we should understand, is not a failed state but it is a weak state that is militantly nationalistic and historically inclined to distrust the outside world. Indeed, the North’s nuclear and missile tests, and its attacks on the Cheonan and Yeongpyong Island, exemplify the risk of coercive diplomacy. Demonstrating acceptance of the regime as a legitimate negotiating partner acknowledges this risk and holds out instead the possibility of eventually transforming the Pyongyang regime through a dedicated program of incentives designed to promote trust.

If we extrapolate Kim Dae-jung’s thinking to present circumstances, what principles should guide engagement of North Korea?

- It should contain concrete incentives for peaceful exchange.
- It should accept the legitimacy of the DPRK regime as a negotiating partner.
- It should reject regime change as a foreign-policy aim, and offer security assurances.
- It should revive regional diplomacy.
- It should employ important symbolic steps to emphasize seriousness of purpose.
- It should maximize modes of direct contact that have substantive outcomes.

Based on these principles, we may outline some specific elements of engagement of the DPRK:<sup>4)</sup>

- Deciding that the complete, verified denuclearization of North Korea is a policy objective but not the precondition to all other engagement steps that might be taken.
- Economic inducements, such as longterm development assistance (see below) and removal of trade barriers.
- Avoidance of stereotyping and hostile rhetoric.
- Making symbolic, high-visibility gestures, such as another Korean summit meeting, a high-level visit to Pyongyang, or a formal invitation to Kim Jong-un to visit Washington.
- Giving reassurances of “no hostile intent” and a determination to end the Korean War by peace treaty.<sup>5)</sup>
- Reciprocal steps to promote military transparency.
- Increasing Track II and Track III exchanges.
- Proposing multilateral projects that include China, Japan, and the ROK, among others.
- Reviving regional diplomacy, including but not limited to the Six Party Talks, without preconditions.

### **Development as an Element of Engagement**

In his 2013 New Year’s Address, Kim Jong-un proclaimed that “building an economic giant” was his country’s “most important task.” He also repeated a promise to improve people’s livelihood, in line with a speech in April 2012 in which he said that “It is our party’s resolute determination to let our people . . . not tighten their belts again and enjoy the wealth and

4) For fuller discussion, see my “Engaging Enemies: Fraught with Risk, Necessary for Peace,” *Global Asia*, vol. 8, No. 2 (Summer, 2013), pp. 8-13.

5) Consider the following: “In the fall of 2002, Donald Gregg, former ambassador to South Korea during the Bush I presidency, and Donald Oberdorfer, former Washington Post reporter, delivered a message from Kim Jong Il to the White House: “If the United States recognizes our sovereignty and assures non-aggression, it is our view that we should be able to find a way to resolve the nuclear issue …. If the United States makes a bold decision, we will respond accordingly.” The North Koreans have given the same message numerous other times.

prosperity of socialism as much as they like.” Still more recently, Kim has indicated that North Korea will pursue a path that emphasizes guns and butter—continuing development of military power, including nuclear weapons, but also an effort to improve the economy by loosening some of the official restraints on it. This last aspect simply acknowledges the enormous problems the regime faces of avoiding economic and environmental ruin and social collapse brought on by food shortages and a health-care crisis. In combination, these problems have sharply reduced individual well-being.<sup>6)</sup> Unfortunately, the focus of the US and its allies has been on Kim Jong-un’s military ambitions and not on his development goals.

So far as I am aware, the United States does not have a strategy for developing North Korea. Or perhaps it would be more accurate to say that the US strategy is to hold out development assistance as a reward for denuclearization. To be sure, the United States has given significant aid to North Korea in the past: about \$1.3 billion between 1995 and 2008, of which around one-half was food aid and 40 percent was energy assistance.<sup>7)</sup> But all US food and energy assistance to North Korea ceased in 2009—and in 2012 the US Senate expressly barred food aid to the DPRK—leaving only minuscule medical aid (under \$1 million). Washington remains preoccupied with isolating, sanctioning, and ultimately displacing the regime; denuclearizing North Korea is the lead element of that policy. Any future US aid to the North is now tied to the denuclearization objective.

No doubt among the State Department’s North Korea specialists are some who see economic development as a tool of engagement; but their views rarely see the light of day. Nevertheless, some scholars do pay attention to the economic and social development of North Korea, understanding that what North Korea most wants is U.S. recognition and the consequent benefits: not just acknowledgment of its legitimacy and security interests, but substantial economic help from the US, the ROK, Japan, and multilateral lenders such as the World Bank. According to a Russian evaluation, a high-ranking North Korean diplomat has argued that “if we succeed in normalizing diplomatic relations with Japan, the DPRK will obtain reliable access to food aid, technology, investment, and other items of great importance for our country.” The diplomat added that Japan is considered in the North as “potentially our most important economic partner in the long run.”<sup>8)</sup>

Changing relations between China and North Korea provide an opening for the United States and others. At the moment, of course, China is far and away North Korea’s most important economic partner. China accounts for about 70 percent of North Korea’s total trade; without Chinese food and energy assistance, North Korea would be substantially worse off than it is now. Chinese luxury goods feed the Pyongyang elite’s appetite for the better life. But while trade increases every year, Chinese leaders, informed by sharply critical expert analyses of North Korean behavior following its third nuclear test in February 2013, now seem to consider North Korea’s unpredictable behavior a growing liability.<sup>9)</sup> Moreover, Chinese investments in the border areas with North Korea, particularly in mining, have created what some observers regard as economic colonialism. Members of the North Korean leadership may bridle at this extensive dependence on China, and may look to other sources, including the West and Japan, for balance.

6) On the environmental problems, which are of the sort typically experienced by underdeveloped countries, see David F. Von Hippel and Peter Hayes, “Environmental Problems and the Energy Sector in the Democratic People’s Republic of Korea,” *Asian Perspective*, vol. 22, No. 2 (1998), pp. 51–77.

7) Mark E. Manyin and Mary Beth Nikitin, *Foreign Assistance to North Korea*, Congressional Research Service Report R-40095, June 11, 2013.

8) “The DPRK Report,” No. 22 (January–February 2000); in NAPSNet, February 28, 2000, online at [www.nautilus.org/napsnet/dr/0002/Feb28.html](http://www.nautilus.org/napsnet/dr/0002/Feb28.html).

9) For one of several Chinese articles that argue for jettisoning the North Koreans altogether, see Xie Tao, “What’s Wrong with China’s North Korea Policy?” (March 26, 2013), at <http://carnegieendowment.org/2013/03/26/what-s-wrong-with-china-s-north-korea-policy/fjw?reloadFlag=1>.

Development assistance plays a central role in common security—first, by directing economic assistance toward improving the lot of ordinary North Koreans; second, by allowing the US, in partnership with South Korea, Japan, and others, to play positive roles that will be appreciated; third, by going beyond charitable work (aid), which can be demeaning to the recipient and politically problematic to the provider, to longterm commitments that cultivate on-the-ground relationships. In a word, it is the difference between food security and food dependence. To be sure, any assistance to the DPRK risks diversion to the military. But as Stephan Haggard has long argued, while diversion is significant, it should not stand in the way of food aid; there are powerful moral grounds, to which the United States has always proclaimed its commitment, for not politicizing food aid.

To be clear, I am talking about assistance for development—i.e., projects to which both provider and recipient are committed because of the expected longterm benefits—as distinct from periodic food shipments that are merely stopgap measures. Two examples of development projects are Mercy Corps’ provision of apple orchards and fisheries, and Nautilus Institute’s wind energy facilities. Precisely because of the practical accomplishments of these projects, these NGOs have had consistent access to the North.

There is no lack of other ideas for engaging North Korea. For example:

- Creation of a joint environmental/ecological zone in the DMZ to preserve and protect precious plant species.
- Establishment of a regional biodiversity zone that would include portions of the DPRK and other countries.<sup>10)</sup>
- Provision (perhaps by an multilateral group) of comprehensive food security assistance—education and training, agricultural equipment, seeds, nutrition education, transportation, and capital investment in farm equipment manufacturing.<sup>11)</sup>
- Helping meet modernization and expansion of North Korea’s energy needs, nuclear and non-nuclear.<sup>12)</sup>
- Enabling a NE Asia electric grid to extend to and through North Korea.
- Greatly expanding scientific exchange and cooperation, such as Syracuse University has conducted with the Kim Chaek University of Technology and the North Korean State Academy of Sciences.<sup>13)</sup>
- Expanding health-care assistance in recognition of the health-care crisis that has gripped North Korea ever since the famine of the 1990s, especially for children. North Korea desperately needs medical equipment, for instance.
- Contributing mobile phones and Internet-accessible computers to speed North Koreans’ understanding of the world.

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10) See Peter Hayes, “Sustainable Security in the Korean Peninsula: Envisioning a Northeast Asian Biodiversity Corridor,” Nautilus Institute Paper, August 24, 2010, at [www.nautilus.org/publications/essays/napsnet/policy-forums-online/security2009-2010/sustainable-security-in-the-korean-peninsula-envisioning-a-northeast-asian-biodiversity-corridor](http://www.nautilus.org/publications/essays/napsnet/policy-forums-online/security2009-2010/sustainable-security-in-the-korean-peninsula-envisioning-a-northeast-asian-biodiversity-corridor).

11) See the comprehensive report by Karin Lee, “Working at the People-to-People Level: Recommendations for United States Government Involvement,” National Committee on North Korea, n.d.

12) As David von Hippel, Scott Bruce, and Peter Hayes of the Nautilus Institute have written: “There are a number of areas in which international assistance for the redevelopment of the North’s energy sector is vital, ranging from “soft” measures such as institution- and market-building, to the rebuilding or replacement of power plants and electricity transmission and distribution networks, to the introduction of renewable energy, energy efficiency, and natural gas technologies that would allow the DPRK to leapfrog intermediate development stages and join regional energy networks.” See their paper, “Engaging the DPRK, Part II: Transforming the DPRK Through Energy Sector Development,” at <http://nautilus.org/publications/essays/napsnet/forum/PF11006vonHippeletal>.

13) See Stuart J. Thorson and Hyunjin Seo, “From Adversaries to Partners: Academic Science Engagement with North Korea,” *Global Asia*, vol. 8, No. 2 (Summer, 2013), pp. 43-47.

## Conclusion

Taking into account that the DPRK must deal with substantial human and environmental insecurity, the case for a common-security approach to North Korea is compelling. It is widely accepted that North Korea has legitimate security interests, just as the US and the ROK have. And as the ROK's own experience shows, real security is meaningless without development, just as development requires security. The former US ambassador to South Korea, James Laney, put the matter succinctly when he said another war with North Korea is senseless. Rather, "the important things right now are to respect North Korea's right to survive, and to help it normalize its relations with the outside world."<sup>14)</sup>

Human-security focused development in North Korea requires an international, basic-needs assistance program, one that might most readily be accepted if channeled primarily through private voluntary organizations (PVOs). (The United States has a network of PVOs already in place.) The program should focus on training, equipment, and the building of relationships at the local level. Especially important is that a development program should not be contingent on political, military, or other concessions. North Korea's disastrous health-care system desperately needs equipment and drugs as well as a modest (several million dollars) infusion of cash.<sup>15)</sup> Energy is in short supply and could benefit from the kind of comprehensive expert evaluation that the Nautilus Institute has undertaken.<sup>16)</sup> Alleviating North Korea's economic and public-health crisis is not only a humanitarian issue; it is also a way to promote human security, facilitate a soft landing in the event of sudden chaos in the North, and thereby ease future Korean integration. While governments jockey fruitlessly for political advantage at Track I meetings, much can be accomplished under Tracks II and III. Grassroots programs have worked in North Korea. Many more are needed, including those that bring a truthful picture of the world to North Korea's repressed people.<sup>17)</sup>

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14) "Talk with Former Ambassador Laney," Joongang Ilbo (Seoul), April 22, 1999, in NAPSNet, April 23, 1999, online at <http://www.nautilus.org/napsnet/dr/9904/Apr23.html#item1> [QUERY].

15) John Leicester, "WHO Seeks Aid for N. Korea Hospitals," Associated Press (Beijing), November 20, 2001, and John Ruwitch, "N. Korea Health Care Collapsing, Mortality Rising—WHO," Reuters, November 20, 2001, both in NAPSNet, November 20, 2001, online at <http://www.nautilus.org/napsnet/dr/0111/Nov20.html#item3> [QUERY].

16) Nautilus' evaluation of the North Korean energy picture is available in several research papers in Asian Perspective 26:1 (2002), guest edited by Timothy Savage.

17) As argued by Kongdan Katy Oh and Ralph Hassig, North Korea Through the Looking Glass, pp. 206-08.



## *Assessment of North Korea's Economic Development and International Intervention Strategies*

North Korea's Economic Development Plan in the Kim Jong Un Era:  
Global Perspective and Response

**Scott SNYDER** (Senior Fellow, Council on Foreign Relations)

Internationalization of the Kaesong Industrial Complex  
and North Korea's SEZs: The Role of Neighboring Countries

**Troy STANGARONE** (Senior Director, Korea Economic Institute of America)

Development of North Korea's Infrastructure:  
Trilateral Korea – China – Russia Cooperation

**Tagir KHUZIYATOV** (Professor, Far Eastern Federal University)

Explaining China's Shifting Attitude toward DPRK since Kim Jong-un

**Simon SHEN** (Professor, Chinese University of Hong Kong)

Discussants

**YANG Moon-Soo** (Professor, University of North Korean Studies)

**LIM Eul-Chul** (Professor, Kyungnam University)

**NA Hee Seung** (Senior Research Associate, Korea Railroad Research Institute)

**Lim Kang-Taeg** (Senior Research Fellow, Korea Institute for National Unification)



Presentation

# North Korea's Economic Development Plan in the Kim Jong Un Era: Global Perspective and Response

**Scott SNYDER** |

(Senior Fellow, Council on Foreign Relations)



## 김정은 시대 북한의 경제발전계획: 글로벌 관점과 대응

긴장과 위협이 고조된 상황에서 북한은 2013년 3월 말, 조선로동당 중앙위원회 전원회의를 열고 경제와 핵무력 건설을 동시에 발전시키는 정책노선을 채택했다. 북한 매체도 이를 “새로운 전략적 노선”으로 보도하며 이 노선이 김정은 통치하에 주된 국가 전략목표로 추진 될 것으로 제시하였다. 따라서 북한은 경제개선을 우선순위로 하되, 핵포기를 통해 달성 할 수 있는 목표가 아닌 경제발전이 안보의 토대로 연결되어 핵 개발을 지속적으로 추진하려 하는 의도를 가지고 있는 것으로 여겨진다. 그러므로, 이 정책 방향은 비핵화 정책 목표에 대한 도전으로 여겨지며 북한 미래 자립경제 가능성에도 의문을 제기하고 있다.

이 논문은 북한의 새로운 정책 의의, 원리, 그리고 함의를 분석하고 북한의 지속적인 핵 개

발이 경제발전 계획에 부과되는 대략적 비용을 추정하려고 한다. 북한의 주요 무역 파트너들과의 무역 관계 패턴을 분석하고 북한이 경제 개혁에 착수할 경우, 이에 대한 거래 수준을 추측해 보고자 한다. 이러한 시도는 지속적인 핵 개발 노력에 의해 부과되는 북한의 경제 개발 목표에 상대적 비용을 추정하는데 유용 할 수 있다. 대략적 추정에 기초하여 북한의 국가 정책 선택 뒤에 가능한 이론적 근거를 이해하는 데에도 도움이 될 것으로 생각된다. 그리고 제재에 대한 비용을 정량화하고 경제개혁과 주변 국가들과의 통합을 받아드리지 못함이 북한의 경기 회복에 대한 잠재력을 제한하는 요인으로 분석하였다. 마지막으로 북한의 경제 정책이 향후 국가 발전에 미치는 영향에 대한 예비적 결론을 내리고자 한다.

## North Korea's Economic Development Plan in the Kim Jong Un Era: Global Perspective and Response

By the end of March of 2013, against the backdrop of an escalating cycle of tensions and threats, the DPRK Central Party Committee Plenum announced policy guidelines that state clearly North Korea's intent to simultaneously pursue nuclear and economic development. These guidelines have been characterized in the North Korean media as an unswerving "strategic line," suggesting that they represent the main strategic objectives the DPRK will pursue under Kim Jong-un's rule. Thus, North Korea has prioritized economic improvement, but as an objective that is tied to and perhaps designed to build on North Korea's nuclear pursuits as a foundation for its security, rather than as an objective that can only be achieved through the abandonment of North Korea's nuclear program. This policy direction poses a challenge to the policy goal of denuclearization and raises doubts among many external observers regarding North Korea's future economic viability.

This paper will attempt to analyze the significance, rationale, and implications of the DPRK's new policy. It will then attempt to

provide a rough estimation of the costs that North Korea's continued nuclear development imposes on its economic development aspirations in its relations with its major trading partners by analyzing patterns in DPRK trade relations with its major partners and by speculating on what trade levels would be like if North Korea were to embark on economic reforms. This exercise can also be useful in attempting to estimate the relative costs to North Korea's economic development goals that are imposed by its ongoing nuclear development efforts. These rough projections should help us to understand possible rationales behind North Korean national policy choices, quantify the costs of sanctions and failure to embrace economic reforms and integration with its neighbors as factors that limit North Korea's potential for economic recovery, and draw preliminary conclusions about the significance of North Korea's economic policies and implications for North Korea's future development.

## **Introduction:**

The Democratic People's Republic of Korea identified 2012, the one hundredth anniversary of Kim Il Sung's birth, as the year in which it would achieve the significant goal of becoming a "strong and prosperous state." As part of these plans, major initiatives were undertaken to build at least 100,000 new housing units in Pyongyang and citizens and soldiers were mobilized for many different types of projects to beautify Pyongyang. But North Korea's pursuit of a long-range satellite test and nuclear test in 2009 and ensuing UN Security Council sanctions threatened to squeeze North Korea's existing international economic links, constituting a potential setback to these goals. The implementation of inter-Korean sanctions on May 24, 2010, following the South Korean government's determination that the sinking of the Cheonan may have been attributable to a North Korean covert operation, constituted a further drain on external support for North Korea's economic growth. On the other hand, the Sino-DPRK trade relationship grew in a rapid upward trajectory, seemingly shielding North Korea from the worst effects of the sanctions.

As 2012 approached, it seemed certain that the reality of North Korean claims to prosperity would fall short of aspirations, and the DPRK began to mark 2012 as the start of a continuing effort to achieve the status of a "strong and prosperous state" by 2020. Then Kim Jong Il died on December 17, 2011, an event that seemed likely to deal a decisive blow to North Korean aspirations to unveil its new status and to the celebratory mood projected for the centennial of Kim Il Sung's birth on April 15, 2012. But that date in fact marked a further affirmation of North Korean economic aspirations, as Kim Il Sung's grandson and new leader Kim Jong-un made a public speech for the first time declaring his intent to ensure that the North Korean people never have to "tighten their belts." This pledge provided new hope for internal and external observers that the North Korea's economic problems might finally be elevated to become a central agenda item for the regime.

Kim Jong-un's statement engendered a great deal of speculation over whether North Korea might indeed be on the verge of pursuing Western style economic reforms as part of a redoubled effort to improve the economy. Hopes spread regarding a supposed "6.28" package of measures that purported to liberalize North Korean agricultural practice, including with some types of measures analogous to China's agricultural-reform led economic development strategies of the 1970s. However, by the end of 2012, concrete evidence of North Korean reform measures had not materialized; instead, many of Kim Jong-un's initiatives appeared to be 'show' projects designed to cater to elites and to distract from North Korea's central economic challenges. Moreover, North Korea continued to pursue policies including the launch of a satellite and nuclear test banned under UN Security Council resolutions that seemed certain to further restrict North Korea's access to international support for North Korea's economic reform.

By the end of March of 2013, against the backdrop of an escalating cycle of tensions and threats, the DPRK Central Party Committee Plenum announced policy guidelines that state clearly North Korea's intent to simultaneously pursue nuclear and economic development. These guidelines have been characterized in the North Korean media as an unswerving "strategic line," suggesting that they represent the main strategic objectives the DPRK will pursue under Kim Jong-un's rule. Thus, North Korea has prioritized economic improvement, but as an objective that is tied to and perhaps designed to build on North Korea's nuclear pursuits as a foundation for

its security, rather than as an objective can only achieved through the abandonment of North Korea's nuclear program. This policy direction poses a challenge to the policy goal of denuclearization and raises doubts among many external observers regarding North Korea's future economic viability.

This paper will attempt to analyze the significance, rationale, and implications of the DPRK's new policy. It will then attempt to provide a rough estimation of the costs that North Korea's continued nuclear development imposes on its economic development aspirations in its relations with its major trading partners by analyzing patterns in DPRK trade relations with its major partners and by speculating on what trade levels would be like if North Korea were to embark on economic reforms. This exercise can also be useful in attempting to estimate the relative costs to North Korea's economic development goals that are imposed by its ongoing nuclear development efforts. These rough projections should help us to understand possible rationales behind North Korean national policy choices, quantify the costs of sanctions and failure to embrace economic reforms and integration with its neighbors as factors that limit North Korea's potential for economic recovery, and draw preliminary conclusions about the significance of North Korea's economic policies and implications for North Korea's future development.

### **The Adoption of a Dual Economic and Nuclear Development Policy in North Korea**

Despite limited available information regarding the formation of North Korean economic policies, North Korea has been relatively straightforward in revealing both its aspirations and perceived constraints as it tries to improve its economy. North Korea's essential goal of achieving a "strong and prosperous" state has remained unchanged in the transition from Kim Jong Il to Kim Jong Un. In fact, Kim Jong Un's announcement of his strategy is connected rhetorically to an earlier more successful phase in North Korea's economic development in which Kim Il Sung pursued simultaneous economic and military development in 1962.

Kim Jong Un's announcement of the new policy portrayed it as evidence of continuity: a progression to a higher stage that builds directly on the foundation of previous efforts toward the establishment of a strong and prosperous state. But because the leadership continues to struggle with a security environment dominated by what it perceives as a "hostile" U.S. policy, the "strategic line" of the Korean Workers' Party affirms the simultaneous pursuit of nuclear and economic development toward the goal of building a "powerful state" [kangso'nggukka]. In laying out the new "strategic line," Kim characterizes the international community's insistence that the DPRK abandon nuclear weapons as a product of "blackmail" by North Korea's "enemies." He argues that "the more they do this, the more firmly we should grasp the nuclear treasured sword and open a way out for great revival." At first glance, it appears that this is a revivalist rather than a reformist approach, with nuclear capabilities serving as a silver bullet that is necessary to "bolster our war deterrent and brilliantly achieve the cause of building a socialist powerful state by putting greater spurs to economic construction."

The North Korean policy of simultaneously pursuing nuclear and economic development includes the following objectives and rationales:

- 1) nuclear development and the munitions industrial sector are cost effective ways of avoiding an arms race and limiting defense spending,

- 2) nuclear development is the foundation for a strong atomic energy industry, which can help address North Korea's electricity problems,
- 3) the electric power, coal, and metal industries and the railway transport sector will serve as the backbone for building the North Korean economy,
- 4) state investments and new technology in agriculture will raise production, and light industrial sector investments will raise the quality of available consumer goods,
- 5) development of science and technology (including space technology) will enable a knowledge-economy-based powerful state.<sup>1)</sup>

But if we look at the means by which North Korea intends to pursue its economic strategy, it appears that there are focused efforts to enhance effectiveness of economic management, including possible steps toward reform. First, the focus is on improved "socialist enterprise management methods in which all enterprises carry out their management activities independently with initiative." This statement is intriguing because it could suggest a step away from central planning and a devolution of decision-making authority to the firm level. However, North Korea's actual circumstances already reflect limited capacity by the central government to effectively implement central planning and guidance to individual firms.

Second, North Korea seeks diversification of foreign trade as a means by which to "smash the sanctions and blockade maneuvers of hostile forces and open an advantageous phase in the construction of an economically powerful state." This suggests both that North Korea's renewed push to attract foreign investment is a leadership priority and that it is designed to provide a safety valve against pressure from sanctions and is as much a means by which to evade external economic pressure measures designed by the international community to force North Korea into making a strategic choice to give up its nuclear capabilities. The relative success or failure of North Korean efforts to attract foreign capital despite sanctions may prove to be a decisive factor that will influence both North Korea's economic prospects and its ability to avoid international pressure on denuclearization.

Third, North Korea is pursuing the promotion of tourism and economic development zones in all provinces. North Korea's opening to tourism suggests that this sector is perceived as a proven means by which to earn foreign capital for state purposes at relatively minimal risk to control or influence within North Korea. North Korea has also experimented with economic development zones sufficiently over the past two decades to have developed confidence that it can use the zones as a means by which to earn foreign currency while controlling the effect of outside influences on the local populations. But the location and focus of these zones suggests a potentially greater seriousness of purpose and desire to more effectively utilize special economic zones as an instrument by which to enhance productivity of the economy.<sup>2)</sup>

North Korean governmental efforts to simultaneously pursue nuclear and economic development do not mean that North Korea wants to forgo prosperity, but it is clear that North Korea is seeking pathways to prosperity that do not involve a loss of political control and that do not involve denuclearization. This fear of loss of control appears to be one of the fundamental obstacles that has prevented the North Korean leadership from pursuing Chinese

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1) "Kim Jong Un's Report and Remarks at KWP Central Committee Meeting 31 March 2013," North Korea Leadership Watch, accessed at <http://nkleadershipwatch.wordpress.com/kim-jong-un/kim-jong-uns-report-and-remarks-at-kwp-central-committee-meeting-31-march-2013/>.

2) Yi Cho'ng-u'n, "North Korea Opens Even Regions Near Pyongyang to Attract Investment," Dong-A Ilbo, October 28, 2013.

style economic reforms. Instead, North Korean leaders continue to pursue prosperity on their own terms, and despite studying closely what it will take to effectively interact with the capitalist world, they remain fearful of economic measures that might reduce the leadership's capacity to maintain political control, increase North Korea's dependency on the outside world or provide external parties with leverage over North Korea.

North Korea's established dual policy of pursuing both nuclear and economic development is naturally Pyongyang's preferred alternative to giving up its nuclear program, but it also means that North Korea must operate against a clear ceiling on prospective international cooperation in support of economic reform and growth. It is North Korea's last viable alternative to making a choice between nukes and economic growth, given the leadership's apparent policy preference for improving productivity while maintaining economic control. However, while this path appears to have achieved short-term economic stability within Pyongyang, this approach is fragile and vulnerable to external shocks because North Korea's external dependency is growing. Ultimately, the decision to hold on to nuclear weapons, regardless of the extent to which North Korea pursues economic development, is costly in terms of lost growth potential compared to a North Korea that is integrated with its neighbors.

### **International Responses to North Korea's Dual Economic and Nuclear Development strategy**

Outside observers of the North Korean economy have shown great skepticism regarding the viability of a dual strategy by which North Korea attempts to hold on to its nukes while developing its economy. The primary reason for such skepticism is the perception that denuclearization is a necessary prerequisite for North Korea to earn the levels of foreign investment and to attract the foreign currency necessary to support a successful North Korean economy. Stephan Haggard succinctly and skeptically asked "Can a country issuing nuclear threats and aggressively pursuing a missile program hang out a shingle that says 'open for business'? Can North Korea suspend access to Kaesong, an industrial park run jointly with South Korea, and still claim to seek foreign investment?"<sup>3)</sup>

Mainstream South Korean assessments of North Korea's decision to simultaneously strengthen economic and nuclear development suggest the policy is unlikely to succeed. Choi Soo-young of the Korea Institute of National Unification (KINU) viewed the "byungjin" policy as a shift away from Kim Jong Il's previous "military first" policy. From this perspective, economic development has received renewed attention, but at the same time the KWP's "strategic line" reveals a renewed commitment to institutionalization of nuclear development as a central pillar of state policy. Despite the emphasis on solving economic problems, Choi noted that the "6.28 policy directives" to improve the economy had not been implemented and the military opposed the decision to transfer responsibility for managing foreign currency earning enterprises to the Cabinet. Choi views the decline in international support from the international community following North Korea's third nuclear test as a constraint on prospects for economic reform despite the appointment of reputed reformist Park Bong Ju to the position of Premier.<sup>4)</sup>

Park Hyeong-jung, also of KINU, provides an assessment of the "6.28 policy directives" that

3) Stephan Haggard, "Change We Can't Believe In," April 8, 2013. Accessed at [http://www.foreignpolicy.com/articles/2013/04/08/change\\_we\\_can\\_t\\_believe\\_in\\_kim\\_jong\\_un\\_reform](http://www.foreignpolicy.com/articles/2013/04/08/change_we_can_t_believe_in_kim_jong_un_reform).

4) Choi Soo-young, "Assessment and Prospect for the 7th Session of the Supreme People's Assembly," Online Series CO 13-10, Korea Institute of National Unification, 2013. Accessed at [https://www.kinu.or.kr/upload/neoboard/DATA01/co13-10\(E\).pdf](https://www.kinu.or.kr/upload/neoboard/DATA01/co13-10(E).pdf).

notes North Korean efforts to seriously grapple with internal economic challenges, but faces significant obstacles resulting from its non-productive investments in military and state propaganda projects. He suggests the North Korean leadership is seriously grappling with internal system constraints on economic growth and that under Kim Jong-un, a decision has been made to pursue the “our-style economic management method.” Park suggests that this approach constitutes a potential step forward in economic management that could reduce the government’s central economic management role in favor of decisions made by state-owned enterprises in response to market conditions. Park suggests the range of steps under consideration include the ability of state owned enterprises to enter into production contracts on their own rather than strictly in response to state orders. Likewise, rumored steps toward independent management of cooperative farms and permission for farmers to sell surplus grain in the market would presumably be structural changes from a “planned socialist economy” to an “unplanned socialist economy” that Park compares to the early phases of China’s economic reform period. However, the successful implementation of these measures will face many bureaucratic and systemic challenges before this reorganization can successfully take hold.<sup>5)</sup>

Kim Young-hwan argues that North Korea's established nuclear possession may provide a sufficient deterrent against foreign aggression to enable Kim Jong Un to focus on economic development. He seems impressed by North Korean plans to increase economic production, diversify trade, construct new tourist zones, and establish special economic zones in each province, and he challenges conventional wisdom of outside experts, which he argues is based on a false assumption that North Korea's confrontation with the international community will lead to North Korea's collapse. He concludes that if China does not implement sanctions and if bilateral economic cooperation continues to improve, “North Korea's dual strategy may even succeed. . . . China's continued efforts at a relationship can be seen as tacit acceptance of past and future North Korean nuclear tests, as well as Pyongyang's ownership of nuclear weapons.”<sup>6)</sup>

Chinese analysts have historically viewed North Korea’s perceived security threat and tensions in U.S.-DPRK relations as a serious obstacle to prospects for North Korea’s economic reform. Although China formally opposes North Korea’s pursuit of its nuclear program, many analysts perceive the root cause of North Korea’s current problems in the continuation of a hostile relationship between the United States and North Korea. From this perspective, the logic behind North Korea's nuclear pursuits is first, self-protection, and second as a means by which to create time and space for economic revitalization.<sup>7)</sup> Chinese media have reported rapid changes in North Korea's economy, including increased consumption, agricultural privatization, use of foreign currency, leadership support for reforms, and an open attitude toward foreign investment, without mention of the need for denuclearization.<sup>8)</sup>

Following North Korea’s third nuclear test in February of 2013, China has banned its Foreign Trade Bank from conducting financial transactions with North Korea in May and publicly issued a list items subject to export controls that could have dual uses in North Korea’s nuclear or missile program aside from intended commercial use. However, Chinese officials are emphatic in their insistence that economic sanctions against North Korea do not mean that China-DPRK trade

5) Park Hyeong-jung, “One Year Into the ‘6.28 Policy Directives’: Contents and Progress,” Online Series CO 13-18. Available online at <https://www.kinu.or.kr>

6) Kim Young Hwan, “Kim Jong Eun’s Dual Approach: Pursuing Nuclear and Economic Development,” Daily NK, September 2, 2013. Accessed at <http://www.dailynk.com/english/read.php?catald=nk03600&num=10912>.

7) Wang Fan, “Economic Reform is a Choice that North Korea Cannot Stop,” Huanqiu Shibao, May 2, 2013, English translation accessed at [opensource.org](https://open-source.org). Doc#: CPP130506671002.

8) Du Baiyu and Zhang Li, “Experiencing ‘Masik Speed’ in Pyongyang,” Guoji Xianqu Daobao Online, June 14, 2013.

relations will be cut off. PRC Ministry of Commerce specialist Mei Xinyu wrote that “Although our country has consented to and participated in the economic sanctions against the DPRK after the third DPRK nuclear explosion . . . yet sanctions cannot change the fact that China is North Korea’s largest, most reliable, and most important trading partner.” The author makes clear that North Korea’s economic construction enable greater opportunities for Sino-DPRK cooperation as a trade entrepot, and describes China’s interest in the DPRK mining sector, and as a partner in processing subcontracts.<sup>9)</sup>

Likewise, Jilin provincial government officials have continued to push their vision for economic integration that would include active trade links and industrial cooperation in a range of manufacturing sectors. The vision is one that promotes mutually beneficial cooperation and establishment of development zones that would promote cross-border cooperation in the automobile, petrochemical, and agricultural products processing sectors. Nowhere is there evidence in provincial plans that efforts to achieve such cooperation would be predicated on denuclearization of the Korean peninsula. Thus, Chinese businessmen would likely respond to signs of economic improvement in North Korea without predicating cooperation in North Korean economic improvement efforts on Pyongyang’s abandonment of its nuclear program.<sup>10)</sup>

The external response to North Korea’s announcement of its simultaneous pursuit of economic and nuclear development reveals that Western and South Korean analysts view North Korea’s dual policy as a non-starter, but in contrast, China may be forward-leaning in efforts to encourage North Korean economic reforms, especially at the provincial and local levels, regardless of whether Pyongyang holds on to its nuclear weapons. An underlying assumption of many Chinese analysts appears to be that if North Korea moves in the direction of economic reform that such reforms would eventually render North Korea’s nuclear program less valuable to Pyongyang, either because reform would drive up the perceived cost of nuclear brinkmanship by giving North Korea something to lose or because the fruits of reform would gradually occupy the lion’s share of the leadership’s attention, making the nuclear program less important to North Korea’s goals of regime survival and prosperity.

### **The Current State of North Korea’s Economy**

North Korea has continuously sought to enhance productivity gains within its centrally-led economic system in the aftermath of a disastrous currency devaluation in late 2009. Measures of GDP from the Bank of Korea suggest that North Korean leaders to feel that these efforts have successfully stabilized North Korea’s economy, and that further productivity improvements within North Korea’s current system may lead the way toward economic stability, if not modest growth. However imperfect Bank of Korea calculations might be, they do give a sense that the North Korean economy overall has stabilized since 2011, as shown in Figure One.

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9) Mei Xinyu, “China’s Sanctions against North Korea are not Cuttingoff Trade,” Zhongguo Wang, June 10, 2013. English translation accessed at [opensource.org](http://opensource.org). Doc#: KPP20130626032003.

10) Program (2012-2020) for Opening Northeast China to the Northeast Asian Region, General Office of the Jilin Provincial People's Government,” Jilin Provincial People's Government Online, September 23, 2013.

Figure One



Source: Bank of Korea Economic Statistics System, "Foreign Countries/North Korea: North Korea GDP"

This growth has come against the backdrop of a strengthened international sanctions regime following North Korea's 2009 nuclear test and the passage of UNSC Resolution 1874. It is clear that Chinese trade has more than offset any declines in North Korea's overall trade balance, and has presumably assured that Pyongyang's economic situation has remained stable. Although trade figures for the first half of 2013 showed a slight drop in Sino-DPRK trade in the aftermath of North Korea's February 2013 nuclear test, the level of Sino-DPRK trade through the first nine months of the year showed a slight year-on-year increase from 2012. In fact, Figure Two below shows that Sino-DPRK trade has doubled in the years following the adoption of Resolution 2874, which authorized interdiction of suspected shipments of North Korean nuclear or missile-related materials. The evidence for a correlation between UN sanctions and North Korean economic performance is weak, especially when one considers the spotty enforcement of UN sanctions by member states following 2006 resolutions banning trade of luxury goods to North Korea.

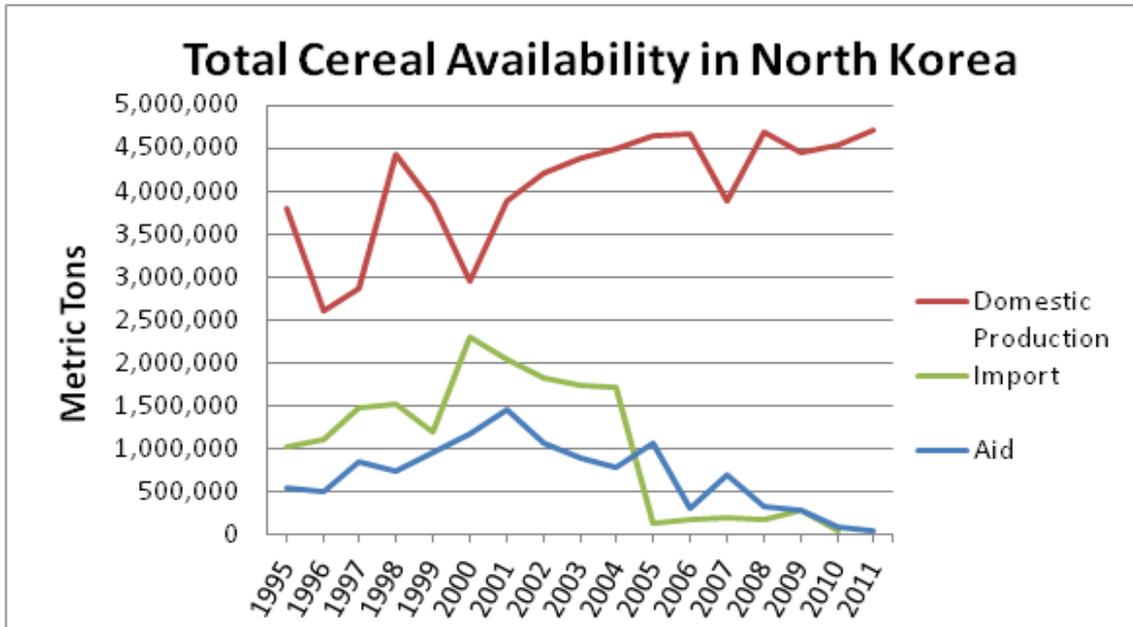
Figure Two



Source: KOTRA

Additional evidence that North Korean leaders do not currently feel pinched by current economic conditions comes from UN assessments of North Korea's food situation. Figure Three shows that North Korea has avoided significant reductions in agricultural production resulting from poor weather conditions in recent years, as shown by estimates of food production from the UN World Food Program.

Figure Three



Sources: Food and Agriculture Organization Statistics System (FAOSTAT); Food Aid Information System (INTERFAIS); World Food Programme

The performance of the past two years probably gives the North Korean leadership some confidence that it can weather international sanctions while holding on to its nuclear program; moreover, productivity improvements within a central planning framework appear to have allowed for stability if not some modest gains, even despite the apparent tightening of the international sanctions regime. Based on this analysis of recent performance within the North Korean economy, it is plausible that North Korean policymakers feel that they are on the right track and that they need not feel threatened by international sanctions, even as they forego high growth rates that would accompany reform and opening. They may even feel that they have the margin to experiment with selected economic reforms under controlled circumstances, on the assumption that North Korea's nuclear capabilities provide a sufficient deterrent to minimize external interference in North Korea's domestic affairs. The statement that economic diversification would provide means by which to "smash the sanctions and blockade maneuvers of the hostile forces" suggests that North Korea's leadership believes the economic situation is a potential strength rather than a vulnerability and that it does not face the need to make a choice between economic and nuclear development.

Based on this assessment of the current state of the North Korean economy, I examine the costs to the North Korean economy resulting from North Korea's dual strategy by analyzing its effects on the inter-Korean relationship, and on the potential for Sino-DPRK trade relations.

### **Costs/obstacles to NK econ growth resulting from North Korea's dual strategy**

A main assumption behind North Korea's pursuit of its dual strategy appears to be that the costs to its economic performance resulting from pursuit of nuclear weapons are bearable and that North Korea can indeed pursue economic development while also pursuing nuclear development. In fact, North Korea's dual strategy directly identifies economic diversification as a means by which to bypass the international sanctions regime while retaining its nuclear capacity. This premise is widely dismissed by outside analysts of North Korea's economy. There are good reasons for skepticism that North Korea can be successful in pursuing major improvements to its economy given that North Korea's record of economic failure exemplified by its famine in the 1990s and hostility to the markets as shown by its currency devaluation maneuvers in late 2009. Moreover, the international sanctions regime, with its discouragement of North Korean imports of luxury goods, imposes limits on North Korea's ability to achieve large amounts of trade or investment from external sources. Even North Korean internal assessments implicitly concede that it may be impossible for North Korea to simultaneously pursue nuclear and economic development. For instance, one North Korean authority observed that North Korea's efforts to pursue "socialist modernization produced no result" between 1970 and 2012.<sup>11)</sup>

The sacrifices imposed on the North Korean people by the regime's intent to hold on to nuclear weapons are even more stark when one considers that its closest trading partners China and South Korea both experienced 8-10 percent economic growth for decades following decisions to pursue economic reforms, while North Korea's economy has at best remained stagnant. North Korea would presumably grow at similar rates if it were to set aside its nuclear program and pursue export-led economic reforms. Thus, it should be clear that North Korea's decision to pursue its dual policy comes at great cost to North Korea's overall prospects for economic growth.

Based on the above analysis, Table I identifies three possible scenarios for North Korea's economic future depending on how North Korea handles its effort to simultaneously pursue nuclear and economic development. These scenarios take into account South Korean and American statements of intent to support North Korea's economic reform and integration into the regional economy based on North Korea's choice to abandon nuclear weapons as well as the likelihood that the international community is likely to tighten international sanctions against North Korea in response to further nuclear and missile tests. A third possible pathway considers the possibility that China might respond positively to North Korean efforts to prioritize economic development even without a North Korean commitment to denuclearization. In this scenario, China may provide limited economic support to North Korean reform efforts through provincial-level economic engagement efforts and downplays strict implementation of international sanctions.

Despite the economic costs of pursuing nuclear development, North Korean leaders may feel satisfied about their ability to at least weather international sanctions as long as Chinese support is sufficient to forestall the prospect of a North Korean economic collapse. North Korea may have relative confidence that China's desire to avoid instability on its border would prevent it from imposing a level of sanctions that would allow conditions of instability to develop. In fact,

11) "New Strategy Toward Independence, Reunification, Peace and Prosperity—Line on Simultaneously Pushing Forward Economic Construction and the Building of Nuclear Armed Force," Choson Sinbo, May 29, 2013. Accessed through [opensource.org](http://opensource.org) Doc#:KP20130530115002.

it is still not clear at what point continued North Korean provocations might lead China to implement the sorts of sanctions that would result in economic contraction in North Korea, especially if China perceives such sanctions as potentially inducing internal instability in the country. Although more North Korean nuclear and missile tests could push China in that direction, it is doubtful that China would allow North Korea's economic and political situation to become unstable.

Table I

North Korea's policy choices	Expected growth rate
North Korea's reform and denuclearization	8-10 percent growth
Pursuit of dual policy (econ growth without nuclear/missile tests)/passive int'l response	0-3 percent growth (or more if NK reforms with China's support), vulnerability to external shocks
Pursuit of dual policy (econ growth with nuclear or missile tests)/active international response	Possible negative economic growth.

On the other hand, if North Korea moves toward limited reform even while holding onto its nuclear capability, it might be able to squeeze some additional financial support from China and South Korea, even if it does not give up its nuclear weapons. North Korea is clearly sacrificing potential to reach the level of growth that would be attainable for a reformist non-nuclear North Korea, but the costs of such reform might also impinge on the capacity of North Korea's leaders to maintain political control in any event. Thus, North Korea appears to willing to absorb the costs of slow or stagnant economic growth in order to hold on to its nuclear capability.

Based on these three scenarios, the rest of this paper attempts to lay out prospects for North Korea's economic growth in bilateral relations with China, South Korea, and the rest of the international community by considering the trajectory of North Korea's current economic relationships and the effects to date of sanctions on North Korea's bilateral economic relations with its two major trading partners, China and South Korea. In this way, it should be possible to draw a rough picture of the costs of North Korea's current decision to hold on to nuclear weapons while pursuing economic improvement, the potential economic growth benefits that North Korea might accrue by giving up its nuclear weapons, and North Korea's prospects for pursuing economic growth and even limited reforms while holding on to its nuclear weapons capability.

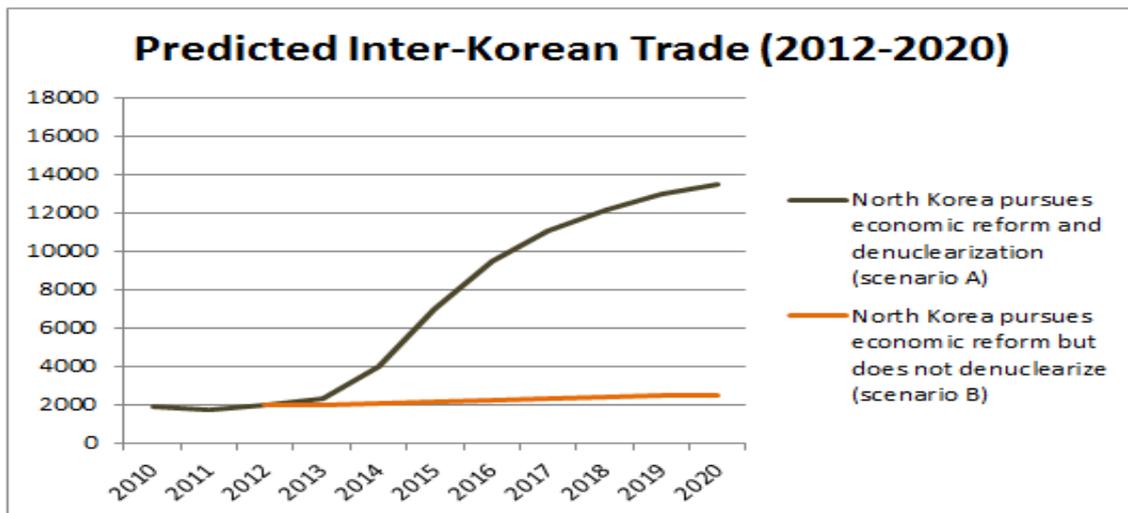
#### **Costs of the Byungjin policy for inter-Korean economic relations**

North Korea's pursuit of its dual economic and nuclear development policy and South Korean sanctions resulting from the collapse of the Kumgang project and North Korean provocations has resulted in stagnation of inter-Korean trade levels in recent years. In fact, it is somewhat surprising that the trade relationship has simply stagnated and not dropped following Lee Myung-Bak's May 2010 sanctions measures, but this is largely because trade via the Kaesong Industrial Zone continued to grow to replace the non-Kaesong based interactions that had existed prior to 2010.<sup>12)</sup> These sanctions have imposed tangible costs on North Korea's economic

development that would not likely have been imposed if North Korea had been willing to abandon nuclear weapons and pursue normal economic interactions with South Korea. The evidence of the cost to growth in inter-Korean trade resulting from North Korea's nuclear pursuits is most clear in the slowing of growth in the inter-Korean economic relationship that occurred under Roh Moo-hyun in 2007 and 2008. Although growth in inter-Korean economic relations further stagnated under Lee Myung-Bak, the rhetorical policy line of the Lee government to bring North Korea's per capita GNI to \$3000 represented a considerable potential for investment in North Korea once the nuclear issue is resolved.

There have been several past efforts using gravity models for estimating the potential growth of inter-Korean trade that would result from the normalization of North Korea's economic relations with its neighbors that would be expected if North Korea pursued economic reform and denuclearization. The most recent of these studies by Yonsei University's Lee Doowon has projected that North Korea's trade volumes would grow by 5.6-8.3 times from 2008 levels if North Korea were to become a normal economy.<sup>13)</sup> Thus, if North Korea were to move toward reform and denuclearization, inter-Korean trade would likely grow rapidly from the present amount of roughly \$2 billion/year to approximately \$12-14 billion/year in a relatively short period of time. Figure Four below shows the potential difference in inter-Korean trade in the event of stagnation in inter-Korean relations that currently exists as a result of a tense inter-Korean relationship where North Korea refuses to move toward denuclearization and the potential growth in inter-Korean economic relations that would be likely to occur if the inter-Korean trade and political relationship were to be normalized by 2020. The difference in the projected growth rates suggests that if North Korea persists on its current path until 2020 rather than embracing economic reform and denuclearization, the cost to inter-Korean trade would reach almost \$10 billion dollars per year and would represent lost cumulative trade in the amount of \$50 billion through 2020.

Figure Four



Unit=one million dollars

12) Patrick M. Cronin, "Vital Venture: Economic Engagement of North Korea and the Kaesong Industrial Complex," Center for New American Security, February 2012. Accessed at [http://www.cnas.org/files/documents/publications/CNAS\\_VitalVenture\\_Cronin\\_0.pdf](http://www.cnas.org/files/documents/publications/CNAS_VitalVenture_Cronin_0.pdf).

13) Doowon Lee, "Estimating the Potential Size of Inter-Korean Economic Cooperation," in Prospects for Emerging East Asian Cooperation and Implications for the United States, Joint U.S.-Korea Academic Studies Vol. 21, 2011, Korea Economic Institute of America, Washington, DC, pp. 149-163.

The loss of growth in inter-Korean trade also represents a drag on North Korea's potential to raise its Gross National Income (GNI). Lee Doo-won projects that a normal inter-Korean trade relationship would increase the relative importance of inter-Korean trade as a contributor to North Korean GNI from around 7 percent in 2008 to over forty percent. The realization of a normal inter-Korean trade relationship would surely contribute to much faster overall growth for the North Korean economy. If North Korea were to pursue economic growth and nuclear abandonment rather than hewing to its policy of simultaneously pursuing economic and nuclear development, its economy might grow 6-10 times faster than it is likely to grow under current circumstances. And this projection would only be valid if North Korea is able to avoid some of the natural disasters and other internal bottlenecks in supply that have resulted in negative growth rates in recent years.

Even if North Korea tries to promote economic reform without denuclearization, for instance through the establishment of special economic zones in each of thirteen provincial jurisdictions and through stepped up efforts to attract international investors, it is unlikely that South Korean investors will be able to respond to these efforts under current circumstances. North Korean reform efforts could increase political pressure on the South Korean government to relax its insistence on denuclearization as a prerequisite for a major expansion in inter-Korean economic ties, but it appears unlikely that Park Geun-hye would back away from her insistence on denuclearization as a prerequisite for major economic support. This means that North Korea's nuclear program will remain a major obstacle preventing the South Korean private sector from being able to support North Korea's renewed emphasis on improving its economy. Under these circumstances, it is unlikely that North Korean efforts to promote economic development in the absence of denuclearization is likely to result in increased inter-Korean trade and investment.

### **North Korea's Byungjin Policy and Sino-DPRK Economic Relations**

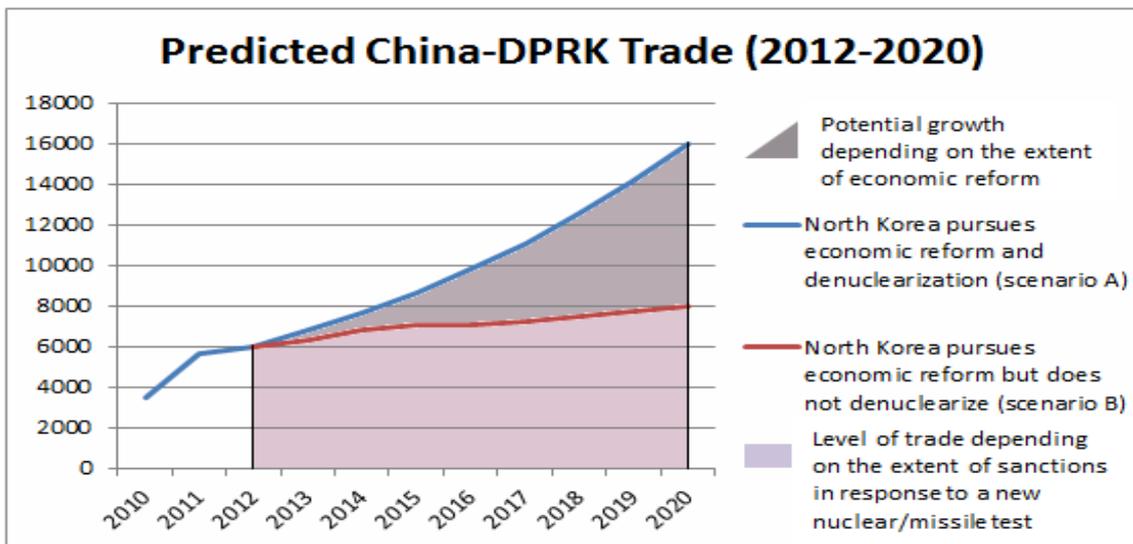
North Korea's simultaneous pursuit of nuclear and economic development may have a slightly different impact on future Sino-DPRK economic relations from its effect on inter-Korean relations. This difference is best explained by China's longstanding interest in seeing North Korea take the path of economic reform and its relative reticence to make North Korea's denuclearization a precondition for economic engagement. In fact, the story of Sino-DPRK economic relations over the course of the past decade has really been about Chinese efforts to utilize economic engagement effectively both to build political influence with Pyongyang and to entice North Korea in the direction of economic reforms. While China has tried to use the promise of economic benefits as a source of influence in an effort to restrain North Korea from actions that might heighten regional security tensions, it has also persistently tried to support and encourage North Korea's leadership to follow the Chinese model of promoting economic reforms while maintaining strong political control over its system.

Therefore, China will be tempted to show strong support for North Korean steps toward economic reform regardless of whether or not it continues to hold on to nuclear weapons. Marcus Noland and Stephan Haggard have conducted surveys with Chinese firms that show that the primary factor constraining Chinese firms from doing more business in North Korea lies with the governance failings and opacity of North Korea's own system.<sup>14)</sup> At the same time, China is subject to persistent encouragement from the United States and South Korea to maintain strong

sanctions on North Korea’s nuclear and missile programs and to limit flows of luxury goods to the North Korean leadership under existing UN Security Council resolutions. Moreover, Chinese analysts often refer to the need for a peaceful environment as an essential prerequisite for its own leadership to pursue reform, showing sympathy for the idea that a reduction in U.S.-DPRK tensions may be necessary to give North Korean leaders the confidence necessary to pursue reforms. The flip side of that argument that Chinese analysts tend to accept is that North Korea’s nuclear capability now provides it with a deterrent capability that provides necessary space for North Korea to experiment with economic reforms. As suggested above, provincial and local level actors have a strong interest in integrating a reformed North Korea into a broader economic system without being bothered by whether or not North Korea has nuclear weapons.

Figure Five shows that under current circumstances, Sino-DPRK relations are likely to continue to grow steadily unless additional North Korean provocations constrain that growth. However, North Korean provocations in recent years have not resulted in any downturns in Sino-DPRK economic relations and it is probably unlikely that such actions will result in a contraction in the economic relationship. Instead, North Korea’s willingness to consider economic reforms and to accept integration with its neighbors are likely to be the primary variables affecting the rate of growth in Sino-DPRK trade. The figure uses the thirteen percent rate of growth that Jilin provincial authorities have targeted in their plans through 2020 as a baseline for projecting continued growth in Sino-DPRK trade in an environment where North Korea is willing to pursue economic reforms and integration with its neighbors. The extent to which North Korea is willing to implement economic reforms as a component of its current policies is likely to have an impact on the rate of growth in Sino-DPRK trade relations, with Chinese actors as possible sources of trade and investment to the extent that North Korea’s economic situation improves and North Korea is perceived as an environment where there is an expanded opportunity to make money.

Figure Five



Unit =one million dollars

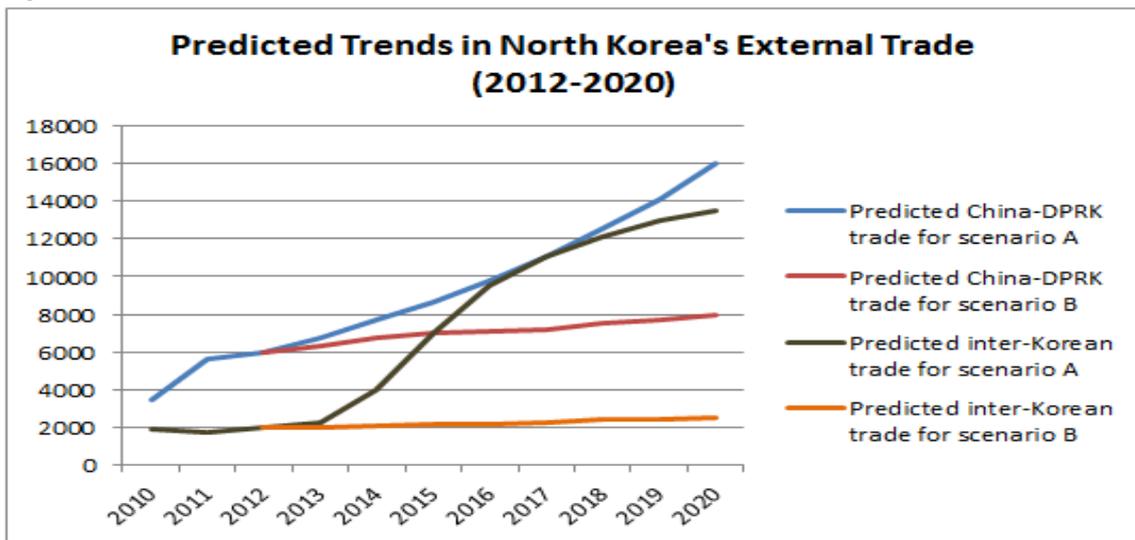
14) Stephan Haggard and Marcus Noland, “Economic Relations Between China and North Korea: Evidence from a Firm-Level Survey,” in Bonnie Glaser and Brittany Billingsley, Reordering Chinese Priorities on the Korean Peninsula, Center for Strategic and International Studies, Washington, DC, November 2012.

## Conclusion

By deciding to prioritize both nuclear and economic development, North Korea's new leadership under Kim Jong Un is sacrificing its best option for achieving high economic growth that would most rapidly improve the well-being of the North Korean people. But the perceived risks of high growth and the likelihood that the effects of growth and reform would also undermine prospects for political stability and/or regime survival probably make this option undesirable for North Korea's leadership, despite the manifest benefits that would accrue from a reform and denuclearization path. Figure Six below shows that North Korea's failure to abandon its nuclear weapons and integrate economically with its neighbors is costing the regime tens of billions of dollars in trade and perhaps an order of magnitude reduction in lost GNI (the difference between growth potential of 10 percent/year and actual growth of about one percent/year). And this estimation does not include the likely increase in trade between North Korea and other countries besides China and South Korea that would likely result from a North Korean decision to denuclearize and pursue economic reform.

Figure Six also shows that a secondary effect of North Korea's decision to prioritize both economic and nuclear development is that such an approach has the effect of enhancing North Korea's economic dependency on China, especially compared to the more diversified trade profile that would result from the integration of a reform-oriented, non-nuclear North Korea into the region. This is illustrated by the relatively equal and robust growth in both inter-Korean and Sino-DPRK trade that would result from North Korea's integration into the region. But North Korea's insistence on holding on to its nuclear weapons and China's simultaneous prioritization of stability and encouragement of North Korean economic reform has magnified China's share of North Korea's trade. On the other hand, China's hopes for North Korea to move toward economic reform while prioritizing North Korea's economic stability may provide the North with its best opportunity to sidestep international sanctions while holding on to its nuclear weapons.

Figure Six



Unit equals one million dollars

Thus far, North Korea's leadership has rejected that idea that it faces a strategic choice that necessitates the abandonment of a nuclear capability, instead enshrining its nuclear accomplishments in its constitution, touting nuclear development as an achievement of past leaders, and enshrining it as a main objective of the new leadership. The decision to prioritize nuclear development along with economic development as main pillars of North Korea's policy suggests that the leadership does not feel that it needs to make a choice to give its nuclear capabilities, and that the international sanctions imposed as a consequence of North Korea's past missile and nuclear tests have not had a decisive impact on the leadership's calculations.

Instead, the North Korean leadership appears to believe that its nuclear deterrent capabilities have provided political space for the regime to focus on economic improvement, and even to pursue limited economic reforms. The question then becomes whether international sanctions imposed on North Korea for its nuclear pursuits are likely to deprive North Korea of resources it needs in order to be able to improve its economy, or whether North Korean efforts to improve its economic situation even despite holding on to nuclear weapons might in fact prove to be a pathway by which North Korea can break out from economic sanctions and emerge as a "powerful socialist state." North Korea's ability to find this pathway around international sanctions appears likely to depend primarily on the extent to which China is willing to support North Korean economic reform efforts regardless of North Korea's nuclear development efforts.



Presentation

# Internationalization of the Kaesong Industrial Complex and North Korea's SEZs: The Role of Neighboring Countries

**Troy STANGARONE** |

(Senior Director, Korea Economic Institute of America)



## 개성공단의 국제화와 북한의 경제특구: 주변국들의 역할

개성공단은 남북한 협력의 드문 사례 중 하나이다. 그러나 최근 북한이 그들의 노동자를 철수함으로써 생겨난 여파로 인한 개성공단의 잠정적 중단 사태는 개성공단의 장기적 실행 가능성과 미래에 대해 의문을 제기하게 만들었다. 한국의 박근혜 대통령은 '신뢰프로세스'정책의 한 부분으로서 개성공단의 국제화와 이를 통해 향후 위기에 대한 개성공단의 안정성을 시도하고자 함을 밝혔다. 그러나 개성공단에 외국투자자들을 유치하기 위해서는 인터넷접속과 같은 일상적인 문제부터 정치적 위험과 개성에 위치한

회사가 이윤을 창출할 수 있을 것인가에 대한 아주 기본적인 문제 등에 직면하게 될 것이다. 이러한 여러 위험들과 어려움을 장기적으로 제거하거나 상당히 완화시킬 수 있겠지만, 개성공단에 이케아(IKEA)와 같은 주요 외국 기업이 들어오기까지는 상당한 시간이 걸릴 것이다. 잠정적으로 주변국들의 회사는 위험성이 큰 상황에서나 아니면 이미 북한과 사업을 해 본 경험이 있다면, 개성공단의 국제화 과정의 시작에 있어서 중요한 역할을 할 수 있을 것이다.

## **INTERNATIONALIZATION OF THE KAESONG INDUSTRIAL COMPLEX AND NORTH KOREA'S SEZS: THE ROLE OF NEIGHBORING COUNTRIES**

The Kaesong Industrial Complex has served as one of the rare forums for cooperation between North and South Korea. However, the recent suspension of the complex in the aftermath of North Korea withdrawal of its workers has raised questions about the long-term viability and the future shape of the complex. As part of her policy of "Trustpolitik," South Korean President Park Geun-hye has sought to internationalize the complex and in doing so bring a degree of stability to the complex in the event of future crises. However, attracting foreign investors to Kaesong will face a series of challenges ranging from mundane issues such as internet access to

challenging ones related to political risk and the ability of firms to make a profit in Kaesong. While there are steps that can be taken that will in the long-run eliminate or significantly mitigate many of these risks for firms, it will likely take time before major Western firms such as IKEA invest in the complex. In the interim, firms from neighboring countries that either have experience working in high risk environments or already do business in North Korea can play an important role in beginning the process of internationalizing the Kaesong Industrial Complex.

Since coming to office, the Park Geun-hye Administration has pursued a policy of “Trustpolitik” towards North Korea. The foundation of this policy is the idea that the relationship between North and South Korea can only improve once trust is established between both sides. In the crisis of this past spring, President Park held firm after North Korea withdrew its workers and has sought to transform the Kaesong Industrial Complex from a light industrial zone composed of small and medium enterprises based in South Korea into a true international industrial zone. To achieve this, the Park administration has worked to attract foreign firms to investment in production facilities in Kaesong.

However, the events of this spring and summer have raised questions about the long-term viability of the Kaesong Industrial Complex. While there had previously been a brief closure of the border between North and South Korea, there had been no significant interruption of operations in the complex prior to this spring. That all changed this year. On April 3, after nuclear, missile tests, and continuing threats, North Korea barred South Korean firms from moving material and personnel across the border into the Kaesong Industrial Complex. On April 9, North Korea withdrew all of its workers from the complex and on May 3 the last of South Korea’s workers returned to South Korea. Operations at Kaesong remained suspended until limited operations began to test equipment on September 16.

Attracting foreign investors into Kaesong after a five month suspension of operations will require the two Korea’s to begin a process of addressing the issues that in the past have made operating in Kaesong more challenging than at other industrial zones around the world. Only time and a change in North Korean behavior can truly address the issue of political risk in investing in Kaesong, but progress can be made on the other issues.

### **North Korea’s Special Economic Zones**

Under Kim Jong-un North Korea is making a more concerted effort to attract foreign investment. While Kaesong is the most well-known special economic zone (SEZ), North Korea first attempted to develop an SEZ in Rason with China. After years of little progress in the north, the past year has seen headway in the development of zones in Rason, where Russia has recently reconnected the Trans-Siberian Railway with North Korea, along with increased construction in the Chinese zones of Hwanggumpyong and Wihwa islands.

Earlier this year, it was announced that North Korea would look to establish two SEZs in each province. While there has been little progress on those zones, North Korea did announce that it had agreed to develop a second, high-tech zone in Kaesong near the Kaesong Industrial Complex. The new venture, which does not involve South Korea, would include a group of companies from both the Middle East and East Asia.

### **The Current Situation in Kaesong**

While operations have resumed in Kaesong after the five month suspension, the conditions in the facility will continue to remain challenging in the short-term. After months of sitting idle and uncared for, some firms found their factories to have degraded. The president of Fine Renown, a maker of clothing, found his sewing machines so rusted that all of the parts had to be replaced. Mold was throughout the building.<sup>1)</sup>

However, the difficulties extend beyond the condition of the factories. Contracts have been canceled, and firms may still yet face lawsuits from unfulfilled orders.<sup>2)</sup> During the shutdown 59 firms tapped into the state supplied insurance fund to stay afloat. Now that operation have resumed, firms are required to repay the state or face having their assets auctioned off. Thirty-five firms that have not repaid their insurance funds and face going under if they are unable to do so.<sup>3)</sup>

Prior to the suspension of operations in Kaesong in April, 123 South Korean firms employed 53,000 North Korean workers. Today firms in Kaesong only employ 43,000 North Koreans<sup>4)</sup> and production levels are only at 80 percent of prior levels. Of the 123 firms operating in Kaesong, three have yet to restart operations and two have chosen to sell their investment. Seven other firms who had leased land and sought permits to build factories have withdrawn their plans. Other firms are reassessing their commitment to the complex in light of their insurance payments.<sup>5)</sup>

### **Can the Kaesong Industrial Complex Be Internationalized?**

One of the misnomers about the Kaesong Industrial Complex is that there has been no foreign investment in the complex. When the industrial park opened in December of 2004 one of the initial factories was a joint venture, Taesung Hata,<sup>6)</sup> between a South Korean and Japanese company.

Beyond that initial investment, other Western firms have considered setting up shop in Kaesong. Kimberly-Clarke,<sup>7)</sup> a U.S. firm that makes healthcare and sanitary goods, explored the possibility of investing in Kaesong in 2007. In 2008, German auto parts maker Prettl Group, along with two Chinese companies, was set to build a factory in Kaesong. However, all three eventually decided not to invest in the complex.<sup>8)</sup>

More recently, there has been some Western interest in the complex. On a political level, the most important statement has come from the Italian government, which has expressed support for South Korea's efforts to turn Kaesong into an international industrial park.<sup>9)</sup> While there has not yet been public interest from Italian firms, there has been from other Western firms. Members of the Korean Apparel Association in the United States have expressed interest in investing, while it has been reported that the German firm Me & Friends has agreed to a joint investment deal with Samduk Tongsang, a Korean shoemaker that already has a facility in Kaesong.<sup>10)</sup> The investment by Me & Friends was likely helped by its decade long relationship with Samduk Tongsang.<sup>11)</sup>

While Me & Friends is investing an existing business relationship, before foreign firms without prior ties to a firm already in operation in complex are likely to invest they will initially need to see a return to normal operations in the Kaesong Industrial Complex. While the

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1) Simon Mundy. "Kaesong Reopening Offers No Quick Fix." Financial Times. October 14, 2013. Accessed on November 5, 2013.

2) Ibid.

3) Kwanwoo Jun. South Korean Businesses Quit Kaesong. Wall Street Journal Korea Realttime. November 5, 2013. Accessed on November 5, 2013.

4) Ibid.

5) "Two S. Korean Firms in Kaesong Face Ownership Change." Shanghai Daily. November 6, 2013. Accessed on November 6, 2013.

6) "After test, Kaesong's future uncertain." The Hankyoreh. October 11, 2006. Accessed on May 30, 2013. The author also visited Kaesong in May of 2006 and was told the same by workers at the factory.

7) "Kimberly-Clark considers opening factory in North Korean industrial park." Yonhap News Agency. August 22, 2007. Accessed on May 30, 2013.

8) Flacker, Martin. "Big Dreams for North Korean Industrial Park." New York Times. August 20, 2008. Accessed on May 30, 2013.

9) Kim Se-jeong. "Italy Supports Internationalization Project of Gaeosong." Korea Times. October 6, 2013.

10) "Foreign Businesses Nose Around Kaesong Complex." Chosun Ilbo. September 27, 2013.

11) German Business Leader Visits Kaesong Complex." Chosun Ilbo. September 26, 2013.

vast majority of firms are back in operation, many are still not running at their pre-suspension capacity. If existing firms in the complex are unable or do not see an incentive to return production to its pre-shutdown levels and eventually expand the complex will be a less attractive site for foreign investors.

Foreign firms would likely see reluctance on the part of South Korean firms to make new investments or expand operations in Kaesong as a warning sign about the complex's viability, since South Korean firms have a greater incentive to invest. Investing in Kaesong has always had an element of nationalism for South Korean firms that is lacking for foreign firms, and the advantages that attract South Korean firms to Kaesong - close proximity, a common language, and low wages - are not necessarily the incentives that would override the political risk that is attached to operating in Kaesong for foreign firms. In the recent crisis, North Korea suggested that, as with Mount Kumgang, it might seize the factories and look to enter into new agreements with foreign firms. The prospects of an investment at Kaesong being expropriated or undergoing an unexpected extended closure for political reasons unrelated to the firm make the advantages of low cost labor in North Korea less appealing when cheap labor and stronger rule of law can be found in less volatile countries.

### **The Dimensions and Benefits of Internationalization**

Much of the focus on internationalizing Kaesong has been on attracting foreign firms to set up new factories in the complex. However, there are multiple avenues for internationalizing the complex. Beyond setting up shop directly in Kaesong, a firm could enter into a joint venture with a South Korean firm similar to the original Taesung Hata venture or the more recent agreement with Me & Friends. Additionally, a foreign firm could choose to indirectly invest by investing in the South Korean operations of one of the firms already set up in Kaesong. Investment could be as simple as holding an equity stake in a South Korean company to having a production capacity through either a joint venture or full investment in Kaesong.

Internationalization would bring three potential benefits to Kaesong. First, it could help speed the expansion of the project. Under the initial plan the first phase was scheduled to conclude in 2007 with 300 South Korean firms employing 100,000 North Korean workers. While the employment figures of stage one have been surpassed, the final stage of the project calling for 1,500 firms employing 350,000 North Koreans and including tourist destinations, hotels, and shopping centers by 2012 is still far from being realized. Foreign investment could help to jumpstart expansion.

Second, foreign investment would help to further spread international standards and best business practices to North Koreans. One of the initial goals for the complex was to for it to serve as a platform for introducing market mechanisms and practices into the North Korean economy. Foreign investment in Kaesong would expose North Korea to a more diverse set of international standards and management practices, as well as provide a venue for the leadership in Pyongyang to better understand the types of systems and legal structures that need to be in place to attract additional investment into the North Korean economy.

Lastly, it could also help to make the complex less vulnerable to arbitrary shutdowns. While internationalizing Kaesong will not in itself eliminate the political risk firms in the complex face, it can raise the political risk for North Korea taking similar action as it did this spring in the future.

However, internationalization should not simply be viewed in terms of foreign investment, as it also entails greater market access for goods produced in the Kaesong Industrial Complex. This could include increasing the international market access for the sale of final goods produced in Kaesong to non-Korean markets as well as the sale of parts to other produces as part of regional supply chains. The difficulties of obtaining greater market access for goods produced in Kaesong are discussed in greater detail later in this paper.

### **The Challenge in Internationalizing the Kaesong Industrial Complex**

Operating in the Kaesong Industrial Complex poses unique challenges to the South Korean firms that have already set up shop in the complex. Companies in Kaesong face difficulties from basic issues dealing with logistics and communications to the political risk of future shutdowns. This would be no different for foreign investors. The following are some of the difficulties of operating in Kaesong that will need to be addressed to enhance the complex's appeal to foreign firms.

#### **Profitability**

Prior to this year's suspension, it is unclear that investing in Kaesong has been a profitable venture for South Korean firms. The first firm did not pay taxes in Kaesong until 2010 with four firms paying a total of \$153,000 in taxes in 2011.<sup>12)</sup> However, the combined net loss of firms has been decreasing. For the 119 firms that did not make a profit in 2011, the Ministry of Unification reported that their combined net loss was only \$12,681, down from more than \$121,000 in 2010 and nearly \$250,000 in 2009.<sup>13)</sup>

#### **The Political Risk of Investing in Kaesong**

Political risk is the prospect that political decisions or events can have a negative impact on business operations. In the case of North Korea, prospective firms face the prospect of risk from decisions made for political gain, the risk of conflict, and the risk of expropriation among others. These risks were most recently highlighted during the five month shutdown of the Kaesong Industrial Complex for non-commercial reasons. While North Korea may have learned that brinkmanship and provocations are good for negotiating with its neighbors to extract concessions, those tactics are not conducive to investment in an era of global capital flows. Firms can simply invest their funds in countries with less proclivity to shut facilities down for political reasons.

While the standoff from earlier this year may be the most recent example, there are a series of issues that highlight the political risk for firms thinking of investing in Kaesong. Over the years, North Korea on more than one occasion sought significant raises in the wages paid to workers and looked for ways to extract extra revenue from the firms operating in the complex. While the rules governing Kaesong call for increases in the minimum wage of no more than 5 percent per year, in 2007 Pyongyang demanded an increase of 30 percent for university graduates and a 10 percent increase for graduates of two year degree programs.<sup>14)</sup> In 2009,

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12) Firms are exempt from taxes for five years after they reach profitability and receive a 50 percent reduction for the following three years.

13) "S. Korean firms in Gaeosong complex plagued by North's hefty taxes." Korea Times. .October 18, 2012.

14) Lee Jin-woo. "NK Demands Wage Hike in Kaesong." Korea Times. April 14, 2007.

North Korea threatened to unilaterally raise wages to \$300, well beyond the legal 5 percent increase.<sup>15)</sup>

Last year, North Korea took the issue a step further and sought to unilaterally impose new taxes on firms in the complex based on its own estimates of their revenues rather than on revenues reported by the firms. The new rules that North Korea tried to impose before backing down would have eliminated the prohibition on retroactive taxation and imposed a penalty up to 200 percent for accounting fraud, leaving one firm with a tax bill of as much as \$100,000. If the prohibition on retroactive taxation had been eliminated the original tax benefits of investing in the complex would have been lost to all of the firms. Pyongyang attempted to enforce the new rules by threatening to limit the movement of goods and people to Kaesong.<sup>16)</sup>

Kaesong is not the only example of an economic venture that could potential make foreign investors wary of investing in North Korea. With Mount Kumgang shut down after the death of a tourist in 2008, North Korea sought to expropriate South Korean property and restart tours to the resort with foreign companies. In 2012, the Xiyang Group, a Chinese firm, went public with its troubles in North Korea. After building an iron ore facility, its North Korean partner demanded changes to the contract by raising land, water, labor and other costs driving Xiyang out of the project.<sup>17)</sup>

### **Perceptual and Reputational Risk**

Foreign firms considering investment in Kaesong face the prospect of both reputational risks to their brand and a perceptual risk from the closed nature of North Korea. There is a reason that no major South Korean firm has set up shop in Kaesong. While labor costs might be cheaper in Kaesong, major firms would potentially open themselves up to consumer protests and boycotts from NGOs and other groups. Nike, which saw its share price drop by half in the mid-1990s over allegations of running sweatshops, and recently faced new allegations, most likely serves as a cautionary tale for name brand firms considering investment in the Kaesong Industrial Complex. International reputations for major consumer brands and their share price likely far exceed any benefits from investing in Kaesong in the current environment.

Another reputational concern relates to brand named Western firms with operations in South Korea. They will not want to risk those profitable investments by investing in Kaesong. Should tensions rise again and public opinion swing against North Korea, they are unlikely to risk their reputations in South Korea being damaged by their operations in Kaesong.

The perceptual risk comes from how conditions in North Korea, and Kaesong by extension, are perceived. During his time as U.S. Special Envoy for Human Rights in North Korea, Jay Lefkowitz referred to the conditions in Kaesong as “slave labor.” More recently, a member of the European Parliament suggested in a written question for the EU Commission that workers in Kaesong were supplied from labor camps inside North Korea.<sup>18)</sup> Because of concerns about human rights conditions in North Korea Kaesong will likely continue to face perceptual concerns that the conditions inside the complex are similar to those inside North Korea.

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15) Lee Sang Yong, “Wage Hike a Good Excuse to Quit Kaesong.” The Daily NK. July 15, 2009.

16) “N. Korea’s ‘tax bomb’: Keeping Gaesong complex benefits both.” Korea Times. October 18, 2012.

17) David Stanway. “Exclusive: ‘Cheated’ China firm urges Beijing not to push investment in North Korea.” Reuters. September 5, 2012.

18) Question from Lorenzo Fontana, Member European Parliament. July 11, 2013. Accessed on October 30, 2013.

<http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=E-2013-008388&format=XML&language=EN>

### **Market Access**

Since Kaesong's opening, South Korea has sought to have goods made in Kaesong considered as South Korean. Because North Korea is a non-market economy and not a member of the World Trade Organization (WTO), goods produced in North Korea do not receive Most Favored Nation status from other countries. As a result, goods from Kaesong would seem their competitive advantage degraded in many markets, despite wages for labor being lower than in competitors such as China and Vietnam, if they were to be considered of North Korean origin.

Kaesong largely produces light industrial goods such as textiles and small manufactured items such as watches, cosmetics cases, and pots and pans. Setting aside current U.S. sanctions for the moment that prohibit the export of goods and parts to the U.S. that have not received an import license, these items would face much higher tariffs than goods from other non-FTA, WTO trading partners of the United States. For example, a coat made in Kaesong would face a 50 percent tariff, while other non-FTA trading partners face only a 15.9 percent tariff. In the case of cotton suits, the tariff for a North Korean good would rise to 90 percent, while a WTO member would only face a tariff of 9.4 percent. A knitted woman's blouse that is made of 70 percent or more silk would face a tariff of 60 percent rather than 0.9 percent. A wrist watch with an optical display is tariff free from most nations would face a 35 percent tariff, while a steel tea kettle would face a 35.5 percent tariff as opposed to a 2.7 percent tariff.<sup>19)</sup>

To address this issue, South Korea's has sought to include provisions in each of its FTAs, its first agreement with Chile which predates the Kaesong Industrial Complex being the exception, calling for goods from outward processing zones to be considered South Korean. These provisions have ranged from an agreement to form a committee to determine the conditions that must be met for consideration of inclusion in goods from an outward processing zone, as in Korea's FTA with the United States, to provisions laying out what percentage and types of goods would be eligible for benefits as in the Korea-India FTA (Table 1).

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<sup>19)</sup> All tariffs from the U.S. Harmonized Tariff Schedule

Table 1: Provisions on Outward Processing Zones in South Korean FTAs

Free Trade Agreement	Key Provisions
KORUS FTA	<ul style="list-style-type: none"> <li>• Provides for the establishment of a committee to consider the inclusion of outward processing zones 1 year after entry into force.</li> <li>• The committee's key criteria for consideration include: progress toward the denuclearization of the Korean Peninsula; the impact of the outward processing zones on intra-Korean relations; and the environmental standards, labor standards and practices, wage practices and business and management practices prevailing in the outward processing zone, with due reference to the situation prevailing elsewhere in the local economy and the relevant international norms.</li> <li>• The committee shall establish a maximum threshold for the total value of the originating good which may be added in the outward processing zone.</li> </ul>
European Union FTA	<ul style="list-style-type: none"> <li>• Provides for the establishment of a committee to consider the inclusion of outward processing zones.</li> <li>• The committee will establish what criteria must be met and will determine what total value of the final good may be added in the outward processing zone.</li> </ul>
European Free Trade Area FTA	<ul style="list-style-type: none"> <li>• Provides for an exemption from the principal of territoriality.</li> <li>• Goods shall be determined to be South Korean goods if (1) the total value added does not exceed 10 percent; or (2) the total non-originating input does not exceed 40 percent of the final price claimed and the total value of the originating material is not less than 60 percent of the total value of the materials used in the re-imported material or product.</li> <li>• Allows for revisions to the exemption from the principal of territoriality after 3 years.</li> </ul>
Singapore FTA	<ul style="list-style-type: none"> <li>• Provides for the use of outward processing under the following conditions: (1) the value of the non-originating inputs do not exceed 40 percent of the customs value of the final good as claimed; (2) the value of the originating material is not less than 45 percent of the final customs value claimed; (3) the producer of the exported material and the final product are the same; and (4) the last process of production takes place in the originating country.</li> </ul>
India FTA	<ul style="list-style-type: none"> <li>• Provides for an exemption from the principal of territoriality related to the Kaesong Industrial Complex.</li> <li>• Provides a list of eligible goods.</li> <li>• Goods shall be determined as originating in South Korea if the total value of the North Korean input does not exceed 40 percent and the value of the South Korean content is not less than 60 percent of the value of materials used in manufacturing the re-imported material or good.</li> <li>• Provides for the usage of safeguards on goods exported from Kaesong with a two month notice and the rescinding of the exemption from the principal of territoriality after 5 years.</li> </ul>
ASEAN FTA	<ul style="list-style-type: none"> <li>• Provides for goods from either party to be considered originating from the party if processing is taken on materials exported from the originating party and re-exported to the party.</li> <li>• Provides for the list of eligible products and procedures to be determined at a later date.</li> </ul>
Turkey FTA	<ul style="list-style-type: none"> <li>• Provides for the establishment of a committee to consider the inclusion of outward processing zones.</li> <li>• The committee will establish what criteria must be met and will determine what total value of the final good may be added in the outward processing zone.</li> </ul>

Source: South Korea's FTAs with the United States, the European Union, the European Free Trade Association, Singapore, India, Turkey and ASEAN.

Despite Korea's FTAs with the European Free Trade Association, India, and Singapore seemingly allowing for the export of goods from Kaesong under their FTAs, it is unclear if any goods have been exported using these provisions. Statistics on exports from Kaesong are sparse. In 2011, the Congressional Research Service (CRS) produced a report indicating that from 2006-2010, there had been exports to third countries from Kaesong (Table 2). What we can see from this data is that through 2010, exports to 3rd countries seem to have leveled off in terms of total value, but progressively decrease in terms of the percentage of the production in Kaesong. What this report does not make clear is if these goods were exported under Korea's existing FTA privileges or under regular trade as goods from North Korea?

While the data from CRS only runs through 2010, exports to 3rd countries from Kaesong were likely taking place up until the shutdown of Kaesong earlier this year. As a result of the shutdown, an Indian firm canceled its contract with Daewha Fuel Pump Industrial Ltd., a South Korean auto parts supplier, due to the failure of Daewha to deliver parts. The company also sought the return of modeling equipment it supplied or payment equal to its investment.<sup>20)</sup>

Table 2: Exports to 3rd Party Countries from the Kaesong Industrial Complex

(in U.S. millions)

	2006	2007	2008	2009	2010
Total Production	74	185	250	256	323
Exports to Countries Other than South Korea	20	40	36	29	37
Percentage of Total Production as 3rd Party Exports	27%	21.6%	14.4%	11.3%	11.5%

Source<sup>21)</sup>: Congressional Research Service

### **Logistics and Communications**

Anyone who has crossed the DMZ to travel to Kaesong is familiar with the long lines that develop in the morning as trucks line up on the South Korean side of the border. These lines develop not due to high volumes of traffic, as along many borders and customs points, but rather due to the border between North and South Korea only being open during certain periods of the day. Any parts a firm wishes to bring up for assembly, or any final products it wishes to ship back to South Korea, can only cross the border during these set periods of time.

Everything must move across the DMZ via truck. Except for a brief period during late 2007 and 2008 there has been no freight train service to and from Kaesong or nearby port access. The agreement reached in September to reopen Kaesong increases the number of border crossings to eight each day, but logistical access from Kaesong to the wider world is still restricted.

Beyond the logistical challenges of operating in Kaesong, communications are also restricted. The use of cell phones and the internet, two keys of modern communications and commerce, are not allowed. However, this is a case where the practice deviates from the established codes and regulations for the operation of the Kaesong Industrial Complex. According to the 2009 version of the Codes for the Act and Regulations of the Kaesong Industrial Complex, telecommunications

20) "Prolonged Kaesong complex suspension chokes S. Korean small firms." Yonhap News. April 23, 2013.

21) Mark E. Manyin and Dick E. Nanto. "The Kaesong North-South Industrial Complex." Congressional Research Service. April 18, 2011.

is defined as:

The term “telecommunications” refer to all types of data transmission using a landline or cordless telephone, facsimile, the Internet, data, images, video communication or satellite communication that transmits or receives sound, characters, signs, and images via electromagnetic means.

Article 2, Clause 2 of the codes for communications goes on to state that:

Both Parties shall guarantee the free exchange of mail and telecommunications in the KIZ and between the territory of the South and the KIZ.

### **Labor and Wages**

The rules and codes of the Kaesong Industrial Complex establish basic rules for issues such as the length of the work week, provisions for overtime and leave pay, as well as for the establishment of a safe working environment. The rules also lay out that employees may resign for their own reasons and take up other employment, but it is unclear how enforceable an individual’s ability to choose their employment is since all hiring must take place through recruitment agencies.

The recruitment agencies are responsible for providing each business with potential employees. The business may test candidates to determine if they are qualified for the prospective job. While this system provides employers a degree of choice in choosing their labor force, the current structure also means that any firm is restricted to the employees prescreened and provided to it by North Korea. Firms are not free to recruit workers on their own or through other means.

As was noted previously, wages are preset by agreement. This limits competition between firms. However, market signals have begun to creep through. Firms began to provide extra food, the most famous of which is Choco pies, as incentives to maintain morale among their workers. In essence the additional food has become a form of wage subsidy.

More problematic is the payment of wages. Wages are paid directly to the state and not the workers. This is outside normal business practices and an issue that will need to be resolved before many foreign firms invest in Kaesong.

### **Sanctions**

One final consideration is the impact of sanctions on internationalizing the Kaesong Industrial Complex. While U.S. and UN sanctions on North Korea’s nuclear and missile programs do not preclude investment in North Korea for the development of light industry, they do play a role in deterring investment and the risk of future sanctions from further nuclear or missile tests could inhibit the prospects for internationalizing Kaesong.

Current U.S. sanctions prohibit the importation of any goods or parts from North Korea that do not already have or receive an import license. This effectively precludes trade between North Korea and the United States. Investment, on the other hand, in Kaesong by U.S. firms is not prohibited. However, a recent piece by Bruce Klingner included suggestions for prohibiting investment by U.S. firms in Kaesong and the use of third party sanctions as potential financial sanctions the United States could place on North Korea.<sup>22)</sup> Additionally, sanctions legislation in

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22) Bruce Klingner. “Time to Get North Korean Sanctions Right.” The Heritage Foundation. Backgrounder 2850. November 4, 2013.

the House of Representatives has a provision, among others, that would require listed firms to disclose their activities in North Korea in their quarterly and annual reports.

While market access issues, often related to sanctions as in the U.S. case, reduce the appeal of investing in Kaesong, firms also have to take into account the probability that future sanctions related to North Korea's weapons programs will seek to further curtail the prospective market for goods from Kaesong or financial investments both more broadly in North Korea and more specifically in Kaesong. As a chief executive officer of Ninox, Joseph Naemi, said in regards to its stake in a North Korean oil refinery, "If the sanctions change, and if they target the oil and gas industry, that would put us out of business, and we will have to comply," Naemi said. "That is a risk one takes."<sup>23)</sup>

Beyond international sanctions already in place, South Korea has its own set of prohibitions on investment in North Korea. In response to the sinking of the Cheonan, South Korea put in place the May 24 sanctions. While these sanctions allow Kaesong to continue functioning, they did ban further South Korean investment in the complex.

### **Addressing the Challenges of the Kaesong Industrial Complex**

Earlier this year it was reported that the South Korean government held discussions with IKEA about Kaesong in 2012. The Swedish firm, based in one of the few Western nations with diplomatic ties with North Korea, is the type of high profile firm that could help encourage other foreign firms to invest in the complex by sending the signal that it is safe for major Western firms to set up shop. Ultimately IKEA did not pursue an investment in Kaesong,<sup>24)</sup> and similar firms may not be the most appropriate for investment in Kaesong at this stage.

Addressing the challenge of internationalizing the Kaesong Industrial Complex will entail taking a series of steps to resolve the difficulties described above. Some issues, such as the use of cell phones and the internet, should be relatively easy to resolve, while dealing with political risk will be more difficult.

The first steps towards internationalization will likely need to be taken by South Korea. Until Seoul removes the restrictions on South Korean investment in Kaesong, it sends a signal to potential foreign investors that investment is not appropriate at this time. Once the restrictions are lifted, if South Korean firms are unwilling to make new investments in the complex it is unlikely that foreign firms will do so in their absence. From this perspective the first step in internationalization could be termed increased domestication of Kaesong.

Tax incentives will need to be developed to make investing in Kaesong financially appealing to foreign firms. The advantages of Kaesong that appeal to South Korean firms – cheap labor, proximity, a common language, and a common purpose in building a unified Korea – are not as enticing to foreign firms faced with the political risks presented by North Korea.

There is currently legislation before the National Assembly which would provide an exemption on taxes for five years, insurance against expropriation, and low interest loans at rates lower than small and medium enterprises receive in South Korea.<sup>25)</sup> As foreign firms and investors were already eligible to invest in Kaesong any tax benefits in the zone should already

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23) Michael Kohn and Yuriy Humber. "Mongolia Taps North Korea Oil Potential to Ease Russian Grip (2.0)" Bloomberg News. June 18, 2013. Accessed on October 28, 2013.

24) Kwanwoo Jun. "Seoul Says IKEA Declined Kaesong Investment." Wall Street Journal Korea Real Time Blog. July 24, 2013. Accessed on October 17, 2013.

25) Kwon Ho. "Seoul tries to interest foreigners in Kaesong". JoongAng Ilbo. October 4, 2013. Accessed on November 1, 2013.

accrue to them. Additional legislation by the National Assembly, however, would be needed to extend any subsidy benefits, such as low interest loans or state backed insurance to foreign investors.

Any financial incentives provided by Seoul to induce foreign firms to invest will likely have to either meet or exceed those available to South Korean firms. One specific area that may need to be addressed is insurance for disruption of the complex. Firms that utilized state insurance funds during the suspension are required to repay the funds. However, firms still entail losses during suspensions despite Kaesong reopening. Future insurance schemes may need to account for this.

In order to expand market access, Seoul will need to raise the level of transparency surrounding Kaesong. For reasons pertaining to North Korea's nuclear program and human rights concerns, gaining duty free access in the United States and the European Union will likely be long-term objectives. However, maintaining support for the Kaesong project in Washington and Brussels will require more transparency on what goods are shipped to third markets from Kaesong and the conditions in the complex to counter perceptual risks abroad.

During the debate over the U.S.-Korea FTA, one of the major issues of contention in Washington centered on concerns over North Korean goods entering the United States under the FTA. This concern ultimately led the Obama Administration to issue a new Executive Order clarifying that both goods and parts that do not receive an import license are prohibited from importation into the United States. Increased transparency on where the goods are going and perhaps a special tracking number could help ease concerns in the United States and Europe.

At the same time, if increasing market access in the United States and Europe are long-term propositions, South Korea should look to increase market access for goods from Kaesong in other developing markets that may not have the same concerns regarding the nuclear issue.

As part of the agreement to reopen Kaesong, a joint permanent secretariat with both North and South Korean representation was established. The secretariat is an important step forward in preventing a future disruptions in the complex, but only after an extensive period of time will the jointly run body be able to develop a reputation for maintaining stability in the complex's operations. The secretariat in itself will be unable to prevent another suspension should North Korea decide to withdraw its workers at a future point in time. However, it can serve an important function in addressing many of the issues that make operation in Kaesong difficult, including cell phone and internet usage.

The problem of cell phone and internet usage is one of the issues that the permanent secretariat's subcommittee is supposed to address. Failure to do so as of yet was one of the reasons for the postponement of the proposed foreign investor relations event scheduled for October 31. In practice the issue should be resolvable as North Korea has begun the development of its own cellular network and the flow of traffic can be managed over the internet.

A more difficult issue for the secretariat to address may be the payment of wages. It has long been suspected that North Korea requires the payment of workers to be directly to the state in order to enable it to extract extra revenue from its workers by manipulating the exchange rate. One solution to this problem would be to establish a non-Korean bank in Kaesong to handle payments. However, since an increased focus on financial sanctions on North Korea has placed a greater reporting burden on banks it may not be an appealing proposition for a foreign

bank. The only practical solution may be for a South Korean bank to handle these transactions.

Efforts should also be undertaken to restore rail access and increase the number of border crossings. Park Geun-hye recently pushed for restoring rail links between Korea and Europe as part of her Eurasia Initiative. Restoring the rail link would increase the efficiency of moving goods in and out of Kaesong.

### **The Role of Neighboring Countries in Internationalizing Kaesong**

If firms such as IKEA are unlikely to invest in Kaesong at this point, what types of firms might accept the risks involved in investing in the complex? Firms that already have a business relationship with North Korea or that are used to operating in high risk environments are the most likely to initially invest in Kaesong. Along with firms from countries that are less invested in the North Korean nuclear issue that carry less of an immediate physical or ideological threat to Pyongyang.

A company such as Orascom is an example of the type of firm that might find advantages in investing in Kaesong and be the ideal partner for establishing a cellular network in Kaesong. Additionally, securing an early commitment from a company like Orascom could be the key to encouraging other foreign firms with a similar profile to invest in Kaesong. The Egyptian conglomerate has already set up cellular networks in different parts of North Korea making it a potentially acceptable partner for the North Koreans and a company used to dealing in a high risk environment. In any initial internationalization phase at Kaesong it will be companies like Orascom that are used to dealing in high risk environments that will be the first to set up shop.

While securing a U.S. investor is unlikely in the early stages, some European firms have set up shop in North Korea. Phoenix Commercial Ventures, which has experience in developing business projects in North Korea. Approaching other European firms that already have established relationships in North Korea could be another important source of foreign investors in Kaesong.

Though, securing commitments from companies such as Orascom and Phoenix Commercial Ventures would help in the process of internationalizing Kaesong, the most likely prospects are neighboring countries in East Asia.

Mongolia could be one such country. Earlier this year, HBOil JSC purchased a stake in an oil refinery in Rason from a company based in Malaysia.<sup>26)</sup> With significant mineral wealth, a joint venture based in Kaesong for processing ore for the South Korean market or other products produced in Kaesong could be a workable synergy. It would also have the advantage of encouraging North Korea to reconnect the rail line to facilitate the shipment of ore from Mongolia.

Additionally, in the new high-tech zone that North Korea announced, Singapore's Jurong Consultants and Hong Kong's P&T Architects & Engineers were announced as being involved.<sup>27)</sup> Hong Kong firms are playing a more significant role in the development of China's zones in the north and Singapore already has provisions in its FTA with Korea to import goods from Kaesong.

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26) Ibid Kohn and Humber.

27) "N Korea agrees new Kaesong venture with foreign firms: KCNA." Business Standard, October 18, 2013.

## **Connecting China's Special Economic Zones to Kaesong**

The most important regional player in internationalizing Kaesong will likely be China. Chinese firms are used to dealing with North Korea, and often on market terms, while the ongoing FTA negotiations between South Korea and China are expected to include the respective zones of each country in the agreement. Including zones in the FTA would help to facilitate trade between Kaesong and the Chinese zones. More specifically, South Korea should seek a commitment from China to encourage investment in Kaesong and ensure that South Korean companies have the ability to invest in China's zones along the northern border.

If a successful cross pollination of the zones were to occur, it would necessitate the development of additional port and transportation links in North Korea. All of which will be necessary if North Korea is to move towards real economic reform and integration into the global economy. Additionally, while a Chinese presence in Kaesong would be unlikely to preclude North Korea pulling its workers out of the zone during a future crisis; it would raise the political costs of Pyongyang doing so.

## **Integration into the North Korean Economy**

While internationalization, especially with Chinese cooperation, can help to raise the costs of future shutdowns for North Korea they cannot ultimately eliminate the problem. An additional way to raise the costs of a suspension is to further integrate Kaesong and China's own economic zones into the broader North Korean economy.

At the moment, Kaesong is largely an island in North Korea. While there are some food supplies purchased from North Korea,<sup>28)</sup> nearly all of the inputs for production come from South Korea. If firms in North Korea had a greater stake in the continued viability of the zones it would help to provide an additional layer of support for their continued operation.

However, there are two challenges to further integrating Kaesong into the North Korean economy. First, it is unlikely that the leadership in Pyongyang has made the decision to allow for the development of alternative centers of power to develop as might from successful North Korean business operations tied to Kaesong. Additionally, any significant business owner in North Korea would likely be tied to a key member of the regime and may at some point be subject to sanctions.

## **The Road Ahead**

The internationalization of the Kaesong Industrial Complex will be a process that takes place over years. The initial foreign firms will likely come from a mix of companies that already do business in North Korea or are well established in the region. However, as issues related to labor regulations, the payment of wages, communications, logistics, and other issues are addressed the complex will become more attractive to foreign investors.

The greatest obstacle to the internationalization of the Kaesong Industrial Complex, however, will remain political risk. If North Korea continues to pursue the Byungjin line, additional

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28) From interview with Ministry of Unification Officials in December, 2013.

nuclear and missile tests will inevitably lead to additional sanctions. While those sanctions may not directly target investments in North Korea's economy they will continue to raise concerns about the profitability of investing in North Korea.

*Troy Stangarone is the Senior Director for Congressional Affairs and Trade at the Korea Economic Institute of America. The views expressed here are his alone.*

Presentation

# Development of North Korea's Infrastructure: Trilateral Korea – China – Russia Cooperation

**Tagir KHUZIYATOV** |

(Professor, Far Eastern Federal University)



## 북한의 경제 기반 개발: 한-중-러 삼각협력

이 논문은 북한 경제발전의 두 가지 측면을 살펴보고자 한다. 첫 번째 섹션에서는 북한의 최근 경제 발전을 분석하고 인프라 개선의 필요성을 제시한다. 두 번째 섹션에서는 인프라 개발을 위한 다자간 협력을 위한 필수 요소, 기회와 한계를 설명한다. 특히, 성공적인 관여 전략은 강력한 다자간 차원에서 논의되어야 한다. 다자협력은 북한이 6자회담에서 다른 다섯 국가간의 이익을 대립시키는 가능성을 줄일 뿐만 아니라, 궁극적으로 국제 및 지역 경제에 효과적으로 참여하기 위해 필요한 막대한 투자에 대한 자원을 얻을 수도 있다. 특히 중요한 점은 빠른 해결책의 추구가 아니라 가능한 방법을 발견하고 그것을 마스터하는 것이다. 변수 제약 조건을 감안할 때, 우선 순위 프로젝트를 우선적으로 구별 할 필요가 있고 이런 프로젝트는 인프라 구축의 다양한 목적을 충족시켜야한다. 이외에도 NEA 인프라 네트워크 구축 및 북한 경제에 촉매 역할

을 해야 한다. 한국, 중국과 러시아와의(물론 다른 국가의 참여도 가능) 다자적 협력이 가능한 지역으로는 중국 관문 도시로 신의주, 국제적 기업의 지역으로 개성, 그리고 중계 무역의 중심으로 나선을 지명할 수 있다. 개성공단의 경험은 북한의 다른 지역으로 확장 되어야한다. 필요한 제도적 장치는 GTI , UNESCAP - ENEA 등을 통해 이웃 국가들과의 협력기회를 극대화시키고; KIDO(한반도 인프라 개발기구)를 통해 보안 문제를 해결하고; 세계은행(World Bank) 또는 아시아 개발은행(ADB) 혹은 유럽부흥개발은행 (EBRD) 이 "특별신탁기금"을 설정하여 북한에 인프라 및 개발자원을 조정하고; NEADB 구상도 북한을 포함한 동북아 지역의 간주 될 수 있을 것이다. 하지만 성공적인 다자협력과 긍정적인 상호작용을 위한 전제조건은 북한과 주변국가 모든 당사자가 진정하고 서로를 헐뜯는 행위를 중지해야 한다는 점이다.

## **Development of North Korea's Infrastructure: Trilateral Korea – China – Russia Cooperation**

This paper looks at two aspects of economic development of North Korea. In the first section, I look at the recent economic development of DPRK and needs for improvement of infrastructure. In the second section, I discuss imperatives, opportunities and limitations for coordinated multilateral cooperation with DPRK in infrastructure development. In particular, a successful engagement strategy should have a strong multilateral dimension. Multilateral cooperation will reduce the chances that North Korea will play the interests of the other five parties of the Six Party Talks against one another, but will also provide additional resources for the tremendous investment ultimately required for DPRK to effectively join the international and regional economies. In particular, the key is not to seek a solution too quickly, but to find a workable method and master it. Given the variable constraints, priority projects need to be identified. Priority projects should satisfy multiple purposes of infrastructure building. They should play a catalyst role for NEA infrastructure networks building and lift DPRK economy. There are several possible areas of multilateral cooperation/coordination between ROK, China and

Russia (other countries are welcome to join), including Shinuiju as gateway city to China, Kaesong as an international enterprise zone, and Rason as a transit trade center, among others. The experience of Kaesong Industrial Complex should be extended to other provinces of DPRK. Required institutional arrangements may include maximizing the opportunities for collaboration with neighboring countries through GTI, UNESCAP-ENEA, etc.; “KIDO” (Korean Peninsula Infrastructure Development Organization) can be considered during the resolution process of security issues; “Special trust fund” can be set up at the World Bank and/or Asia Development Bank/EBRD to coordinate infrastructure and development assistance to DPRK; and idea of NEADB can be considered for the NEA region including North Korea. The only precondition for successful coordinated multilateral engagement and for facilitation a positive interaction between DPRK and neighboring countries is that all involved parties will have to cool down and to stop demonizing each other.

## Outline

1. *Recent economic development of DPRK and needs for improvement of infrastructure.*
2. *Imperatives, opportunities and limitations for coordinated multilateral cooperation with DPRK in infrastructure development.*

### **Recent Economic Development of DPRK and Needs for Improvement of Infrastructure**

North Korean real annual GDP increased by 1.3% in 2012 (two consecutive years of modest growth) according to the Bank of Korea.

Manufacturing production shifted to an increase owing to increases in both the light and the heavy & chemical industries and agriculture, forestry & fishing output was favorable.

Production in the agriculture, forestry & fishing sector grew by 3.9% in 2012 (+5.3% in 2011), as production of agricultural products such as rice and corn expanded on increased inputs of fertilizer, and as production of livestock such as pigs and poultry grew by 12.3%.

Mining output rose by 0.8% (+0.9% in 2011), on the strength of increased coal production. Metallic mineral production declined by 0.5%, but coal production increased by 1.2%.

Manufacturing production grew by 1.6% (-3.0% in 2011) as output in both the light and the heavy & chemical industries shifted to increases.

Light industry output registered a 4.7% increase (-0.1% in 2011), as production of items such as food and tobacco rose sharply.

Production in the heavy & chemical industry gained 0.2% (-4.2% in 2011), as chemical products and transportation equipment saw increased output.

Electricity, gas & water production expanded by 1.6% (-4.7% in 2011), with increases both in thermal and hydroelectric power generation.

Construction contracted by 1.6%, (+3.9% in 2011) owing to a drop in civil engineering such as road-building.

Building construction rose by 3.4% centering around iron and cement plant constructions, while civil engineering decreased by 9.9%.

The services sector grew by 0.1% overall (+0.3% in 2011), despite a decline in government services (-0.2%), as output increased in other sub-sectors such as transportation & communications (+2.0%), wholesale & retail trade and restaurants & accommodation (+2.2%).

However, though the North Korean economy has emerged from the worst of the economic doldrums of the 1990s, it still suffers from the effects of long-term strain and chronic poverty. Food, energy and transportation infrastructure are still remain three shortages considering rehabilitation of DPRK economy.

Energy shortage needs to be addressed quickly in order to make production activities normal. The DPRK is operating with significantly less domestic or imported energy resources than during the Comecon era. This sector will require very expensive inputs as all parts of the infrastructure are falling into disrepair. In 1996 many of its hydroelectric plants were damaged in floods.

Thermal power plants are in poor condition and power transmission lines are seriously degraded, to the point where a nationwide grid no longer appears to operate. Energy imports are still assumed to be low given the overall trade and financial position of the country, even as cross-border trade in oil may have picked up in recent years.

Energy is so restricted that new economic activity appears feasible mainly in low-energy areas such as light industry, the service sector, and laborintensive agriculture. Factories are idled lacking energy, and residential energy is shifting to local sources, such as mini-hydropower and biomass.

In addition to the problems listed above, the DPRK also is not maximizing the energy resources available to it. Energy efficiency is extremely poor due to bad management and deteriorated infrastructure, so conservation is an immediate imperative. The Nautilus Institute estimated that energy conservation programs could reduce energy use by 25 to 30 percent — perhaps even as much as 40 percent. From those savings, and with limited investments, aid organizations could provide the DPRK with far greater energy resources.

Current political and economic realities make it unlikely that the development of light water nuclear power plants will continue in foreseeable future unless the ROC government initiates joint North-South civilian nuclear industry development projects. This is a special topic under the process of trust-building on the Korean Peninsula through resolving the nuclear issue which can be discussed separately.

But other projects may be more pressing in the near future. The restoration and repair of existing power plants and the upgrading of the transmission and distribution infrastructure are required to operate the system already existing or to make practical use of energy provided from outside sources. In addition, the DPRK's coal production could be made more efficient using available and relatively inexpensive local resources. Developing renewable and alternative energy sources will further enhance resources available to the DPRK while promoting experience and interest in sustainable energy alternatives. Finally, energy integration and planning in coordination with the bordering countries of China, the ROK, and Russia are a necessary step toward more effective regional energy use. In particular, ongoing China-DPRK and future ROK-DPRK and Russia-DPRK-ROK energy cooperation projects may prove key to this process. In all of these areas multilateral, bilateral, and nongovernmental organizations could provide assistance and advice.

The main opportunities for quick but sustained improvement in this sector's performance rest with better training and planning. Outside observers have found DPRK energy professionals to be well-grounded in the fundamentals of their system and aware and knowledgeable about the national energy situation. What energy specialists lack is experience or information about how a modern power system is controlled, including even basic comprehension of waste control and energy efficiency. These officials are keen to improve their management skills, and this suggests assistance with training and planning would lead to some short-term improvement in energy services.

Currently, training of energy specialists is ongoing in China, Russia, and some EU countries. But more training of managers and technicians is urgently needed and is a high priority for assistance to this sector. Particular needs are for training power plant and grid managers in energy efficiency methods, modeling, data collection, and management practices.

As for planning, this is a priority not only for more effective energy management but also because improving other parts of the economy depends upon the creation of a national energy strategy. Multilateral development organizations have experience developing umbrella plans for energy that also include the linked, vital sectors of transportation and agriculture. The DPRK critically needs help with energy planning for security, growth, environmental sustainability, and

emergencies. If international politics ever allow, the IFIs can help not only with financing but also with risk protection and technology transfers that will undergird eventual implementation of an energy strategy while multilateral and nongovernmental organizations can work together with regional governments on energy integration and coordinated planning.

Nonetheless, development of this sector is closely related to sensitive regional security issues and therefore assistance will be highly dependent upon real progress in the 6PT. However, this is the 6PT who can initiate the process of real international cooperation on energy issues in the Northeast Asia centering DPRK.

Transportation is essential for the development of the North Korean economy and it is critical for the integration of DPRK into the regional economy, too.

Much of the DPRK's transportation infrastructure dates to the 1930s and roads, ports, and rail lines are deteriorating significantly. Regional disparities in infrastructure quality and quantity are great and need to be addressed to better link resource areas and markets. The DPRK has almost no container transport capacity in its ports. Much transportation is done by over-road vehicles, but large tonnage is handled by railroad, and is often moved at night. In recent years foreign observers have noticed a substantial increase in the number of transport vehicles. Load data is not available from government sources, and estimates by foreign observers and ROK research institutions are not comprehensive enough to provide reliable statistics. Like energy, transportation remains a sensitive political and security issue. In fact, the army builds and maintains the transport infrastructure, while local communities are assigned sections of roads to maintain.

There is a great need for investment in the transportation sector, some of which may come from private or regional sources as the DPRK opens its economy more. China and the ROK are investing privately and publicly in some roads and railroads, especially in border regions and around special economic zones. Entrepreneurs in China and the ROK hope to build roads to connect Chinese and South Korean markets through the DPRK.

China and, to some extent, Russia are also interested in access to North Korean ports. There is evidence that transshipment between China and other countries is happening already. As the plans materialize, these countries will need to agree upon common standards for linking their roads, railroads, and other transportation networks. The involvement of multilateral institutions could prove helpful to regional governments in this process.

The main immediate opportunity for the international community to help improve the DPRK's transportation sector is through assistance with planning and assessment that can ensure good use of future investment financing.

To improve the transport infrastructure, a national or master plan will be needed (or revised, should one exist). The first step in preparing that plan will be to undertake a thorough assessment of the current capacity and needs (building and repairing). Again, as in the energy sector, international and regional political realities would need to be changed to allow for enough openness in this sector for outside agencies to be effective.

The communications sector needs to be linked to infrastructure planning.

Food shortage can be relieved through institutional reform and other measures.

As the share of agriculture in GDP is quite big, agriculture could lead a revival of the DPRK economy if appropriate policy changes are implemented and international assistance is better coordinated.

The government's policy agenda has targeted agriculture as a top national priority, which some analysts believe is an encouraging trend for further reforms in this sector. Other positive trends in recent years include the granting of more autonomy to local level officials, the increased authority allowed farm managers, and the shift to family-managed farming in some areas. All of these pilot projects are similar to what China did in its early stages of rural reforms in the 1970s. The new cash crops resulting from the freedom to plant has generated more prosperous farmers. But it is unclear how widespread the agricultural reform program is and what plans the government has for its future.

In general, the difficulties faced by DPRK farms as well as the means to overcome them are quite clear. There are no technical obstacles to substantially increased farm productivity. Nothing exceptional is required — only the widespread application of commonplace good farming practices. For example,

- applying lime to the fields to offset acid soils would increase yields by 20-40%;
- rotating cereal crops (especially maize and wheat) with legumes such as soy or green manure crops would increase yields by around 10%;
- using better seeding equipment would increase yields by around 10% because of better germination and appropriate spacing between each plant;
- using the methods of SRI (system of rice intensification) in paddy fields can increase rice yields by over 20% with no other inputs; and
- conservation agriculture (low tillage farming) would reduce soil erosion, save fuel, and improve soil quality.

But it is not clear enough whether the DPRK is properly situated to be a self-sufficient agrarian country given its population base. Some agricultural specialists argue that it should instead focus its policymaking toward improving its commercial and industrial sector to provide the economic security necessary to import food.

We believe that agriculture could actually be the foundation for a revived DPRK economy. In the short run, it is the most critical sector for human security, and appropriate assistance programs coupled with domestic investment and policy changes could lead to a virtuous spiral whereby increased farm productivity would allow purchase of needed machinery and repair parts (whether domestically produced or imported), as well as judicious amounts of fertilizer and fuel.

In any case much greater multilateral and regional cooperation on developing a comprehensive agricultural development and food security strategy is needed to make significant improvements in this area.

### **Imperatives, Opportunities and Limitations for Coordinated Multilateral Cooperation with DPRK in Infrastructure Development**

Research into North Korea's external economic ties is difficult because of the shortage of full and authentic data. North Korea's official economic statistics are beyond researchers' reach and have not been published for quite a long time.

Government agencies in the Republic of Korea (such as KOTRA, the Ministry of Unification, and the Bank of Korea), Korean research institutes and international organizations (including UNCTAD and the IMF) that collect data and work out the results using their own techniques, frequently as estimates, are the principal sources of statistics on North Korea's economy.

Information about North Korea's economic relations with other countries can also be requested from its trading partners as customs statistics. Whatever indirect approach is used, any survey of North Korea's economic relations with the outside world rests on data that cannot be always crosschecked, and figures obtained from different sources are often significantly at odds with each other.

It is hard to estimate North Korea's foreign trade quota in the absence of reliable statistics on its GDP. For a more revealing insight into the ongoing trends, it is appropriate to take a look at North Korea's economic ties with its principal partners in recent years and where they are now.

By the end of the first decade of the 21st century, China had become North Korea's principal trading partner and investor, and North Korea's economic ties with China have become a lifebelt keeping the North Korean economy afloat. Between 2001 and 2012, China's share of North Korea's foreign trade (including trade between the two Koreas) increased from 28% to 70%.

In the past few years, China has been investing heavily in North Korea. Chinese investments in North Korea have been spreading from the services and commerce into production and manufacturing, and further on into mining and infrastructure. For example, According to reports published in early 2012, China had obtained a long-term 50-year lease of three of the six terminals (numbered 4, 5, and 6) of North Korean seaport Rajin. In September 2012, the road between Rajin and Wonjong (a town across the China border) 53 kilometers long was paved with asphalt and open to traffic on October 26, 2012. The two-lane highway will speed up significantly the delivery of freight from Jilin Province to Rajin that the Chinese are using to capacity to ship coal and farming produce from the Northeastern provinces to China's coastal southeastern cities. As reported by the Korean Central News Agency, North Korea and China are planning to build a speedway between Hunchun and Rajin and a new bridge across the Tumen River.

The Chinese media reported in September 2012 that on September 1, 2012 Yanbian Huaihua Group, a private Chinese company in Jilin Province, entered into a contract with North Korea to develop the Chongjin port by joint efforts. Under the contract terms, the joint venture, Chongjin Harbor Joint Venture Company (in which the Chinese company owns 60% of the authorized capital, and North Korea the remaining 40%) will develop, manage, and use the third and fourth port wharfs for another 30 years. Also in September 2012, the official sources in Beijing confirmed that, in addition to the projects already under development in Rajin and Chongjin, North Korea and China were going to develop jointly several other ports on North Korea's eastern coast and that the two countries' companies were negotiating the precise terms of their joint projects.

A trend has surfaced in the past two to three years toward China's greater involvement in efforts to modernize transportation facilities in North Korea, including seaports on its eastern coast, in the first place, that the Chinese need most, the roads converging on them, and routes both countries use in their bilateral trade. In a most probable scenario, continued cooperation between China and North Korea will help Pyongyang to restore and modernize sections of its outdated transportation infrastructure as a tradeoff for its long-term use by Chinese companies.

In recent years, joint operation of economic zones in North Korea's border areas has become a major area of trade and economic cooperation between the two countries. The first session of

the joint governing board for joint development and management of the Rason Trade and Economic Zone and the Hwanggumpyong and Wihwa Islands Economic Zone was convened in November 2010, with Chen Deming as its chairman on the Chinese side and Jang Song Thaek, Vice Chairman of North Korea's National Defense Commission, as his counterpart on the North Korean side. The joint economic zone development project received much media attention because it was supported by China's central government. Previously, it had kept away from joint projects with North Korea, leaving them to local governments and private companies to be involved in.

It is a tradition now to name Russia among North Korea's principal trading partners, even though its weight in North Korea's trade has been slipping in recent years. In the early 2000s, Russia's trade with North Korea showed an upward trend, increasing from \$105 million in 2000 to \$233 million in 2005. Having reached the top, though, it started downhill in 2006, bottoming out at \$49 million in 2009. In 2010 and 2011, bilateral economic cooperation recovered some lost ground, springing back to \$113.7 million (less than 1.5% of North Korea's total foreign trade) in 2011, only to slide back again, to \$81 million, in 2012.

By another longstanding tradition, North Korea's ties with Russia's Far Eastern areas, particularly Amur Region and Primorye and Khabarovsk territories, have held a prominent place in bilateral economic relations. Recruitment of Korean labor for employment in these Russian regions is the most common area of interregional cooperation. As federal and regional development programs went ahead, they brought out a trend toward a significant increase in labor recruitment from North Korea. In 2010, approximately 21,100 North Koreans held jobs in construction, agriculture, forestry,<sup>50</sup> health care, fisheries, and the textile and leather industries. In 2013, Russia raised the quota of North Korean labor to 35,000.

Settlement of North Korea's debt to Russia after several years of talks is the most recent confirmation of Russia's interest in developing economic ties with North Korea. On September 17, 2012, Russia and North Korea signed an agreement on settlement of North Korea's debt to Russia under loans it had contract-ed from the former U.S.S.R. The debt was estimated at \$11 billion, including accrued interest, with consideration for the exchange rate of the ruble at the time. Russia agreed to write off 90% of North Korea's debt, with the remaining 10% (or over \$1 billion) to be credited to the Russian Vnesheconombank's account opened with a North Korean bank. Under the terms of the agreement, this amount can be used to fund joint Russian-North Korean humanitarian (in education and health care) and energy projects. The debt problem put out of the way, a major obstacle to bilateral cooperation (in investments, in the first place) has been removed and Russia has shown its political will to meet North Korea halfway.

In September 2013, Russia and North Korea completed the restoration of Khasan – Rajin railroad connecting Rason TEZ with Transsiberian Railway.

However, there are problems of bilateral cooperation projects such as rent-seeking by Pyongyang regime; unnecessary competition and duplication of efforts by neighboring countries; fragmented projects without coordination and loss of efficiency; and sometimes they are not conducive to forging regional cooperation in NEA.

A successful engagement strategy should have a strong multilateral dimension. Multilateral cooperation will reduce the chances that North Korea will play the interests of the other five parties of the Six Party Talks against one another, but will also provide additional resources for the tremendous investment ultimately required for DPRK to effectively join the international and

regional economies.

The key is not to seek a solution too quickly, but to find a workable method and master it. Given the variable constraints, e.g., political and financial, priority projects need to be identified. Priority projects should satisfy multiple purposes of infrastructure building. They should play a catalyst role for NEA infrastructure networks building and lift DPRK economy.

Possible areas of multilateral cooperation/coordination between ROK, China and Russia (other countries are welcome to join) are:

- Shinuiju as gateway city to China;
- Kaesong as an international enterprise zone;
- Guemgangsan as an international tourist zone;
- Rason as a transit trade center;
- Nampo as an export-processing zone;
- Wonsan as a center of logistics and shipbuilding in the East sea rim as well as a hinterland city for Guemgang-Seorak international tourist zone.

The experience of Kaesong Industrial Complex should be extended to other provinces of DPRK.

Required institutional arrangements may include the following:

- Maximize the opportunities for collaboration with neighboring countries through GTI, UNESCAP-ENEA, etc.;
- “KIDO” (Korean Peninsula Infrastructure Development Organization) can be considered during the resolution process of security issues;
- “Special trust fund” can be set up at the World Bank and/or Asia Development Bank/EBRD to coordinate infrastructure and development assistance to DPRK;
- Idea of NEADB can be considered for the NEA region including North Korea.

There is the only precondition for successful coordinated multilateral engagement and for facilitation a positive interaction between DPRK and neighbouring countries – all involved parties will have to cool down and to stop demonizing each other.



Presentation

# Explaining China's Shifting Attitude toward DPRK since Kim Jong-un

**Simon SHEN** |

(Professor, Chinese University of Hong Kong)



## 김정은 정권 이후 북한에 대해 중국의 변화된 태도 고찰

최근 북한에서 일어나는 변화는 동북아시아 지역의 안보상황을 고조시키고 있다. 2012년 성공적인 위성발사 이후로, 검증되지 않은 지도자였던 김정은은 국제적인 비난에도 불구하고 올해 2월에 핵실험을 강행하였다. 북한의 핵확산에 대한 학술적인 관점을 검토함으로써, 이 글은 북한과 그들의 전통적 동맹국인 중국 사이의 악화되고 있는 양자관계의 결과에 대해 중점을 두고 있다. 특히, 중국은 북한이 미국에게 직접적으로 접근하고자 하는 시도로 인해 불안해하고 있다. 지속적인 중재자로서 중국의 노력과 김정은 정

권에 의한 지나친 요구도 개의치 않고 미국과 직접적인 접촉을 하고자 한다. 최근 중국은 북한에 대한 냉각된 태도를 보이고 있다. 이는 중국이 지역적 전략 포지션을 안전하게 만들기 위하여 북한에게 그들의 정책을 바로잡기를 강요하고 있다는 사실을 드러내고 있는 것이다. 아시아에서 미국의 재균형 계획을 고려한 중국의 태도 변화라는 잠재적인 장애물과 함께, 이 글은 한반도를 둘러싼 행위자들간의 상호작용을 강화하는 방안과 북중관계의 변화에 적응하는 방안을 제안해보고자 한다.

## Explaining China's Shifting Attitude toward DPRK since Kim Jong-un

Recent development in North Korea has heightened the security situation in Northeast Asia region. Following the successful launch of satellite in late 2012, the untested leader Kim Jong-un conducted a nuclear weapon test in February this year despite international condemnation. In examining the academic perspectives regarding North Korea's nuclear proliferation, this paper focus on explaining the consequences of deteriorating bilateral relation between North Korea and its traditional ally China. Notably, China is alarmed by North Korea's attempts to approach the United State directly, regardless of continuous mediating efforts led by China

and unreasonable requests made by Kim regime. The recent signs of cooling attitude toward North Korea are supported by the fact that China is compelled to adjust its policy toward the DPRK in order to secure regional strategic position. Along with potential obstacles to the shift of Chinese attitude in light of U.S. rebalancing strategy in Asia, this paper offers suggestions to strengthen interactions with actors in the Korean Peninsula and to accommodate to the changing China-North Korea relationship.

***Promoting Cooperation between North Korea  
and the Nations of Northeast Asia:  
The Role of International Development Agencies***

International Financial Institutions in Myanmar's transition:  
potential Implications for The DPRK

**Bradley O. BABSON** (Consultant on Asian affairs)

Vietnam's Economic Transition: Well Begun, Not Yet Done

**Deepak Mishra** (Lead Economist, World Bank)

The Experience of Systemic Transition and Economic Development in Eastern Europe

**Piroska NAGY** (Director of Country Strategy and Policy, Office of the Chief Economist, EBRD)

Promoting Regional Cooperation under GTI (Greater Tumen Initiative) framework

**CHANG Dohwan** (Program Advisor, UNDP GTI Secretariat)

Engaging China in International Development Cooperation: Implications for North Korea

**ZHOU Taidong** (Program Officer, The Asia Foundation)

Discussants

**ZANG Hyoungsoo** (Professor, Hanyang University)

**CHOI Changyong** (Professor, KDI School of Public Policy and Management)

**Yoon Deok Ryong** (Senior Research Fellow, Korea Institute for International Economic Policy)

**Philo KIM** (Professor, Seoul National University)



Presentation

# International Financial Institutions in Myanmar's transition: potential Implications for The DPRK

**Bradley O. BABSON** |

(Consultant on Asian affairs)



## 미얀마의 경제체제 전환에서 국제금융기구의 개입: 그 중요성과 북한에 대한 함의

이 글은 미얀마에서 2010년 11월 총선 전후 기간 동안 국제금융기구의 활동과 역할에 대해 두 시기로 나누어 조사해보고자 한다. 첫 번째는 제한적이지만 총선 전 20년의 기간으로, 미얀마에서의 주된 활동은 경제개혁을 장려하고 국제사회에게 발전하는 경제상황을 알리면서 인도주의적 필요에 부응하는 전문적인 지식을 기여하

는 등의 역할을 하였다. 두 번째는 총선 이후 시기로, 국제사회와 새로운 정부로부터의 격려와 함께 국제금융기구는 미얀마의 경제정부와 미래 발전 전략의 도전을 지지하는 활동을 다양하고 선택적인 방법으로 증가시켰다. 이 글은 북한에 대한 국제금융기구 개입의 이 같은 두 단계의 타당성에 대한 접근을 제시해 주고자 한다.

## **INTERNATIONAL FINANCIAL INSTITUTIONS IN MYANMAR'S TRANSITION: POTENTIAL IMPLICATIONS FOR THE DPRK**

This paper examines two phases of activities and roles that the IFI's have played in Myanmar in the period before and after national elections in November 2010. In the 20 years prior to the elections, the primary but limited focus was on encouraging economic reform, helping educate the international community about evolving economic conditions, and contributing specialized expertise to addressing humanitarian needs. Since the elections, with encouragement from the

international community and new government, the IFI's have ramped up their activities to support the challenges of Myanmar's transition in economic governance and future development strategy in diverse but selective ways. The paper then assesses the relevance of both phases of IFI involvement for the DPRK.

## Introduction

Myanmar's remarkable transition in governance and international relations from authoritarian military rule and sanctions to democracy and opening up to the international community, is not on the surface a likely precedent or model for the DPRK. The political, social, economic, historical, cultural and geo-strategic differences between these two countries situations are too large easily to draw parallels that could translate Myanmar's experience into lessons for the DPRK context. Even so, there are certain features of their experience since the end of World War 2 that have created dilemmas for managing change in these countries that are similar in some respects. One is the post-colonial effort to shape a future less dependent on foreign influences. Burmese xenophobia and North Korea's Juche philosophy of self-reliance, are manifestations of the reluctance of the military-dominated governments of these countries during this period to adopt international norms while at the same time seeking to chart a national development path that emphasized domestic stability and security. Another similarity is the pursuit of economic policies that centered on the dominance of the State and deprived a large portion of the population of improvements in their standard of living, suppressed the growth of the middle class, and isolated the economy from the regional and global economies and especially the dynamism of Asian economic growth of the last 60 years. Isolation and poor economic performance are thus common features of the Burmese and North Korean legacies, similar also to the situation of Vietnam in the late 1980's.

The International Financial Institutions (IFIs) comprising the International Monetary Fund (IMF), World Bank, and Asian Development Bank (AsDB) played an important role in Vietnam's opening up to the international community and transition to a market economy in the early 1990's. Since then, the landscape for international development cooperation has changed significantly and the IFI's have sought to adapt their role and modalities of operation to the changing international environment for development assistance.

The intersection of economic and political factors surrounding international engagement with both Myanmar and the DPRK created a situation over the past 20 years where IFI involvement was both needed but not allowed in these countries. The absence of any significant IFI involvement was due in part to reluctance on the part of military governments to engage in serious dialogue on the need for economic reforms and in part to the reluctance of prominent IFI member governments to uphold the status quo political situation in these countries by IFIs supporting improvements in economic performance without more fundamental governance reforms. For Myanmar, while the space for IFI involvement was deeply circumscribed after the political events of 1988, because it was a member of all three IFI's some limited engagement was in fact possible off and in during the this period. This has not been the case for the DPRK, which has not become a member although exploratory contacts have take place from time to time.

This paper examines two phases of activities and roles that the IFI's have played in Myanmar in the period before and after national elections in November 2010. In the 20 years prior to the elections, the primary but limited focus was on encouraging economic reform, helping educate the international community about evolving economic conditions, and contributing specialized expertise to addressing humanitarian needs. Since the elections, with encouragement from the international community and new government, the IFI's have ramped up their activities to support the challenges of Myanmar's transition in economic governance and future

development strategy in diverse but selective ways. The paper then assesses the relevance of both phases of IFI involvement for the DPRK.

### **Historical Context**

Myanmar was one of the first developing countries to become a member of the IFI's, joining the IMF and World Bank (International Bank for Reconstruction and Development) in 1952 and the AsDB in 1973. Following the trauma of World War 2 and with national independence, Myanmar aimed to become a democracy with active involvement in international institutions. The creation of the United Nations and the Breton Woods institutions were seen by Myanmar authorities as important innovations in global governance that would protect the interests of weak countries from powerful ones. During Myanmar's initial democratic period in the 1950's, three World Bank loans were approved for railways and ports. Following the military coup of 1962, IFI relations continued. World Bank lending was modest, focusing largely on agriculture and infrastructure. Total lending through 1987 amounted to US\$804 million equivalent. New lending ceased in 1987, although implementation and supervision of approved projects continued until their completion. AsDB provided 32 loans totaling US\$530.9 equivalent from 1973 through 1987, mainly in the agriculture sector, and 38 technical assistance grants totaling US\$10.7 million, of which 28 were for project preparation and 10 were advisory.<sup>1)</sup> The World Bank chaired a Consultative Group for Myanmar until 1987 and has not played any donor leadership role in the country since then.

### **The Sanctions Period: 1990-2008**

During the period between 1990 and the devastation caused by Cyclone Nargis in May 2008, the World Bank and AsDB were not involved in any direct financial assistance activities, but both maintained low key contacts through participation in IMF-led Article IV Consultation missions which occurred on a 12-18 month cycle throughout this period and through meetings with Myanmar officials attending their Annual Meetings. Typically, staff from both development banks provided support to the IMF missions on structural aspects of the economic assessment, supplementing the financial and macroeconomic management focus of IMF staff.

The IMF Article IV Consultations were thus the primary vehicle during the sanctions era for maintaining IFI staff contacts with technocrats in the Ministry of Finance and Revenue and Ministry of Planning and Development and opportunity to engage senior officials in dialogue on economic policy and management issues. While the Myanmar authorities were responsive to some recommendations and sought technical assistance on specific issues from the IMF, there was an abiding lack of willingness to address fundamental issues creating major distortions in the economy, notably the exchange rate regime and inflationary financing of the public budget deficit by the Ministry of Finance and Revenue. Requests for technical assistance were resisted by the IMF Board of Directors, largely for political reasons of not wanting to help the government to succeed in the face of international criticism of its political and human rights record.

In 1995 the World Bank produced an Economic Report that assessed efforts by the Myanmar

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1) Data for World Bank is from the IMF Country Report 13/250 dated August 2013 and data for the AsDB is from the IMF Country Report 12/104 dated May 2012.

government to introduce economic reforms to attract foreign investment and stimulate the private sector and recommended elements of a potential structural adjustment economic reform program. But a change in leadership that occurred that year brought Senior General Than Shwe to power and he refused to endorse these proposals and reshuffled the economic leadership team, effectively sidelining all efforts at economic reform. This leadership transition also hardened antagonism to the National League for Democracy and its leader Aung San Suu Kyi and changed the name of the governing authority from State Law and Order Council (SLORC) to State Peace and Development Council (SPDC).

Speeches at World Bank and AsDB Annual Meetings made by the Myanmar Governor to these institutions during this period tended to complain about unfair treatment of a member country's rights to receive development assistance under the Articles of Agreement, which were ignored both by the larger shareholders and by the managements of the development banks. In January 1998, the Governor announced that Myanmar would no longer make payments on outstanding loans from the World Bank and AsDB and in September that year the country was formally declared in arrears, a step that foreclosed any future lending until the arrears were cleared.

In 1998 the Special Envoy for Myanmar under the Good Offices of the Secretary General of the United Nations Alvaro Desoto sought to bring economic development needs for Myanmar into the political dialogue addressing democracy and human rights concerns that dominated the agenda of the international community in its relations with the country. This led to informal World Bank participation in a meeting held at Chilton Park in the U.K. to assist in putting economic perspectives into the strategies being discussed about how to influence constructive change in Myanmar. This was followed by an initiative of the World Bank to prepare a full-scale Poverty Assessment report in cooperation with the Myanmar authorities and informal consultation with Aung San Suu Kyi. The idea was to seek some space of common ground where cooperative efforts could be started to address needs of vulnerable groups within Myanmar society and to provide an incentive to address the political issues with prospects for international economic assistance on the poverty alleviation agenda. In the end, the report never was finalized although it was widely circulated in draft form and the dialogue process was suspended after the resignation of the Special Envoy in October 1999. While the Government of Myanmar wished to proceed with formal review and discussion of the report, the political support among member countries for proceeding evaporated and World Bank management placed high-bar conditions linked to willingness to engage in a serious dialogue on economic reform to the Bank's willingness to continue the review process on the report, and consequently the initiative died. The ultimate impact, however, was a deepening recognition among the international community of the humanitarian issues needing to be addressed in Myanmar in addition to political and human rights issues, and this contributed to another review of future Good Offices strategy in a meeting held in Seoul under the auspices of the South Korean Government in March 2000 in which addressing these humanitarian needs was endorsed in principle. Following this meeting the lead in formulating humanitarian assistance strategies for Myanmar fell to the UN Country Team in Yangon with no IFI involvement.<sup>2)</sup> The World Bank's only involvement in this agenda was supporting an "Avian Influenza Support" project, which was funded by an Avian and Human

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2) The source for this information is the personal involvement of the author who was responsible for World Bank relations with Myanmar during this period.

Influenza European Union Trust Fund at the World Bank and executed by the Food and Agriculture Organization.<sup>3)</sup>

AsDB's only independent activity involving Myanmar during this period was its Program of Economic Cooperation in the Greater Mekong Subregion (GMS) that included Myanmar as one of the GMS countries. This primarily involved participation in regional meetings and studies organized and funded by the AsDB.

### **IFI Role in Responding to Cyclone Nargis and Pre-Election Period 2008-2010**

Cyclone Nargis inundated the coastal areas and Irrawaddy River Delta of Myanmar in 2008, causing widespread loss of life and a huge humanitarian crisis far beyond the capacity of the Government to manage on its own. The event fundamentally changed the context for Myanmar's relations with the international community and brought humanitarian concerns to the forefront, trumping the longstanding denial of significant foreign aid flows to the country and placing other political and human rights issues on the back-burner. While the UN and ASEAN took the lead in organizing international humanitarian support and coordinating its implementation with the Government through a Tripartite Core Group (TCG), the IFIs played a supportive role that was low key but very important for the management of the crisis.

The IMF took the lead in assessing the macroeconomic impacts of the cyclone and proposed policies and strategies to mitigate the issues created for the economy. The World Bank undertook to design and support under ASEAN leadership a TCG-sponsored damage assessment and identification of priorities for recovery. The World Bank subsequently as part of this effort also undertook to design Social Impact Monitoring studies carried out in cooperation with local civil society organizations and local governments to assess both the impact of the cyclone and post-disaster assistance on local communities. This later led to the World Bank to provide monitoring and analysis for a multi-donor livelihoods assistance trust fund, on a fee for service agreement with the concerned development partners. This assessment activity is ongoing through 2015.<sup>4)</sup> AsDB also participated in the initial damage and needs assessment.

From 2003, the Government of Myanmar committed itself to a seven-step process leading to a new Constitution and national elections. This was widely viewed skeptically by the international community, especially in view of the continued house arrest of Aung San Suu Kyi and marginalization of any meaningful role in a national reconciliation process or in preparing a new Constitution for the National league for Democracy. During the post-Nargis period from 2008 until national elections were held in November 2010, the primary activities of the World Bank and AsDB were limited to monitoring developments in Myanmar, participating in informal information sharing meetings in Bangkok among the development partners, building relations with civil society groups in Myanmar, and participating in the ongoing post-Nargis monitoring studies.

### **IFI Roles and Activities in the Transition Period after National Elections**

The national referendum approving a new Constitution in May 2010, followed by the release

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3) International Development Association and International Finance Corporation Interim Strategy Note for The Republic of the Union of Myanmar for the Period FY13-14, October 30, 2012, pg. 11.

4) World Bank Interim Strategy Note for the Period FY13-14, page 11.

of Aung San Suu Kyi from house arrest and the holding of national elections in November, changed both the domestic and international context for IFI involvement in Myanmar. While considerable skepticism greeted the new Constitution with its tilt towards continued high level of military participation in the new political system and the election results in which the military-affiliated Union Solidarity and Development Party (USDP) dominated both legislative houses, the new Government was established with civilian leadership and both democratic national parties and ethnic-affiliated parties were given legitimate voice in parliamentary proceedings and committee assignments.

After decades of denial of external assistance to the central Government, the problems emerged of extremely low level of capacity of the civil service to adjust to demands to improve governance performance and delivery of new programs and projects, as well as design and implement major reforms under intense time pressure. Both the international community and domestic advisors to the new Government recognized that to meet its challenges, the new Government needed advice and support from the IFIs that it had long been denied and that their re-engagement was desirable to nurture the nascent reform process. The same was true for the UNDP, which had been operating under severe mandate restrictions under the sanctions era.

#### *Leading Role for the IMF*

The role of the IMF during the initial transition period was extremely important. Building on its routine practice of fielding Article IV Consultation missions annually, the IMF gave initial attention to the issues of macroeconomic stability. Priority attention was given to addressing plans to unify the exchange rate, remove exchange restrictions, establish a consistent monetary policy framework, and improve public financial management. Also, a medium-term agenda was identified to modernize the economy and remove impediments to growth by enhancing the business and investment climate, promoting agricultural productivity, modernizing the financial sector, and further liberalizing trade and foreign direct investment. Building human capital and reducing poverty were also identified as critical to the success of this agenda.<sup>5)</sup> Both an intensification of policy dialogue and expansion of technical assistance with a receptive new Government led to follow-up work on actions on these issues with a recognition that reforms must be designed and implemented taking into account logical steps forward and capacity constraints. IMF initial technical assistance focused on plans to unify the exchange rate and lift foreign exchange restrictions, monetary operations, organization of the Central Bank, and drafting a new Central Bank law and foreign exchange law. The willingness of the Government to pursue exchange rate unification after decades of intransigence on this issue was a highly visible sign of the credibility of its commitment to pursuing reforms that went a long way to build confidence among the international community in the reality of change and sincerity of the intentions of the new Government to make fundamental changes in economic policy and management.

In 2013, the IMF has deepened its policy dialogue on macroeconomic management and financial system reform, ramped up technical assistance, and established local staff presence in Myanmar to support its expanding activities. Priorities are: monetary policy and operations, financial sector development, economic statistics, tax administration and policy, and public

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5) IMF 2011 Article IV Consultation Report, pgs.1 and 13.

financial management. The Myanmar Government is in agreement with the agenda and recognizes that implementation of reforms needs to be sequenced in line with their capacity to absorb and implement technical assistance.<sup>6)</sup>

#### *Normalization of Relations with the World Bank and AsDB*

Resolving Myanmar's external arrears, both to governments (notably Japan) and the World Bank and AsDB were also identified as high priority in order to improve the investment climate and pave the way for future development assistance from these historically major sources prior to the sanctions era. Japan agreed on a bilateral debt-restructuring plan in April 2012 and arrears to the World Bank and AsDB were cleared in January 2013 using bridging loans provided by Japan. Also in January 2013, the Paris Club reached agreement with the Government of Myanmar on a concessional treatment that will write off 50% of all arrears and reschedule the remainder over a 15-year period with 7 years grace starting in 2014.<sup>7)</sup>

Both the World Bank and AsDB have begun to resume normal operational planning in their relations with Myanmar, with international political support for step-by-step re-engagement deepening following the strong showing by the National League for Democracy in the bi-elections to the National Parliament in April 2012, including the election of Aung San Suu Kyi, and growing international confidence in the Government's reform efforts. Interim Country Strategies were prepared by both the World Bank and AsDB in October 2012 to serve as guides for their activities prior to the elections scheduled for 2015 and have been approved by their Boards of Directors.

#### *World Bank Interim Strategy for FY13-14*

The aim of the World Bank Group Interim Strategy is to “support the Myanmar Government in the country's triple transition -- from an authoritarian military system to democratic governance, from a centrally-directed economy to market-oriented reforms, and conflict to peace in boarder areas -- for the benefit of the people of Myanmar.”<sup>8)</sup> It is noteworthy that this strategy was significantly influenced by the World Bank's recent focus on issues affecting conflict-affected States, and especially the World Development Report of 2011 with its emphasis on transforming institutions and building confidence. The major elements of the strategy are:

1. Transforming institutions through policy advice and capacity building, together with technical assistance and investment to support building domestic institutions. Priority areas are in public financial management and private sector development. An initial activity undertaken in mid-2013 was a Public Expenditure and Financial Accountability Assessment that will underpin formulation of specific policy advising and capacity building activities. This will be deepened by a Public Expenditure Review and complemented by a demand-driven program of knowledge support for the Government in macroeconomic and public sector management. Specific activities will include

6) IMF 2012 Article IV Report, Annex on Fund Relations, pgs.4 and 6.

7) IMF 2012 Article IV Report, pg.4.

8) World Bank Interim Strategy, pg. 11.

just-in-time policy notes, short diagnostic reports, South-South exchanges to learn from other developing country experiences first-hand, and workshops and seminars to discuss emerging economic issues.

For private sector development, an Investment Climate assessment will be undertaken jointly with the International Finance Corporation (IFC) affiliate of the World Bank Group to analyze constraints on small and medium-sized firms and assess the policy and regulatory environment. A financial sector development program is also planned to run through 2014 that will include a master plan, building a legal and regulatory framework, enhance supervision of financial institutions, establish financial infrastructure including payment systems, and provide policy advice to support expanded banking services to small and medium-sized enterprises.

Other planned institution-building activities include support for project design and implementation and public sector governance improvement.

2. Building Confidence in the long-term reform process by delivering visible interim results. Specific activities are focused on support to the peace process through financing community-driven programs to promote the economic and social recovery of conflict-affected communities; support to civil society through re-establishing links between civil society and communities with local institutions and authorities; and supporting financially activities that deliver tangible impacts and quick-wins at the community level. A National Community Development Support Project grant was approved in November 2012 for \$80 million as an initial operation pending full normalization of relations through clearance of arrears and preparation of a future lending program.
3. Preparing for a full-scale normal country assistance program. The Interim Strategy provides for a Development Policy Operation linked to the arrears clearance that took place in January 2013 that supports the Government's economic reform program aimed at macroeconomic stability, improving public financial management and enhancing the investment climate, with proceeds of the loan used to support Myanmar's foreign exchange needs including refinancing of the bridge loan for clearance of arrears. In parallel, assessments of financial management and procurement capacity for future project implementation and studies of longer-term issues needing to be addressed for development of the economy will be initiated, including a household income and expenditure survey.

Initial priorities for World Bank lending activities are focused on energy infrastructure pending a development of a Poverty Reduction Strategy Paper to guide future operations based on reliable data and broad consultation. World Bank involvement in education and health sectors is expected to be limited and focused on technical support in light of the high degree of priority and financing being given to these sectors by bilateral donors.

At the World Bank Annual meetings in October 2013, an \$140 million IDA Credit for power generation in Mon State was signed and Myanmar joined the Multilateral Investment Guarantee Agency affiliate of the World Bank group that provides

non-commercial risk insurance to private investors.

At the IMF-World Bank Annual Meetings in October 2013 a proposed new strategy for the future evolution of the World Bank Group was discussed and approved by its Governors. Many of the features of this new strategy are fully compatible with the World Bank's existing interim strategy for Myanmar, notably: the focus on issues relevant to conflict-affected States, desire to work in a less fragmented way; selectivity in areas of World Bank Group comparative advantage among development partners; efforts to connect more fully with the private sector, local communities and civil society; forming effective partnerships; and focusing on results. Similarly, the Bank's new mission focus on eliminating absolute poverty by 2030 and boosting shared prosperity for the bottom 40% of the population in all client countries means that the Bank will seek to identify and concentrate its resources on those issues that most directly impact on the achievement of this mission, which will vary by country. The Bank also plans to strengthen its internal capacity to mobilize global knowledge to support its country-level programs and crosscutting issues such as global warming.

*AsDB Interim Country Partnership Strategy 2012-2014*

The AsDB interim strategy aims to “reengage in Myanmar and develop a comprehensive country partnership and program in support of sustainable and inclusive economic development and job creation. In the interim strategy period ADB will emphasize three program areas: (i) building human and institutional capacity in ADB's areas of focus and strength to help lay the foundation for medium-term engagement and effective development processes; (ii) promoting an enabling economic environment, which is needed to achieve macroeconomic stability, promote trade and investment, diversify the economy, create jobs, improve financial intermediation, and increase agricultural productivity; and (iii) creating access and connectivity for rural livelihoods and infrastructure development by promoting enhanced access to markets and basic social services, improving rural infrastructure to boost farm productivity and incomes, lowering transaction costs, enhancing opportunities for domestic and cross-border trade and investment, and improving access to reliable and sustainable utility services. Links between these priority areas will be leveraged to the extent possible. While ADB's reengagement will initially cover relatively broad areas, it will become increasingly selective as ADB's assessments, government priorities, and division of labor with other development partners evolve.”<sup>9)</sup>

In implementing this strategy, AsDB intends to emphasize five themes: environmental sustainability, good governance, private sector development, regional cooperation and development, and gender equality. Knowledge building is also a major area for focus, through conducting economic and sector assessments as the basis for developing sector support strategies; providing analytical and advisory support to selected government agencies, sharing international good practices, and fostering exchanges with other developing economies; and providing analytical work, advisory services and training in project development and project management.

AsDB's primary operational modalities are technical assistance grants and after clearance of arrears lending through the Asian Development Fund, its concessional lending window. Funding

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9) AsDB Interim Country Partnership Strategy, pgs. 5-6.

for technical assistance grants is expected to be about \$3 million per year during the interim strategy period.

As of early October 2013, AsDB has approved 22 technical assistance grants for a wide variety of projects linked to the interim strategy objectives and one loan for Support for Myanmar's Reforms for Inclusive Growth January 2013 linked to the clearance of arrears in parallel with that of the World Bank. Future proposed operations under preparation include four grants linked to civil service capacity building, institution-building for a better investment climate, financial sector reform support, and strengthening public debt management. Three grant-funded projects for enhancing rural livelihoods, providing pro-poor community infrastructure and basics services, and a regional capacity building for HIV(AIDS) are also planned as are two loans for power distribution improvements.

### *The IFIs and Other Donors in the Interim Period*

Many bilateral development assistance agencies and NGOs have opened active programs in Myanmar since the 2010 elections, posing significant challenges for aid coordination and making high demands on limited civil service capacity to plan and manage donor-assisted projects and activities, and to ensure effective internal coordination both among agencies and between levels of government. In January 2013 the Government organized an international Development Cooperation Forum and presented its own proposed Nay Pyi Daw Accord for Effective Development Cooperation as a framework to guide priority setting among the Government and development partners and as foundation for agreeing on assistance modalities and aid coordination. This was approved by acclamation. It was also proposed at the time to establish a Union of Myanmar-Development Partner Working Group to prepare a Government performance framework and action plan to guide implementation of the agreement and set standards and benchmarks for monitoring progress. In September 2013, the Government also announced an overhaul of its internal development assistance coordination organizational arrangements.

The international development community has evolved its policies in recent years following the Paris Declaration of Aid Effectiveness on March 2, 2005. This declaration highlighted core principles to guide future development assistance cooperation, emphasizing country ownership, harmonization and alignment of donor funded activities, results-orientation, and mutual accountability. Myanmar did not participate in this process and thus was not exposed to the new thinking in development circles except through a multi-donor funded program supported by UN agencies active in Myanmar and some bilateral donor agencies addressing HIV(AIDS) to meet humanitarian needs during the sanctions era. The IFIs were not directly involved in these efforts until much later.

While the World Bank chaired a Consultative Group for Myanmar before 1987, this has not been re-established. The Government's Development Cooperation Forum and proposed working group of development partners effectively have replaced the Consultative Group mechanism and are more in line with Paris Accord principles of development cooperation. A separate informal Partnership Group on Aid-Effectiveness (PGAE) was established for Myanmar by a group of major bilateral donors.<sup>10)</sup> This group acts as a forum for increasing aid effectiveness in Myanmar

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10) Myanmar Donor Profiles, March 2012.

emphasizing principles of building on existing information where possible; building capacity of the Government to coordinate and deliver aid services; avoiding drawing skilled labor from the Government; prioritizing analysis and joint ownership; managing expectations about the speed with which development gains will occur; ensuring coordination between diplomatic, development, and security actors; building flexibility into engagement and programming; and engaging with all relevant donors including non-traditional donors. Chairmanship of PGAE rotates by consensus. The UN Resident Coordinator for Myanmar has a standing invitation to attend meetings as an observer and representatives of the World Bank Group and other international and regional organizations may be invited to attend meetings, as may a NGO liaison officer. Multi-donor trust funds established by PGAE members for Myanmar include the Multi-Donor Education Fund Phase 2 (2012-2016), Three Diseases Fund (2006-2012), Three Millennium Development Goal Fund (2012-2016), and the Livelihoods and Security Trust Fund (2009-2016).

Apart from technical support and informal coordination with these programs and other bilateral donor activities, the principal focus of IFI coordination in Myanmar at present is with each other on overlapping areas of their individual strategies, notably in financial system reform, public management, and macroeconomic policy support. The IMF and World Bank have established a Joint Managerial Action Plan for June 2013-May 2014 that details specific planned activities for close coordination during this period.<sup>11)</sup> Specific focus areas are: macroeconomic management policy advice and capacity building and structural reforms for a better investment climate, private sector development and social development.

### **Comments on the IFIs Roles in Myanmar's Transition and Implications for Potential Future Role in the DPRK**

#### *A Limited Presence is Better than None*

Throughout the sanctions era in Myanmar all three IFIs were able to maintain a limited engagement with economic technocrats, mainly under the auspices of the IMF Article IV Consultation mechanism and their Annual Meetings, where the Governor from Myanmar had a right to participate regardless of the location of the meetings and policies on visa restrictions imposed by some Member States on travel for senior Government officials. Because the DPRK is not a member of the IFIs as was Myanmar, it is not possible to replicate the Myanmar experience there. Nevertheless, one lesson from the Myanmar experience is that the benefits of even limited contacts in updating understandings of economic developments and Government policies, engaging in policy dialogue at a senior if not supreme level, and maintaining relations with mid-level technocrats were important in several respects. First, such engagement provided a platform on information and relationships on which it was possible to build rapidly when the Government proceeded with its process to approve a new Constitution and hold national elections and pursue a robust economic reform agenda. Second, it provided pro-reform elements within the Government encouragement and confidence in seeking to influence change from within the system in a difficult domestic and international political environment. And third, it enabled the international community to have a more realistic understanding of the economic dimension of the

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11) IMF Article IV Consultation Report 2012, Annex on Bank-Fund Collaboration, pg. 9.

country's circumstances and opportunities to meet development challenges. This was important input to strategic thinking about engagement policies to achieve political goals in relations with Myanmar on the part of various countries, which in fact adopted rather different engagement policies depending on their national values and interests.

#### *IFI Involvement in Political Initiatives*

World Bank involvement in the political dialogue process led by the UN Special Envoy for Myanmar under the Good Offices of the Secretary General was an unusual and perhaps unprecedented form of IFI involvement in an isolated and difficult country. This was a situation where consensus did not exist among concerned countries in the international community about what policies of engagement or sanctions would be most effective for inducing externally desired change in the country and where national interests at stake varied considerably. The invitation to seek World Bank inputs on economic assessment and development needs and the decision to add the prospect of development assistance to the political dialogue agenda placed the Bank in an awkward position vis-a-vis the Government of Myanmar and complicated its ability to maintain independent objectivity and abide by its Articles of Agreement to not take political considerations into account in its dealings with Members.

The DPRK poses a similar dilemma both for the international community and for the potential involvement of the IFI's in political processes aimed both to eliminate its nuclear program and to resolve the longstanding conflict on the Korean Peninsula with an eventual Peace accord and stable relations between the two Koreas. To date, there has been no direct involvement by any of the IFI's in the political process, although a senior World Bank economic official and IMF official participated in a workshop on economic issues facing the DPRK on the sidelines of a Northeast Asia Security Dialogue Conference in Tokyo in April 2006. The potential does exist for involving the IFIs in some form as part of a future diplomatic effort to re-start the stalled Six Party Talks process or enter into some new form of multi-lateral negotiations with the DPRK. Holding out the prospect of supporting IFI relations has also been a feature of political positions taken by some Government officials over the years as an inducement for DPRK to engage in serious political talks, but there is no evidence that this has had any effect on North Korean negotiating behavior. In light of the earlier experience with Myanmar, any such initiative should be carefully planned with advance consultation among concerned parties, including the DPRK Government, for IFI involvement to be helpful and in line with their missions and Articles of Agreement.

#### *The Critical Role of the IMF being in the Lead*

The IMF's role in Myanmar during the transition period has been particularly important both to anchor a meaningful economic reform process within the new Government and to build confidence in the international community of the sincerity of the Government's reform intentions and commitment to addressing longstanding issues of contention. For the DPRK, this is equally important, especially in light of the lack of any statistical reporting on national accounts or balance of payments, poor macroeconomic management capacity and rudimentary financial system not suited to an increasingly mixed economy with growing market activities of both households

and enterprises. In September 1997, the IMF did send a fact-finding mission to the DPRK at a time of economic crisis when it was willing to explore the potential for pursuing IFI relations, and this was a useful step. The DPRK did not follow-up at the time because of concerns about transparency requirements and conditionality associated with IMF membership, and while some informal visits were made to Washington in subsequent years, there has been no official IMF contact in the past decade. Looking ahead, it would be highly desirable that the IMF be given a lead role in engaging the DPRK on the same agenda of issues that it has been addressing in Myanmar, even before a membership process is politically feasible.

#### *Comparative Advantages of the World Bank and AsDB*

Both the World Bank and AsDB have comparative advantages in addressing structural issues in transition economies and in providing both knowledge and financial resources to support institutional changes needed, capacity building, and investments required for transition adjustments and stimulating economic growth. Their interim strategy activities in the post-sanctions period in Myanmar are good models for potential initial activities in the DPRK, concentrating on policy advice, data collection and analytical assessments to underpin policy dialogue and assistance programming in the medium-term; supporting institutional development through capacity building training and technical assistance; nurturing confidence in the civil service in implementing a demanding new workload of economic reform and development activities; building bridges to local communities and enterprises; and forming effective partnerships with other development partners. The World Bank's new mission definition and organizational strategy are also well aligned with its potential future role in the DPRK and national priorities to improve the livelihoods of ordinary North Koreans and expand trade and investment with other countries. Both development banks are potentially significant suppliers of investment capital for critically needed public infrastructure in the DPRK, especially in energy and transport, and in supporting agricultural development and social services targeted on the most impoverished segments of the population.

The World Bank Group also has an advantage in its integration of private sector support arms in its programming, both through the International Finance Corporation (IFC) and Multilateral Investment guarantee agency (MIGA). As the DPRK intends to establish a number of Special Enterprise Zones as part of its economic development strategy, both the IFC and MIGA could provide important support to both the Government and private investors.

One potential drawback for the AsDB in its potential future activities in the DPRK is fact that Russia is not a Member State of the AsDB. To the extent that future AsDB involvement in infrastructure projects might involve collaboration with Russia, special arrangements would need to be set in place.

#### *Political Aid, Humanitarian Aid and Development Aid*

Both Myanmar and the DPRK have experienced the dilemmas of balancing political aid with humanitarian aid and development assistance on the part of the international community as it has shaped engagement with these countries over the past 20 years. While the focus of international attention in Myanmar was on relinquishing military rule for democracy, inter-ethnic and religious

reconciliation, and reduction of human rights abuses, the focus in the DPRK has been on its nuclear, missile and conventional weapons threats both globally and locally. While Myanmar's poor and vulnerable populations suffered from a combination of Government aggression and neglect in different parts of the country, in the DPRK the famine of the mid-1990s affected large segments of the population, especially in urban and remote mountainous areas. Human rights abuses in the DPRK linked to the regime's social control policies and security apparatus have been receiving increasing attention in the international community, but political engagement is still primarily driven by the security agenda.

The question of how to integrate humanitarian aid with political aid has been one that neither the Myanmar nor DPRK experience has handled well. In the case of Myanmar, humanitarian aid was denied or severely limited for over a decade after the imposition of sanctions, further exacerbating a downward trend in human capital in the country driven largely by domestic policy of limiting social expenditures and closing universities. Humanitarian aid only was introduced in a meaningful way after 2000 and then was interpreted differently by different donors limiting its overall impact and cohesiveness. The IFIs played no significant role in this effort until the devastation of Cyclone Nargis when both the volume and quality of humanitarian aid increased dramatically and the IFI's played an important role in impact assessment and monitoring mitigation efforts and results.

In the DPRK case, the infusion of humanitarian aid in response to the famine of the mid-1990's did not lead to lasting impacts on donor relations with the Government and by the early 2000's had dwindled to near insignificance, swamped by the ongoing political standoff over the DPRK nuclear program and increasing willingness of major providers of humanitarian assistance, -- the U.S., Japan and (later) South Korea -- to curtail humanitarian aid in the absence of meaningful progress on the security agenda. While some humanitarian aid provided by NGOs and some European governments had elements of development assistance integrated in the activities, these have been modest and without significant traction. In the current environment of the DPRK, it is hard to see a potentially meaningful role for the IFI's in the humanitarian assistance agenda for the time being.

As attention shifts from purely humanitarian aid to incentives for economic reform and potential benefits of development assistance, the dynamics of the relationship of political aid and other forms of assistance may change in the DPRK as it did in Myanmar. In this case the potential role for the IFIs could be significant in the DPRK depending on strategy for integrating incentives and rewards political progress with genuinely useful assistance to address economic management and economic development needs. Calibration of IFI activities that would reinforce confidence in both political negotiations and economic transition processes would need to be given careful attention and be based in large part on incorporation of the principles of development effectiveness that are now being applied in Myanmar.

#### *Development Effectiveness and Aid Coordination*

Aid coordination and ensuring aid effectiveness in Myanmar's transition have been a major challenge. Part of the reason is weak Government administrative capacity and lack of understanding of how policies of donors and coordination modalities for development assistance have evolved since the late 1980's at the time of the last Consultative Group meeting for

Myanmar. Another factor is the rush of new donors, NGOs and potential private investors into Myanmar since the 2010 elections, with attendant risk of conflicting or overlapping programming objectives and conflicting advice on policies and priorities. In this environment, the IFI aid coordination role has been modest. Most important has been the IMF Article IV Consultation process and its lead role in assessing and advising on macroeconomic policy and formulating an agenda of core economic reforms linked to the Government's absorptive capacity in close collaboration with the Government and World Bank. Informal support for the Government's own efforts to set the development agenda and manage relations with the development assistance community is a useful role for the IFIs in the current situation, but one shared with advice and support being provided by the UN system and some bilateral donors. The World Bank's public expenditure review and analytical studies being sponsored by both the World Bank and AsDB are also important for future aid coordination by providing sound information-based frameworks to help guide development assistance programming for all development partners in the medium-term. Since Myanmar's transition process is still at an early stage, it is too early to assess the longer-term impact of the IFIs from both aid effectiveness and coordination perspectives. Further adjustments in the arrangements are likely.

The DPRK poses both some similarities and important differences in considering a potential future role for the IFIs in aid effectiveness and coordination. Like Myanmar, the DPRK has been isolated from international development assistance policies and practices that have been applied in other transition countries. The Government administrative apparatus is also not well suited at present for engaging on development coordination issues, as relations with both Governments and NGOs tend to be handled by separate counterpart organizational arrangements with little internal coordination across different parts of the bureaucracy. During the famine of the mid-1990's, when there was a high level of humanitarian aid flowing to the country, both an inter-agency government coordinating body and an informal coordination group of donors established by the UN functioned fairly successfully. Both were dismantled when humanitarian aid flows dwindled. While Myanmar is now fully committed to economic reform and opening up to the international community in new ways, the DPRK is resistant to pursuing a robust economic reform agenda and reluctant to open up, despite its desire to make improvements in economic management and to expand trade and investment with other countries.

In contemplating a potential future IFI role in the DPRK, it is likely that a combination of IFI and UN leadership will be needed to help establish and develop capacity for aid coordination and management. A multilateral rather than bilateral approach is more likely to be acceptable both to the Government and development partners than reliance on one or two leading bilateral relationships. If IFI relations begin with some commissioned activities under the auspices of a multilateral political negotiation process, then the IFIs can be expected to be looked to by all parties involved to provide information and technical support for effective coordination of these activities and efficient use of any resources that may be provided. This can also play an important role in trust building needed to advance the negotiation process. Beyond that, it is unlikely that as in Myanmar the DPRK process will evoke a rush of donors, NGOs and investors if there is a significant change in the policy for opening up and international political environment. Thus the challenges for aid coordination and effectiveness are likely to be very different, influenced less by competition among donors and more need for the IFIs and UN to provide frameworks for expanding development assistance involvement with appropriate safeguards

against various downside risks perceived by the donors.

### **Concluding Comments**

It is important to recognize the limitations of seeking to draw lessons from the IFI role in Myanmar's transition for the DPRK. One is the need to take into account South Korean interests in anything the IFIs do with North Korea and the various issues related to inter-Korean relations and stake that South Korea has in IFI relations with both countries. Another is the overriding preoccupation of the U.S. with the North Korean nuclear program and desire that any significant IFI involvement be linked to the process of achieving a resolution of the longstanding security threats on the Korean peninsula. Nevertheless, the constructive if limited role that the IFIs have been playing in Myanmar's transition is relevant to discussions of conceiving a possible way forward in meeting the challenges that the DPRK faces both in its own internal transition process and in reshaping its relations with the international community. If a new multilateral negotiation process gains traction in addressing the political and security challenges posed by the DPRK and also aims to help put the North Korean economy on a sustainable growth path and better integrated in the international economy, it may be possible and desirable to build a role for the IFIs that could contribute in a meaningful way. In any case, eventually developing a relationship and membership in the IFIs will be important for the DPRK as a visible and substantively significant part of the process of normalizing relations with the international community and creating an environment conducive to expanding foreign investment and trade necessary for its long-term economic success.



Presentation

# Vietnam's Economic Transition: Well Begun, Not Yet Done

**Deepak Mishra** |

(Lead Economist, World Bank)



## 베트남 체제전환 사례에서 본 국제협력의 필요성

계획경제중심에서 시장경제로의 전환과 극빈곤국에서 중양하위 수입국가로의 베트남 경제개혁은 한 세대만에 놀라운 성공을 이루었다. 이러한 전환은 어떤 경제적 위기나 정치적 내란 그리고 사회적 변동 없이도 실현가능한 유일한 사례이다. 이전 소비에트연방국이었던 많은 국가들은 순조로운 전환에 실패했는데 왜 베트남은 성공할 수 있었을까? 이 글은 시장중심개혁이 베트남의 고도성장과 일관된 경제성장을 성공으로 이끄는 주요한 역할을 했음을 밝힌다. 이러한 성공은 기본 서비스의 분야에서, 지역에 대한 접근, 그리고 인적자본과 사회공공기반시설에 대한 투자에 대한 평등주의적이며 분권화된 정책이 뒷받침되었다. 그리고 이는 베트남 리더십의 협력적 방식, 즉 새로운 아이디어에 대한 수용 및

진행 방식을 통한 생활수준의 향상, 빈곤의 경감, 그리고 큰 경제위기를 피하는 등 긍정적인 결과를 초래할 수 있었다. 특별히 5가지 요소로 정의할 수 있다: (a) 경제상태에서 거의 왜곡 없는 최소화된 불리한 초기조건, (b) 점진적으로 아래로부터 일어나는 개혁 과정, (c) 광범위한 정책 개혁과 올바른 유인구조, (d) 국내 개혁을 이끄는 외부지향적인 무역 및 투자정책, (e) 인적자본의 역할 부여, 기업가 활동, 그리고 당-국가 시스템이 바로 그것이다. 그러나 베트남의 개혁은 계속 진행되고 있다. 중간소득국가로 올라선 베트남은 더 효율적인 경제와 생산적인 사회를 창조하기 위해 시장의 힘과 국가간의 촉진 역할을 활용할 수 있는 새로운 방법을 모색하고 있다.

## Vietnam's Economic Transition: Well Begun, Not Yet Done

Vietnam's economic transition from a centrally planned economy to a market economy and from an extremely poor country to a lower-middle-income country within one generation is a remarkable achievement. The fact that this transition was realized without the country experiencing any economic crisis, political infighting and social upheaval makes it quite unique. Why did Vietnam succeed, when so many other countries from the former Soviet Union failed to achieve a smooth transition? This paper argues that market-based reforms to promote high and sustained economic growth were critical to Vietnam's success, supported by egalitarian and decentralized policies in provision of basic services, access to land, and investments in human capital and infrastructure. The cooperative way in which new ideas were processed and accepted by the Vietnamese leadership also explains why the country was so

successful at raising living standards, reducing poverty and avoiding major economic crises. Specifically, we identify five factors: (a) a less unfavorable initial condition with fewer distortions in its economy; (b) a gradual and bottom-up reform process; (c) getting the broad policy reforms and incentive structure right; (d) embracing outward-oriented trade and investment policies to steer domestic reforms; and (e) the enabling role of human capital, entrepreneurship, and the party-state system. But Vietnam's transition is ongoing: after becoming a lower middle income country, it is exploring ways to use the power of the market and the facilitating role of the state to chart a new course to create a more efficient economy and a more productive society.

## I. THE CONTEXT

**1. Vietnam's transition to a market economy has transformed the country and the lives of its people.** In 1986, Vietnam launched *Đổi Mới*—a homegrown, political and economic renewal campaign—that marked the beginning of its transition from a centrally planned economy to a socialist-oriented market economy. At that time, Vietnam was one of the poorest countries in the world, and with many problems: hyperinflation, famine, drastic cuts in Soviet aid, and a trade embargo by the west.<sup>1)</sup> For most Vietnamese, life was harsh and the future looked bleak. When measured against this backdrop, the economic performance of the last two and half-decades has been impressive. Between 1990 and 2012, Vietnam's economy has grown at an annual average rate of 7.1 percent, and the per capita income quintupled. The rapid expansion of the economy has been accompanied by high levels of growth of international trade; large-scale inflows of foreign direct investment; a dramatic reduction in poverty; and almost universal access to primary education, health care, and life-sustaining infrastructure such as paved roads, electricity, piped water, and housing. Vietnam's economic transition—from a centrally planned economy to a market economy and from an extremely poor country to a lower-middle-income country in less than 20 years—is now studied as a successful case study of transition among developing countries.<sup>2)</sup>

**2. While Vietnam's transition process has many distinctive features—influenced by its own history and politics—it shares some common features with other successful transitional countries.<sup>3)</sup>** With hindsight it is clear that market-based reforms to promote high and sustained economic growth were critical to Vietnam's success, supported by egalitarian and decentralized policies in provision of basic services, access to land, and investments in human capital and infrastructure. Unlike countries in the former Soviet Union, Vietnam did not experience any sharp drop in output nor did it experience any internal coups, political purges or open infighting. The unusually smooth transition process of Vietnam has been attributed to a number of factors, five of which are discussed here: (a) a less unfavorable initial condition with fewer distortions in its economy; (b) a gradual and bottom-up reform process; (c) getting the broad policy reforms and incentive structure right; (d) embracing outward-oriented trade and investment policies to steer domestic reforms; and (e) the enabling role of human capital, entrepreneurship, and the party-state system.

**3. Vietnam's success has created new challenges, prolonging its transition process.** Rapid structural transformation and ongoing transition to a market economy has revealed new structural problems. In recent years Vietnam has experienced bouts of macroeconomic turbulence including double-digit inflation, depreciating currency, capital flight, and loss of international reserves. The quality and sustainability of growth is another source of concern, given the declining productivity, depleting natural resources and the deleterious impact on the environment. The country also faces many new social challenges: vulnerability is increasing, poverty is becoming concentrated among

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1) With a per capita gross domestic product of US\$98 (in current U.S. dollars), Vietnam was indeed the poorest country in the world in 1990. The next two countries with the second- and third-lowest per capita income were Somalia (US\$139) and Sierra Leone (US\$163). In terms of per capita gross domestic product adjusted for purchasing power parity, Vietnam was among the 20 poorest countries in the world.

2) See, for example, Growth Commission (2009).

3) According to Rama (2009), the renovation process of Vietnam was neither an outright imitation of any prepackaged economic model from the west nor did it involve heavy outside influences. Yet, Vietnamese leaders were certainly observing the reform experience of several former Soviet Union countries, sometimes with concern, and were eagerly learning lessons from successful East Asian countries.

ethnic minorities, inequality in incomes and opportunities are rising, underpinned by continuing disparities in human development between urban and rural areas as well as widening disparities within rural areas and across different socioeconomic groups and the pace of job creation is slowing. But it would be wrong to use these problems as an excuse not to transition from a centrally planned economy, because these are part and parcel of a journey to a market-based economy.

**4. The rest of the paper is organized as follows.** Section II discusses the factors that have contributed to Vietnam's success. Section III explores the emerging challenges. Section IV concludes with the key lessons for other transitional countries.

## II. FACTORS UNDERPINNING THE INITIAL SUCCESS

**5. Vietnam's transition to a market economy has been subject to much research.** During the last two decades, numerous books and reports have been written documenting Vietnam's transition to a market economy. Many multilateral organizations have commissioned reports and several national and international scholars have written on the topic.<sup>4)</sup> The discussion in this section draws lessons from past success to inform future debate, and is not meant to be an exhaustive exploration of factors explaining Vietnam's transitional success.<sup>5)</sup>

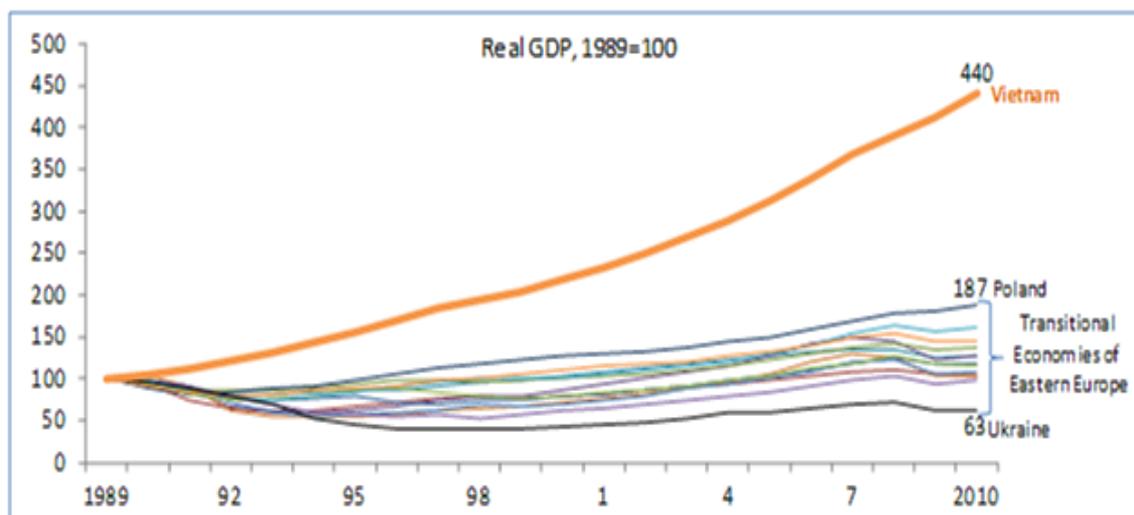
**6. Vietnam stands out as a clear success story among the transitional economies.** The transition in Eastern Europe proved to be a complex and problematic process, with recurrent economic crises, involving some combination of factors including falling output, declining average incomes, sharp increases in poverty, rising mortality and falling birthrates, and rapid inflation (figure 1) (World Bank 2002). However, Vietnam also experienced high rates of economic growth, rising investment, vigorous exports, and a sharp drop in inflation, with a program of limited and gradual reform. Moreover, the changes in Vietnam occurred in the context of the continuation of single-party rule, high levels of state intervention, and significant direct control of production through the SOEs. Why did Vietnam succeed while so many other countries failed?

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4) See the list of references at the end of the report.

5) For more comprehensive discussion on transition, see Arkadie and Mallon (2003), IMF (1996) and ADB (2006).

Figure 1 Vietnam's Output Performance Relative to other Transitional Economies



Sources: WDI 2010; <http://www.databasece.com/en/gdp-during-transition>; WB estimates.

## II.A Different Initial Conditions

7. At the start of its transition, Vietnam was the poorest and the least industrialized of all the transitional countries—which in hindsight seems to be an advantage.<sup>6)</sup> Its economy was never subjected to the same level of effective centralized control as in the Former Soviet Union and Eastern European transitional economies (Arkadie and Mallon (2003). For example, the list of commodities allocated under plans was always limited compared to the Soviet material balance system. Similarly, the SOE sector in Vietnam accounted for a small part of nonagriculture production, 29 percent, and an even smaller part of employment, 16 percent, unlike other transitional economies where the share of SOEs in total output was 75 to 95 percent (IMF 1996). While the transitional economies of Eastern Europe had achieved a higher level of industrialization under the central planning system with the development of heavy industry, much of the existing capital stock was found to be uncompetitive. Thus, while Vietnam could continue to use a large part of its pre-transition capital, other transitional countries often had to rebuild new capital stock, thereby experiencing a significant drop in output, primarily in the industrial sector, in the initial years.<sup>7),8)</sup>

8. Another important feature was the relative importance of the rural sector and the dominant role of household units in Vietnam's agriculture production. Arkadie and Mallon (2003), Lin (2010), and others have argued that Vietnam, like China, was largely an agrarian economy at the time of transition, so its production structure was broadly consistent with its comparative advantage. Therefore, when Vietnam opened its economy to domestic and external competition,

6) Given our focus on Vietnam, there is much about other transition countries that may have been neglected here. For example, the former Yugoslavia broke into five (now seven) different countries and had a war. The Soviet Union broke into 15 countries, each of which had to establish new sets of political institutions and legal frameworks. Some borders remain in dispute to this day. There were wars in Caucuses and Tajikistan. Czechoslovakia broke into two separate countries. The need to establish new political institutions and legal frameworks, dealing with international and domestic security, and addressing the collapse of the socialist trading system and soviet aid must have posed massive challenges, much of which Vietnam was spared.

7) Critics have argued, however, that such an interpretation assumes that the problem was simply an overgrowth of the state sector and wrong investment in large capital-intensive projects. This ignores the deeper incentive problems associated with central planning and direct state involvement in production.

8) A possible variant of this hypothesis can be that it was sheer desperation—famine, hyperinflation, little or no aid—that pushed Vietnam's government to reform. In a humorous vein, some call this period reform by the PhDs—the poor, the hungry, and the driven.

its agricultural sector responded vigorously to changes that incentivized agriculture—offsetting any contraction in the industrial sector. For example, Party Resolution No. 10, passed in 1988, provided farmers with property rights (albeit limited), which the Party Secretary-General, Do Muoi, argued was a turning point in agricultural development (see Box 1). The limited property rights, along with price and trade reforms, contributed to sustaining agricultural growth, generated the surplus necessary to diversify into nonagricultural sectors, and strengthened the resilience of the economy.<sup>9)</sup>

Box 1: Vietnam’s land reform was key to its agricultural success

The Land Law of 1993 marked the continuation of a program of agriculture reforms that were initiated in 1988 with the implementation of Resolution 10. Resolution 10 radically changed the incentive system in the rural sector by recognizing, for the first time, that the household was the basic production unit of Vietnam’s agrarian economy and granting it the needed autonomy. With the aim of consolidating these changes, the 1993 Land Law granted households five basic rights: to transfer, exchange, inherit, rent, and mortgage their land. The law also extended the lease term to twenty years for annual crop land and fifty years for perennial crop land. The implementation of this law resulted in an extensive land titling program in Vietnam. In terms of scale and speed of implementation, it was one of the largest rural titling programs in the developing world (Iyer and Do, 2008). Resolution 10 and the Land Law of 1993 together played a crucial role in boosting agricultural growth in the 1990s, thus enabling Vietnam to turn around from a food deficit country in the 1980s to one of the world’s largest rice exporters by the end of the 2000s.

Source: Well Begun, Not Yet Done: Remarkable Progress on Poverty Reduction and the Emerging Challenges, The World Bank, June 2012.

## II.B A Bottom-up, Gradualist Approach

**9. Reform in Vietnam, certainly in its early stages, was bottom-up and gradual, focusing heavily on productive units.** The incremental process meant that at each step the effectiveness of new institutions and policies were tested and adjusted to Vietnamese conditions. This process was particularly evident in the agricultural sector, which was subject to a continuous crisis in the years prior to the adoption of *Đổi Mới*.

**10. Agricultural reforms were inspired by the resistance of farmers in the Mekong Delta to collectivization after reunification.** Agrarian collectivization was an important part of socialist strategy. This was particularly true in the North, where the cooperatives were developed both as productive units and as providers of social services. The experience of the South, and in particular the Mekong Delta, was somewhat different. There were two successive waves of collectivization in the Mekong, in 1979–80 and then in the early 1980s, although collectives never played as decisive a role in the southern rural economy as they had in the North.<sup>10)</sup> As has been documented, many of the agricultural reforms were inspired by the resistance of

9) Other initial conditions that helped Vietnam avoid a sharp decline in output include the timing of natural resource (mainly oil) exploration, and its location in one of the most dynamic and fastest growing regions in the world.

10) Even in northern and central Vietnam, farm households were an important element of the production system.

farmers in the Mekong Delta to collectivization after reunification. In particular, it relates to farmers' refusal to grow rice beyond the need to satisfy their household requirements. Some senior policy makers witnessed the benefits of household farming and later formulated policies to encourage similar changes throughout the country (Dixon 2003; Rama 2009; also see Box 2).<sup>11)</sup> They decollectivized agriculture, established

Box 2: Reforms started in the communes and then spread to the entire country

Market-based reforms in agriculture (dubbed as “fence breaking” experiments) involved the local party officials allocating land to farmers and then directly contracting with them to buy the produce at prices above those set by the plan.

In the late 1970s, villagers in the North were struggling to make ends meet. Many of those in Doan Xa commune had chosen to migrate to the nearby city of Haiphong and become beggars. In 1979, some of those remaining in the commune argued that it was necessary to farm out the land to individual households. The proposition was put to vote and supported by nine out of ten local party leaders from the commune. But the inhabitants of Doan Xa also agreed not to leave any paper trail of this decision, swearing secrecy and mutual support if the authorities were to discover the “sneak contract.” The result was a six-fold increase in crop volume and a dramatic improvement in living standards.

News of this development soon reached the Party leadership at the district level, and a team of investigators was sent to the commune. The initial reaction was not to renew the Party membership of the local leaders. But gradually, information about this experiment spread, and Doan Xa became a model for the entire district.

By 1980 the Party Secretary of Haiphong, Mr. Bùi Quang Tạo, had not only extended the contracting approach to the entire province: he also vowed to lobby the Party Central Committee so that the approach could be scaled up nationwide. Knowing that Mr. Trường Chinh, the President of Vietnam, would be reluctant to endorse farming contracts, he first exposed the “spontaneous” farming out process to Mr. Lê Duẩn, who had the reputation of being practical. Mr. Lê Duẩn soon visited the province to assess the situation in person; he was enthused by what he saw. Shortly after, Prime Minister Mr. Phạm Văn Đồng visited in turn and expressed sympathy for the difficulties the villagers had faced. By the time the Haiphong leadership could finally expose the situation to Mr. Trường Chinh, he did not make any comment. This time nobody was disciplined, and by 1981 the Party Secretariat had officially endorsed the contracting approach for the entire country.

Source: Rama, Martin 2009. Making Difficult Choices: Vietnam in Transition. Working Paper No. 40, Commission of Growth and Development.

land-user rights, reduced the role of cooperatives, liberalized agricultural prices, and encouraged farmers to export—transforming the country from being chronically food deficient to the third-largest exporter of rice in two years.<sup>12)</sup> The disappearance of food rationing became the

11) It has been reported that Mr. Do Muoi, the Deputy Prime Minister responsible for unification, came from Hanoi to visit the farmers and told them that what they had done was correct (Howie 2011).

12) Others, however, have cautioned against bottom-up learning, arguing that “references to grass-roots communities are better translated as references to the base of an apparatus,” see Florde (2009).

first tangible success of economic reform in Vietnam. It helped build support for doing away with the subsidy mechanism and letting goods and services flow freely.

**11. Another example of step-by-step reform can be seen in the development of market institutions.** Unlike many other transitional countries, Vietnam did not entirely do away with its pre-reform economic institutions and structures, but rather adapted and reoriented them to changing times. Instead of complete destruction of old institutions as a prelude to the installation of new mechanisms, many reforms were directed at making existing institutions work better, while gradually introducing new market institutions. It is, therefore, not an accident that, among the economies closely linked to the Former Soviet Union, Vietnam was unique for its swift adjustment with the least output disruptions (Dollar 1999).<sup>13)</sup>

### **ILC Policy Reforms and Incentive Structure**

**12. Perhaps the most fundamental change during the first few years of its transition is the slew of policy changes** aimed at raising the efficiency of the enterprise sector, boosting production in agriculture, opening the economy to foreign trade and investment, and reforming the government. Several of the key policy changes in each of these areas include (ADB 2006; IMF 1996):

- *Liberalizing prices, exchange rate and trade:* (a) Liberalizing most industrial prices by the end of 1988, and the few remaining prices that were controlled for official (state) customers, such as those of cement, steel, and electricity, were generally set close to free-market values; (b) devaluing the official exchange rate and aligning it closely to the rate in the parallel market; (c) eliminating export subsidies; (d) allowing retention of foreign currency earnings; (e) liberalizing trade, in particular by allowing production enterprises to trade directly abroad, thereby dismantling the tight and bureaucratic grip of the trading companies; (g) creating export processing zones and industrial parks; and (vi) abolishing internal customs checkpoints (ADB 2006; IMF 1996).
- *Permitting private businesses.* (a) Reducing restrictions on private enterprises; (b) allowing private sector enterprises equal access to credit and creating a legal framework more supportive of their operation (see box 3); (c) subjecting all enterprises to uniform rules of taxation; (d) allowing all enterprises to establish direct trade links or to use trade companies of their own choice rather than a specific trade channel; (e) exposing all enterprises to foreign competition by liberalizing the import regime; and (f) decollectivizing agriculture and establishing land-use rights.

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<sup>13)</sup> Critics of the gradualist approach to reforms have depicted it as a reflection of a limited understanding of the market, reinforced by inefficiency, corruption, internal opposition, lack of human resources, and the “trial and error” or “groping” approach followed by the government.

Box 3: Enterprise Law was key to unleashing private entrepreneurship in the country

A series of additional policy reforms outside the agriculture sector helped to lay the foundations for rapid development of the private sector, whose role was officially recognized by Vietnam's 1992 Constitution. The most important milestone in the process was the Enterprise Law of January 2000. It represented a radical change in approach compared to the preceding Private Enterprise Law and Company Law, both of which were approved in 1990. Private enterprises were allowed to operate prior to 2000, but subjected to a series of government approvals and controls. With the introduction of the new Enterprise Law, citizens were allowed to establish and operate private businesses with limited intervention from government officials. The most important innovation introduced by the Enterprise Law was the simplification of registration procedures and the associated elimination of a large number of business licenses, which sharply reduced transaction costs for businesses and helped to install greater business confidence. As a result of these reforms, the number of registered enterprises increased by almost 15 times within a time span of only 10 years, from 31,000 in 2000 to 460,000 in 2009, according to the Ministry of Planning and Investment (MPI).

Source: Well Begun, Not Yet Done: Remarkable Progress on Poverty Reduction and the Emerging Challenges, The World Bank, June 2012.

- *Reforming the state-owned enterprises:* (a) Replacing central planning powers with substantial state enterprise autonomy; (b) giving enterprises the authority to set most prices, select appropriate mixes of inputs and outputs, and determine their own investment; (c) giving managers the right to lay off excess workers based on prescribed guidelines; (d) allowing enterprises the freedom to sell their excess production (beyond a centrally planned amount) at market prices for all outputs; and (e) imposing hard budget constraints on SOEs. A cash compensation program was also set up for redundant workers from SOEs.
- *Labor market liberalization.* (a) Reducing restrictions on the mobility of labor enabled underemployed people in rural areas to move to new jobs in urban and peri-urban areas; and (b) successive modifications to the labor code formalized labor hiring practices and eliminated obstacles to free labor mobility.

**13. Many of these policies, though incomplete and partial, provided the basis for a non-state sector to emerge and to respond to market-based incentives.** Vietnam's physical and human capital was underused as a result of controlled prices and an incentive system that discouraged more production. By liberalizing prices and instituting an incentive system, the market economy succeeded where central planning had failed.

#### **II.D Using External Trade Agreements to Shape Domestic Reforms<sup>14)</sup>**

**14. The commitments undertaken by Vietnam in a number of regional and multilateral trade agreements provided a considerable boost to domestic reforms during the transition period.** Vietnam signed a slew of trade agreements to signal its intention to play by the international

14) This section draws on a background note prepared by the EU-funded MUTRAP III project

rules including the Association of Southeast Asian Nations (ASEAN) Free Trade Area (FTA) in 1995 (including ASEAN FTAs with Australia, China, India, Japan, the Republic of Korea, and New Zealand); Bilateral Trade Agreements with the United States in 2000 and with Japan in 2008; and becoming a member of the World Trade Organization (WTO) in 2007. Some of the benefits of trade liberalization include (a) a predictable and transparent regime for international trade, (b) a substantial reduction of tariffs for domestic manufacturers and exporters, (c) elimination of all export subsidies considered illegal by the WTO, and (d) liberalization of services such as banking, distribution, construction, health care, tourism, insurance, and business services (auditing, legal, information technology, and research and development) (CIEM 2010).

**15. Trade liberalization has had a huge positive impact on Vietnam's economy.** Some of the visible benefits of trade liberalization include a significant boost to foreign direct investment, a resilient export sector, lower prices, and improved quality of goods and services. Bilateral trade agreements and WTO commitments have led Vietnam to introduce important modifications in its institutional and administrative systems. For example, as part of its WTO commitments, Vietnam publishes an official journal of all the laws, regulations, and administrative procedures of general application before enforcing them. Moreover, the full texts of the legal acts are posted on a government website at least 60 days prior to approval so agencies, organizations, and individuals can submit comments. A study conducted by the Multilateral Trade Assistance Project concluded that the impact of ASEAN, plus liberalization on almost all the main trade and economic indicators, will be largely positive.

#### **II.E Role of Human Capital, Entrepreneurship, and the Party-State System**

**16. Vietnam's transition to a market economy reduced the barriers to the adoption of existing knowledge,** which, along with improved incentives and increased competition, is crucial in explaining the rapid improvements in economic performance over the last two decades (Arkadie and Mallon 2003). Vietnam's ability to rapidly exploit existing knowledge was aided by solid performance in promoting literacy, numeracy, and broader human development in the pre-reform period. In fact, at the beginning of the reform period, Vietnam had much higher literacy rates, life expectancy, and education than most other countries with similar levels of per capita income. The strong human capital base was complemented by the energy, liveliness, and entrepreneurial skills of the population and the quality of Vietnamese workforce.

**17. Some economic historians have argued that the Vietnamese party-state system played an important role in the country's smooth transition** (Dixon 2003). The pre-reform period party-state bureaucracy was a complex system that connected the central state to all elements of society, extending through many layers to the workplace and small community groupings. These systems enabled decrees, quotas, and policies to be transmitted through the systems and were extremely effective in mobilizing people and organizations at all levels. It is apparent that at all levels, considerable administrative and organizational capacity existed, which explains Vietnam's remarkable achievements in terms of such measures as literacy rates, life expectancy, and infant mortality rates even before the onset of the transition. Therefore, Vietnam entered the reform period with the ability to focus on long-term national goals, and with considerable administrative,

managerial, and implementation capacity, which contributed to its initial success.<sup>15)</sup> But as discussed later, with the expanding private sector, the party-state system has found it increasingly difficult to attract and retain talent—causing gradual erosion of its administrative and management capacity.

### III. EMERGING CHALLENGES AND LESSONS WITH HINDSIGHT

**18. Vietnam’s economy has grown so rapidly in recent years that it is easy to overlook some of its lingering challenges.** In a span of five years, between 2003 and 2012, Vietnam’s economy more than doubled from US\$40 billion to US\$[135] billion, and its exports more than tripled from US\$20 billion to US\$[96] billion. This period also saw booming investment, thriving stock market, escalating real estate prices and rising prosperity all around. It is therefore easy to overlook that this period also coincided with declining contribution of productivity to growth, increased macroeconomic instability, fragmented development and inability of public institutions to keep pace with a rapidly globalizing economy. The origin of some of these problems can trace their roots to the pace and sequence of the reform process and therefore can provide important lessons to countries that are about to attempt similar transition and therefore avoid costly mistakes. Vietnam’s experience shows that mechanisms underlying Doi Moi may be well-suited to support the transition from plan to market but less so in addressing new challenges. We discuss two such challenges here: decentralization without proper accountability and emergence of special interest groups.

**19. Vietnam has historically been a highly decentralized economy.** It has a long tradition of relative autonomy of village and communities in managing their local economies. This practice was also consistent with the immediate requirement of war-time economy. And decentralization has had many virtues. It was the high degree of practical autonomy that led Vietnam to avoid the gigantism of Soviet-style industrialization. In recent years, decentralization has been responsible for more inclusive development and healthy inter-provincial competition.

**20. Yet decentralization without proper accountability could result in fragmented and sub-optimal development outcomes.** Common purpose and strong leadership had meant the local and national governments each contributed in their own ways to common national goals. But overtime Vietnam’s new economy has developed under a degree of independence from the central system (Probert and Young 1995, 520), where the center’s ability to direct activity toward national development goals and the means to establish the necessary institutional and regulatory framework for sustained growth has weakened. In combination, the reforms and the associated reduction in centralized control have promoted development within and closely connected to the SOEs, the local administrations, and subsectors of the centralized system. The resulting networks and localized “corporatism” have become major factors in economic change (Grabher and Stark 1998; Smart 1998). Thus, lower echelons of the state have emerged as a form of new business elite (Forsyth 1997, 245, 257). While the majority of the new economic elite may neither wish for nor be in a position to demand political change, they have had a significant impact on

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<sup>15)</sup> However, there are others—Fforde and de Vylder (1996) and Pike 2000, for example—who have suggested that post-1990 growth in Vietnam owed little to the state.

decision making and policy (Dixon 2003). The localization of development and control in Vietnam contrasts sharply with the highly centralized systems that characterized such economies as South Korea and Taiwan (China).<sup>16)</sup>

**21. The scope and pace of reforms have been influenced by differing views within the party and the state and the proliferation of interests.** These include such broad sections as the military, police, trades unions, women, regional and local administrations, SOEs, and the various ministries and departments. There have also been significant shifts in the importance of these groupings, notably the increased representation and influence of local administrations and technocrats (Fforde and Goldstone 1995, 105). The major divisions are also variously reinforced and divided by the proliferation of the new economic interests. The result is that there are fewer fixed positions, with, for many individuals and groupings, the attitude to reform reflecting particular measures rather than the process as a whole (Dixon 2003; Koh 2001, 537–38). The proliferation of interest groups and the nature of the Vietnamese legal and regulatory systems—which operate on the basis of what is permitted rather than what is not—has resulted in the production of an enormous volume of decrees, regulations, and legislation. The operation of the system has been further hindered by lack of professionals and technocrats at higher levels, the ones who provide the cores of the bureaucracies in such Asian developmental states as South Korea; Singapore; and Taiwan, China.

**22. The fragmentation of development has also been associated with the weakening of the quality of the country’s economic institutions.** The legacy of central planning sometimes weighs heavily on Vietnam’s economic institutions. Although markets are now the main mechanism of resource allocation, they often function poorly because the underlying institutions are missing, poorly formed, or incomplete. Its public and private sector economic institutions are highly fragmented. Fragmentation is a problem because it increases the costs of coordination, which can result in a loss of efficiency. A fragmented regulatory system generates conflicting rules. Fragmentation of public investment results in duplication and waste.

#### IV. CONCLUDING REMARKS

**23. Vietnam turned the crisis of the late-1980s into one of the greatest development successes of our time.** The country has shown itself to be remarkably adaptable and has made impressive progress during the initial transition years under extremely difficult conditions. It was the decision to embrace market-based reforms and to change the incentive structures to conform to market principles that played a critical role in its success. The cooperative way in which new ideas on economics were processed and accepted by the Vietnamese leadership over the last two and half decades may explain why the country was so successful at raising living standards, reducing poverty and avoiding major economic crises.

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16) Dapice (2008).

**24. Transition is, however, best viewed as a journey and not as a destination.** While it is easy to define Vietnam's initial point in its journey to becoming a market economy, there is unlikely to be a finish line. Even the most mature market economies must constantly change, update, and fine-tune their policies and institutions to keep up with the changing times. After becoming a lower middle income country, Vietnam is exploring ways to use the power of the market and the facilitating role of the state to chart a new course to create a more efficient economy and a more productive society. It is therefore redoubling its effort to develop new institutions, new incentive structures and a more transparent and open society to support the strong and healthy market economy that has already evolved. Vietnam is on course to embark on its next journey to develop a mature market economy that befits its status of a dynamic, emerging middle-income country in Asia. Such a journey is necessary, desirable and perhaps unavoidable.

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Presentation

# The Experience of Systemic Transition and Economic Development in Eastern Europe

**Piroska NAGY** |

(Director of Country Strategy and Policy, Office of the Chief Economist, EBRD)



# The Experience of Systemic Transition and Economic Development in Eastern Europe

IFES-Eximbank Conference  
Seoul, 19 November 2013

**Piroska M. Nagy**  
*Director for Country Strategy and Policy*  
*European Bank for Reconstruction and Development*

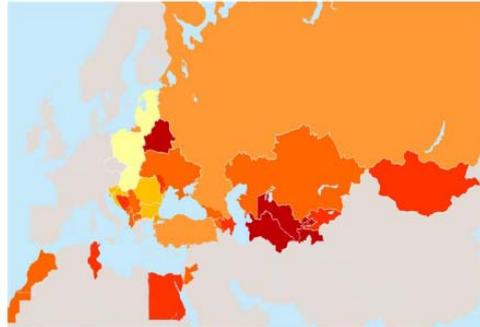
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## Overview

- **Successful private sector-led transition**, facilitated by capital inflows
- **Reliance on capital inflows have been beneficial** but came with vulnerabilities - needs to be managed
- **Institution-building is key**
  - Create an enabling environment for private sector investment
- **Risks of an "unfinished agenda": *Stuck in Transition***, Transition Report 2013

## Transition experience extremely diverse...

- In terms of approach:  
'Big Bang' vs. piecemeal/punctuated reform or little reform.
- In terms of outcome:  
Large variance in EBRD transition gap scores (see heatmap)
- In Central Europe similar outcomes  
Key role of EU as external anchor



Source: EBRD 2013.  
Darker colours correspond to larger transition gaps (lower overall progress in reform) across 16 sectors.

## ESTONIA: big bang + consistent reforms

- By 1992 (mostly before independence in Aug 1991): big bang
  - Subsidy cuts; Measures to rapidly develop a SME private sector; Elimination of price and wage controls; principles governing ownership; *independent* privatization agency; outward orientation: measures to encourage FDI; removal of all tariffs.
- *Sweeping and rapid* privatization through sale of majority ownership, mostly to foreign investors:
  - in 18 months from Q4 1993 50% of state owned enterprises privatized;
  - program complete by end-1997.
- Macroeconomic stabilization early on:
  - Currency board arrangement to DM in 1992 → inflation stabilization
  - No government support for failing banks → closure or FDI

## CZECH REPUBLIC: Reform in fits and starts



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- After unsuccessful start with mass privatisation, rapid agglomeration of shares; eventual sales, mostly to foreign owners;
  - By end-1995, 71% of privatizations completed
- Rapid tariff elimination;
  - December 1992 EU Associate membership
- Stepwise reduction in subsidies;
- After an initial protectionist stand in the financial sector and a subsequent financial crisis, major banking sector assets sold to foreigners; combined with tight monetary and wage policy.
  - Avoided typical transition hyperinflation

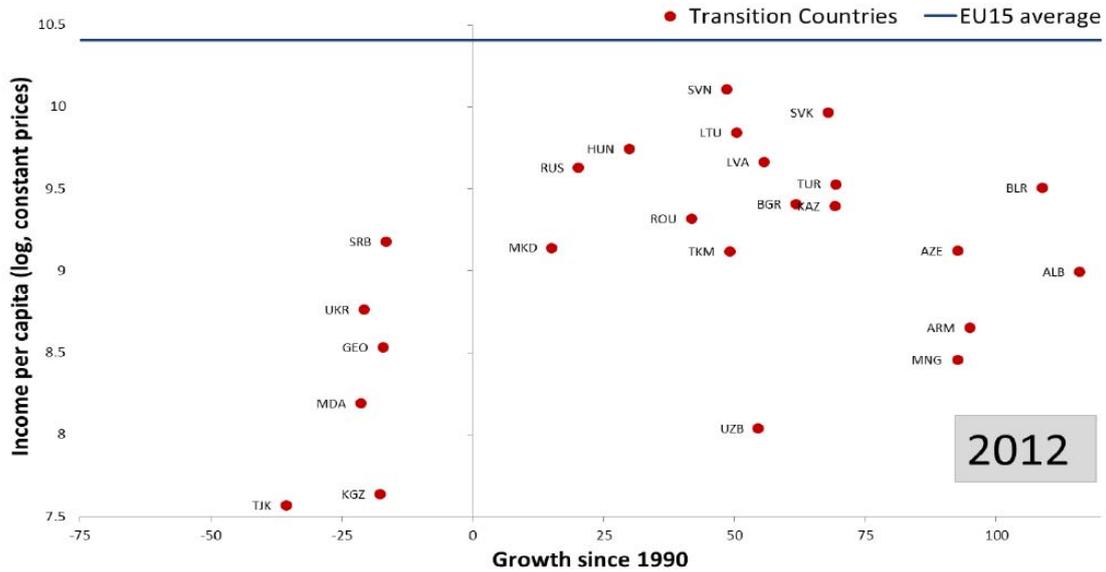
## TURKMENISTAN: very little reform



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- 75% of the economy remains public sector;
- Pervasive price controls despite some liberalization in petrol prices for individual consumption;
- Pervasive production targets and input subsidies in agricultural and industrial sector;
- Endemic directed lending at subsidized interest rates through state-controlled banking system;
- Some reforms have started recently.

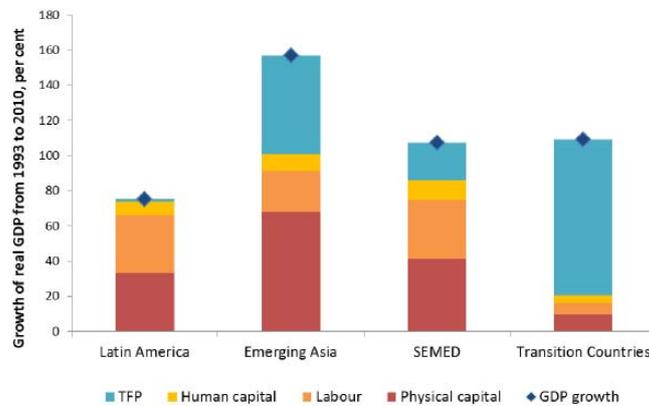
## 25 years of transition: after initial deep recessions, rapid income convergence



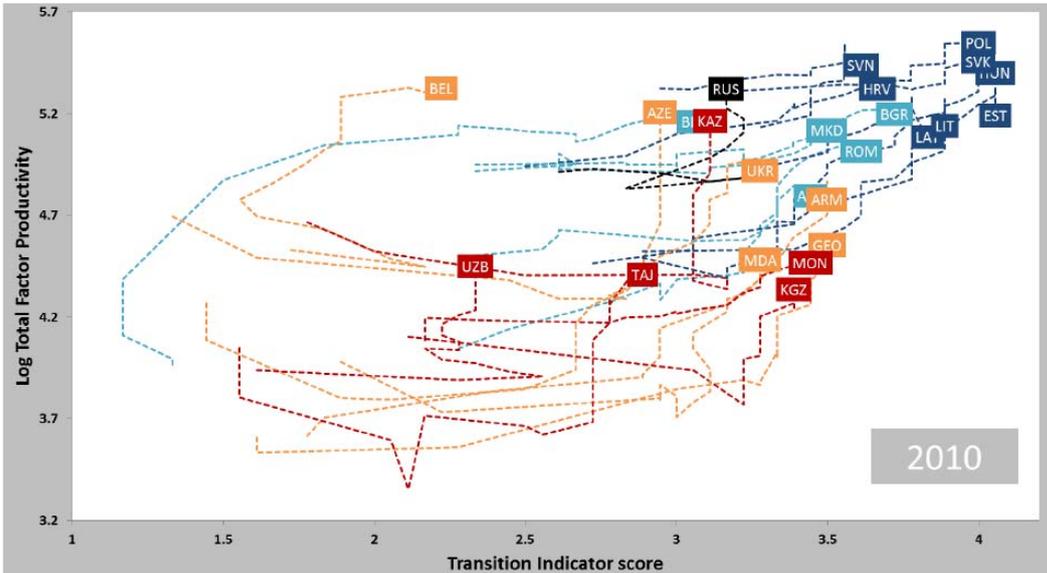
## Growth driven by improvements in TFP

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- Total factor productivity – efficiency with which K and L are employed - has been converging rapidly from the low levels under central planning
- While population growth has been slow, labour participation and (formal) education levels already high

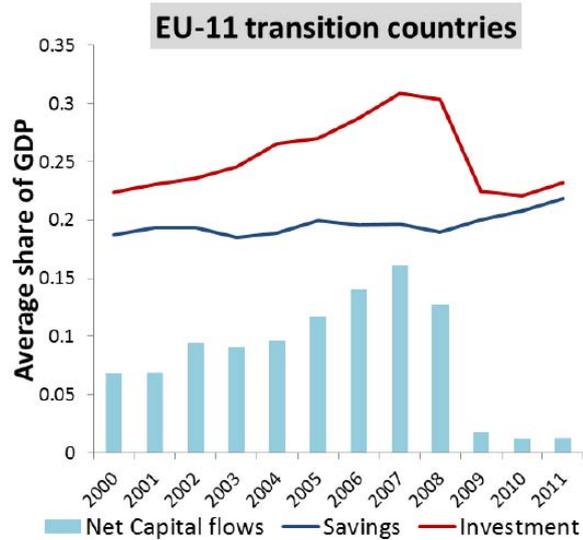


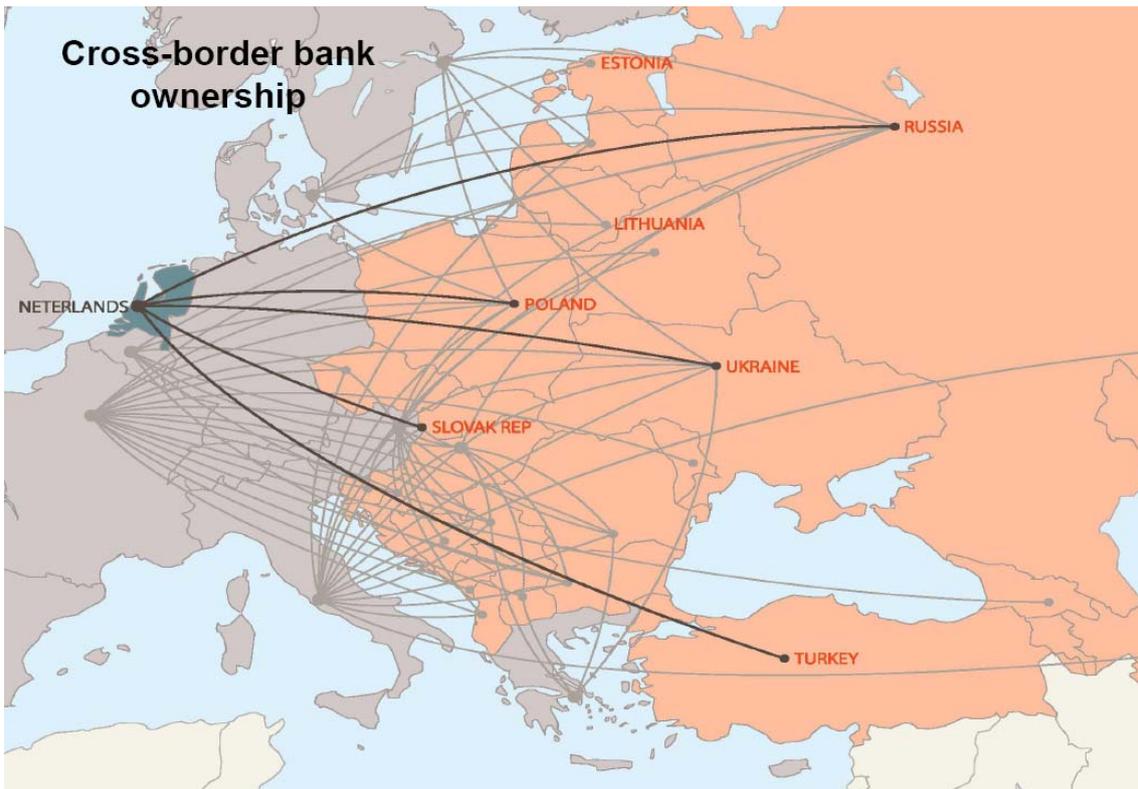
## Productivity growth clearly linked to reform...



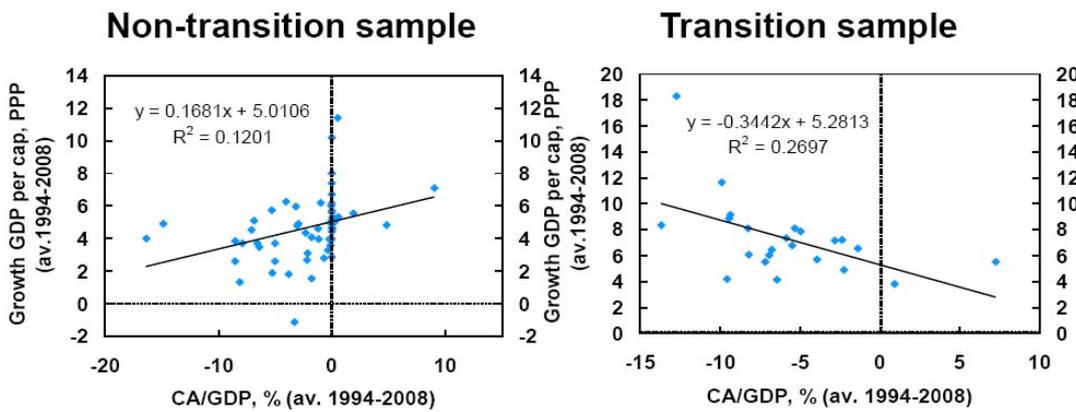
## Region relied on capital inflows

- Supported development, higher investment
- Often channelled through foreign banks
  - High foreign bank ownership
  - Complex links





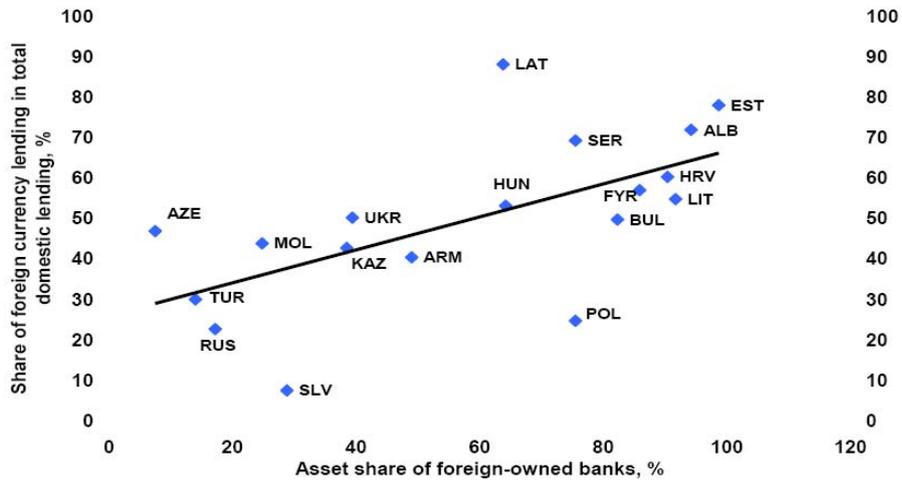
**Capital inflows drove growth in transition countries, unlike in other emerging countries**



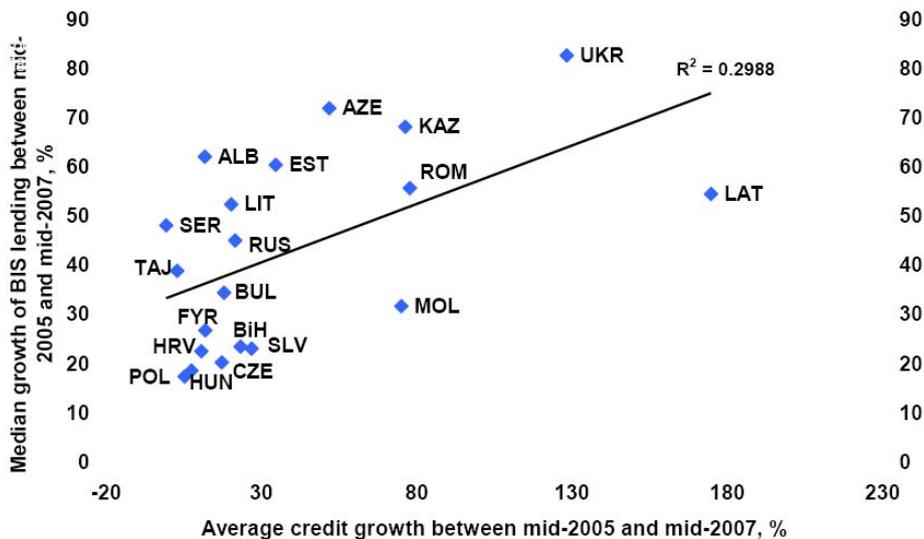
- Analysis suggests a **causal relationship**, due to deeper integration

## However, foreign finance led to FX lending...

... and capital inflows not only boosted investment but also reduced savings /fuelled consumption boom...



## ... credit booms, and external (over-)indebtedness

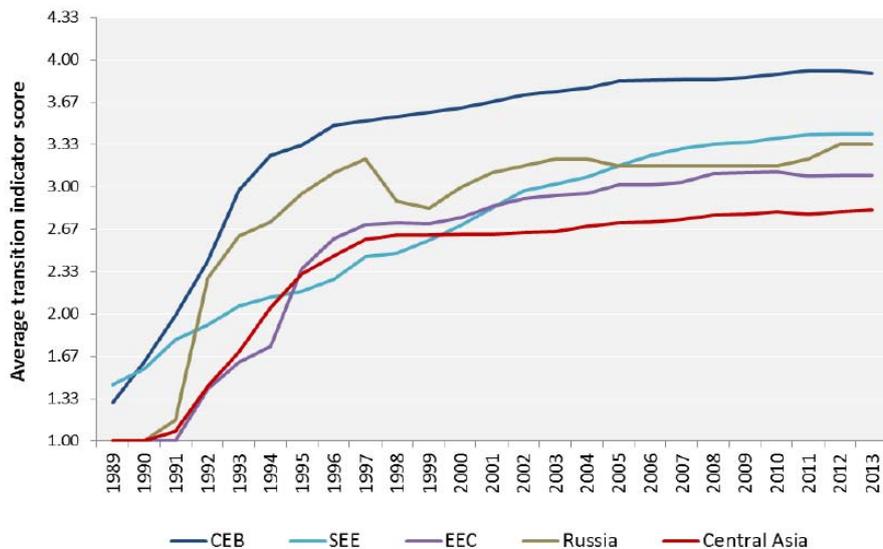


## Vulnerabilities from external finance need to be managed



- Stronger institutions
- More enabling business environment
- Diversification of sources of investment: building stronger links with Emerging Asia and other regions
- Continued structural reforms to support long-term growth

## New concern: reforms have stalled across the region



## Why do countries get “stuck” in transition?



- **Quality of economic and political institutions closely linked:**
  - Latter are hard to change
- **EU “pull” less effective, especially in advanced countries:**
  - Still a force for change in SEE, but weaker than before
- **Reforms → growth, but the reverse also true: low growth → low reform:**
  - Easier to reform when the economy is growing

## What does this mean for future growth?



Panel of 88 countries, 30 years

An augmented 4-equation neoclassical growth model:

**TFP** = f(Initial TFP, human capital, FDI, distance, political institutions)

**Savings** = f(demography, natural resources, financial openness)

**Investment** = f(initial capital, savings rate, FDI, political institutions)

**FDI** = f(initial GDP, trade and financial openness, law and order, share of services and manufacturing in GDP)

## Main results



- Strong negative relationship between initial levels of TFP and subsequent  $\Delta$ TFP (productivity catch-up)
- Quality of institutions (constraints on the executive) and the level of human capital important determinants of  $\Delta$ TFP
- A greater degree of trade and financial openness leads to larger inflows of FDI, which in turn results in a faster  $\Delta$ K but also faster  $\Delta$ TFP.

## Long-term scenarios: reform vs no-reform



### Scenario 1: No reform to political and economic institutions

- Major slowdown in convergence
- Convergence would stop in some countries (Croatia, Slovenia, Russia)

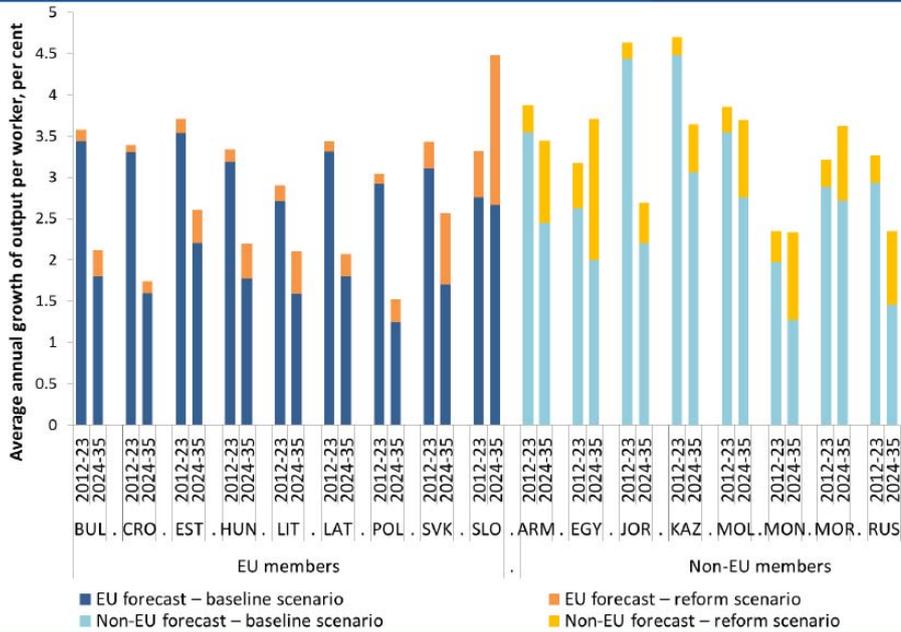
### Scenario 2: Economic and political reforms converge to highest current level in EU

- Convergence returns to all countries
- Some CEB countries would have 80 per cent of EU-15 average by 2035
- Higher impact in non-EU countries

# Reforms will have large impact on growth in countries with weaker institutions



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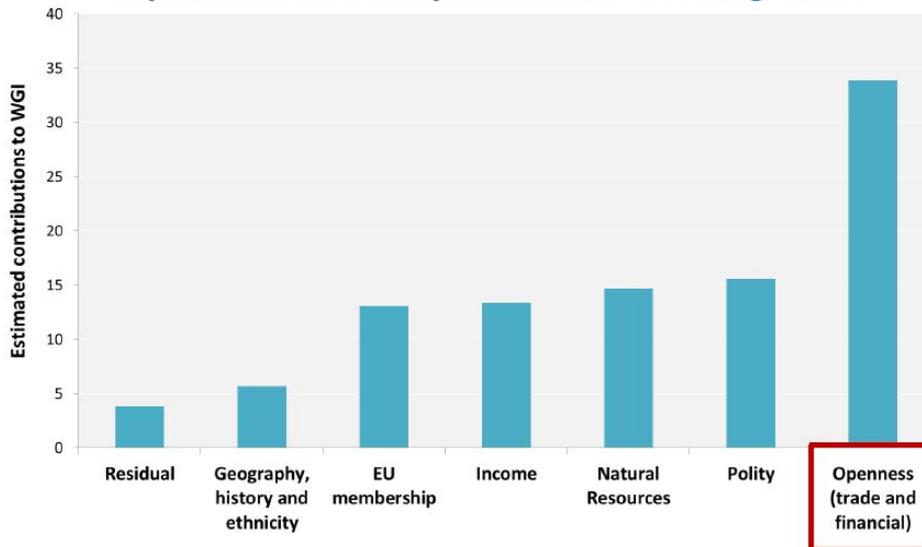
# What policies make reforms more likely?

October 2010

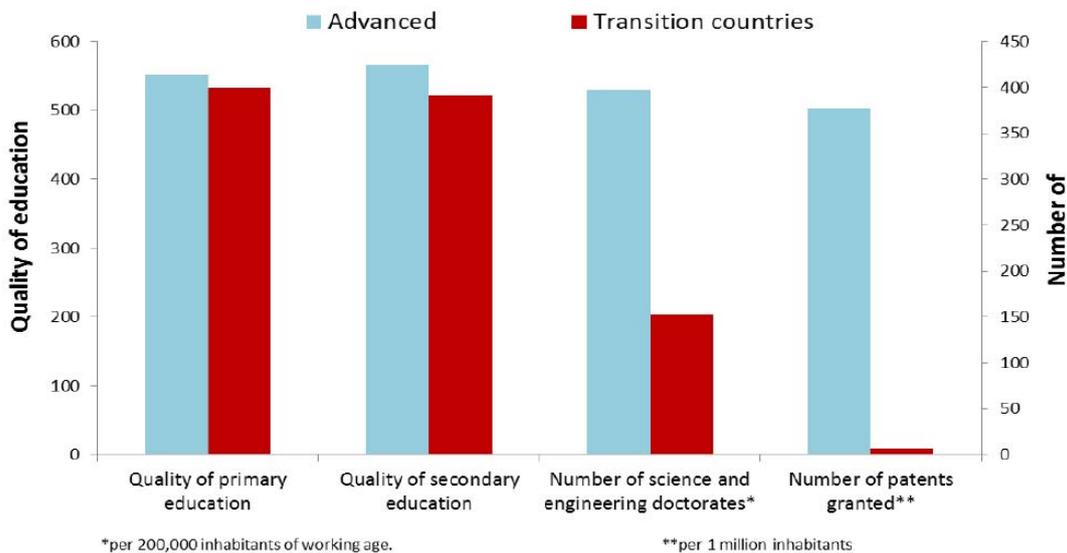


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## Openness and deep international integration



## Strong human capital, particularly in tertiary education



## Transition is as much an *economic* as a *political* process \*



- Contrary to conventional wisdom, political turnover has benefited reforms, while strong executives tended to deter them
  - Due to the influence of political and economic elites who profited from state subsidies, insider privatisation and weak enforcement of the rule of law in the absence of appropriate checks and balances
- Economic development makes democratisation more likely
- Market reforms appear to influence future democratisation – at least in the sense of preventing reversals to less democratic systems
  - This could be due to economic liberalisation weakening the power of interest groups who benefit from less democracy.

\* Transition Reports 2013 and 1999.

## Lessons from transition



- 1. Sequencing of reforms difficult but unavoidable**
  - Build constituencies through easy early “wins”
  - Partial liberalization often increases reform resistance
- 2. Appropriate sequencing can avoid reform fatigue**
  - Targeted social safety net softens the impact of subsidy cuts
  - Market-oriented training and low cost of starting a business
- 3. Institutional reform critical for liberalisation/privatisation**
  - Competent independent agencies
  - Critical for legitimacy that can sustain political support
- 4. State role needs reforming – support markets**

## Lessons from transition



- 5. Strong external anchor to avoid the transition-fatigue and/or political populism**
- 6. Capital flows supported growth and transition but associated risks need to be carefully managed**
  - Capital flows drove growth in Central and Eastern Europe, due to deeper integration
  - Overreliance leads to vulnerabilities, needs to be managed / minimised: role of local regulation
  - Challenge to find new sources of growth – structural reforms, human capital
- 7. Transition is as much an economic as a political process**
  - Build coalitions for reforms, checks-and-balances, and social safety net for the most vulnerable.

**Thank you for your attention!**

**European Bank for Reconstruction and  
Development: Supporting transition to  
market-based democracies**

***Transition is our business***

Presentation

# Promoting Regional Cooperation under GTI (Greater Tumen Initiative) framework

**CHANG Dohwan** |

(Program Advisor, UNDP GTI Secretariat)



# Promoting Regional Cooperation under GTI Framework

Chang Dohwan, Programme Advisor  
GTI Secretariat

International Cooperation for Enhancing In Northeast Asia  
and North Korea's Development  
November 2013



## 1. History of GTI

- 1. TRADP (1991-2005) :** Tumen River Area Development Programme
- 2. Greater Tumen Initiative (2006-current)** is a unique intergovernmental cooperation mechanism in NEA, supported by the United Nations Development Programme (UNDP),
- 3. GTI's Regional Coverage:**



China	Mongolia	Republic of Korea	Russian Federation
Northeastern provinces: - Heilongjiang - Inner Mongolia - Jilin - Liaoning	Eastern aimags (provinces): - Dornod - Khentii - Sukhbaatar	Eastern ports: - Busan - Sokcho - Ulsan - Pohang	Primorsky Territory Khabarovsk Territory



## 2. DPRK's Exit from GTI in 2009

- ✓ **When and how did they exit**
  - After UN Resolution to the 2<sup>nd</sup> Nuclear Weapon Test in 2009.
  - DPRK follow all detail exit procedure of Declaration of Agreement of GTI.
- ✓ **Why did DPRK exit?**
  - (Nominal) No tangible outcome of GTI
  - (Real) Counter measure by DPRK to UN Resolution
- ✓ **Did DPRK choose the GTI's Exit Card as counter measure to UN Resolution if GTI had made tangible outcomes?**
- ✓ **Why no tangible outcomes in GTI Cooperation till 2009**
  - Lack of Ownership of member countries
  - Insufficient Regional Development Demand in the Region



## 3. Dramatic Change of Economic Environment in Greater Tumen Region

- ✓ **ChangJiTu Development Plan (China, from 2009)**
  - Develop two industrial cities(Changchun-Jilin), Special Economic zones in border area and Construct a transportation corridor to Sea (Tumen River).
  - Previous Tumen Delta Region was highlighted.
- ✓ **Fareast and Siberia Development Strategy (Russia, from 2012)**
  - Biggest Country's biggest investment plan (290 billion \$)
  - Infrastructure development for energy export to ROK, China and Japan
- ✓ **Creative and Northern Economy (ROK from 2013)**
  - Only region underdeveloped (Blue Ocean to ROK Economy)
  - Increase potential growth rate of ROK Economy by 1% a year
- ✓ **Eastern Policy (Mongolia), Economic New Strategy (DPRK)**



## 4. GTI Revitalization

- ✓ **Political Leadership in member countries**
  - 2012 APEC Leaders Summit (Vladivostok)
  - Bilateral summit between ROK and China(June 2013) and ROK and Russia (November 2014)
  
- ✓ **ROK's Strong Effort**
  - Comprehensive Development Strategy of GTI for enhancing NEA Cooperation (Int'l Ministerial Meeting, Oct 2013)

*Ex) Internal Strategy, New proposals & initiatives for GTI Development, Increase ROK's supporting to GTI (budget and manpower)*
  
- ✓ **The 14<sup>th</sup> GTI Consultative Commission (Oct 2014)**
  - All members adopted all of ROK's Proposals as its major development plan

*Ex) Creating new cooperation areas in Agriculture, Policy Research Institutes and Business Sector*



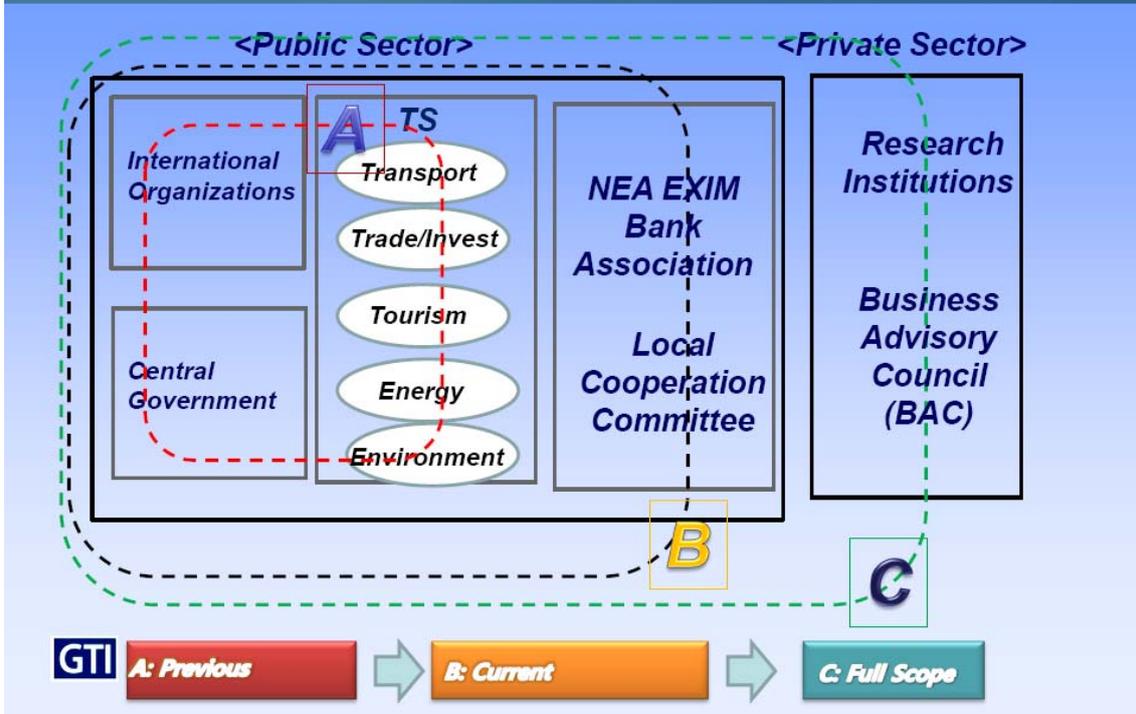
## 5. GTI 5 Priority Sectors and 3 Cooperation networks

•Transport	– Corridor Study / Rajin-Khasan Study Project
•Tourism	– Multi-destination Tourism / Visa Facilitation Study
•Trade & Investment	– Networking among Customs and Quarantine Officials and Experts – GTI Trade and Investment Expo
•Energy & Environment	– Revitalizing cooperation network among related bodies in NEA countries

•Exim Banks Association	– Financial Resource Mobilization Mechanism to Development Projects
• Biz Advisory Council	– Participation mechanism of the companies to the cooperation and projects
•Local Gov Cooperation	– Regional government (Province Governor Level)



## 6. Expansion of GTI Activities



## 7. Future Development of GTI

- ✓ **Critical Time and Strategic Position**
  - Strategic position in NEA Cooperation as the sole multilateral government cooperation platform
- ✓ **Post GTI and Legal Transition**
  - Develop the current GTI into Development-Oriented Organization by 2016
  - Independent International Organization with more Budget/Staffs and higher level of representatives
- ✓ **Pilot Projects (New Trend of Trilateral Cooperation with DPRK)**
  - Rajin-Khasan Railway and Harbor Component Project
  - Electricity and Transmission Projects (So call BalHae Project)
  - Highway and Railway project connect China-DPRK-ROK

## 8. GTI and DPRK

### ✓ Meaning of DPRK's Participation to GTI

- As most development projects in GTR are deeply connected with DPRK and its participation to the cooperation is essential for success of GTI activities.

### ✓ Prospects of DPRK's Re-joining to GTI

- GTI's efforts and DPRK's reaction
- Essential factor : tangible outcome of GTI activities, really beneficial for DPRK

### ✓ Benefit of DPRK to join Post GTI

- DPRK can utilize GTI as leverage for excess to Int'l Development Institutions (WB, ADB and other MDB) if GTI will be developed into MDB / Int'l Development Corporation / Guarantee Provider.



***Thank you!***

*Chang Dohwan  
Programme Advisor  
Tumen Secretariat/UNDP  
dohwan.chang@public.un.org.cn  
www.tumenprogramme.org*





Presentation

# Engaging China in International Development Cooperation: Implications for North Korea

**ZHOU Taidong** |

(Program Officer, The Asia Foundation)



## 국제개발협력에 대한 중국의 참여: 북한에 대한 함의

이 발표의 목적은 국제개발협력에 대한 중국의 참여 기회와 과제, 그리고 그것이 북한에 미치는 함의에 대해 연구하는 것이다. 이 발표는 4개의 장으로 구성되어 있다. 중국의 원조에 대한 개관은 중국외국원조의 평가, 재정 유형, 지원 크기, 주요 방식, 지리적 분포뿐만 아니라 경영 구조에 대한 것을 소개하는 것을 시작으로 한다. 그리고 기본원칙과 원조 조달 방식을 강조함으로써 중국의 원조방식이 서양에 원조국들과 어떻게 다른지를 이해할 수 있도록 하고자 한다. 세 번째 장에서는 국제개발협력에 대한 중국의 관여 기회, 최근 진행과정 그리고 과정에 대한

것을 탐구하고자 하였다. 마지막으로 네 번째 장에서는 북한에 대한 중국의 원조에 대해서 간략하게 짚어보고 초기 단계에서 다른 원조국들과 개발협력활동을 협력하고 조율하기 위한 몇 가지 권고사항을 제시하였다. 이 글에서는 국제개발협력에 대한 중국의 참여가 가능하지만, 또한 정치적 세심함과 전략적 개입 포인트가 필요함을 고려하였다. 정치와 큰 관계가 없는 이슈를 다루는 다자기관과 부문을 통한 간접접근 방법이 강하게 그리고 크게 환영 받을 수 있음도 밝혀두고자 한다.

## **Engaging China in International Development Cooperation: Implications for North Korea**

The purpose of the presentation is to explore the opportunities and challenges in engaging China in international development cooperation and its possible implications for assistance to North Korea (NK). The presentation consists of four parts. An overview of China's aid is given at the beginning to introduce the evolution of China's foreign aid, financial types, volume, major forms, sectoral and geographical distribution, as well as management structure. It then highlights some of the basic guiding principles and aid delivery approaches to facilitate understanding on how China's aid approaches differ from those of the Western established donors. The third section then explores the

opportunities, recent progresses, and challenges of engaging China in international development cooperation. The fourth section will briefly touch upon China's aid to NK and some initial recommendations for different donors to coordinate and cooperate their development assistance activities. The presenter considers that engaging China in development cooperation is possible but requires political sensitivity and strategic entry points. Indirect approaches through multilateral agencies and sectors with less politicized issues are strongest and most welcome.

- The presentation includes four parts, including an overview of China's aid, China's aid policy, opportunities and challenges for engaging China in development cooperation, and implications for development assistance to NK.
- China's aid can roughly be divided into three stages: the first stage extends from 1950 to 1978 when China adopted the reform and opening up policy; the second stage runs from 1978 to 2003 during which China continuously adjusted the scale, arrangement, structure and sectors of its foreign aid; and the third stage starts from 2004 to the present when China began to rapidly increase its aid to other countries.
- Types of financial resources of China's aid include grants, interest-free loans and concessional loans, as well as contributions and trust funds to multilateral agencies.
- By the end of 2009, China had provided a total of 256.29 billion yuan in aid to foreign countries, including 106.2 billion yuan in grants, 76.54 billion yuan in interest-free loans and 73.55 billion yuan in concessional loans. From 2004 to 2009, along with the rapid economic growth and enhancement of overall national strength, China's aid volume increased on average 29.4% annually. In 2011, the aid volume reached nearly 30 billion yuan (US\$ 4.7 billion).
- There are eight forms of China's aid, including complete projects; goods and materials (commodity aid); technical cooperation; human resource development cooperation; medical teams sent abroad; emergency humanitarian aid; volunteer programs in foreign countries; and debt relief.
- China's aid covers around 120 countries, and mainly goes to Africa (45.7% in 2009) and Asia (32.8% in 2009), but also covers countries in Latin America and the Caribbean (12.7% in 2009), Oceania (4% in 2009) and Europe (0.3% in 2009). They are mostly delivered through bilateral channels.
- Sectoral distribution of China's aid covers agriculture, industry, economic infrastructure, public facilities, education, medical and health care, as well as clean energy and climate change.
- Ministry of Commerce is the administrative department authorized by the State Council to oversee foreign aid, responsible for formulating foreign aid policies, regulations, overall and annual plans, examination and approval of foreign aid projects and management of the project execution. China Exim Bank is responsible for assessing projects with concessional loans and the allocation and recovery of loans. Regular communication takes place with the Ministry of Foreign Affairs, Ministry of Finance and China Exim Bank. Other ministries and departments also participate in the management of foreign aid programs involving professional expertise.
- China's aid policies and practices are formed and transformed by the following factors: China as a developing country and domestic opinion; path dependencies and ideologies of the 1960s and 1990s; China's own development experience; and China's experience of receiving aid.
- Basic guiding principles for China's aid policy include "equality, mutual benefit and common development", "respecting the sovereignty of recipient countries and imposing no political conditions", "self-reliance", and "substantial results".
- China adopts a holistic approach in delivering development assistance, combining aid, investment and trade. Most of China's aid projects are fully or partially tied, either providing assistance in kind or requiring that Chinese goods and materials should be purchased or Chinese contractors must be awarded the infrastructure contract financed by interest-free or concessional loans.

- With China sharply increasing its aid in both scale and scope, there are opportunities for engaging China in international development cooperation for first, China might need to learn from the hard truths gained in providing development assistance by Western donors; second, China wants to be a responsible power; and third there are appeals from recipient countries.
- Some progresses have been made over the recent years, including a MOU between China and Australia on development cooperation partnership, and a project supported by DFID on strengthening research capacity in China on international development cooperation in July 2013, as well as the different cooperation initiatives between China and multilateral agencies like UNDP, UNIDO and WFP.
- Nevertheless, there are also serious challenges ahead, including a lack of consensus on what constitutes effective or good aid; significant gap between rhetoric and practices from the Western DAC donors; different principles (no strings attached vs. conditionality); and different understanding on some of the key terms (development, ownership etc.). There are challenges at operational and institutional levels. For example, there is lack of in-depth studies and candid discussion on the feasibility, benefits, and potential administrative architecture. In addition, MOFCOM, China's aid administration department, is very understaffed, and China has been heavily relying SOEs in implementing aid projects.
- There has been little information on China's aid to NK. However, news reports indicate that China has been providing commodity aid (largely food, fertilizer and fuel), offering assistance in economic infrastructure projects (such as roads and electricity power), and supporting human resources development (such as showing NK officials on China's economic development zones). There are two main channels for China's aid to NK, one is bilateral channel, and the other is through international organizations like the WFP. For example, in 2012, China contributed US\$ 1million to WFP's operation in NK to assist Children and their mothers who are most vulnerable to under-nutrition.
- Directly engaging China in development cooperation is possible but requires political sensitivity and strategic entry points. Indirect approaches are strongest and most welcome. Knowledge-sharing on sectors like disaster management and human resources development might be more workable. Making use of multilateral agencies such as WFP and regional multilateral development cooperation forums like the Greater Tumen Initiative (GTI) are, however, more realistic at this stage.



