

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

Scott Snyder**

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국문요약

긴장과 위협이 고조된 상황에서 북한은 2013년 3월 말, 조선로동당 중앙위원회 전원회의를 열고 경제와 핵 무력 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, 핵 포기를 통해 달성 할 수 있는 목표가 아닌 경제 발전이 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 자립 경제 가능성에도 의문을 제기하고 있다.

이 논문은 북한의 새로운 정책 의의, 원리, 그리고 함의를 분석하고 북한의 지속적인 핵 개발이 경제발전 계획에 부과되는 대략적 기회비용을 추정하려 한다. 북한의 주요 무역 파트너들과의 무역 관계 패턴을 분석하고 북한이 경제 개혁에 착수할 경우, 이에 대한 거래 수준을 추측할 것이다. 이러한 시도는 지속적인 핵 개발 노력에 의해 발생하는 북한의 경제 개발 목표에 기회비용을 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 경제 개혁과 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.

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** Senior Fellow, Council on Foreign Relations



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.¹⁾

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/>.

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.²⁾

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 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.

2) Yi Ch'ong-u'n, "North Korea Opens Even Regions Near Pyongyang to Attract Investment," *Dong-Ailbo*, October 28, 2013.



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?”³⁾

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

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.

reputed reformist Park Bong Ju to the position of Premier.⁴⁾

Park Hyeong-jung, also of KINU, provides an assessment of the “6.28 policy directives” that 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.⁵⁾

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

4) Choi Soo-young, “Assessment and Prospect for the 7th Session of the Supreme People's Assembly,” Online Series CO13-10, 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).

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>.

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".⁶⁾

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.⁷⁾ 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.⁸⁾

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 of 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

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?cataId=nk03600&num=10912>.

7) Wang Fan, "Economic Reform is a Choice that North Korea Cannot Stop," *HuanqiuShibao*, May 2, 2013, English translation accessed at open-source.org, Doc#:CPP130506671002.

8) Du Baiyu and Zhang Li, "Experiencing 'Masik Speed' in Pyongyang," *GuojiXianquDaobaoOnline*, June 14, 2013.

economic sanctions against North Korea do not mean that China–DPRK trade 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.⁹⁾

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 predating cooperation in North Korean economic improvement efforts on Pyongyang’s abandonment of its nuclear program.

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

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

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.

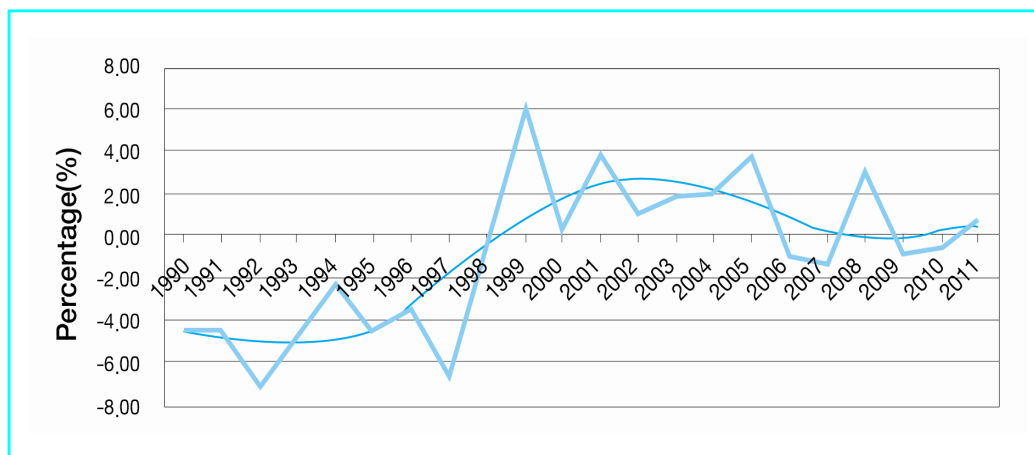
IV

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

<Figure 1>

North Korea's Annual GDP Growth

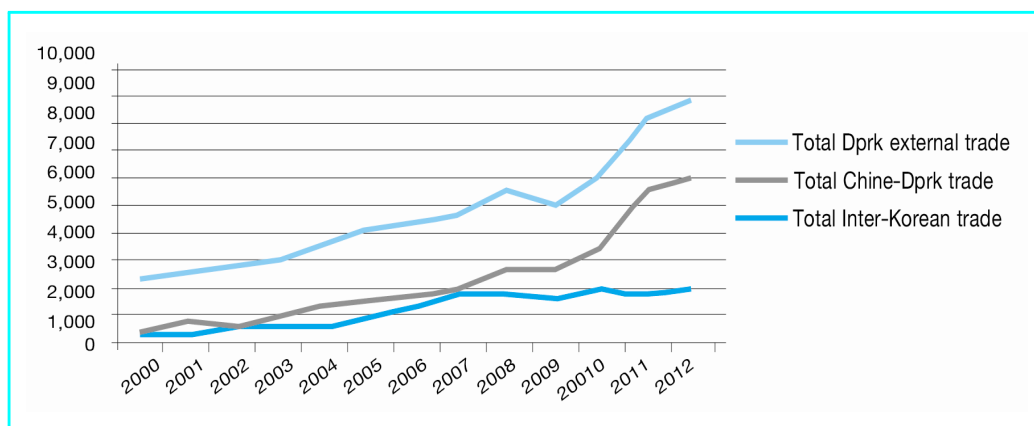


Source : Bank of Korea Economic Statistics System, "Foreign Countries/North Korea: North Korea GDP"

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.

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.

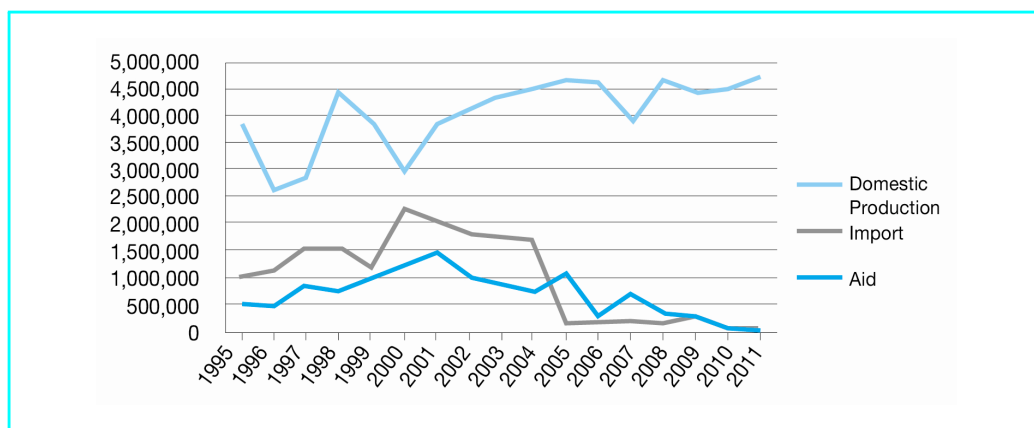
<Figure 2> North Korea's External Trade (2000-2012)



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 3> Total Cereal Availability in North Korea



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 2012.¹⁰⁾

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.

10) "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 Doc#:KP20130530115002.

<Table 1>

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.

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, 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.

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 Kungang 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 2010.¹¹⁾ 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

11) 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.

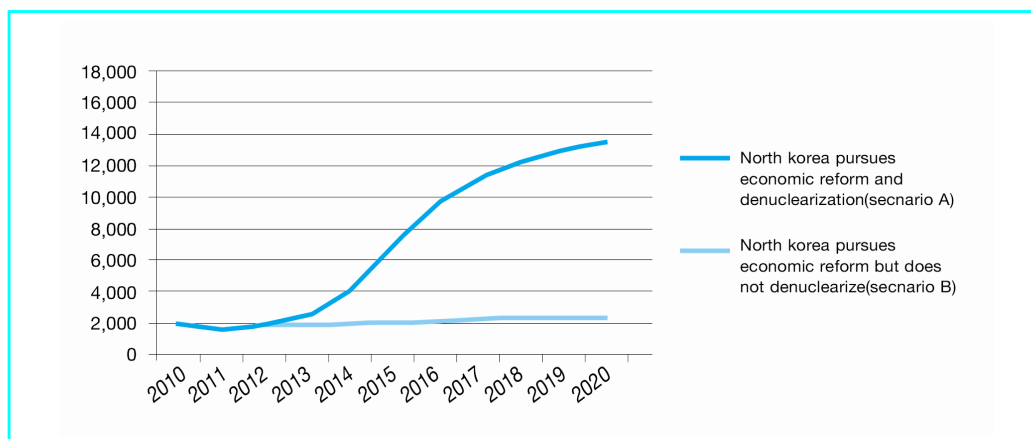
South Korea. The evidence of the cost to growth in inter-Korean trade resulting from North Korea's nuclear pursuits is most clear in the slowing of growth in the inter-Korean economic relationship that occurred under Roh Moo-hyun in 2007 and 2008. Although growth in inter-Korean economic relations further 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.¹²⁾ 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.

12) 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.

<Figure 4>

Predicted Inter-Korean Trade (2012-2020)



Unit : one million dollars

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.

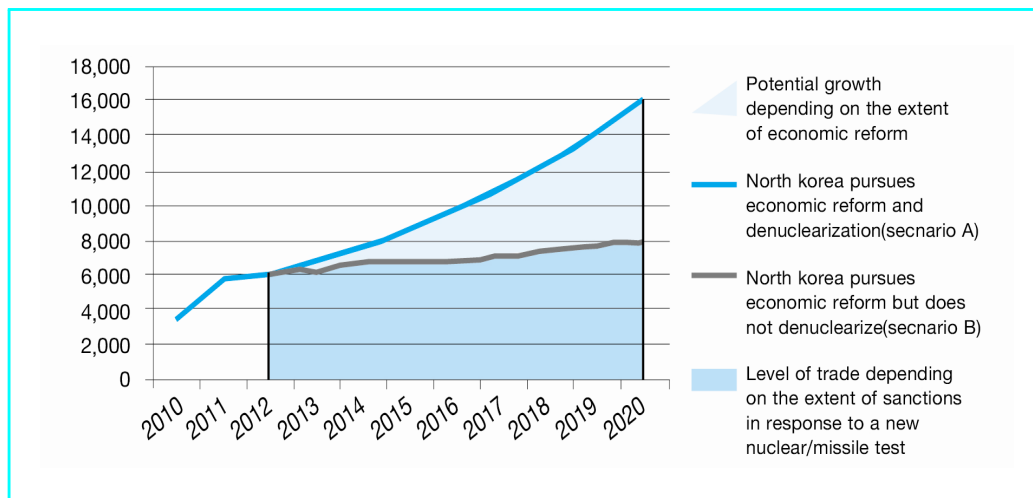
Therefore, China will be tempted to show strong support for North Korean steps toward economic reform regardless of whether or not it continues to hold on to nuclear weapons. Marcus Noland and Stephan Haggard have conducted surveys with Chinese firms that show that the primary factor constraining Chinese firms from doing more business in North Korea lies with the governance failings and opacity of North Korea's own system.¹³⁾ 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

13) 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.

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 5> Predicted China-DPRK Trade (2012-2020)



Unit : one million dollars

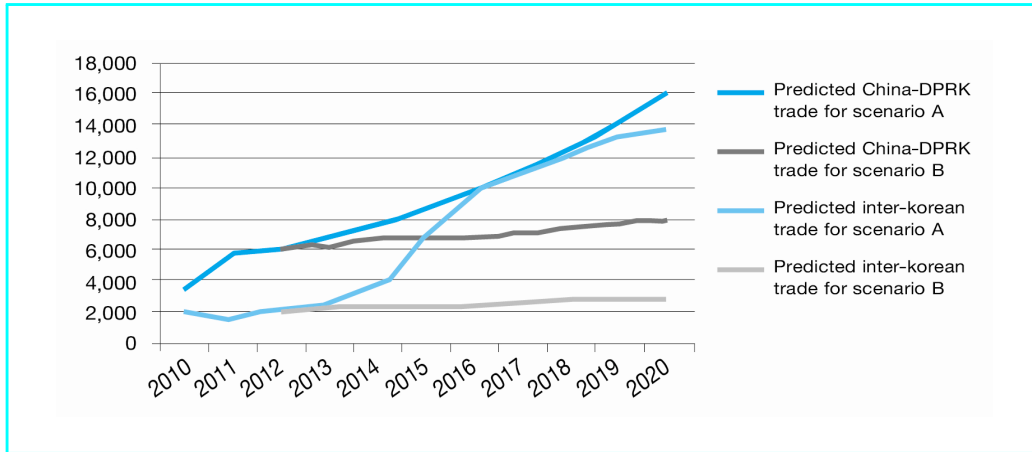


Conclusion

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

<Figure 6> Predicted Trends in North Korea's External Trade (2012–2020)




Unit : equals one million dollars

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.

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. 

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