



Edited by **Kyuryoon Kim**

# North Korea's External Economic Relations

[www.kinu.or.kr](http://www.kinu.or.kr)



Edited by Kyuryoon Kim

# North Korea's External Economic Relations



Korea Institute for  
National Unification

## North Korea's External Economic Relations

---

Edited by Kyuryoon Kim

Korea Institute for National Unification (KINU)

Printed: December 29, 2008

Published: December 31, 2008

Registration No.: 2-02361 (April 23, 1997)

ISBN 978-89-8479-486-3 93340 ₩ 9,000

Copyright © 2008 KINU

All Rights reserved. No Part of this book may be reproduced in any form by any electronic or mechanical means (including photocopying, recording, or information storage and retrieval) without permission in writing from KINU.

Published in 2008 by KINU.

Address: 275, 4.19(Sailgu)-Gil, Gangbuk-Gu, Seoul 142-728, Korea

Homepage: <http://www.kinu.or.kr>

To order KINU documents or obtain additional information, contact Distribution Services: Telephone 82-2-900-4300/2524, Fax 82-2-901-2572, or the Government Publication Sales Center: Telephone 82-2-734-6818, 82-2-394-0337.

North Korea's External Economic Relations / Edited by Kyuryoon Kim — Seoul: Korea Institute for National Unification, 2008  
p. ; cm. — (KINU Research Monograph 08-11)

ISBN 978-89-8479-486-3 93340: ₩ 9,000

349.11-KDC4

327.5193-DDC21

CIP2008003937



# North Korea's External Economic Relations



○ The Analyses, comments and other opinions contained in the monograph are those of the authors and do not necessarily represent the views of the Korea Institute for National Unification.

# CONTENTS

<b>Editor's Note</b> .....	i
<b>I . North Korea's Economic Opening-Up Policies:</b>	
<b>Past Records and Future Prospects</b> .....	1
<i>Kyuryoon Kim</i> (Korea Institute for National Unification)	
<b>II . South Korea's Policies toward North Korea:</b>	
<b>Continuities and Changes</b> .....	21
<i>Han-bum Cho</i> (Korea Institute for National Unification)	
<b>III . Economic Relations between South and North Korea:</b>	
<b>Present Status and Future Scenarios for Development</b> .....	47
<i>Hyeong-jung Park</i> (Korea Institute for National Unification)	
<b>IV . South Korea's Economic Policies toward North Korea:</b>	
<b>Alternatives for Promoting North Korea's Economic Opening-Up</b> .....	73
<i>Kang-taeg Lim</i> (Korea Institute for National Unification)	

**V. Economic Relations between China and North Korea:**  
**Current Status and Future Prospects** ..... 97  
*Zhe Jin* (Liaoning Academy of Social Science)

**VI. Recent Economic Relations between Japan and North Korea** ..... 121  
*Mitsuhiro Mimura* (Economic Research Institute for Northeast Asia)

**VII. Economic Relations between Russia and North Korea** ..... 145  
*Alexey Yu. Starichkov* (Far Eastern National University)  
*Kyuryoon Kim* (Korea Institute for National Unification)

**VIII. North Korea's External Economic Relations:**  
**Past, Present, and Future** ..... 157  
*Kyuryoon Kim* (Korea Institute for National Unification)

# CONTENTS OF TABLES

<Table V -1> Statistics of Commerce between China and North Korea .....	107
<Table VI-1> Trends in North Korea-Japan Trade in Recent Years .....	134
<Table VII-1> North Korea's Trade Relations with Russia .....	149

---

# CONTENTS OF FIGURES

---

<Figure VI-1> North Korea's Exports to Major Countries .....	124
<Figure VI-2> North Korea's Imports from Major Countries .....	125
<Figure VI-3> Trends of North Korea-Japan Trade .....	125
<Figure VIII-1> Changes in North Korean Foreign Trade per Year .....	164



---

## **Editor's Note**

Since the beginning of the 21st century, in order to overcome the country's economic crisis, North Korea has tried to implement various economic reform policies such as announcing measures on July 1st, 2002 to improve economic management. They have also designated special economic zones to host foreign capital. However, by maintaining the framework of a planned economy and introducing reforms which only partially adopted the principles of the market economy, these policies failed to produce proper results and instead produced many side effects. Actually, as long as the problems of productivity and the lack of supplies remain unresolved the recovery of the North Korean economy will be very difficult to achieve. It is clear that in order to solve these problems, North Korea must adopt a path of reform and openness.

However, there are many obstacles that prevent North Korea from taking this path. North Korea, which prioritizes the preservation of its system, is indifferent to the management of an open market economy. In addition, North Korea is not an attractive place for investment because of its closed economy, the North Korean nuclear problem and its hostile relationship with the US. Therefore, North Korean open-door reform policies can be promoted most realistically only when a solution to the nuclear issue

---

is in sight, international society makes offers to engage North Korea, and North Korea in turn actively expresses a genuine desire to accept those offers.

Yet even under these circumstances, the reason why this book chose to discuss the topic of economic trade with North Korea is not only because of the realistic recognition that the North Korean economy cannot recover by itself, but also because implementing open-door policies in North Korea is essential to maintaining inter-Korean exchanges and humanitarian aid. These efforts will help establish a continuous peaceful co-existence with the people of North Korea.

Furthermore, the circumstances surrounding North Korea are not all negative with regards to North Korean foreign trade. South Korea, which has been North Korea's most important partner for economic recovery since the July 7th declaration made in 1988, is determined to help open up the North Korean economy. South Korea's firm resolution on this point is easily recognized in the North Korean policies of the Lee Myung-bak administration. The traditional trading partners of North Korea, China and Russia, along with the economic powerhouse Japan are also geographically close. The recent economic growth in Northeast Asia has provided North Korea with sufficient opportunities to the revitalize its economy.

---

The progress in multilateral cooperation will most likely be decided by the mechanism of the Six-Party Talks, the search for a potential solution to the nuclear problem, and the speed in which the US-North Korean relations are improved. However, if North Korea declares its intent to enact domestic economic reforms, and open up to foreign trade many countries including the US, Japan, China, and Russia (the four neighboring powerhouses) might promote efforts to engage in international cooperation with North Korea. Therefore, this book will look at the cooperative economic relations between North Korea and neighboring countries such as South Korea, Japan, China, and Russia, which will play an important role in the implementation of future open-door policies in North Korea. This book will also try to forecast the future direction of development for international economic exchange in North Korea.

First, We will take a look at the North Korean foreign policies in entitled, “North Korea’s Economic Opening-Up Policies: Past Records and Future Prospects (Dr. Kyuryoon Kim).” Next, after examining South Korea’s policies toward North Korea (Dr. Hanbum Cho), scenarios for economic relations between South and North Korea (Dr. Hyeong-jung Park) and the future direction of South Korea’s economic policies toward North Korea (Dr. Kangtaeg Lim) will be discussed. In addition, experts from neighboring

---

nations will assess their respective country's economic relations with North Korea. Dr. Mitsuhiro Mimura from Japan will inquire into recent economic relations between Japan and North Korea, Dr. Zhe Jin from China will discuss economic relations between China and North Korea, and Dr. Alexey Starichkov from Russia will introduce information about economic relations between Russia and North Korea in detail.

Finally, in conclusion, We will analyze prospects for the future development of North Korea's external economic relations (Dr. Kyuryoon Kim).

The fact that inter-Korean relations are currently very tense may make this discussion seem meaningless. However, inter-Korean relations have repeatedly experienced ups and downs over the last 60 years, and difficult times such as these have provided the most appropriate opportunity for preparing for more prosperous periods. This book is the result of hard work and efforts made by scholars from South Korea, Japan, China, and Russia, and our hope is that it becomes a necessary and useful guide when North Korea takes to the path of reform and openness.

Kyuryoon Kim

(Director, Division of South-North Korean Cooperation Studies, KINU)



I

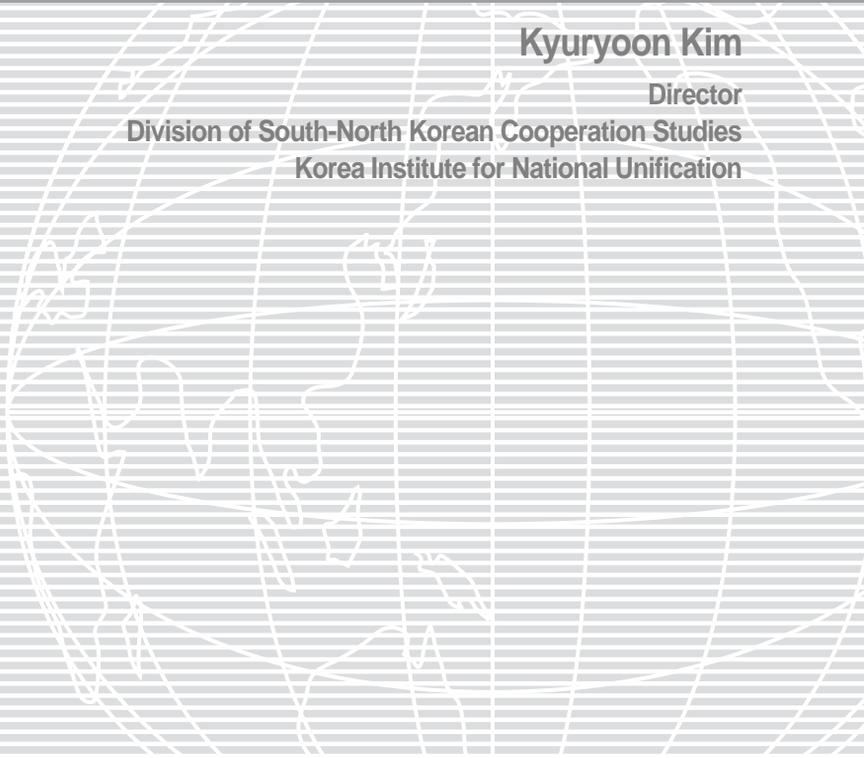
# North Korea's Economic Opening-Up Policies: Past Records and Future Prospects

**Kyuryoon Kim**

Director

Division of South-North Korean Cooperation Studies

Korea Institute for National Unification





# 1. Introduction

After North Korea established its government, it started off as a typical socialist satellite state that built a foundation for economic development with assistance from the former Soviet Union. After North Korea was defeated in the Korean War in early 1950s and its economy was demolished, North Korea adopted the economic system that completely depended on the Soviet Union and China. Meanwhile thanks to the external effects of the popular mobilization system compared to other socialist states, North Korea showed relatively sound growth during the 1960s and early 1970s. However, North Korea started to encounter economic hardship in the 1970s because it could not overcome the innate economic deficiencies that existed in the self-supporting socialist planned economy. As a result, North Korea attempted to revitalize its economy by relying on more foreign investment in the 1970s, only to experience failure and ultimately default on its foreign debt obligations.

Even though North Korea tried to open the door to foreign exchange in the 1980s by enacting the ‘Habyoung act’ (North Korean joint management act, a law intended to stimulate foreign investment), it only managed to attract limited amounts of investment from ‘Jochongnyeon’ (the pro-North Korean residents’ league in Japan). In the early 1990s, after the collapse of the socialist bloc and the end of the cold-war, North Korea again tried to attract foreign capital with concentration on the Najin and Sonbong special economic zones. They succeeded to some extent in promoting the interests of foreign investors, even these attempts to stimulate economic development failed because of poor investment conditions created by North Korea’s lack of understanding of the market economy. The failures were also fueled by concerns among the North Korean leaders that the reform policies would

I

II

III

IV

V

VI

VII

VIII

cause political instability.

In the early 21st century, based on the belief that the Kim Jong-il regime had become more stabilized, North Korea adopted economic measures that partially accommodated market economy ideas, but even these economic reforms turned out to be insufficient to overcome the fundamental limitations of the North Korean economy. This study will attempt to analyze the conditions of that time as well as the reasons for the failure of the reform measures for foreign exchange that North Korea implemented throughout its economic history. Based on this analysis, this study will try to provide a comprehensive answer for why the North Korean attempts to open their economy to foreign investment failed, examining both domestic and foreign factors.

## **2. North Korean Efforts to Promote Western Investment**

### **A. Policy Environment**

After the early 1970s, the relatively successful growth achieved from the popular mobilization system of the 1960s demonstrated that there were limitations to extensive growth in the North Korean economy, due to the ineffectiveness and inflexibility of the centralized authoritarian rule. Looking back at the international economic environment of the early 1970s, it should be pointed out that the following conditions were developing. First, this period marked the end of the Bretton Woods system that had been led by the United States since the end of World War II. The United States tried to constrain expansion of the socialistic bloc around the Soviet Union by rebuilding the economies of the western states, and consequently offered support for the economic growth in Europe and Japan. As a



result, even though Europe and Japan achieved successful economic growth, the Bretton Woods system, which relied on the gold standard of the American dollar since the end of World War II, reached a state that could not be sustained. Second, during this period the United States adopted a strategy towards the socialist bloc that concentrated on the development of capitalism in the neighboring states of the Soviet Union in order to contain Soviet power. As a part of the strategy, the United States reconciled relations with China under the leadership of president Nixon. In accordance with these changes, the United States normalized relations with China during the détente era while China continued to compete with the Soviet Union for superior control of the socialist bloc. The new global environment affected North Korea as well, and it seems that North Korea felt the need to pursue more autonomy rather than be subject to unconditional servitude under the power of two superior states. In other words, even though North Korea fortified the one-man leadership through a series of purges by leader Kim Il-sung after the Korean War, the regime felt that it needed to adopt a new economic growth plan in the face of a stagnant economy.

## **B. Measures for Opening-up**

Starting in the early 1970s, North Korea started to implement a regional budget program in order to increase production and foster development of its regional industries. North Korea also divided the national budget into central and local budgets. At the same time, North Korea adopted a self-supporting accounting system for all firms while raising the wages of the workers, the government relinquished control of the farmer's markets, and permitted expansion into the urban areas to solve the problem of a shortage of material necessities. North Korea also tried to improve relations

I

II

III

IV

V

VI

VII

VIII

with western capitalist states as well as made efforts to promote foreign investment.<sup>1</sup>

North Korea acquired capital goods, machinery and other equipment from western states and Japan. During this period, in particular, North Korea borrowed a total of \$1,242,000,000 from OECD states from 1970 to 1975.<sup>2</sup> However, due to North Korea's inability to repay the loans and the subsequent state of economic stagnation, economic cooperation with western states was suspended. Subsequently, beginning in the 1970s, North Korea started to pursue a foreign trade policy that was designed to increase exports and foreign currency income. In other words, North Korea instituted a policy to increase exports to developing states so as to increase foreign currency income. In order to support these foreign trade policies, North Korea established the Daesung and Bonghwa trading companies in the late 1970s, as well as founded the Daesung and Kumgang banks to support foreign trade.<sup>3</sup> However as mentioned above, North Korea's attempts to increase foreign trade and exchange did not succeed, and these failures further contributed to the economic downturn and eventual stagnation.

### **C. Reasons for Failure**

In light of the changing international economic conditions as well as the deteriorating domestic economy, the efforts that North Korea undertook in the 1970s to increase foreign trade appear to have failed for the following reasons. First of all, North Korea attempted to revive the economy by promoting more foreign capital investment while still adhering to the fundamental principles the oil shock and rise in the price of material goods of a socialist economy. However, its plans were altered due to the that caused the worldwide depression of the 1970s altered North Korea plans.



Second, while actively pursuing policies to increase foreign trade, North Korea took limited measures to increase the rate of foreign exchange earnings without reforming the domestic economy, so efficiency in production was impossible to achieve. Finally, the actual reason that these reform measures failed was because North Korea's economic development plans were overly concentrated on heavy industry and the government continued to pursue its goal of creating closed self reliant economy by permitting only limited economic exchange with the outside world.

### **3. Reform Measures and the Enactment of the 'Habyoung Act'**

#### **A. Policy Conditions**

North Korea advanced into the 1980s ailing from the failed reform measures and struggling with the effects of the stagnated domestic economy from the 1970s. At the time, the economic status of the Soviet Union begin deteriorating due to the overwhelming costs of an expensive arms race. The Soviet Union had over-spent on weapons to combat the strategy of the United States', while China was losing its ability to considerably support North Korea due to the pursuit of reforms and open-door policies that it had been attempting to implement since the end of the 1970s.<sup>4</sup> Lastly, North Korea tried to engage in joint ventures with western states but it ultimately failed projects. Faced with these difficult conditions, North Korea acknowledged the need to promote economic cooperation with western states and to create economic ventures that were free from the burden of repayment. As a result North Korea started to draft plans for the 'Habyoung act.'

## **B. Contents of the ‘Habyoung Act’**

North Korea introduced plans to increase foreign trade with capitalist states as well as third world nations during such occasions as the 6th general assembly of the North Korean labor party (October 1980) and the 3rd assembly of the 7th term of the Presidium of North Korea’s Supreme People’s Assembly (January 1984), thus experimenting with changes regarding its foreign exchange policies. Then on September 8, 1984, North Korea enacted the ‘Habyoung act’ in order to develop economic relations with friendly capitalist states, increase the importation of foreign capital and technology, and create joint ventures free from the burden of repayment.<sup>5</sup> Considering North Korea’s consistent pursuit of an exclusive policy for creating an autonomous national economy through self-reliant economic measures, North Korea’s enactment of the ‘Habyoung act’ can be seen as a revolutionary legislative act.

The ‘Habyoung act’ consists of 5 chapters and 26 articles, and emphasizes the principles of equality and reciprocity regarding the subjects of the law, fields to be regulated, percent of financing etc. The first chapter outlines the basic principles of the law along with the limitations and subjects of joint ventures, as well as the subjects of joint ventures that are regulated as foreign companies, firms, and individuals. The sources of capital related to the ‘Habyoung act’ include residents situated in other countries around the world such as in Japan and western countries. The North Korean residents in Japan are the largest source of capital goods. The second chapter describes the organization of joint ventures, the subjects of investment and the extent of investments. Rules on the extent of investment are widely regulated in terms of actual funds, goods, rights to an invention, and technology. The third chapter contains regulations on business activities, the appoint-

ment of a board of directors, and the question of foreign employees. The joint venture companies are to be created in the form of stock companies, the most common form of private company in the capitalist economy, and management is to be run mainly under the supervision of the board of directors. The fourth chapter regulates the settlement of accounts and distribution of profit, whereas the fifth chapter states rules on the dissolution of joint venture companies and dispute settlements. Also, mentioned in chapter 5 is the question of imposing taxes on corporations and requiring income tax be paid on the profits of the company and income of the employees respectively.<sup>6</sup>

On the basis of the ‘Habyoung act,’ North Korea concentrated its efforts on attracting foreign capital, and in particular it put tremendous effort into joint ventures with ‘Jochongnyeon.’ However, although the total amount of investment was nearly \$100,000,000 and there were about 100 the joint ventures promoted in cooperation with ‘Jochongnyeon’ during the early period after the law was implemented, it seems that only 20 ventures were maintained into the 1990s.<sup>7</sup>

### **C. Reasons for Failure**

North Korea enacted the ‘Habyoung act’ in order to revive the overall stagnant domestic economy, but even with the new law North Korea found that it only received economic assistance from patriotic North Koreans residing in Japan. In other words, even though North Korea tried to overcome this crisis, one resulting from a lack of investments from western countries and a steep decline in financial aid from ally states such as the Soviet Union and China, by gathering funds from the ‘Jochongryun,’ these kinds of limited funds were insufficient to revitalize the stagnant

I

II

III

IV

V

VI

VII

VIII

North Korean economy. Despite North Korea's efforts to open up their economy through the implementation of the law, the plan failed to draw in investment from western states. North Korea also had no other choice because it prioritized the survival of its political system. These reform measures did not have a big effect on revitalizing the economy since North Korea could not risk adopting full scale measures for opening up the economy. Afterwards, North Korea only managed to concentrate efforts on increasing economic productivity through use of its own autonomous resources, and this situation grew even worse as the growth of the North Korean economy came to a halt.

#### **4. Attracting Investments Concentrated in the Najin and Sonbong Special Economic Zones**

##### **A. Policy Conditions**

During the early 1990s, the North Korean economy was already on the brink of a breakdown, and the collapse of the socialist bloc further contributed to the deteriorating economic conditions. In the international arena, the friendly economic relations among the socialist countries had disintegrated, and the supply of numerous essential items being sent to North Korea stopped because relations between the socialist states and North Korea were severed. After the end of the Cold War, the influence of socialist ideas started to decline around the world and the principles of an open market economy, which function on the basis of capitalist ideas, rose to supremacy. Close analysis into the domestic conditions of the North Korean economy demonstrate that North Korea tried to confront this difficult situation at the end of the Cold War. How-



ever, North Korea still adhered to the contradictions in the socialist economy, and ultimately failed to overcome the economic difficulties of the 1970s.

As a result, the North Korean economy did not even have the capital to import the necessary materials for production or those that could not be produced domestically. This in turn caused North Korean factories to lose significant efficiency in production.

### **B. Details of the Najin and Sonbong Special Economic Zone**

North Korea designated the Najin and Sonbong area as a special economic zone, and also designated the ports of Chongjin, Najin and Sonong as free trade ports. More specifically, North Korea took the following measures on December 28, 1991, according to the North Korean Administration council ('Chongmuwon') decision number 74. First, a total area of 621km<sup>2</sup>, including 14 'dong's and 'ri's of the city of Najin and the 10 'ri's of Sonbong, were designated as a special economic zone for free trade. Second, the establishment of joint ventures, joint management, and independent foreign companies were permitted in this special economic zone. Third, there were no limitations on the countries that could invest in the special economic zone, and all investments, assets, and profits gained from doing business were to be protected by the law. Fourth, the ports of Najin and Sonbong that fall within the special economic zone, as well as the neighboring port of Chongjin were designated as free trade ports. Fifth, various special privileges such as the reduction and exemption of company income tax were applied.<sup>8</sup>

According to data that North Korea has publically released, the development plans for the Najin and Sonbong special economic zone were divided into three phases. The first phase (1993-1995)

was designed to consolidate preexisting railways, roads, ports and other indirect social capital infrastructure so as to bolster the capabilities and role of the economic zone as a transit facility for international freight. It was also meant to develop a suitable environment for investment. During the second phase (1996-2000), using the infrastructure constructed in the first period, the Najin and Sonbong special economic zone would take shape and function as a base for trade that specialized in large-scale international freight. In addition, the ports of Najin, Sonbong and Chongjin would expand their transaction capabilities to 50 million tons, while developing an export industry of manufactured goods, and would evolve into an international tourist location. The third phase (2001-2010) plans involve increasing the transaction capabilities of the ports of Najin, Sonbong and Chongjin to 100 million tons, while constructing a base for international exchange by comprehensively equipping the area with facilities capable of handling intermediate trade, export industry for manufactured goods, manufacturing industries, finance services, and tourism. In accordance with this plan, North Korea announced that it would promote a total of \$6,980,000,000 worth of businesses by attracting foreign capital investment.<sup>9</sup> However, North Korea only managed to bring in \$120 million worth of business by the end of 2000, and North Korea's reform policies for foreign trade developed for the Najin and Sonbong special economic zone failed to produce satisfying results.<sup>10</sup>

### **C. Reasons for Failure**

The basic development plan for the Najin and Sonbong special economic zone was initiated in order to create a special economic zone for free trade in the outer regions of the country. The region was chosen because of its geographic location and the fear that the



infiltration of capitalism might lead to political turbulence in the capital of Pyongyang. Even though the Najin and Sonbong region possessed the geographical potential to play the role of economic hub to the three northeastern provinces of China as well as the far east region of Russia, it faced limitations in attracting foreign investment due to its poor infrastructure.

Another reason for the failure of the Najin and Sonbong special economic zone was the fact that during a series of events related to the North Korean nuclear problem, North Korea's aggression came to light, and the general perception that investing in North Korea was very dangerous spread in international society. In addition, in order to control domestic affairs and to support the theory of building a strong nation, the leaders of North Korea reacted negatively to the attraction of foreign capital in the process of consolidating Kim Jong-il's political power after the death of Kim Il-sung. This is regarded as another reason why the failure of the Najin and Sonbong special economic zone occurred.

## **5. 'Measures to Improve Economic Management' Announced on July 1, 2002**

### **A. Policy Conditions**

After the death of Kim Il-sung and the succession of power to Kim Jong-il during the early 1990s, North Korea made efforts to strengthen the Kim Jong-il regime. However, the persistent negative impact of natural disasters including floods that occurred in the mid-1990s as well as systematic problems in the agricultural industry led to the so called 'march of hardship' for North Korea. The deteriorating North Korean economy showed some minimal

I

II

III

IV

V

VI

VII

VIII

signs of recovery starting in the late 1990s, but fundamental problems causing the economic deterioration still went unsolved. As a result, the North Korean government reached a point where it could not implement a rationing system for the entire population, and a massive shortage of food was evident in areas outside the capital. Meanwhile, North Korean plans to build a nuclear weapon had a decisively negative effect on North Korea's chances of receiving economic aid from the international community. If North Korea had given up their nuclear program, the international society would have taken various measures to ease the food shortage. Nonetheless, Pyongyang decided to destabilize the security environment in Northeast Asia by developing and utilizing nuclear weapons as a tool for negotiation. In any case, North Korea announced 'Measures to improve economic management' to spur the revitalization of the economy on July 1, 2002.

### **B. Details of the 'Measures to Improve Economic Management'**

The 'Measures to improve economic management' announced on July 1, 2002 established the materialization of the price of goods and services as the essential basis of the law. First, Pyongyang materialized and unified prices, wages and the foreign exchange rate. As a result, food prices rose close to market-value prices at the farmers markets, and transportation fees such as subway and bus fares rose considerably. In addition, wages were raised and new bank notes were issued, while money orders exchanged for foreign currencies became null and void. In other words, North Korea started to price products according to the value of each good and executed measures for cost materialization that took into account the international market conditions as well as the supply



and demand of the domestic market. The government then carried out price reform that raised wages and adjusted the foreign exchange rate related to these changes. For example in the case of wages, North Korea adopted a gradation system, which allocates larger wages to those that have more difficult or technical jobs and those who are more productive. In the case of pricing goods, artificial pricing that ignored the cost of production was abolished. Not only the cost of production, but the international market conditions as well as the supply and demand of the domestic market were considered when pricing goods. The central government still managed and controlled the pricing, but unlike the former fixed pricing system, North Korea adopted a more flexible administrative pricing system that reflected the needs of the supply and demand in addition to the production units. A pricing system where the government and the subjects of the economy could agree upon a certain price was also introduced. Furthermore, electricity fees, housing expenses, price of land use and other fees regarding use of public property that were in the past provided for free according to the socialist provision principle, were suddenly imposed.<sup>11</sup>

Second, the provision of living necessities through rationing system was cut back. Some have actually argued that the rationing system has been abolished, but it is a fact that it is still functioning.<sup>12</sup>

Third, with the ‘Measures to improve economic management,’ North Korea emphasized economic utilitarianism by handing over management of companies formerly held by party officers to executive managers in order to improve professional management. In some cases, the workers or farmers were directly elected to the position of the regional supervising chairman or manager. The power to set some management indexes, such as detailed econom-

I

II

III

IV

V

VI

VII

VIII

ic plans and production indexes, as well as price, quality and standards for products were transferred to the companies and factories as measures to decentralize power.<sup>13</sup>

In addition to implementing 'Measures to improve economic management,' North Korea made efforts to bring in more foreign capital. For instance, North Korea designated Shinuiju, Gaesung and Mt. Kumgang as new areas for special economic zones. In the case of the Shinuiju special administrative region, the government initiated a new type of special economic zone that attempted to imitate the special economic zones of China such as Hong Kong and Shenzhen. Mean while the Gaesung and Mt. Kumgang zones were designated specialized zones in the form of a leased territory, to be solely developed with South Korean capital. To summarize, the North Korean domestic economy adopted some of the functions of a market economy within the framework of a planned economy, while new special economic zones were designed as areas that would function under the rules of a market economy. However, plans to develop the Shinuiju special administrative region were suspended in August 2008 due to multiple reasons such as opposition voiced by China.<sup>14</sup>

### **C. Evaluation and Outlook**

North Korea experimented with various reforms and open-door policies in the early 21st century in order to overcome economic difficulties. It is difficult to simply evaluate, at this point in time, the effects of the economic policies North Korea implemented. Yet, it seems that the measures North Korea took did not produce the anticipated results because they were very limited. All the reform measures, including 'Measures to improve economic management' announced on July 1, 2002, took a restricted form



that only allowed limited areas to be regulated by the market economy under the basic framework of a planned economy. Therefore, the new economic ventures could not achieve the anticipated results for increasing production and expanding supply. In other words, North Korea carried out dubious reform measures, and contradictions naturally arose between the part of the economy run by planned economic principles and the part run by the adopted market economic principles. As a result, even normal management of the North Korean economy became difficult. Looking more closely at the situation, it is apparent from the following economic phenomena have emerged. First, the North Korean economy has been plagued with inflation. By initiating price reform measures and creating a limited market without solving the fundamental economic supply problems, it is said that the North Korean economy created the conditions for extreme inflation that lasted for 3 years during the period subsequent to the announcement of the 'Measures to improve economic management.'<sup>15</sup>

Second, signs of duality in the national economy as well as signs of the planned economic sector starting to depend heavily on the market economic sector are starting to show. The North Korean economy is slowly being divided into two; there is a divide between sectors that are still run by a planned economy and sectors that are run by the free will of the market, as well as a divide between the domestic economy and the international economy. Some areas show signs that the planned economy sector is being eroded by increasing dependence on the market economy sector.

Third, expansion of the illicit market economy (black market) as well as the growth of individual economies is causing extreme polarization. The 'Measures to improve economic management' were formulated to help incorporate market activities, but because of the fact that many of the functions of the planned economy have

I

II

III

IV

V

VI

VII

VIII

been paralyzed, this formulation paradoxically led to the expansion of illegal market activity. This has also contributed to a growing gap between the rich and the poor because it created a difference in income for those who work in the fields of the planned economy and those who work in the fields of the market economy. It is predicted that this duality in the North Korean economy will last for the time being. If the fundamental problems stemming from the lack of supply and low productivity remain, the revitalization of the North Korean economy will be difficult and will take a long time to accomplish. Also, exports to other countries must be increased in order for the North Korean economy to develop, but currently North Korea does not seem resolved enough to genuinely create an economic policy that links the increase in domestic production with that of foreign exports.

## **6. Conclusion**

North Korea has managed to maintain a socialist-style economy, however, the government has taken several steps to adopt policies that open up the economy in order to stimulate economic growth. This paper analyzed the economic reform policies that North Korea executed in the past. It is a well known fact that the production level in North Korea is a mere 20 to 30% and many North Korean people are not guaranteed enough sustenance to live. Under these circumstances, South Korea and the international community have been providing vast amounts of food assistance every year, and basic medical supplies along with essential items are being domestic by various aid organizations. However, provision of international aid to North Korea cannot eliminate the fundamental reasons for the economic crisis, and it is clear that in

order to revive the North Korean economy the country must choose a path of reform and openness.

Even during the early 1990s when socialist states were collapsing all over the world, North Korea declared that it would maintain its socialist system and it is still adhering to those ideals. The solutions that North Korea proposed and implemented in order to solve the problems of its economy are very short-sighted ones, and this is because they are solutions based on an insufficient understanding of the market economy.

Even under these circumstances, North Korea has not fully abandoned its plans to build nuclear weapons and is stubbornly sticking to the idea of using nuclear weapons as leverage in certain negotiations. Although the strategy that North Korea is utilizing may seem feasible at first, the lessons learned from the last 20 years demonstrate that this strategy will not contribute to the revitalization of the North Korean economy. Therefore, not only should North Korea try to pursue various ways of developing their economy by generally adopting a market economy, but the government should improve relations with the US by actively cooperating to solve the nuclear problem and to gain assurances from the international community that the state will be preserved.

#### Notes

- <sup>1</sup>-Ju-hwan Chung, "'Habyoung act' of North Korea," *Danguk law*, Vol. 3 (1993), pp. 305-306.
- <sup>2</sup>-Major loans include \$28 million from Japan and \$15 million from West Germany. Se-won Kim, "Open-door policies and the 'Habyoung act' of North Korea," *North Korea*, April 1990, Vol No. 220 (1990), p. 46.
- <sup>3</sup>-Kikwan Yoon, "Changes in the North Korean foreign trade policy and development in foreign trade," *Studies on Korean Unification*, Vol. 2, No. 1 (1996), p. 113.

- 4-When loans from western states were suspended, North Korea borrowed \$296 million and \$258 million from the Soviet Union and China respectively between 1978 and 1984. After that period, financial aid provided to North Korea declined considerably due to the ideological dispute between the Soviet Union and China, as well as the deteriorating economies of socialist states. Se-won Kim, "Open-door policies and the 'Habyoung act,'" p. 47.
- 5-Kikwan Yoon, "Changes in North Korea's foreign exchange policies and development of foreign trade," pp. 113-114.
- 6-Se-won Kim, "Open-door policies and the 'Habyoung act,'" p. 47.
- 7-As a matter of fact, joint ventures under the 'Habyoung act' all seem to be contributions made by the 'Jochongnyeon' to the state-owned companies of North Korea. Young-hoon Kim, "Expectations and problems of the agricultural industry regarding the measures to improve economic management released on 1 July 2002," *Studies on Problems of Unification*, Vol. 15, No. 2 (2003), p. 149.
- 8-Sang-ho Kim, "Study on Solution of Investment Disputes in the Najin and Sonbong Special Economic Zone," *Collection of Papers on International Management*, Vol. 14 (1999), p. 93.
- 9-Hui-ok Kim, "Changes in North Korean Foreign Policies and inter-Korean economic cooperation," *Studies on Unification*, Vol. 1 (1996), pp. 38-39.
- 10-Young-hoon Kim, "Expectations and problems of the agricultural industry regarding the measures to improve economic management released on 1 July 2002," p. 149.
- 11-Young-kyung Kwon, "Current conditions of North Korean economy, reforms and open-door policies," *Understanding North Korea 2008* (Seoul: Education Center for Unification, 2008), pp. 158-160.
- 12-Young-hoon Kim, "Expectations and problems of the agricultural industry regarding the measures to improve economic management released on 1 July, 2002," pp. 151-153.
- 13-Young-kyung Kwon, "Current conditions of the North Korean economy, reforms and open-door policies," p. 157.
- 14-*Ibid.*, p. 164.
- 15-*Ibid.*, p. 166.

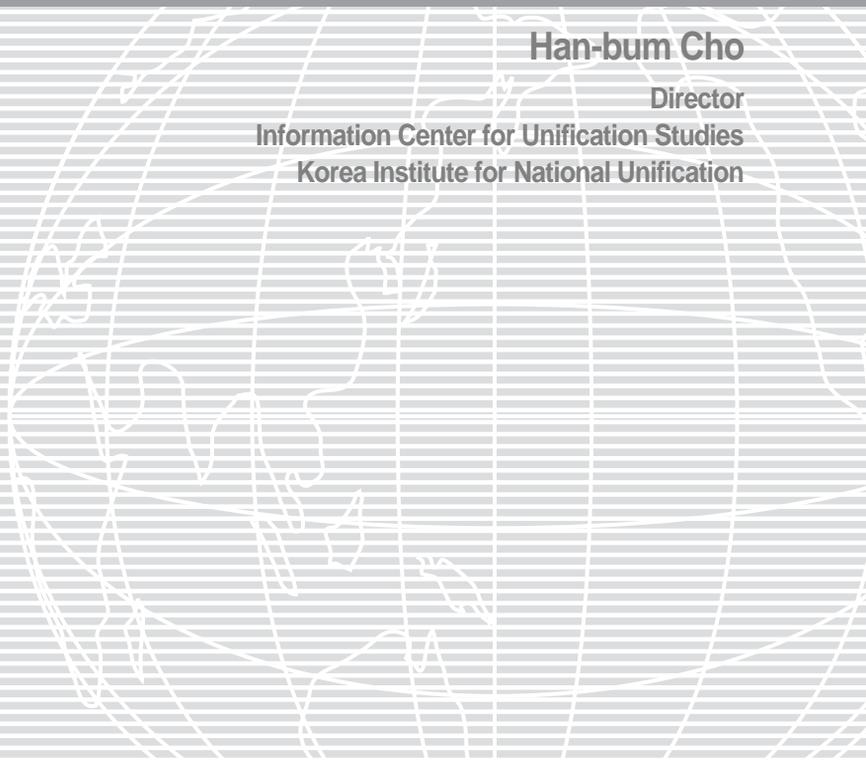


# II

## South Korea's Policies toward North Korea: Continuities and Changes

**Han-bum Cho**

Director  
Information Center for Unification Studies  
Korea Institute for National Unification





## 1. Introduction

With the start of a new administration under Korean president Lee Myung-bak, a wide range of assessments, from positive to negative, have been made about the policies of the former so called ‘participatory government.’ In particular, there has been much discussion and analysis regarding the former government’s policy stance towards North Korea. Despite various assessments of the policies of the Kim Dae-Jung and Roh Moo-hyun administrations, no-one can deny that inter-Korean relations best symbolized by the development of the Kaesong industrial region and the Mt. Kumgang tour projects have changed drastically over this period.

The inauguration of the relatively more conservative Lee administration has implications for policy change in regards to North Korea. However, one thing is certain, the preexisting projects that promote cooperation with North Korea such as business development in the Kaesong industrial region must continue. It is necessary in this crucial phase to maintain a certain level of continuity, even if there is a change in government. Because unlike the past, inter-Korean relations are now confronted with a new paradigm. If continuity in policy is not maintained, the phrase ‘lost ten-years’ will become an even more fitting overstatement when discussing the state of inter-Korean relations. Under these circumstances, South Korea should consider the impact of maintaining continuity with regard to North Korean policies.

Even though there have been some meaningful developments in inter-Korean relations, reflecting on the impact of past North Korean policies and evaluating the progress made in inter-Korean relations will positively contribute to the policy-making and policy-implementing processes of the Lee administration. Leaders

I

II

III

IV

V

VI

VII

VIII

and policy-makers must pay attention to the fact that practical progress has not been made on peace issues, such as the dismantlement of North Korea's nuclear program, and that South Korean society is dealing with many problems that derive from society's inability to adapt to sudden changes in inter-Korean relations. Structural conflict within our own society manifested in the deep divisions between the conservative and the progressive groups, the so called 'southern divide,' is the core factor that is blocking progression the effective development of North Korean policies. Consequently, the primary cause of conflict in the South Korea-US alliance and in other foreign or domestic political situations is the unproductive rhetoric and unnecessary misunderstandings that are created in the process of promoting policies for North Korea. Yet, even if real change occurs in North Korea and an honest assessment and positive vision for inter-Korean relations is put forth, it would still difficult to draw up a concrete blueprint for North Korean policy that could achieve success.

However, it is still important to thoroughly and objectively analyze past changes in policy in order to create a vision for future policy regarding North Korea. Setting aside those policies that are one-sided, the Lee administration can effectively use the analysis of former North Korean policies to establish and apply future North Korean policies. Learning from the past, it is high time to make productive efforts towards creating a new inter-Korean relationship, one that fundamentally solves the North Korean nuclear problem, that constructs a peace system on the Korean peninsula, and makes progress in establishing an inter-Korean cooperative economic community.



## 2. Evaluating the North Korean ‘Engagement policy’

The Kim Dae-jung administration’s North Korean ‘engagement policy’ created a foundation for inter-Korean reconciliation and cooperation. The policy should receive recognition for its efforts to utilize every realistically feasible method to build a basis for improved inter-Korean relations. In other words, it can be said that the administration initiated an important change in the inter-Korean relations paradigm.

The engagement policy implemented by the Kim administration can receive some important credit for transforming the old contentious relationship, which was already decreasing in significance due to the dissolution of the Cold War security system and North Korea’s internal structural crisis, into a relationship based on reconciliation and cooperation. The aim of the engagement policy was to postpone the impossible goal of immediate unification and to create an environment that would facilitate a gradual unification process. In order to achieve this, positive improvements in inter-Korean relations were promoted through all practical means available.

Accordingly, the former policies must be recognized for changing the relationship and making it possible to have real negotiations between the two parties. Even though the relationship was limited, inter-Korean relations under the engagement policy made tangible progress in reconciliation efforts such as holding inter-Korean negotiations, reuniting separated family members, and mobilizing humanitarian aid for North Korea. Significant achievements were also made in joint projects that facilitated inter-Korean cooperation, such as the Mt. Kumgang tour project and the construction of railways that connect the two Koreas. Therefore, it can be concluded that the developments achieved by the engagement

I  
II  
III  
IV  
V  
VI  
VII  
VIII

policy were fundamentally appropriate.

However, the question of whether or not the Kim administration efficiently tackled the problems arising from implementation of the engagement policy is still an important one. The problem of providing insufficient support to carry out the necessary policies must also be pointed out. Discarding Cold War mentality and dismantling the Cold War structure can be an extremely tricky problem, as was already demonstrated by the process of reconciliation between the two Germanies. Therefore, it is crucial to establish a more elaborate and specific plan for reunification, to formulate a basic direction for the development of the engagement policy, and to indicate at what pace the process of policy implementation will proceed.

The first point that should be addressed is the fact that a logical structure for the engagement policy was not clearly established from the beginning. There was a failure to consider the overall development of a consistent policy direction. As a result, different proposals were introduced in each new situation and the lack of coordination created confusion regarding engagement principles and concepts. In other words, the engagement policy did not have a clear consistent line of thought and it was difficult to maintain consistency because the policies were affected by the changes in inter-Korean relations as well as domestic public opinion. Consequently, this negatively impacted the reliability of the policy.

It can also be said that the government failed to react appropriately to events such as the tragic West Sea naval battle because the strategy to 'simultaneously promote security and cooperation,' a fundamental prerequisite of the so called 'sunshine policy,' did not push forward or facilitate actual discussion regarding security issues on the peninsula. Furthermore, the people of South Korea seemed unable to completely accept the logic of flexible reciprocity



that was emphasized in the policy from the beginning. In addition, because the Mt. Kumgang tour project received governmental assistance the government found it increasingly difficult to justify infringements upon the principle of separation between politics and economics.

More importantly, the question of establishing public support for North Korean policies, must be mentioned since this is the most pivotal force driving the policies for North Korea. The engagement policy should have been set forth with the firm understanding that the uniqueness of inter-Korean relations and the structure and culture of the Cold War were all factors that would fundamentally impact or constrain the promotion of North Korean policies. Therefore, even though wide-spread support for North Korea policies might have come a little too late, the former Kim and Roh administrations should have implemented the North Korean policies only after they made more efforts to acquire nationwide support.

The Kim administration, believing strongly that the general course of development for the engagement policy was correct, showed limits in its ability to embrace criticism of the policy. The administration also failed to properly handle and prevent the emergence of a dichotomous conflict regarding North Korean policies and unification plans in South Korean society. Even though this division emerged as the result of the deep-rooted Cold War culture, with the unyielding attitude of the opposition party also contributing to the problem, questions could be raised as to whether this should have been dealt with more efficiently by the government in the process of promoting North Korean policies. Ultimately, progress was made in inter-Korean relations but South Korean society, rather than establishing a solid domestic infrastructure to build better relations, succumbed to the negative

I

II

III

IV

V

VI

VII

VIII

effects of an unyielding division between the conservative and progressive camps. Thus, this political landscape created and fostered more domestic political conflict. Although this could be considered an inevitable outcome of the process of reorganizing the Cold War structure, the government could have created a more cooperative society, one that was more receptive to the North Korean policies, by preparing in advance for this type of conflict.

The formation of a politically polarized society considerably weakened the Kim administration which was already suffering from the limitations of being a minority government and its failure to establish coalitions with the opposition party. As a result, North Korean policies became the subject of political warfare. The government, without support from the opposition party, failed to react effectively to constant criticism of its North Korean policies.

The Kim administration should have accurately predicted the domestic conflict regarding the promotion of North Korean policies and should have prepared measures to respond to the matter accordingly. However, the government, while relying too heavily on a select number of policy-makers and at the same time insisting on the promotion of large scale events to turn the tide in inter-Korean relations, failed to successfully establish a popular constituent base on policy matters. This inevitably demonstrated that the government had a limited ability to persuade people to support its policies.

Another question should focus on the ‘results’ that were achieved, in terms of improvement in inter-Korean relations as well as a change in the North Korean position, in comparison to the ‘cost’ invested in North Korean policies. This is important because an improvement in inter-Korean relations can only be achieved when there is a strong foundation for stable relations and when it is accompanied by change in North Korea. In accordance

with that fact, and in order to justify North Korean policies, the South Korean government tried to promote policies based on unilateral interpretations of change occurring in North Korea. This in turn led to criticism that the government had lost its sense of direction in terms of evaluating North Korea and ultimately failed to help nurture the public's understanding of government policies toward North Korea.

Failure to coordinate cooperation with neighboring countries in relation to North Korean policies can also be regarded as another problem. Realistically, considering the fact that South Korea maintains a national security system with the US-South Korean alliance as the backbone, cooperation with the US is extremely important. But, since the Kim administration relied too heavily on its own unilateral expectations and interpretations of the US-Korea alliance, it failed to fully comprehend the actual intentions of the US and to respond accordingly. This resulted in a lack of policy coordination and cooperation. In particular, because of the failure to accurately evaluate the Bush administration's stance on North Korea, it became extremely difficult to coordinate and execute North Korean policies, and it also contributed to the growing perception gap that existed between the two countries regarding North Korea.

All in all, an evaluation of the basic direction of policy development adopted by the Kim administration demonstrates that it was the correct course. The South Korean government, faced with the historic change of the Cold War structure and a neighboring North Korean state that was dealing with extreme poverty and starvation, appeared to have no viable alternative options. Moreover, the considerable improvements and positive results achieved by the North Korean engagement policy, although limited, were valuable in comparison to the long history of contentious relations between the two Koreas. Yet, as mentioned above, the South Korean gov-

I
II
III
IV
V
VI
VII
VIII

ernment overlooked the possibility of promoting the engagement policy more efficiently and failed to solve the problems created by it. In particular, the policy implementation was problematic because the government failed in domestic politics to build a stable basis for the further promotion of North Korean policies.

### **3. Evaluating the North Korean ‘Peaceful Prosperity Policy’**

The ‘peaceful prosperity policy’ initiated by President Roh Mu-hyun’s administration shared the same principle of embracing North Korea and, therefore, could be seen as promoting the same basic stance as the former engagement policy. Taking into account the overall situation, the Roh administration’s North Korean policy concentrated on laying the foundation for a peaceful unification and preparing methods to achieve this goal.

Even though there were many policies achievements, the structure and culture of the Cold War that persisted on the Korean peninsula limited progress in inter-Korean relations. To achieve success in the policies for North Korea. President Roh and his administration needed to set new goals that reflected the actual problems. The Roh administration however aimed for peace on the Korean peninsula, and tried to create a positive cycle of peace and prosperity. Specifically, it contemplated goals such as prioritizing the resolution of the North Korean nuclear problem above anything else, establishing a system of peace, institutionalizing inter-Korean cooperation, establishing a support base for the promotion of North Korean policies, and persuading the international society to contribute to peace on the Korean peninsula.

The peaceful prosperity policy tried to formulate policies for



North Korea from a national strategic standpoint. In particular, because it utilized a Northeast Asian paradigm as well as an international paradigm to formulate North Korean policies, and also acknowledged the importance of establishing a base for public consensus, it could be said that it made efforts to solve the problems that had been carried over from the engagement policy. However, the limitations of the Roh administration included the failure to achieve any tangible results regarding peace issues such as nuclear development and firing of test missiles, inability to resolve unnecessary misunderstandings with the US, and failure to prevent continuous political warfare on issues of nationalism.

The North Korean nuclear problem is a serious issue that fundamentally threatens stability on the Korean peninsula. It is an issue that is deeply related not only to the progress of inter-Korean relations but also related to peace and security in international society. Progress within the framework of the Six Party Talks such as 'a peaceful solution to the North Korean nuclear problem through talks, and 'direct negotiations between North Korea and the US' were the basic ideas that the Roh administration emphasized. Even taking into account the limitations that were imposed on the situation because of the conflict between North Korea and the US, as well as the complexity of the nuclear problem itself, the efforts of the Roh administration produced certain tangible results in the search for a solution to the North Korean nuclear problem.

Under the Roh administration, talks between the two Koreas were held consistently in the form of ministerial and working group discussions, and the summit talks held between the two Koreas in 2007 maintained continuity in inter-Korean relations. A stable momentum of progress in inter-Korean relations was maintained throughout the summit talks that were held in 2007, and the continuity as well as the practicality of inter-Korean relations was

increased due to the negotiations held during the Roh government's term.

It is a positive development that inter-Korean cooperation projects including the Kaesong industrial region project were maintained even in light of the launch of the Daepodong missiles and the nuclear test. Despite the negative impact of numerous domestic and international factors, the stability of inter-Korean relations was fortified through inter-Korean economic cooperation, and it is meaningful that this contributed to increased pragmatism in inter-Korean relations. An increase in security risk as well as an outflow of international capital could have occurred in light of North Korea's nuclear weapons test. However, the government managed to help prevent a suspension in inter-Korean cooperation and to keep North Korea from closing down the Kaesong industrial region. This was important because it would have required a lot of time and effort to renew inter-Korean cooperation.

There is still some controversy over the Roh administration's handling of the relationship with the US, such as friction caused by calling into question unnecessary issues and trying to induce international cooperation through the Six Party Talks. However, the administration may have had some positive results with regards to finding a solution for the nuclear problem, promoting greater international cooperation and forming a more comprehensive US-Korea alliance. The Roh administration succeeded in gaining more US cooperation on North Korean policies by not only complying with all US requests, such as sending troops to the Middle East and changing the status of US troops stationed in South Korea, but also by discussing the details of the inter-Korean summit talks with the US. Especially from the South Korean standpoint, it is quite significant that the government was able to facilitate and engage in international cooperation in spite of all the bar-



riers that existed.

However at the same time, the peaceful prosperity policy did not solve all the problems created by the Kim administration's engagement policy. In particular, the Roh administration failed to settle many unnecessary controversies and the political conflict that emerged regarding North Korean policies.

Despite the fact that the North Korean nuclear problem was given first priority, the credibility of the policy was damaged because the government failed to predict and prevent North Korea's nuclear tests. The Reactions to the firing of test missiles are another example that demonstrate the limitations of South Korea's policies. In US-Korea alliance related issues, the Roh administrations unnecessary emphasis on and domestic use of the term 'independence' drew criticism from the conservative groups. It also created misunderstandings in both countries even though South Korea accepted US requests to send troops to Iraq and Afghanistan and changed the status of US troops stationed in South Korea. As a result, this weakened the Roh government's negotiating power with the US and caused an unnecessary increase in costs. This is one of the main reasons why the Lee administration has called for the establishment of a stronger US-South Korea alliance.

The Roh government also failed to stick to their principles regarding inter-Korean relations and negotiations with North Korea, and this resulted in the loss of public confidence. The Roh administration did not sufficiently persuade the Korean public to accept its stance on the issue of sending aid to North Korea. Therefore, it can be said that the Roh government also failed to establish a public base of support for its North Korean policies. During the participatory government's rule, the topic of inter-Korean relations was a constant source of political warfare and conflict between conservative and progressive camps. The participatory govern-

I
II
III
IV
V
VI
VII
VIII

ment did not actively try to persuade the conservative camp to build a critical coalition group, and as a result was not able to gain their support. Lastly, the government failed to appropriately confer with the opposition party while preparing for the inter-Korea summit talks, and therefore it left room for controversy regarding fulfillment of the summit agreements after the inauguration of President Lee.

## **4. North Korean Policies of the Lee Administration**

### **A. Changes in the Environment Promoting North Korean Policies**

The beginning of the Lee administration has been quite different from the start of the Roh government due to that fact that it is a de facto change of regime. Regarding North Korean policies, since President Lee was elected by a majority of the people while clearly expressing the opinion of the conservative camp, the Lee administration may be able to establish a legitimate foundation for addressing the criticisms raised during the Roh administration. During his campaign President Lee proposed policies that were in line with many of the main criticisms launched at the participatory government's North Korean policies, including changes in the government's position towards North Korea and a strengthening of the US-South Korean alliance. From this standpoint, the inauguration of President Lee represents a conscious choice made by the South Korean people to make a change in North Korean policy. This choice was likely based on a critical evaluation of North Korean policies that were initiated by the Kim Dae-jung administration and pursued over the last 10 years. However, it is also important



to note that apart from the obvious regime changes, there are other more fundamental changes in the environment<sup>1</sup> that are affecting the formation and promotion of the Lee administration's North Korean policies.

### **[The end of ideological competition]**

The progress made in South Korea's politics, economy and society in construction with the deterioration of North Korea's economic system should create an end to ideological competition between the two Koreas. From an economic standpoint, there is a distinct contrast between North Korea, a country that is dealing with starvation and dire economic conditions, and South Korea, which is approximately the 10th strongest economy in the world. Ideological competition will end not only in the economic arena but also in all fields including politics, society, and culture. While South Korea was successfully admitted into international society, North Korea contrived isolate itself and exhausted the potential for growth in its domestic system by perpetuating structural problems and crisis conditions. These circumstances have laid the foundation for a fundamental change in inter-Korean relations.

### **B. From 'National' to 'Rational'**

The rapid development and growth of South Korea allowed the country to gain entrance into the world capitalist system. This set the basic standard for the state's actions because it created an opportunity for transition from a nationalist paradigm to a capitalist paradigm. There was also a major power shift from the previous pro-US, anti-communist military regimes to democratic progressive regimes, and most recently a transition to a conservative

I

II

III

IV

V

VI

VII

VIII

democratic regime occurred. As a result of these changes, the nationalism discourse was weakened and ultimately transformed. South Korean nationalism, which was originally based on ideas of the purity of the blood line and familial relations, is currently going through a dramatic process of change. Consider for example the fact that international marriages are fast becoming one of the more popular types of marriages in Korea and that the international community has also emphasized the decline in racially homogeneous nations. Accepting the rationality and logic of the capitalist system, rather than promoting nationalism, was an important prerequisite for South Korea in order to be admitted into the world economic system.

Through progress and exposure to globalization, South Korean society is being forced to adopt the standards of the world capitalist system, and the acceptance of new standards can be understood as the effects of an increase in capitalist rationalism within South Korean society. The weakening of nationalism can also be symbolically found in the change of attitude toward the US. After the Gwangju democracy movement of 1980, the US was depicted as an ambiguous figure in South Korean society, even up until recently. When viewed from within the framework of the US-South Korean alliance, the US presence in Asia is a 'reality' that is directly and indirectly connected to the survival of the South Korean system in economic, diplomatic, and security related areas. This has made it very difficult to publically adopt a pro-US discourse in South Korean society since solving issues of nationalism is a priority. Yet, the effects of globalization in South Korea have caused a change in this kind of environment, and the election of President Lee Myung-bak who advocated the strengthening of the US-South Korean alliance provides evidence of this transformation.

In truth, the US presence functioned as a reality for the Roh

government as well, and when the political rhetoric that causes controversy is stripped away, analysis shows that the participatory government accepted most of the requests made by the US. In the specific case of sending troops to assist in the Iraq war, South Korea was one of the countries that deployed the largest amount of troops outside of the US and Britain. Therefore, the term ‘independence’ promoted by the participatory government in regards to the nationalist discourse appears to be no more than mere political rhetoric. By accepting the request to participate in a US led world order it appears that the Roh administration decided to select the ‘rational’ option.

### **C. The Transition from an Ideological to a Practical Paradigm**

The decline of nationalism and the increasing acceptance of capitalist rationality as a dominant value in society are related not only to the weakening of ideological positions but also to the embrace of pragmatism. The decreasing dependence on ideology is creating preferences around the world for practical thoughts and actions over ideological values, and South Korean society seems to be following in the same footsteps. The Lee administration’s policy of pragmatism was formulated against this background, and it seems that the trend had already gained some considerable ground in South Korea. Due to the collapse of the socialist bloc, the world order was restructured into a universal capitalist system, and a more standardized type of globalization spread around the world. Yet, along with these new developments a movement towards reducing the influence of ideology also emerged. Ideological beliefs that reflect the individual characteristics and conditions of each state contain a local ‘particularity’ that clashes with the ‘generality’ of globalism. This consequently means that ideological

I

II

III

IV

V

VI

VII

VIII

orientation cannot correspond with the trend of globalism. Therefore, the embrace of pragmatism is not just a simple choice for a conservative regime, but a complex structural choice. The fact that even the former Roh government supported the South Korea-US Free Trade Agreement (FTA) is evidence of this even though its political support base is generally comprised of progressive groups.

#### **D. Weakening of the Discourse on Unification**

The state continues to justify its national unification efforts despite decreasing support for nationalism. However, recent public opinion polls suggest that public support for Korean unification is not very positive. Support for unification seems to be weaker than in the past, and in particular, indifference to unification seems to be growing in certain groups, especially adolescents. As a news article entitled 'We must be unified, but only after I die'<sup>2</sup> explains, a trend that prioritizes the welfare and conditions of the individual rather than society's justification for unification is growing, and this phenomenon will eventually weaken the discourse on unification even further. There are several factors that have a negative effect on the national unification discourse including, uncertainty about a fundamental change in lifestyle that would result, an economic burden that would be imposed similar to German unification, the extreme economic gap between North and South Korea, and concern that problems such as unemployment and the economic divide in South Korean society will be exacerbated.

On the other hand, the conditions that caused the weakening of the discourse on unification can be found at a higher structural level in the growth of capitalism and the spread of globalization in South Korea. There is a growing tendency to support the principle of global universality as it applies to South Korean society, the

nation being a member of the capitalist system. Therefore, some argue that dealing with global issues should come before local issues (particularity), and they see localism as applying to the North Korea issue. These facts should be considered the foundation for creating policies to improve inter-Korean relations, since improving relations and expanding cooperation is more practical than attempting to justify unification, an impossible task in the short-term. Therefore, it is important to acknowledge the fact that the overall weakening of the unification discourse is a structural issue rather than a temporary phenomenon.

## **5. The Principles and Goals of the Lee Administration's North Korean Policies**

The circumstances in which the Lee administration is able to advance North Korean policies is fundamentally the same as that of the Roh administration. Therefore, the magnitude of change in policies is limited. First of all, the prerequisite of the 'Initiative for Denuclearization, Openness and 3000' created by the Lee government is no different from that of the Roh administration since both emphasize that finding a solution for the North Korean nuclear problem is a necessity for creating policies that promote inter-Korean cooperation. To ensure the stable progress of inter-Korean relations, the South Korean government must achieve tangible results, including continuation of the denuclearization process that is currently underway, and the search for a permanent solution to the nuclear problem. In addition, along with dismantling the nuclear program the parties involved in Six Party negotiations need to concentrate on establishing a peace system on the Korean peninsula.

I

II

III

IV

V

VI

VII

VIII

Tangible results are also needed with regards to the formation of a supra-partisan group that may facilitate the North Korean policy making process. Even the Lee administration, elected with an approval rating higher than other recent administrations has a weak foundation to push forward policies because it failed to win more than half of all the seats in the National Assembly. This problem already arose with regard to the resumption of beef imports from the US. North Korean policies are more complex than any other and the government needs the support of the progressive camp because North Korean issues are essentially a national issue that cannot be implemented only with support of the conservative camp. In particular, the cost of promoting North Korean policies is expected to grow immensely compared with the past, so domestic political cooperation is crucial for creating policies for North Korea. Achieving bipartisan and multilateral support for North Korean policies should be a task of high priority for the Lee administration since this support was nearly non-existent during the participatory government's rule. After the process of denuclearization is actually accomplished the government must establish a large base of public support for its policies since it is anticipated that the costs of pursuing progress and cooperation in inter-Korean relations and economic development North Korea will be enormous. This will also help deal with excessive criticism of North Korea policy and 'arguments of unconditional over-generosity.'

The 'Initiative for Denuclearization, Openness and 3000' must also become more specific or should be outlined in more detail. The ideas of denuclearization, openness, and the revitalization of the North Korean economy represented by the amount \$3,000 take the same basic stance as the North Korean policies of past governments, and as a result may be recognized for maintaining important continuity in North Korean policies. However, the fact that it



asserts that denuclearization is a prerequisite for improvement in inter-Korean relations, as well as the fact that the specific objectives sought by North Korean policies and inter-Korean relations are more clearly stated, are reasons why this North Korean policy differs from the others.

In the case of the Lee administration, the vision behind its North Korean policies is a combined goal of peaceful unification and the realization of a more developed nation. It can be deduced that the Lee administration intends to encourage the coexistence of both Koreas, by creating a positive cycle of improved inter-Korean relations and national development. Based on this understanding, it is possible to outline the following goals of the Lee administration's North Korean policies.

First and foremost, a requirement of the 'Initiative for Denuclearization, Openness and 3000' is the promotion of denuclearization. Since the Lee administration recognizes denuclearization as a basic prerequisite for progress in inter-Korean relations and the establishment of an inter-Korean economic community, dismantlement of North Korea's nuclear program is not only a major goal of the Lee administration but also a task of top priority. Progress in denuclearization is also closely linked to progress made in officially ending the military conflict between the two Koreas and converting the armistice to a system of peace. With denuclearization as a prerequisite, the 'Initiative for Denuclearization, Openness and 3000' will help embody such goals as the promotion of full-scale economic cooperation. This will help create a more developed Korea and further the search for a fundamental solution to the North Korean economic crisis. It will also directly improve the lives of the North Korean people by eliminating poverty and will help reduce the suffering of the people. Furthermore, a major objective of North Korean policies of the Lee administration is the

I

II

III

IV

V

VI

VII

VIII

realization of a more developed Korea. This will be achieved by promoting improvement in inter-Korean relations and North Korean policies within the framework of a long-term program for national development.

The following few principles contain statements to help accomplish these goals. The first principle aims to expand the pragmatism of North Korean policies. This should not be interpreted only in terms of pursuing actual gains from inter-Korean relations, or even making substantial progress in inter-Korean relations in order to build a basis for unification. The North Korean economic crisis cannot be solved by North Korea alone which has become institutionalized must also be considered. This crisis along with the growing influence of globalization on the Korean peninsula create the need to make substantial provisions for unification. From this point of view, enacting measures for the stable management and expansion of inter-Korean relations as well as making plans for possible unification are necessary. The practicality of North Korea policies must be interpreted from this standpoint.

Asymmetric reciprocity must also be deeply considered. This means that South Korean measures such as the expansion of inter-Korean economic cooperation and aid provided to North Korea should promote asymmetric responses from the North in the form of direct benefits for the people of North Korea and the search for solutions to human rights issues. Asymmetric reciprocity takes into consideration that cooperating with North Korea on development and aid issues does not have to necessarily produce symmetrical responses. In other words, North Korean responses to South Korean aid can relate not only to economic reciprocity and issues of military security, but also to a comprehensive range of issues that include a reduction in poverty, development of individual skills, and a solution to the human rights problem. This is requires



an understanding of North Korea's development that extend beyond the economic standpoint and contribute positively to the process of securing peace and unification on the Korean peninsula. Consequentially, investment in inter-Korean economic cooperation also does not necessarily require North Korea to respond with symmetric measures. That is to say, there is a need to recognize a certain asymmetric delay in the time required for the effects of development cooperation with North Korean to materialize. Firmly maintaining this perspective will have positive effects for gaining the support of the public on issues such as provision of necessary resources to North Korea. This will ultimately further the goal of improved inter-Korean relations.

Furthermore, the administration should strive to achieve a national consensus on North Korean policies and should make this a major policy objective. The Lee administration must create a model for cooperation that seeks produce understanding and explains the new initiatives. The ruling party must also not initiate North Korean policies unilaterally and the opposition party must not rely on one-sided criticism or anticipate gains from the failures of a certain policy. Both conservative and progressive camps should foster cooperation on unification and North Korean policies in a sincere manner. Issues of nationalism are problems beyond the interests of individual factions and camps, and are directly related to the shared future of the entire nation. Even with the Lee administration, it is always important to note that establishing a base of public support is important for securing the power needed to promote North Korean policies.

Lastly, the coordination of international cooperative efforts on this issue should be a major principle contrived in the policy. Efforts to build the foundation for a peace system and achieve the strategic goal of denuclearization should be coordinated closely among

I

II

III

IV

V

VI

VII

VIII

neighboring states and in conjunction with the US-South Korean alliance.

## **6. Conclusion**

The inauguration of President Lee Myung-bak, who has a different political stance than other recent presidents, presents certain possibilities for change regarding North Korean policies. However, there should be no change in the basic objectives of achieving peaceful management of inter-Korean relations, prosperity for both Koreas, and the ultimate goal of peaceful unification. From this standpoint, the North Korean policies should maintain a line of continuity.

With regards to these policies, the Lee administration must strive to build a model for productive cooperation in connection with the new policy initiatives.

The most important lesson gained from past North Korean policies is the fact that the ruling party should not initiate policies unilaterally, nor should the opposing party solely criticize and seek to gain from failed policies. Both the conservative and progressive parties should sincerely try to find possibilities for cooperation on unification issues as well as the North Korean nuclear issue. The economic and security problems associated with North Korea are clearly beyond the interests of certain political factions. They are issues that are directly connected to the future of all Korean people.

The conflict between the conservative and progressive camps is the type of transitional pain that must be overcome for the country to move beyond Cold War conflict and advance into a new stage of national reconciliation. The problem is not the mere existence of



conservative and progressive groups, but the fact that they cannot coexist or cooperate. This is the reason why establishing a solid base of public support at the start of the Lee administration is now being thoroughly discussed.

#### Notes

- <sup>1</sup>- Han-bum Cho, “The globalization of Korean society and discussion on unification,” Paper presented at the spring academic seminar at Ewha Institute of Unification Studies.
- <sup>2</sup>- “The younger generation such as high schoolers or university students have clearly different views on North Korea compared to the older generation” ..... “If phrases such as ‘We must be unified, but only after I die’ become common, a lot of people will feel that North Korea is an ‘irrelevant country.’” *Yonhap News*, August 23, 2006.

I

II

III

IV

V

VI

VII

VIII



# III

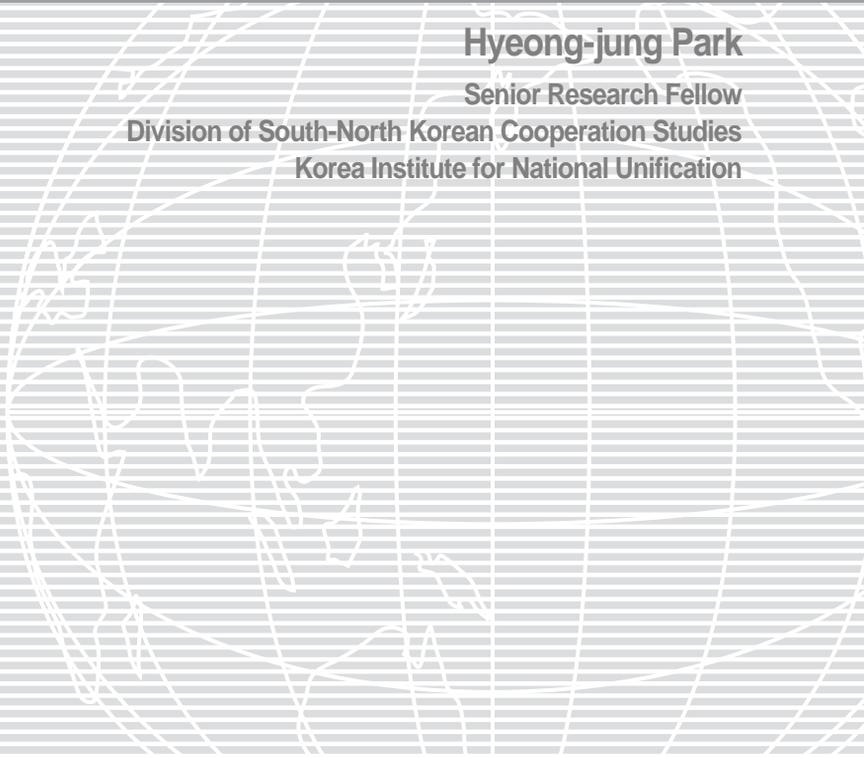
## **Economic Relations between South and North Korea: Present Status and Future Scenarios for Development**

**Hyeong-jung Park**

**Senior Research Fellow**

**Division of South-North Korean Cooperation Studies**

**Korea Institute for National Unification**





# 1. Introduction

On February 25, 2008, President Lee Myung-bak started his term as the new Korean president. Since then, inter-Korean relations have experienced many changes. During negotiations for the second inter-Korean summit in October 2007, the two Koreas agreed to extensively expand inter-Korean economic cooperation. However, the level of economic cooperation between the two countries has significantly decreased since the start of the Lee administration, and relations in general have become stagnant. North Korea has publically attacked the Lee administration several times since April and suspended the Mt. Kumgang tour project in August after the accidental shooting of a South Korean tourist. At the present time, North Korean is also threatening to close down South Korean businesses located in the Kaesong industrial region.

The purpose of this article is to identify the issues that should be addressed and the policy factors that should be considered in inter-Korean relations during the remaining four years of the Lee administration. The analysis will be based on the policy changes made by the Lee administration as well as North Korea's anticipated reactions to future policy plans.

The most important variable to consider when discussing the future of inter-Korean economic relations is the political relationship of the two countries. Thus, the economic relationship is still largely determined by government action and policy decisions on both sides. Each government appears to take into account political concerns more than economic efficiency when drawing up economic policies that concern the other country. As a result, inter-Korean economic relations can be easily affected by one or both sides. Thus, relations may either improve or deteriorate rapidly

I

II

III

IV

V

VI

VII

VIII

depending on how the parties subjectively view the magnitude of common interests and amount of political understanding that exists between the two countries. Since the start of the Lee government, it has become apparent that there are large differences in policies between the former Roh administration and the current Lee administration. These policy differences have created a perception that the two Koreas share fewer common interests, which in turn has affected the development of inter-Korean economic relations.

First, this article aims to examine the different phases of inter-Korean economic cooperation, particularly how they were determined and logically justified. This study will also analyze North Korea's anticipated response to the Lee administration's North Korean policies given certain conditions. Second, in light of the utility and costs of the policy differences between the Lee administration and the North Korean government, this article will attempt to evaluate tactical strategies that can be implemented. Since the future of inter-Korean economic relations will be affected by how the two Koreas view economic cooperation differently during the current Lee administration it is necessary to analyze the strategic countermeasures that each country will take in accordance with these different views.

## **2. The Lee Administration's Inter-Korean Economic Cooperation Model**

The vision for the inter-Korean economic cooperation model set forth by the Lee administration is based on the goal of achieving complete denuclearization of North Korea and establishing a feasible economic relationship with a more open North Korea. In other



words, the plan is to “help North Korea, with cooperation from the international community, to achieve a national income of \$3,000 within ten years if it chooses to give up its nuclear weapons and take a path towards reform.”<sup>1</sup>

However, the possibility that North Korea will carry out the conditions mentioned above is very low, and unfortunately those conditions must be fulfilled in order to achieve the Lee administration’s positive vision for inter-Korean economic relations. Consequently, the South Korean government finds itself in a difficult position where it has to promote economic cooperation with North Korea due to the dire state of the North Korean economy, despite the fact that none or only part of the conditions for denuclearization, reform and openness have been satisfied. Therefore, the possibilities for achieving inter-Korean cooperation will change depending on the Lee administration’s reaction to North Korea’s progress on nuclear issues and certain economic conditions prohibiting the realization of its vision for inter-Korean relations. In fact, the Lee administration has already announced that it will be guided by an approach to North Korean policies that is flexible but also strict at the same time.

### **A. Major Issues**

The basic position of the Lee administration on inter-Korean economic cooperation is as follows. The Lee administration prioritizes finding a solution to the North Korean nuclear problem, and expects inter-Korean negotiations, aid for North Korea, and economic cooperation projects to be promoted in conjunction with one another. The administration also plans to readjust or change South Korea’s attitude towards negotiating with the North. Quoting a remark from President Lee, “once they relinquish their

I

II

III

IV

V

VI

VII

VIII

nuclear program the North Korean regime will be stabilized, peace will be established, and the economy will prosper, allowing the foundation of an independent economy to be built.”<sup>2</sup> Therefore, “the speed, the magnitude and the methods for achieving progress in inter-Korean relations will be adjusted according to the progress made in resolving the North Korean nuclear problem.”<sup>3</sup> With regards to such logic, there are four major principles of inter-Korean cooperation that can be derived; economic cooperation should be fostered in conjunction with progress made on the nuclear problem, economic feasibility, the ability to finance projects, and building a public consensus on North Korean policies. Additionally, the government believes that the approach to negotiating with North Korea must change. “We must keep in mind that negotiating with North Korea is necessary in order to genuinely help the country revitalize its economy which will help the people of North Korea to maintain a minimal standard of living, thus, both Koreas must pursue appropriately equal measures to achieve that aim while negotiating.”<sup>4</sup> If inter-Korean relations are changed to reflect this, “the new government may engage North Korea even more.”<sup>5</sup> To summarize, if North Korea makes progress on denuclearization, reform and opening-up, the ‘Initiative for Denuclearization, Openness and 3000’ has the potential to become a very active policy for promoting economic cooperation with North Korea.

On a different note, the Lee administration has expressed its intent to provide humanitarian aid to North Korea under the principle of reciprocity. In other words, the South Korean government “will continue to help the North Korean people facing hardship,” however, “North Korea must cooperate on humanitarian issues, although not necessarily in exactly the same fashion.”

In sum, the Lee administration does not intend to pursue inter-Korean economic cooperation beforehand in hopes that it will

bring about the denuclearization of North Korea, but rather the government is presenting this as a reward for giving up its nuclear program. The Lee administration is adhering to the position that if North Korea cooperates with denuclearization, the South Korean government will organize an inter-Korean cooperative committee and will gradually promote the development of five major fields (economy, finance, education, infrastructure, quality of life) as outlined in the ‘Initiative for Denuclearization, Openness and 3000.’ The process will start with a “discussion on the signing of an agreement to establish an inter-Korean cooperative committee to further the process of denuclearization, after disablement and verification are completed.”<sup>6</sup>

Meanwhile, even if an agreement on humanitarian aid is concluded, there is still room for the provision of separate humanitarian assistance as distinct from economic cooperation.

## **B. Advantages and Disadvantages**

Each policy has its advantages and disadvantages, the following section explains those contained in the Lee administration’s North Korean policy.

### **[Advantages]**

First of all, the biggest advantage of the North Korean policy of the Lee administration is that it reinforces the United States’ negotiating power with North Korea. After the outbreak of the second North Korean nuclear crisis in October 2002, the biggest problem that the Bush administration had with the Roh government was the generous amount of aid provided by the Roh administration to North Korea.

I

II

III

IV

V

VI

VII

VIII

Since South Korea promoted a bold increase in economic cooperation<sup>7</sup>, the balance of ‘carrot and stick’ approach that the US had planned to use against North Korea proved to be ineffective. As long as the Lee administration adheres to a position of promoting cooperation in connection with progress made in the denuclearization process, the tactics of North Korea will continue to be considerably restricted.

Second, the economic cooperation policy of the Lee administration will help the North Korean government find a more realistic solution to its domestic and international economic problems. In the past, the South Korean government had directly and indirectly aided North Korea with large amounts of money and other resources. But this sort of assistance can create a vicious cycle if the government that receives the aid is lazy or reluctant to solve the problem at hand, and the assistance becomes drawn out. In other words, the government in question is not interested in solving the economic problem, even though it internally recognizes that the economic crisis is bound to reoccur.<sup>8</sup>

Third, the Lee administration’s North Korean policy may slow the increasing rate of moral relaxation that was inherent in the logic of the Roh administration’s policies on economic cooperation which required public funding. The Lee administration’s four major principles not only focus on the political aspects of economic cooperation such as the progress on denuclearization and a national consensus on policy, but also mention economic standards such as economic feasibility and the ability to provide financial resources. The Roh administration stuck to the position that the main objective of economic cooperation was to expand the inter-Korean relationship. The government believed that in order to achieve this goal cooperation needed to be actively promoted. Under this policy, Korean companies were able to develop certain projects while

knowing that the projects would be disadvantageous, because if it coincided with the national policy for North Korea or was deemed politically important the project would be kept afloat with government subsidy.

Fourth, the policy may bolster South Korea's pride in North Korea. During the Roh administration's term criticism arose that the government was 'assuming a low posture in negotiations with North Korea' and that it was keeping silent on problems, such as human rights issues within North Korea. The current policy stance supported by the Lee administration will not receive such an assessment.

### **[Disadvantages]**

First and foremost, the biggest disadvantage of the Lee administration's North Korean policies is the fact that they have failed to consider the interests of the North Korean leader Kim Jung-il. The biggest concern for Kim Jung-il is the preservation of the North Korean system. As a result North Korea's contributions to inter-Korean relations have sought to reinforce this domestic agenda and to support the North Korean position in relation to South Korea and other neighboring countries as well. As long as North Korea pursues this position, it will continue to shoulder the costs of progress in inter-Korean relations or to deal with the affordable side affects. However, the Lee administration has formulated a policy that discourages and tries to intercept the profits that the Kim Jung-il regime had previously gained from inter-Korean relations. Accordingly, it can be said that the North Korean policy of the Lee administration conflicts with the desire of Kim Jung-il to preserve and reinforce his political system. Therefore, the Kim Jung-il regime has maintained a hostile and defensive attitude

I

II

III

IV

V

VI

VII

VIII

towards the North Korean policy of the Lee administration, and refuses to negotiate under the conditions proposed by the Lee administration. It is apparent that a non-negotiable gap exists between the Lee administration and the Kim Jung-il regime.<sup>9</sup>

Second, the 'Initiative for Denuclearization, Openness and 3000' is based primarily on two main optimistic views. It is optimistic about the eventual denuclearization of North Korea and North Korea's acceptance of economic reform policies. This optimism of course is not necessarily confined to the 'Initiative for Denuclearization, Openness and 3000.' This type of optimism is a characteristic that has generally been shared by most South Korean experts, especially those working on inter-Korean economic cooperation. However, even though South Korea had high hopes for these two conditions they currently have little possibility of being fulfilled. In other words, in order for the 'Initiative for Denuclearization, Openness and 3000' to be successful, the denuclearization of North Korea must proceed in a straightforward progressive way. In conjunction with the denuclearization process, the market reform policies of North Korea must also progress swiftly. Realistically however, the denuclearization process is bound to undergo phases of stagnation and reversal due to North Korea's isolated status or because of the interests of different parties. Furthermore, North Korea can always decide not to promote economic reform policies in conjunction with the denuclearization process. In other words, it is uncertain whether or not North Korea will accept the political and economic conditions necessary for embracing inter-Korean economic cooperation by actively pursuing parallel reform measures and also following through with the denuclearization process to a level that satisfies South Korea.

We should first examine the North Korean nuclear problem. Even if measures such as the freezing of nuclear facilities and the

complete declaration of its nuclear program materials are achieved, it will be necessary to promote more intense negotiations in order to gradually resolve other such issues on the matter and to ensure that the nuclear program becomes irreversible. This process is sure to take a long period of time. During this process North Korea, more specifically the Kim Jung-il regime, must substantially dismantle its nuclear capabilities and the relevant states must provide North Korea, with political and economic rewards. In other words, both parties must pay large yet unclear costs to achieve a solution to the problem.

The following are important questions to consider. Does the 'Initiative for Denuclearization, Openness and 3000' guarantee a brighter future for the Kim Jung-il regime? Do South Korea, the US, China, Japan, and Russia share common interests in issues such as denuclearization, peace on the Korean peninsula, and reorganization of the power structure in Northeast Asia?<sup>10</sup> Can the five remaining related states come to an agreement on the reorganization of the power structure in Northeast Asia without North Korea? Can the six parties participating in the nuclear talks continue negotiations while paying costs for a future that does not seem to be very bright, or will they be content with the current situation?

In addition, the 'Initiative for Denuclearization, Openness and 3000' is based on very optimistic predictions about how well the Kim Jung-il regime and the North Korean society will accept and adapt to the political economic cooperation efforts made by South Korea. The aim of the initiative is to "encourage transformation to an export-oriented market economy as well as adopt active market liberalization policies" through massive investment of funds and materials. The belief is that through implementation of these measures building a "foundation for the unification of the two economies, and eventually the establishment of an inter-

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

Korean economic community, which is more or less the economic system of a unified state, will be possible.”<sup>11</sup>

Yet, implementation of the ‘Initiative for Denuclearization, Openness and 3000’ is only possible if North Korea fully cooperates with South Korean demands in the denuclearization process, and makes efforts to change and improve North Korean society.

Moreover, in the process of carrying out these initiatives, North Korea must be able to keep up with systematic domestic policy reforms while South Korea provides funds, materials, and other intellectual services. North Korea must also undertake a large-scale reform program in the political and social arena. The conditions for international politics and the international economy of course must also be extremely favorable.

However, these all expectations put together are unrealistic. The preservation and security of the Kim Jung-il regime is the single most important principle that North Korea will stick to in exchange for making progress in the denuclearization process. The Kim Jung-il regime will be extremely careful on this issue and will reform its policies and systems only when it is completely confident that regime survival is guaranteed. Even without the existence of Kim Jung-il’s regime, it is questionable whether or not the North Korean society, which has been isolated over the last 60 years, will be able to adapt to change quickly enough to meet South Korea demands. The problem is that the ‘Initiative for Denuclearization, Openness and 3000’ has not incorporated consideration of these factors into the policy.

Third, reform is more important than opening up to the outside world. Yet, the government has indicated that openness contained in the ‘Initiative for Denuclearization, Openness and 3000’ is the key to the policy. There are many autocratic states, though relatively open compared to North Korea, which are also suffering from

extreme poverty. Most of these poor states have adopted the market economy but are refusing to reform their policies and organizational structure. This shows that an expansion of the market economy will not necessarily lead to greater productivity or reform in the North Korean domestic economy. However, due to shifting international and domestic circumstances, the North Korean government must adapt to change in order to survive. Although adapting to this change might be relatively simple for the regime because of the authoritarian nature of the system, this might mean more trouble for the already suffering North Korean population. Alternatively, North Korea may choose to adhere to its traditionally conservative system, but adopt defensive open-door policies in order to earn the foreign capital necessary to maintain its current system. The efforts to reform and open-up have included plans to increase international aid, introduce foreign capital through development of resources, and create special economic zone policies. These policies have in fact coincided with South Korean economic cooperation strategies. However, when domestic reforms are not implemented alongside such open door policies, as in the Chinese case, the plans can help sustain a political system without actually reforming the system. Many established theories regarding economic assistance argue that when there is ineffective governance international cooperative aid can make a bad situation even worse, as is the case with such countries.<sup>12</sup> This is the so-called curse of assistance. Yet, if the policies and organizations are reformed, open-door policies will become a part of that reform. In other words, reform is not just a part of implementing open-door policies, but in fact the open-door policies are a significant part of the reform. The current theories and methods of economic assistance are founded upon this kind of understanding.

Fourth, the 'Initiative for Denuclearization, Openness and 3000'

has not moved beyond a one-way expansive economic cooperation plan, based on the unilateral offering of large-scale capital and equipment, such as the one originally initiated by South Korea. In fact, this approach characterized the majority of inter-Korean cooperation projects during the former Roh administration. This type of economic cooperation plan was mostly used in the 1960s and 1970s and utilizes methods in which the offering state provides the majority of capital infrastructure. Thus, past experience shows that in order for large-scale capital infrastructure to be used productively, substantial systematic improvements must be made in the receiving countries beforehand. Therefore, economic relations with North Korea must focus on persuading North Korea to reform its policies and systems according to its own free-will. The policies must also provide capital and equipment based on the different phases of reform.

Naturally, reciprocal inter-Korean cooperation must be a prerequisite for these procedures. In this case the motives and objectives of the North Korean government, which differ from those of its South Korean counterparts, will also influence the procedures. However, it must be pointed out that consideration of this factor has been left out in previous strategic plans for inter-Korean cooperation, and the 'Initiative for Denuclearization, Openness and 3000' is repeating the same mistake.

In sum, the Lee administration will probably have to deal with a North Korea that will not demonstrate sufficient signs of making progress in the denuclearization process. North Korea may not genuinely open its doors during the five years of President Lee's administration. In this case, the Lee administration's North Korean policies should focus on the key factor of how to deal with the North Korean position. Also, the Lee administration must not limit the framework of inter-Korean relations to a relationship that only

includes North and South Korea, or even one that includes only the two Koreas and the US. Realistically speaking, inter-Korean relations should be dealt with within the framework of the Six-Party Talks that involves the two Koreas, the US, China, Japan, and Russia. In this framework, it is crucial for South Korea and other participating states to adopt a careful stance that does not rely too confidently on or express too much hostility toward any other state in the multilateral structure.

Additionally, in the Six-Party framework, North Korea may pursue diplomatic and security related positions that may cause trouble for South Korea. However, the policy vision of the Lee administration is too idealistic and too simple to efficiently handle the immediate problems of this complex reality. This may cause various difficulties.

### **3. Scenarios for Inter-Korean Economic Cooperation During the Lee Administration**

As mentioned before, the ideal goals outlined in the ‘Initiative for Denuclearization, Openness and 3000’ will likely not be realized in the near future, if ever. This perspective brings up two important questions. First, if these goals cannot be achieved what kind of situation will the Lee administration face? Second, how must the Korean government deal with the situation?

First, let us examine the situation that the Lee administration is confronted with. According to the logic proposed by the Lee administration, the promotion of inter-Korean cooperation should be directly linked to North Korea’s denuclearization and the implementation of open-door reform policies.

Based on this logic, we can derive four scenarios that might

	Denuclearization	Open-door policies
First scenario	O	O
Second scenario	O	X
Third scenario	X	O
Fourth scenario	X	X

arise from the inter-Korean cooperation policy of the Lee administration. The first scenario is a case where North Korea successfully makes progress on both denuclearization and reform policies. The second case is where it only makes progress on denuclearization. The third scenario is a case where only open-door reform policies are successfully implemented, and the last one is where North Korea rejects progress on all fronts.

At this point, this article will assess under what circumstances each scenario will become a reality, and how the Lee administration may respond to each case. In mapping out the scenarios, we have to concentrate on the various circumstances and trends that have led to the present situation.

First, the second scenario can be described as a case where North Korea allows progress to be made on denuclearization, but shows no signs of promoting reform policies domestically. This scenario is in fact the same situation that has been occurring ever since the Six Party agreement was made on February 13, 2007. In other words, although North Korea started to show signs of progress on denuclearization issues and international conditions were considerably improved, after the agreement North Korea continued to adhere to conservative domestic policies that reinforced political control and remained hostile to the market economy.<sup>13</sup> In this case, even if North Korea showed engagement in various activities internationally, this is evidence that the government was not ready for reform and openness because it maintained its

conservative domestic policies. In other words, even if the first two phases of denuclearization negotiations focused on disablement of nuclear facilities and an improvement in US-North Korean relations, North Korea would still be able to maintain conservative policies that help preserve their system and to pursue negative open-door policies without reforms. This may continue to be the case if the Kim Jung-il regime regards the threat of instability caused by reform and open-door policies to be greater than the gains. If this happens, North Korea will promote international economic cooperation by focusing on receiving foreign aid, developing resources, and opening restricted special economic zones. This type of open-door policy is designed to maintain the political system. The purpose is to earn sufficient amounts of foreign capital required to preserve the domestic conservative policies of the regime.<sup>14</sup>

In this type of situation, the type of inter-Korean cooperation that North Korea wants to pursue is the kind that was provided by the former Roh administration. An example of this are the demands that North Korea made in order to conclude the inter-Korean agreements signed on June 15, 2000 and October 4, 2007. Under these circumstances, the Lee administration has two alternatives to choose from. If the current government wishes not to pursue inter-Korean relations using the same method as the previous administration, inter-Korean economic cooperation will remain stagnant. This has basically been the case for relations in 2008. Furthermore, since North Korea declared that the Lee administration is a threat to the preservation of its system, inter-Korean economic cooperation has significantly decreased. Another alternative is one in which the Lee administration ‘amends the principles flexibly.’ In this case, the Lee administration must ‘flexibly’ relinquish most of the principles that the government is currently supporting. The

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

Lee administration provides funds and resources directly to North Korea to support the 'humanitarianism' cause while asserting that the reason is because North Korea is now cooperating with the denuclearization process. In addition, the Lee administration, while stating that it has decided to respect the existence of the Kim Jung-il regime, is utilizing public governmental funding to promote inter-Korean economic cooperation.

The first scenario may be described as a case where North Korea promotes both denuclearization and open-door reform policies. In this scenario, North Korea promotes disablement and makes progress on a declaration for denuclearization that the US and other related states can be satisfied with. Additionally, North Korea enters the third phase of denuclearization by agreeing to adhere to a specified verification process. As a reward for North Korea's cooperation, the US and Japan will make progress in normalizing relations with North Korea. In other words, the states will recognize the Kim Jung-il regime as the sovereign ruling system of North Korea, refrain from interfering in the domestic politics of North Korea, and cooperate with the development of the North Korean economy.

In this case, inter-Korean governmental relations and the economic relations initiated or secured by the government can be renewed if the two governments reach a new deal. However, the process for achieving a new deal will not be easy. North Korea, with the international society acting in its favor, will demand additional rewards or 'humanitarian aid' from the Lee administration that will contribute to the stabilization of the Kim Jung-il regime. In return for North Korea making progress on denuclearization and the implementation of reform policies, the Lee administration will probably acknowledge Kim Jung-il as the rightful leader of North Korea, cooperate actively on economic development, and

adopt policies that will not exacerbate the worries that Kim Jung-il might have about domestic issues.

The third scenario is a case in which the dismantlement process faces breakdown between the end of the second phase and the start of the third phase of denuclearization. From the North Korean standpoint, it must assume that the relations with South Korea, the US and Japan will deteriorate in the long-term. China will also hold a negative perception about the change of North Korean policies towards South Korea and the strengthening of the US-South Korean alliance. In this scenario, North Korea will seek to reinforce ties with China in retaliation for the strengthening of the US-South Korean alliance. If the current negotiations on the declaration of nuclear activities break down, the Lee administration will lose all justification to resume inter-Korean relations, and this situation could get worse if the US loses all motivation to improve relations with North Korea. Although China fears the rise of domestic instability in North Korea, because it cannot provide free aid to North Korea, the Chinese government can only promise to provide the appropriate amount of assistance necessary for maintaining stability of the political system in return for reform and market liberalization. In this case, there will be an increase in investments using Chinese capital backed by the Chinese government. Under these circumstances, South Korean capital may choose to invest in North Korea in the form of reciprocal cooperation even though North Korea maintains strained relations with the South Korean government. The Lee administration might even attempt to restore inter-governmental relations with North Korea by expanding inter-Korean economic cooperation with public government funds due to South Korean fears of increased Chinese influence in North Korea. In this case, even though there will be no progress made on denuclearization, economic cooperation with a

I

II

III

IV

V

VI

VII

VIII

North Korea that has started to open up its economy may be expanded.

The fourth scenario can be described as a situation where the denuclearization process fails, and the relationship between North Korea and China deteriorates in the process, leaving North Korea stranded. This is a situation that cannot last for long. North Korea will become domestically unstable, leading to a state of confusion, or transition to any of the other three scenarios mentioned above.

In the long term, situations may switch from one to the other. For example, the third scenario may transition into the first scenario or the second scenario may change to the first. It might even be the case that a certain scenario may be maintained without changing for a long period of time.

#### **4. Conclusion**

South Korea policies that relate to inter-Korean relations and North Korean economic cooperation have always been, and still are methods to achieve general policy objectives for North Korea. The main goals of those policies relate to issues of denuclearization, improvement in inter-Korean relations, and implementation of reform measures in North Korea. North Korea has also pursued its own political agenda in establishing economic relations with South Korea.

Inter-Korean governmental relations and economic cooperation based on that relationship have developed through a variety of compromises made between the two Koreas. Since they had different objectives, the two Koreas briefly exchanged a 'balanced' package, consisting of different components that came about as a result of compromise.

As mentioned in the previous scenarios, the governments of the two Koreas must agree upon a new balance of interests in order to make progress on inter-governmental relations and economic cooperation. The current situation is one in which the Lee administration is demanding such an agreement, but the North Korean government is refusing it. Pyongyang will try to isolate Seoul for the time being, while making various efforts to receive international aid. The ability of the two Koreas to achieve a new compromise agreement will depend on how successful these North Korean efforts are. From the standpoint of the Lee administration, which proposed conditions and structures that require North Korea to take a more rational domestic and international position, this is considered a desirable situation. However, it is uncertain whether this will eventually have positive or negative effects on inter-Korean relations. Currently, due to South Korea's financial burden, the negotiating power of the US and the influence of China are increasing. In reaction to the situation, North Korea is making efforts to inflict losses on South Korea.

Finally, this article has indicated points that should be considered with regard to the resumption of inter-Korean governmental relations and the progress of economic cooperation. First, the South Korean government must adopt an approach to inter-Korean relations that is appropriate for dealing with a state such as North Korea. It should take into consideration the high levels of uncertainty in all aspects, including denuclearization, domestic reform, and the nature of inter-Korean relations. To quote the Organization for Economic Cooperation and Development's Development Assistance Committee (OECD DAC), North Korea is a 'state that is hard to maintain relations with.' When dealing with such a political system, each policy comes with costs and gains, and the next best choice will always be chosen. In this case, having a clear under-

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

standing of the costs and gains of each policy is necessary, and careful consideration must be made when selecting different strategies, policies, methods, and measures to deal with such a difficult opponent. When unilaterally emphasizing only the gains and positive expectations of inter-Korean relations for political publicity, the problems inherent in the next best choice could increasingly lead to uncontrollable circumstances in the long term.

Second, South Korea must try to make realistic and objective judgments, and establish policies based on that judgment with regards to denuclearization, progressive inter-Korean relations and reform changes in North Korea. The government and society of South Korea have over the last few years maintained very optimistic views on those three aspects, and have made efforts to establish North Korean policies that coincide with such views. This has been especially evident in the analysis of North Korean change and in studies on the field of economic cooperation. Yet realistically, there are many obstacles that should prevent South Korea from recognizing that all aspects are positive. Only when a complete understanding of a certain situation is achieved can we find an actual solution to a problem.

Third, the South Korean economic policies for North Korea must not only consider these difficulties, but must also be capable of dealing with the current North Korean government. It is unrealistic to plan to negotiate with North Korea only after South Korean demands on denuclearization, improved inter-Korean relations, and domestic change are satisfied. The future resumption of inter-Korean governmental relations depends on how considerate the Lee administration is of the current North Korean regime. Yet, it is advisable for the South Korean government and society to aim for changes in conditions and the method of negotiations with North Korea. To aim for improving the welfare of the North Korean

population through various North Korean policies is another desirable goal. However, the most crucial interest of the North Korean government will be the preservation and prosperity of the Kim Jung-il regime. The process of creating a new compromise agreement between the two Koreas will not be easy. Considering the interests of the two parties, an increase in government initiated economic cooperation will start with a compromise between the principles contained in the 'Initiative for Denuclearization, Openness and 3000' and the inter-Korean declaration agreed upon on October 4, 2007.

#### Notes

- <sup>1</sup>-Duk-min Yoon, "Initiative for Denuclearization, Openness and 3000': Tasks and outlooks," *Institute of Foreign Affairs and National Security Analysis of Major International Issues* (2008.4.29).
- <sup>2</sup>-Collection of presidential activities and speeches, keynote speech from the report of operations at the Ministry of Unification 2008.3.26.
- <sup>3</sup>-The Ministry of Unification, *Report of Operations Regarding Unification 2008* (2008.3.26), p. 6.
- <sup>4</sup>-Collection of presidential activities and speeches, keynote speech at the report of operations at the Ministry of Unification 2008.3.26.
- <sup>5</sup>- *Ibid.*
- <sup>6</sup>-The acquisition committee for the 17th South Korean President, *White Paper 1, Success and Sharing, the national management philosophy and the major tasks of policies of the Lee administration* (2008.3), p. 187.
- <sup>7</sup>-After an agreement was made at the Six Party Talks on September 19, 2005, economic cooperation was expanded from not only the three major projects including the Mt. Kumgang tour project, Kaesong industrial region, and the railways and road development, but also to the fields of agriculture, fisheries, light-manufacturing industries, and mining. Also, after the North Korean nuclear facilities were frozen in June after the agreement between North Korea and the US was made on February 13, 2007, inter-Korean summit talks scheduled for August

were held in October, and the inter-Korean agreement that included visions for the large-scale expansion of economic cooperation was signed on October 4, 2007.

<sup>8</sup>-Related to this discussion, Yong-seung Dong, "The 'Initiative for Denuclearization, Openness and 3000' and methods for inter-Korean economic cooperation," *North Korean policies of the Lee administration and inter-Korean relations* 19th Forum of Experts at the Peace foundation, 2008.3.19, pp. 41-42.

<sup>9</sup>-On the North Korean position, Jin-uk Choi, "The North Korean position and evaluation of the Lee administration," *Diagnosis and Tasks of inter-Korean Relations in 2008*, Commemorative Academic Forum on the 17th anniversary of the foundation of the KINU, 2008.4.18.

<sup>10</sup>-Of all the states, South Korea must answer this question first. The Roh administration was extremely eager to establish a peaceful system on the Korean peninsula, and was keen on promoting and adopting compromises with North Korea, adjustment of the US-South Korean alliance, and the changes in the situation surrounding the Korean peninsula and Northeast Asia, despite many controversies and criticisms. On the contrary, 'the new peace system' that the Lee administration is envisioning shows signs of sticking to a status quo peace on the peninsula. Desire to establish peace on the peninsula has decreased considerably, and rather the intent to solidify the US-South Korean alliance and to 'establish a new Northeast Asian cooperative system' has been expressed.

<sup>11</sup>-The acquisition committee for the 17th South Korean President, *White paper 1, Success and Sharing, the national management philosophy and the major tasks of policies of the Lee administration*, p. 188.

<sup>12</sup>-In particular, Tim Harford and Michael Klein, "Aid and the Resource Curse: How Can Aid Be Designed to Preserve Institutions?", *Public Policy for the Private Sector*, Note Number 291 (The World Bank Group, April 2005); Other publications on the current issue include, Todd Moss, Gunilla Pettersson, and Nicolas van de Walle, "An Aid-Institutions Paradox? A Review Essay on Aid Dependency and State Building in Sub-Saharan Africa," *Center for Global Development Working Paper Number 74* (January 2006).

<sup>13</sup>-Young-tae Chung *et al.*, *Analysis of the domestic and international status of*

*North Korea during the second half of 2007* (Korea Institute for National Unification, 2007.12).

<sup>14</sup>-In South Korea this type of promotion of open-door policies is generally regarded as 'progress' in North Korean openness. This is also regarded as 'change.' North Korea has to pay a certain political cost for this level of 'openness.' However, the people that reside in the special open areas that are designed for attracting foreign capital are a privileged group in such a poor despotic state. Therefore, these people do not turn against the government despite constant contacts with the outside world. Daron Acemoglu etc., "Kleptocracy and Divide-and Rule: A Model of Personal Rule," NBER Working Paper 10136 (December 2003); South Korea has overestimated costs, and underestimated gains derived from cooperation with the North Korean government.

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

---



# IV

## South Korea's Economic Policies toward North Korea: Alternatives for Promoting North Korea's Economic Opening-Up

**Kang-taeg Lim**

Senior Research Fellow

Division of South-North Korean Cooperation Studies

Korea Institute for National Unification

\* This article is a revised and recomposed version of Kang-taeg Lim, "Promotional Strategies to Stimulate North Korean Open-door Policies," *The Vision and Directionality of the Lee Administration's North Korean Policies*, pp. 143-164, translated into English.



## 1. Introduction

There is a need to understand the differences between past North Korean policies and the current North Korean policies, by focusing on the ‘Initiative for Denuclearization, Openness and 3000’ which is considered the most important piece of current North Korean policy that requires public consensus. It is also important to appropriately reflect on the differences in policy in order to make even more improvements.

First, the current South Korean government has expressed a desire to place more emphasis on international relations as compared to inter-Korean relations. It seems this objective stems from the perception that the US-South Korean alliance, which is extremely important to South Korea, has grown weaker since the main focus of international relations over the past ten years has been on improving ties with North Korea rather than concentrating on relationships with western states such as the US.

Under these circumstances, inter-Korean relations can be seen as the product of a three-dimensional game and should be analyzed overall in the context of the international environment. The game consists of three theoretical levels: the domestic level, the level concerning North Korea, and the international level.

These three levels directly affect the progress of inter-Korean relations and interact with each other even while the two Koreas are conducting negotiations. It is through the reciprocal exchange that a series of agreements can be concluded. Thus, in order for inter-Korean relations to make continuous progress, the three levels must be developed simultaneously with balance and harmony.<sup>1</sup>

Even though the previous South Korean administration understood the importance of interaction at the inter-Korean level and tried to improve inter-Korean relations by expanding economic

I

II

III

IV

V

VI

VII

VIII

cooperation, its activities were limited because it failed to appropriately engage the US, the most important actor in the international scene, as well as various domestic interest groups. In comparison, the new administration has focused on playing 'the game against North Korea' efficiently by solidifying the alliance with the US, a key player in finding a solution for the North Korean problems.

Second, from the perspective of promoting policy strategy, the current government seems to have great intentions to 'appropriately link change and openness with economic cooperation,' rather than just focusing on 'inducing change through contact.' Although there are arguments about whether the 'Initiative for Denuclearization, Openness and 3000' is an 'extensive theory' or a 'phase theory,' it can be said that it is somewhat closer to an 'extensive theory' as compared to the theories of past administrations. The fact that the current Lee administration is pointing to the 'overgenerous aid' and the 'low posture of the South Korean government' as the primary reasons for the failure of North Korea policy, is some evidence that it is closer to an extensive theory. The Lee government has also pointed to the negative results, rather than policy processes, of past administrations such as the 'inability to prevent nuclear testing,' 'failure to induce reforms and open-door policies,' and 'failure to improve the human rights situation.'

This differentiates it from the core policies of the previous administration. The main characteristics of the 'engagement policy,' or the so-called 'sunshine policy,' representing the North Korean policy of the previous administration, were the efforts to induce change in North Korea through contact and exchange. It was an approach that strived to establish a positive cycle comprised of the parallel pursuits of change in North Korea and the expansion of inter-Korean economic cooperation.

The current Lee administration on the other hand seems to feel

strongly that expansion in the area of economic assistance and an increase in cooperative projects should be promoted in conjunction with progress made in the denuclearization process and the implementation of reforms and open-door policies for North Korea. The idea is that economic relations with North Korea should be conducted in accordance with the international environment of cooperation, which will be affected by the level of change in North Korea.

Third, from a theoretical standpoint, North Korean economic cooperation policy will achieve a greater impact when analyzed from an economic integration perspective rather than from a cooperative development perspective. Past administrations focused on 'economic integration' while adopting a functionalistic approach in North Korean policy. They tried to achieve a de facto state of integration through the promotion of exchanges and expansion of economic relations that would bring about change. In order to achieve a domestic public consensus to support this goal, the concept of 'Governance' was adopted.

In contrast, it appears that the 'Initiative for Denuclearization, Openness and 3000,' which is the foundation for the Lee administration's North Korean policies, is firmly based on the theory of 'cooperative development.' Therefore, this demonstrates that the current and past administrations have taken similar approach methods and have expressed concerns about seeking to effectively assist and cooperate with North Korea. Both administrations agree that North Korea is a 'vulnerable country,'<sup>2</sup> and in particular emphasize the importance of cooperation with international society.

In order to be successful, and if the 'Initiative for Denuclearization, Openness and 3000' truly has the strong characteristics of a cooperative development project, it must be able to effectively persuade the international society to engage in cooperation and at the

I

II

III

IV

V

VI

VII

VIII

same time be able to provoke a positive response from North Korea. Therefore, in order to prepare for a situation in which the 'Initiative for Denuclearization, Openness and 3000' can be effectively promoted, the South Korean government must first possess the ability to convince the international society to cooperate despite all of the different interests, operation systems, and standards. After that, one of the most important factors that will lead to the successful promotion of cooperative development projects is the sense of ownership of the related countries, and the strengthening of independent capability to promote these projects. From this standpoint, unless there are fundamental changes in the current situation in North Korea and the capability to promote cooperative projects is strengthened, the success of the 'Initiative for Denuclearization, Openness and 3000' cannot be guaranteed.

## **2. Paths for the Promotion of inter-Korean Economic Cooperation**

### **A. 'Facilitation of North Korea's Openness' as a Policy Goal**

If South Korea intends to achieve the policy goal of facilitating the implementation of open-door reform policies in North Korea, it is necessary to define the exact meaning of openness 'the opening of North Korea.'

First of all, at the level of the state, the adoption of open-door reform policies will not necessarily mean the 'normalization of North Korea.' A normalized North Korea would exist as a state that no longer depended on illegal trading, and as a proper member of the international society it would generally follow the norms of the international economic system.

Second, on the economic systems level, the open-door policies of North Korea might be regarded as ‘marketization’ because the process would increase exchanges with the global capitalist market.

Third, at the level of individual economic livelihood for North Koreans, the open-door policies of North Korea may represent ‘liberalization or democratization’ because they expand the free choices of the population while still maintaining the material conditions for producers in the economy.

Therefore, if South Korean policies for economic cooperation intend to bring about increasing openness in North Korea, policy-makers must comprehensively consider all three levels of open-door policies mentioned above. Here, it is important to realize that the people of North Korea should be the main subject for those South Korean policies that relate to North Korea. In particular, there is a tremendous need to assess the fact that North Korean people who were born during the continuous and chronic food shortage of the mid-1990s are gradually becoming the main producers in the North Korean economy.

## **B. Key Points of North Korean Policy**

First, the policy for North Korea pursues ‘creative pragmatism.’ Creative pragmatism can be understood as ‘getting actual results by seeking to constantly change approaches and perspectives in order to adapt to new situations.’ While applying this principle to the process of selecting a field for economic cooperation at the governmental level, we should prioritize fields or overlapping areas that contribute to the revitalization of the South Korean economy, and also focus on areas that are necessary for solving the problems of the North Korean economy. In addition, at the individual level, economic cooperation should be concentrated in

I

II

III

IV

V

VI

VII

VIII

fields that are directly related to the lives of the general public, so the people of South and North Korea can actually benefit from the results of inter-Korean cooperation. In the long term, a foundation for future economic integration can be solidified by establishing institutions and expanding the number of interactions, as well as by improving the exchange mechanisms between the two Koreas.

Second, the policy advocates ‘cooperative reciprocity.’ Cooperative reciprocity is described as ‘establishing a cooperative partnership based on the acknowledgement of the differences between each other.’ This means making efforts to understand each other’s position and to respect the pride of the opponent when promoting economic cooperation. For this, it is important to ‘put yourself in the other’s shoes.’ Cooperative reciprocity strives to establish a foundation of trust or ‘emotional connection’ between the two governments or two societies that is necessary in order to build an economic community.

Third, the policy is promoted on the basis of national support and public consensus. There are two aspects to this point. The initial aspect is recognizing and respecting the national consensus on North Korean policy that was achieved in the past, and the other is promoting the development of policy consensus by emphasizing the importance of gaining public support. The former can include adopting a stance for negotiations with North Korea that does not undermine the pride of our people. The government must play a strong guiding role in the realization of the latter. Thus, the government must be able to provide hope to the people of South Korea by presenting convincing objectives and visions for economic cooperation.

Fourth, in order to solidify cooperation with international society important relationships must be developed or established. The ‘normalization of North Korea,’ which could catalyze change and

help bring North Korea into the global market economy, is only possible when cooperation with international society is achieved first. A structure for basic relations must be well established, not only so that we can thoroughly understand the requirements and expectations that international society has for South and North Korea, but also to effectively advocate our position to the world. In addition, we must develop our capability to negotiate with the international community. This is necessary to prepare for situations in which the international community supports projects that foster North Korean development. We need to take a leading role in this in order to realize our own interests.

### **C. Strategies for Promotion**

Pursuit of balance and harmony and the expansion of relationships

#### **(1) Gradual Cooperation and Integration**

Effective promotion of economic cooperation with North Korea is a struggle because of the political and economic environment that constantly changes both domestically and internationally. Therefore, in addition to presenting long-term methods, goals, and visions, we must ensure that strategic flexibility can be used to respond to situational change. Also, it is preferable to categorize policy goals, strategy initiatives, and policy priorities while at the same time making sure that they are balanced and harmonious.

In the short term, emphasis should be placed on the pending economic issues of the two Koreas. From our perspective, development in North Korea should be used as an opportunity to solve the problem of decreasing profitability, in which small and medium enterprises are affected heavily by increases in the cost of pro-

I

II

III

IV

V

VI

VII

VIII

duction. In addition, reducing security risks on the Korean peninsula through stable management of the North Korean problem is another important task. From North Korea's perspective, solving economic problems including food shortages and preparing a foundation for the recovery of its economy are the issues with the most interest. The key task is to find a way for the two Koreas to promote exchange and respectfully acknowledge each other's respective interests. During this process, our government needs to focus more awareness on policies for improving human rights and reuniting separated families.

In the long run, building a foundation for integration of the two economies must be prioritized. This foundation can be established by securing the ability to procure the necessary materials and manpower for integration, as well as by preparing for the installation of legal and institutional structures. A project that the South Korean government should develop with interest is that of cultivating human resources. If the integration of economies is specifically carried out, our society and government will require working groups that have expertise and knowledge in various areas to take on different roles. Among those tasks, the development of human capabilities that lead to cooperative efforts with international society in the fields of economy, society, diplomacy and security will be extremely important.

It is also necessary to help North Korea with the task of establishing a foundation for integration. The effective development of the North Korean economy requires the North Korean government to voluntarily participate and demonstrate a genuine desire to implement change. In particular, there is a need to help the experts of North Korea enhance their understanding as well as knowledge of the international economic system. Also, attention must be paid to the significance of the demographic change in

North Korea. First, the people and the bureaucracy of North Korea are composed mostly of the so-called ‘apres-guerre generation,’ people born after the Korean War. Among this section of the population, feelings of hostility towards South Korea have decreased and the factor of ideological conflict has become relatively weaker. Second, people who were born after 1995, the peak of the famine in North Korea, are beginning to enter the labor market. The foundation for human production in North Korea is becoming more vulnerable.

## **(2) Practical Division of Economics and Politics**

In light of the fact that inter-Korean relations are sometimes limited due to periodic deadlocks caused by political reasons, a breakthrough in inter-Korean relations must be made by engaging in economic cooperation. In the long term, the creation of a positive cycle that consists of cooperation in the fields of politics and security, as well as cooperation in the fields of economy and society, will be important. From this standpoint, a new level of separation that effectively divides politics from the economy also needs to be established. As a matter of fact, this principle has been followed relatively well with regards to inter-Korean cooperation, but here the emphasis is on a rather more strategic approach. The separation ensures stability, objective expert analysis, and expansion in the areas of exchange.

First, politics and economic issues must be separated based on governmental ties. This will allow the government to establish institutions that can guarantee the continuation of negotiations and contact that facilitate cooperation in the fields of economics and society even if political tension breaks out between the two parties. To this end, there is a need to encourage greater participa-

I

II

III

IV

V

VI

VII

VIII

tion by non-governmental experts in government relations for the economy and society. Furthermore, each opportunity for negotiation should be specially handled by experts in each field while maintaining independent negotiations. For example, political talks can be held by the Ministry of Unification, military talks by the Ministry of Defense, economic talks by the Ministry of Finance and Economy, and talks on humanitarian issues by the Red Cross Society or the Ministry of Health and Welfare. The different organizations must be prepared of course with the capability to comprehensively and systematically manage as well as mediate these negotiations. For this approach to be successful, the North Korean government also needs to establish differences between the various negotiations.

Second, the division of roles among the actors promoting economic cooperation projects must be clarified. Most of the projects so far have been initiated by the government, with companies or private organizations promoting projects for profit or humanitarian issues, relying on various forms of aid provided by the government. As a result, even though the government stuck to the principle of separation of politics and the economy, economic cooperation projects were inevitably affected by changes in the direction of government policy or tension between the two Koreas. In order to reorganize this kind of structure, it would be preferable for the government to focus on indirect aspects of economic cooperation such as creating cooperative foundations as well as establishing financial and institutional support.

In the end, it is advisable to allow the companies and private organizations to promote economic cooperation projects freely based on individual assessments. However, considering the fact that the business environment in North Korea is extremely poor and private companies lack information, the government should

give support by providing information and advice. The government is likely to continue taking a leading role in North Korean investments considering the fact that private organizations will not be able to individually expand the industrial infrastructure in North Korea for the time being, and the fact that the business environment will not improve until the problem of industrial infrastructure is solved. Yet, even in this case the government should use the proper expertise and objectivity to establish an organization with separate funds, rather than being involved directly at the forefront. This organization might be tentatively named the ‘public corporation for inter-Korean cooperation assistance.’

Third, humanitarian aid projects should be promoted regardless of the political situation, but a fundamental solution to the North Korean food crisis must be sought by creating a systematic, long-term framework and strategy to deal with the problem. Humanitarian aid can be considered one way our government interacts with the people of North Korea, and it must be seen as a form of assistance and investment that will enable all Korean people to function as healthy citizens after integration of the two economies.

### **(3) Links between the Various Fields and Areas**

First, economic cooperation at the domestic level, the inter-Korean level, and the international level should be promoted in close relation with each other so that balance and harmony can be achieved. In order to reach this goal first of all, reciprocal economic exchange should be enhanced by pursuing a connection between domestic economic development and inter-Korean economic cooperation. This will create motivation and incentives for the entire Korean peninsula to develop together at the same time.

I

II

III

IV

V

VI

VII

VIII

Also, by promoting the participation of the international society in the development of North Korea, as well as increasing trilateral cooperation with third states, the link between inter-Korean and international cooperation will be expanded.

In addition, various relationships and networks should be established and expanded. By building numerous connections between the fields, industries and the social classes that comprise the two Korean economies, the autonomous subjects in the economic integration process will become diversified and the decision making process will become decentralized as much as possible. Here, the establishment of industrial relationships between the two Koreas signifies the preparation of physical infrastructure for the integration of the two economies. In particular, it is important to build a foundation for the establishment of an integrated system for inter-Korean industries.

In the long term, the development of a Northeast Asian network will be furthered by connecting progress achieved in the inter-Korean cooperation network to progress made in the Northeast Asian network.

### **3. Short Term Tasks**

#### **A. Presenting Priorities for Governmental Policy**

The standards that should be considered when prioritizing governmental economic cooperation projects with North Korea are economic feasibility, urgency, integration and consensus derived from feasibility. Here, 'economic feasibility' means economic profitability, and is mostly based on the needs of our own economy. 'Urgency' can be stated as the reason for deciding to provide eco-

conomic assistance in order to solve the pending problems of the North Korean economy such as the food crisis. The South Korean problem of separated families can also be included under this category. The meaning of ‘integration’ is evaluating the extent and the effect that each policy has on building a foundation for economic integration. Therefore, it indicates the relatively mid-to-long term effects such as institutionalization of cooperation and marketization of the North Korean economy. Finally, ‘consensus derived from feasibility’ is a complex consideration of consensus building in South Korean society, the possibility of achieving results through negotiations with North Korea, and the possibility of inducing international cooperation.

This order of priority can change according to changes in developing circumstances.

Economic cooperation projects should be pursued while considering these four standards comprehensively, though if necessary, the standards might be prioritized in the following order: urgency, economic feasibility, consensus derived from feasibility, and integration. Regarding the standard of urgency, methods for assisting the people of North Korea so that they can become producers and grow into partners for different cooperation projects must be included.

## **B. Seeking New Models of Economic Cooperation**

If the purpose of inter-Korean economic cooperation is to create new growth engines and promote the marketization of the North Korean economy, there is a need for the centrally planned North Korean economy to co-exist with the market economy during the process of establishing industrial foundations for sustainable development.

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

The first possible cooperation model is one where products are produced in the form of joint-ventures and joint management is established in the North Korean market. Through this model, the North Korean domestic market will be revitalized, and a positive cycle consisting of consumption and production, that consequently leads to increased domestic and international investment in production, can be established. For this to be realized, efforts to attract foreign capital must be made by the North Korean government. In particular, individualized pursuit of profits must be guaranteed through the expansion of official markets along with systematic institutionalization.

For the second model, considering the fact that in North Korea not only is investment capital nearly exhausted but also industrial infrastructure is poor, inter-Korean economic cooperation should be promoted in industrial regions such as in the Kaesong industrial region to foster economic cooperation. Under the current economic circumstances, there is an unavoidable aspect to promoting economic cooperation by assisting investment overall, including investments toward SOC, for the development of a specified area. In the special economic zones, production and consumption are fall under the principles of the market economy, and the North Korean people and businessmen are invited to participate. Through this system expanded production can be established at the regional level, and this will gradually spread to other areas.

The third model takes in to consideration the fact that most of North Korea's resources are human labor, and it proposes cooperation projects that utilize North Korean manpower. Forestry, construction, management of large-scale farms are examples of this model. These projects may take place in far-east Russia, the middle east, or Mongolia, and it therefore it seems preferable for these projects to be promoted in the form of trilateral cooperation, utiliz-

ing capital from the related nation.

During the early stages of these projects, personnel management is expected to be the most sensitive and important issue. Utilizing ‘Korean Chinese’ or ‘ethnic Koreans’ as middle managers in the short term and training North Koreans to become middle managers in the long term is an aspect of this model that must be considered.

The fourth model is a cooperation model that seeks to jointly develop the natural resources of North Korea in order to import them to South Korea, China or Russia. The point that must be carefully considered in this model is that under the current SOC situation, it will be difficult to find mines or coal mines that guarantee payment. In addition, the conservative attitude of the North Korean government and lack of infrastructure make matters worse, and all these factors must be cautiously approached.

Furthermore, there is a need to not only to pursue projects that help resolve the energy crisis in North Korea in the form of joint management, but also to seek a solution to the overall energy problem on the Korean peninsula by constructing long term power plants in North Korea. Here, projects to build oil pipelines or gas pipes to import energy resources from far-east Russia can be included in this model.

Lastly, inter-Korean cooperation in environmental businesses that may contribute to solving the worldwide environment problems, an important international issue, should be pursued. For instance, we can secure carbon-trading through assistance from North Korean forestation projects.

### **C. Selection of Strategic Fields of Development**

If development projects are actively encouraged in North Korea, selection and prioritization of projects during the early stages of

economic cooperation will be inevitable from the standpoint of investment conditions or investment resources. There will be problem with selecting the fields to concentrate on, since the planning and the preparing process must be undertaken immediately.

In order to select the appropriate fields for economic cooperation, the needs of the North Korean economy and the mid-to-long term development strategy of our economy must be considered.

Fields that must be developed first are fields that, above all, reflect the urgent demands of the North Korean economy, as well as those that can establish an industrial base for securing productivity and improving management capabilities.

As a result, during the early stages of economic cooperation the focus should first be put on industries that utilize the natural resources and labor of North Korea so they can improve the quality of life in North Korea, beginning with simple light industry production. Also, interest should be placed on improving the production environment of the agriculture, fisheries, forestry, and the mining industries, while concentrating investment on the export-related manufacturing industry. Hopefully the North Korean economy can be revitalized through these measures.

During the next phase, it would be advisable for the focus to move to developing the service industry and mid-level manufacturing industries. In this phase, emphasis should be put on rebuilding the industrial foundations of North Korea, and a strategic approach should be adopted for the domestic marketization of the North Korean economy.

Additionally in the long term, the shipbuilding, chemical, steel, distribution industry along with tourism should be intensively strengthened, as a matter of decentralizing South Korean industries.



## 4. Long Term Tasks: Strengthening Economic Cooperation by Promoting Capabilities

### A. Promotion of Future Paths for Development

First, a strategy for multi-dimensional governance should be established to advance international cooperation. To achieve this aim, international society should take the initiative in establishing a cooperative development governance system for North Korea. Regarding inter-Korean relations, a system of close cooperation should be established through the formation of a standing organization that deals with inter-Korean cooperation. Furthermore, within the South Korean society a system should be created to promote efficient cooperation between the government and the private sector, namely within civil society.

Second, the human capacity to initiate cooperation with international society should be improved. For this goal, specialized officials in charge of governmental cooperation should be trained, and experts including government officials that are in charge of cooperation with international organizations should also be educated. Furthermore, a systematic assistance plan should be prepared in order to increase the expertise of NGO's that will promote cooperation with other international NGOs. Lastly, financial experts that can pursue cooperation with private international investors or experts that can assist cooperative development with North Korea should also be trained.

Third, our government should actively assist North Korea in increasing its capability to develop its economy. The capabilities of the North Korean government should be continuously expanded in order for inter-Korean economic cooperation projects to sustain long term results. In the international society, actively participating

I

II

III

IV

V

VI

VII

VIII

in cooperation with the international society with a sense of ownership is recognized as an important task, and interest is concentrated on assisting the capacity building process in relation to this sense of ownership.

Fourth, we should enhance the position of South Korea within international organizations by assuming an expanded role in international society. Contributing a larger amount of international organization membership fees, and increasing cooperative projects and ODAs toward developing countries through international organizations are methods to achieve this goal. Furthermore, more efforts should be made to become a council member of different organizations and to participate in the chairing of international committees. Additionally, attempts to host the regional headquarters of international organizations should be made, and more governmental assistance, that concentrates on expanding opportunities for Koreans to be chosen for responsible positions in international organizations, should be provided.

## **B. Major Promotional Tasks**

### **(1) Establishing a System for Training Experts on Economic Integration and International Cooperation**

First, the government should provide numerous educational training opportunities for experts in the fields of economic integration and international cooperation at the governmental level. Above all, experts should be systematically trained by dispatching officials to related organizations and increasing opportunities for training abroad. Furthermore, the government should provide assistance for expert training in fields involving international NGO cooperation, which, compared to experts on international stan-

dards lack both experience and opportunities for education and training. In the mid-to-long term period, the government should assist in training programs for North Korean officials and experts.

Second, a general long term plan for the education of talented personnel should be established and systematically promoted. In regards to this goal, the government should conclude agreements with international organizations at the governmental level in order to systematically train experts. Through these measures, internship programs among others can be actively utilized along with other training programs, and major organizations such as the IMF, World Bank, ADB, EBRD, and the UNDP are organizations that must be considered first.

## **(2) Establishment of an Overall Promotion System of the Government for Economic Integration**

A governmental promotion system for adjusting the role of government and evaluating existing policies should be established. If the scale and magnitude of inter-Korean cooperation is expanded and investment in North Korea is widely promoted, under the current promotion system, more cases of conflicts due to overlapping roles among the government ministries can be expected. From this standpoint the need to specifically reorganize the roles of the ministries will arise or there will be a need to establish a new governmental promotion system. To deal with this problem creating a mid-to long term plan for this issue will be necessary. However since mediating the interests of the different government ministries is expected to be tricky, it can be said that this needs political resolution.

Therefore, there is the additional need to organize separate organizations, for example the tentative “Committee for Promo-

I

II

III

IV

V

VI

VII

VIII

tion of Inter-Korean Economic Integration.” But, during the early stages where consideration of the particularity of North Korea is necessary, the head of the National Security Council (NSC) should chair the committee and supervise the meetings and policy-making procedures, and when duties become more varied and the effects it has on the Korean economy grow larger, the Prime Minister should head the committee.

### **(3) Establishing a System for Cooperation with International Organizations**

First, the government must work to solidify regular cooperative relations with international organizations. Efforts to establish an institutionalized system for cooperation with domestic related institutions along with efforts to form a human network must be increased. For this, efforts to increase the number of government officials and unofficial experts that work at international organizations are also required.

Second, preparing a foundation for effective coordination among the various actors of the international community as well as the South Korean society is also important. Through this basis, it is possible to establish the necessary cooperation among the many domestic and international actors who seek to participate in the North Korean development projects. Here, North Korea can also participate as a major actor.

Finally, from a more long term perspective, the effectiveness of cooperation can be enhanced by establishing multiple systems of cooperation that have distinct groups with different characteristics. Evident in the development assistance programs for Vietnam, there is a need for different negotiating channels to be established after the participating parties have been classified into groups such



as the group of ODA member states, group of banks, group of international NGOs, and the UNDG. Within the framework of these different channels, there is a need to persuade North Korea to participate with our government as a key negotiating partner.

#### Notes

- <sup>1</sup>- Kang-Taeg Lim, *Seeking a new inter-Korean cooperation model: A cooperation model capable of sustainable development* (Seoul: Korea Institute of National Unification, 2002), pp. 41-43.
- <sup>2</sup>- A concept proposed when assistance is pursued for a state that does not have the basic qualifications required by international organizations or states.

I

II

III

IV

V

VI

VII

VIII

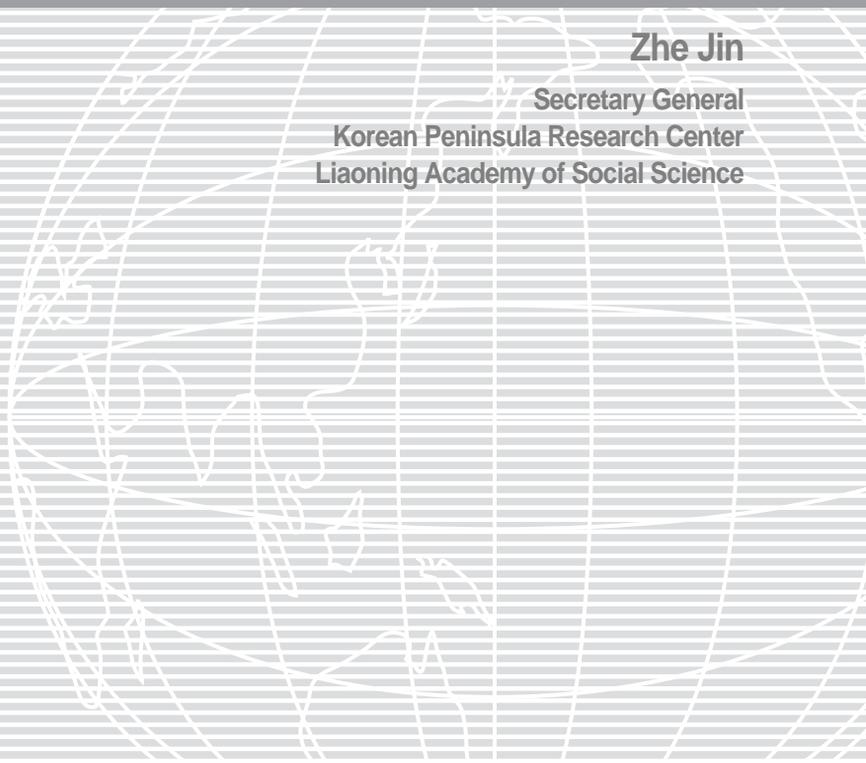


V

# Economic Relations between China and North Korea: Current Status and Future Prospects

**Zhe Jin**

Secretary General  
Korean Peninsula Research Center  
Liaoning Academy of Social Science





## 1. Introduction

As close neighbors, China and North Korea have maintained friendly relations for a long time. However, at the start of the new century China-North Korea relations entered a new phase, and the two countries realized that promoting economic cooperation would be important for developing their relationship. Thus, efforts to build a stronger North Korea-China economic relationship have fostered friendly cooperation between the two countries.

North Korea has not yet overcome its economic difficulties of course, and with its low financial capacity to repay foreign debts the prospect for engaging in economic cooperation with other countries remains poor. These factors place North Korea in a very weak position with regard to proposing or planning foreign economic cooperation with China. However, North Korea's unique geopolitical situation has made China reconsider the political interests over the economic ones, the long-term interests over the short-term gains, and the general interests over national interests. Therefore, the China-North Korea economic relationship must be characterized as a strategic one since China sees the overall potential benefits of the relationship as having more value than the economic factors alone.

In addition to present problems, the plans to rejuvenate old industrial bases in the Northeast region and a development strategy now in progress for the Liaoning province coastal economic belt, also as known as the 'Five points-one line' strategy, have the potential to generate immense resistance for China-North Korea economic cooperation.

In this context, I will first analyze the present state of affairs for China-North Korea economic relations, and then I will forecast future trends for the relationship.

I

II

III

IV

V

VI

VII

VIII

## **2. Present State of China-North Korea Economic Relations**

As mentioned above, the economic relationship between China and North Korea has strategic value, particularly when focus is placed on its unique position in China's foreign economic relations. To be more specific, China's economic policy for North Korea, the provision of economic assistance to North Korea, China-North Korean trade, and investment cooperation between the two states are all a part of China-North Korean economic relations. The following sections will explain these aspects in more detail.

### **A. China's Economic Policies for North Korea**

China's North Korean economic policy is always formulated within the broader framework of China-North Korea relations. Therefore, as the relationship between China and North Korea changes, the same new developments will apply to their economic relationship.

#### **(1) The Change in China-North Korea Relations and its Major Characteristics**

The relationship between the two countries experienced a large transformation as the traditional alliance relationship broke down after half a century. However, China and North Korea still maintain close ties, which is demonstrated by an analysis of the major characteristics of the relationship.

First, the relationship is strategic in nature. This characteristic of their relations is manifested in the strategic geopolitical value of



North Korea to China and China's foreign policy. Two different aspects can explain North Korea's strategic value to China.

- North Korea still acts as a safety buffer zone for China. The Korean peninsula is a place where the interests of the four great powers collide and they are locked into a stalemate position. Thus, the peninsula should become the foundation for peace and prosperity in Northeast Asia, not become a battleground or a territorial front that threatens China's security. A unified Korean peninsula will not necessarily be a threat to China but if other great powers take the initiative to assert their power over the peninsula, it will certainly become a threat to China. Under these circumstances, North Korea is considered a safety barrier that helps maintain a balance among the four powers.
- In terms of China's foreign policy, leaders have chosen the three-Lin policy (睦臨, 安臨, 富臨) to provide a long-term stable surrounding environment needed for establishing a Xiaokang society. This requires North Korea to be a stable, friendly, and a prosperous state, and China must make efforts to help achieve this.

Second is the double-sided character of the relationship. The current phase of China-North Korea relations contains both characteristics of the traditional alliance and characteristics of a normal state-to-state relationship.

- The relationship remains unchanged in terms of the traditional alliance. The legal basis for this is the "Treaty of Friendship, Co-operation and Mutual Assistance between the People's Republic of China and the Democratic People's Republic of Korea," signed by both states when Prime Minister Kim Il-

I

II

III

IV

V

VI

VII

VIII

Sung visited China in November, 1961. According to the 'treaty,' both sides have to employ all possible resources available, prevent any foreign invasion attempts by each other, and if one side is attacked by another country or by a coalition, the other has to provide strategic assistance including military support etc. Yet, in the present era where the Cold War is over, and achieving peace and prosperity are mainstream goals, of course the actual meaning of this alliance must be scrutinized. However, the Cold War structure still exists on the Korean peninsula. Which means, since security issues in the North have not been resolved and considering the fact that such instability is directly related to China's security, both countries cannot simply sit and watch the security concerns unfold in North Korea. As long as the Cold War structure persists China-North Korea ties will continue to maintain their alliance-type character.

Since the beginning of the new century, changes have been made to the China-North Korea relationship, and one development is the growing closeness between both state's political parties.

Phenomenon 1: The two nations are both seeking to pursue their own methods for development and both recognize that they have a duty to develop the economy, so as to enhance the people's standard of living. This shows that the two political parties have generated a new common perspective. This perspective is the basis for deepening their relationship.

Phenomenon 2: President Hu Jin Tao carried the title 'General Secretary of the Communist Party of China' when visiting North Korea in October, 2005.



Phenomenon 3: In June, 2008, Xi Jinping, vice-president of China, visited North Korea and made four proposals in the round of talks with Hyeong-Sup Yang, vice-chairman of the Supreme People's Assembly, and the first was about building stronger ties between the two parties.

- The aspects of normal state relations. After the Cold War ended, there has been a progressive change in China-North Korea relations as China initiated its reform and open-door policies. China switched to a socialist market economy after decades of running a socialist planned economy, and achieved openness in all areas even foreign policy. China's relationship with North Korea has improved and changes have also been made to the spot trading method used between the governments. These structural changes ultimately demonstrate that the economic relationship of the two nations has changed from a relationship based on a socialist planned economy to a relationship based on the socialist market economy and a planned economy. Also it implies that, along with the changes in policies toward the Korean peninsula, the two nations have entered a mutual adjustment period in which their bilateral alliance relationship is being transformed into a normal relationship. At the start of the new century, North Korea and China established a new relationship to "succeed tradition, be future-oriented, maintain good ties and strengthen cooperation." In May 2005, when president Hu Jintao visited North Korea, both heads of state agreed to "maintain close correspondence, enhance mutual communication, enrich the material for cooperation, promote economic cooperation and joint development, actively harmonize and protect common inter-

I

II

III

IV

V

VI

VII

VIII

ests,” while pushing to foster common development principles between the two states.

In conclusion, China-North Korea relations are advancing on the basis of normal state relations, resulting in many changes in the relationship. One thing to be emphasized here is that, due to the extraordinary nature of the relationship, it cannot revert back to the former alliance-based relationship, but at the same time there is little probability that the relationship will be abandoned by either side.

## **(2) China's Economic Policies for North Korea**

Trade between China and North Korea began in the 1950's, and the two maintained a barter trading system until 1991. Later in 1992, they entered into new agreements that were dependant upon the cash payment system.

When China-North Korea relations entered a new phase of development, economic cooperation became an important part of it, and was regarded as a major driving force in fostering friendly relations between them. In October, 2005, China's Deputy Prime Minister Wu Yi discussed with the North methods for revitalizing economic cooperation, and the potential for creating new mechanisms based on the principles of amity, mutual gain and mutual growth. She emphasized practical and in-depth development in this new system and field for collaboration.

Subsequently, China's leader Hu Jintao emphasized the need to move a step forward in economic cooperative efforts when visiting North Korea. He declared that China, under the principles of mutual benefit and growth, would promote and support various forms of investment in which China's industries cooperatively



invest with North Korean industries. Furthermore, he encouraged an increase in the scale and level trades in order to achieve continuous improvement in economic cooperation between the two countries.

In January 2006, during a round of talks in China, Kim Jong Il and Wen Jiabao, Prime Minister of China agreed on the following: “governments lead, business participates, the market runs,” as a basic principle for economic cooperation.

## **B. China’s Economic Aid for the North Korea<sup>1</sup>**

Economic aid provided to North Korea is a key issue in China-North Korea relations. The national government plays the most fundamental role, but there are different ways that local government, private organizations, and other non-government parties participate.

### **(1) Support from the Chinese National Government**

The Chinese government actively supported North Korea during the Cold War. After the Cold War when China reformed and opened up its system to a market economy, the government placed more importance on the North’s ability to repay the aid, applying reciprocity as a key principle.

Thus, there is a limit to China’s support of North Korea. Right now, humanitarian relief and development aid such as support for the establishment of a glass factory are ways in which China provides assistance to the North, and the latter is the major method. There is no specific statistical information on the scale of the aid.<sup>2</sup>

I
II
III
IV
V
VI
VII
VIII

## **(2) Support from the Chinese Local Government**

The local government supports North Korea through sisterhood relationships with different regions in the North. For example, Liaoning provincial government has established a friendly provincial relationship with Pyeonganbukdo of North Korea. When the North is hit with a natural disaster representatives from Liaoning province visit North Korea and provide economic support.

## **(3) Support from Non-governmental Organizations**

Chinese non-governmental organizations also provide temporary economic assistance to North Korea when natural disasters take place or other special occasions occur. After the Yongcheon train explosion, for example, the Shenyang Korean-Chinese Association of Entrepreneurs and other non-governmental organizations made donations to support North Korea.

## **(4) Support from Private Actors**

This paragraph covers the economic support given to North Korea by private actors. There are some businessmen who give donations in their own name, but most non-official aid is given by private citizens to relatives during visits. Although the quantity of individual support is insignificant, given that the numbers of the population who are floating is large, the amount of private support cannot be taken for granted. Since this aid reaches North Korean people without interruption through a direct route, it contributes to the stabilization of North Korea and improvement of living conditions for the North Korean people.



### C. Commercial Relations between China and North Korea

Commerce relations between China and North Korea started initially with trade along the border after the new Chinese government was established. In 1958, delegates organized from Jilin and Liaoning visited Pyongyang and signed the <Protocol on spot trading in the exterior of China and North Korea> with the <Central Consumers Union> of North Korea, subsequently the border-trade with North Korea began officially in 1961. Through nearly half a century of fluctuating growth, China's trade with North Korea developed into various forms of commerce such as cash trade, visible trade, processing trade, barter trade, package trade, and maritime trade. The main characteristics of this commerce are described in the following paragraphs.

<Table V -1> Statistics of Commerce between China and North Korea

Years	Imports and Exports		Exports		Imports		Balance of Account (US\$100 Million)
	Sum	Growth Rate	Sum	Growth Rate	Sum	Growth Rate	
	(US\$100 Million)	%	(US\$100 Million)	%	(US\$100 Million)	%	
2001	7.37	51	5.7	27.1	1.7	351.4	4.0
2002	7.39	0.20	4.7	-18.4	2.7	62.4	2.0
2003	10.3	39.2	6.3	34.2	4.0	48.1	2.3
2004	13.85	35.4	8.0	27.4	5.86	48.1	2.14
2005	15.80	14.1	10.81	35.2	4.99	-14.8	5.82
2006	17.00	7.58	12.32	13.9	84.68	-6.29	7.65
2007	19.76	16.2	13.93	13.0	5.83	24.7	8.09
2008.1~2	2.76	23.6	1.96	37	0.79	-0.4	0.64

Source: These statistics are classified by the writer and refer to the Statistics of Chinese Custom Houses and Statistics of the Ministry of Finance and Economy.



### **(1) The Amount of Commerce between China and North Korea is Showing an Increase in New Millennium**

As China and North Korea concluded a new trading agreement that adopted a cash payment system and abandoned the spot trading method, North Korea's economic circumstances rapidly deteriorated. North Korean commerce took a downturn, recording a total amount of trade of 370 million US dollars. However, since 2000 it has shown an increase, recording 480 million US dollars in trade that year.

### **(2) North Korea's Market Demand is Growing Larger and North Korean Consumers have Started to Attach Importance to Brand Goods**

The growth and recovery of North Korea's economic situation provided some resources for external trade and created a domestic consumer market, thus sharply boosting the growth of commerce between China and North Korea. Consumers in North Korea now attach more importance to the brand and quality of goods and the standard of merchandise exported to North Korea continues to improve. North Koreans not only have more purchasing power potential but a high-expenditure group has also emerged in North Korea. This group can be classified into 3 types.

- A family who has relatives living in abroad. Approximately 60~70% of North Korean families have relatives living abroad, ranging in places from China to Japan to South Asia. Relatives overseas send large amounts of foreign money to North Korea via irregular routes.
- External business owners. The majority of them are in the



- external trade service sphere or international travel agencies.
- Foreigners who are stationed in North Korea for a long period.

**(3) Every Possible Method for Settlement of Commerce  
Accounts between China and North Korea is  
Being Pursued**

Since February 21, 2008, Dandong's trade with North Korea has been paid in Chinese currency (the Yuan). This implies that property as a method of payment has been incorporated into the trade. More than 70% of Dandong's trade accounts are from China. Previously, settlement in foreign currency or Yuan cash, which was a very common practice, involved a lot of ventures in reputation and commerce, and impeded the growth of commerce between China and North Korea. In order to stimulate economic cooperation with North Korea, the Dandong branch of the People's Bank of China obtained permission from the superior office to require trade accounts to be settled in Yuan currency so that the organizations or individuals could open bank accounts for exclusive use in settling commerce accounts with Yuan currency. Thus, they could exchange funds kept in the account without any further conditions, and it would encourage the use of the Yuan as the currency for settling trade.

On February 20, 2008, a "Jilin Province Business Meeting for Trade with North Korea" was held in Yanji and the "Interim Regulation of Jilin Province for Accounting and Managing Border Trade with North Korea" was concluded, implying that all methods for settling trade with North Korea would be opened up, and allowing simultaneous adoption of the bank payment system. "The Jilin Regulation" is described as follows.

First, include Yuan as the currency for settlement of trade with

I  
II  
III  
IV  
V  
VI  
VII  
VIII

North Korea. Also, the enterprises trading with North Korea must pay in Yuan or foreign currency.

Second, properly expand the possible range of transactions in foreign exchange accounts opened at banks in the territory of China by North Korean trade organizations or individuals.

Third, North Korean organizations or individuals can open a bank account in Yuan currency for exclusive use of commerce with North Korea in the territory of China.

Fourth, foreign money can be purchased with Yuan that has been earned legally by North Korean organizations or individuals that trade in exports with China.

Fifth, the foreign money can be deposited into classified foreign currency accounts by the enterprise trading with North Korea.

#### **(4) The Physical Distribution System for Commerce Transactions with North Korea is Being Completed**

- China is creating a customs house for trade with North Korea. China shares a 1334km border with North Korea and is installing 12 custom houses ; Tumen in Jilin province (圖門口岸), Quanhe (圈河口岸), Guchengli (古城里口岸), Shatouzi (沙坨子口岸), Nanping (南坪口岸), Sanhe (三河口岸), Kaishantun (開山屯口岸), Jian (集安口岸) and Dandong Taipingwan (丹東太平灣口岸) of Liaoning province, Dandong road (丹東公路口岸), Dandong railway (丹東鐵路口岸), and Dandong port (丹東港口岸). Each of these is making the best of its territorial traits to be the forerunner in China that expands commerce with North Korea. For instance, the Jian custom house of Jilin province promoted “4 zones versus 1 Bridge project; China-North Korea Trade Area, the Processing trade zone, the Physical Distribution Warehouse zone and the General trade zone versus The Yalu River Road Bridge” for strategic purposes to



gain a foothold for expanding external trade. The Jilin province-North Korea trade construction plan included this project already and the Manpo city of North Korea reached an initial agreement.

- The method of transportation between China and North Korea is also becoming diversified. Existing methods of transportation were roads and rail traffic. However, in the Dandong port development area, a marine transport company began to operate a container-ship that runs between the Donggang port of China and Nampo of North Korea on November 22, 2007, and this has opened up a new transportation method for going to North Korea. It runs 4 times a week at the present time.

### **(5) Problems in Commerce Transactions between China and North Korea**

- The structure of commerce is not reasonable.

This means that China's trade surplus is relatively too large and a trend for the imbalance is towards the deepening of trade. The main reason is that China is the major route by which North Korea receives goods. As a matter of fact, the commerce between both countries actually consists mostly of China's supply of goods to North Korea. Because China's economic trade with North Korea has roots in the free market system, the demand for supplies from North Korea must be settled in the way of commerce, not through provision of humanitarian aid. So it is expected that the imbalance will be corrected as the economic conditions of North Korea improve.

- There is too much risk in the commerce between China and North Korea.

Various ventures exist in the trade between both countries and what matters most of all is North Korea's inability to pay back the

I

II

III

IV

V

VI

VII

VIII

assistance. North Korea used to postpone, default on, or secure the balances in the name of the government after China sent goods in advance of payment to North Korea. Even though North Korea maintained its reputation in small-scale trade several times, it refused to pay in large-scale trade operations. However, North Korea did come up with several new methods.

First, North Korea changes their external trade policy frequently. North Korea permits Chinese enterprises to send large quantities of merchandise in advance, and then later alters the policy to regulate the items that Chinese enterprises planned to import. In the end, Chinese corporations suffer a loss.

Second, a single North Korean enterprise will make multiple deals with various Chinese companies using the same product while getting Chinese companies to send the goods beforehand and then refuse to fulfill the contract based on the fact that it failed to get an export permit from the government.

Third, blackmail the company's merchandise using unfair methods. North Korea informs the Chinese corporation by telephone to send a vehicle to immediately pick up the goods when they arrive at the customs house. When the vehicle arrives, the North Korean side undeservedly demands gasoline, food, etc. They will not hand over the goods until the Chinese meet their requests. There are some cases in which Chinese vehicles return with nothing.

Fourth, regulate the quantity and type of items which are carried by Chinese visitors who enter North Korea. When the economic circumstances of North Korea are poor, North Korea encourages Chinese people to bring it what it needs and when the conditions turn around, they exchange the existing items with necessary ones on the list.



## **D. Investment Cooperation between China and North Korea**

China's investment in North Korea began when its economy expanded sharply and it executed an external penetration strategy. North Korea's commerce investment in China started later after the implementation of reforms and open-door policies. Yet, this investment is still limited to the initial stages.

In the early days, China's investment in North Korea was small-scale and involved low-technology, mainly focused on the restaurant business, food processing factories, and extracting mineral resources. As North Korea restrictively reforms its economy, the trend of investment has expanded to other fields and it is possible to see increased amounts of investment. Yet, big-scale investment has not been accomplished.

Until 2005, investment of Chinese enterprises in North Korea occurred only 13 times, totalling US\$ 53.69 million, and up until January 2008, investment occurred 28 times, totalling US\$ 260 million, which shows a slow increasing trend. Thus, it can be described as "Think a lot, but act little, struggle a lot, but succeed little, and more small-scaled one than big-scaled." The reasons why are stated as follows.

### **(1) Institutional Barriers**

Entrepreneurs from both countries are having difficulty in communicating each other because each of them have adopted different economic structures. For example, when the Chinese side requests a legal basis for ensuring a process of consultation in investment, North Koreans answer that if the Chinese enterprises trust them with the investment, the government will frame a

I

II

III

IV

V

VI

VII

VIII

favorable policy of property, because their superior stands above the ministry or even the law. This kind of negotiation does not correspond with the logic of the market economy.

## **(2) North Korean Factors**

– Obstacles caused by North Korea's economic conditions.

The fact that North Korea's economy is on the verge of collapse is blocking progress in investments. The deficiency of electricity, which is a major concern, worn-out facilities and poor shipping capacity of harbors are major obstacles for investment. For instance, when a Chinese enterprise conferred with a North Korean representative in 2005 about investing US\$ 100 million in mine development, he was told not to invest more than US\$ 5 million because North Korea could not supply enough electric power equivalent to US\$ 100 million. Even if the electricity matter is solved, obstacles in transportation, roads, landing capacity at harbors also exist, thus the ideal investment conditions and returns in many fields can hardly be expected. There must be an organized investment in infrastructure in various areas of normal production.

– The limited capacity to repay North Korean debt.

The return on investment is the primary factor that decides whether China will invest in North Korea or not because China applies the logic of the market economy. However, North Korea has only two kinds of resources which can be traded on equal terms with China at this stage. One of them is the manpower and the rest are the underground resources. Naturally, China's investment is concentrated on developing underground resources. This imbalance will be corrected as the economic circumstances of North Korea return to a favorable track.

– The issues related to North Korea's funds-attracting policy.



First, North Korea encourages 'joint ventures' and refuses to support 'cooperation' in resource development, which means that North Korea will not share the long-term profits with investors. 'Joint venture' is intrinsically nothing but a short-term loan. Second, mining projects proposed by North Korea are not good enough for ideal development, but also not bad enough to pass over, making it hard for Chinese enterprises to decide whether they will invest or not. Third, North Korea makes excessive demands on companies who invest in good quality mines. For example, the reason why the China Minmetal Corporation's investment project in the Mu-san iron mine company failed to make substantial progress, even though the project was agreed upon by the government of both countries, is because North Korea imposed an additional condition and demanded that the Chinese rebuild the Gim-Chaek iron foundry. Fourth, the methods by which North Korea attains funds is quite problematic. When they attract funds, various North Korean trade companies compete to win the development rights for one project. The company who has already concluded an investment contract or agreement with a Chinese enterprise gains the rights. So, prior to finding a genuine partner, to get receive priority North Korean trade companies must enter into an investment contract with a Chinese enterprise that may have no intention of investing. As a result, Chinese enterprises intending to invest in the project have to negotiate for investment on the basis of an existing contract which has been concluded by a North Korean company with another Chinese company before. This policy of North Korea makes one single project difficult to accomplish with various enterprises involved in the situation.

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

---

### **3. Prospects for the Future of the Economic Relationship between China and North Korea**

There is room for possible growth in the economic relationship between China and North Korea since North Korea is still developing and both countries are at an early stage in their economic relationship. Also China takes a strategic approach to its North Korean economic policy for the sake of maintaining Chinese stability. Thus, with improvement in relations between China and North Korea the importance of the economic relationship will be emphasized more over time. However, apart from its importance, there are also various limitations to the economic relationship. So progress made in the relationship will be gradual, not rapid.

#### **A. The Limits for North Korean Economic Reform**

A basic principle for China's economic cooperation with North Korea is the application of the logic of the market economy. This principle will be the momentum that leads North Korea to initiate reform, but improving economic cooperation while applying this principle to North Korea is closely connected with its intent to reform. Currently, there are some signs of restricted reforms in North Korea and in the future of course reform must occur. However, North Korea has not shown any substantial movement towards true reform yet. Even if North Korea already started its reforms, the introduction of a market economy require a definite and stable process. The combination of a planned economy and market economy has certain limitations.



## **B. The Limits for Progress in North Korean Economic Development**

As pointed out previously, the economic difficulties of North Korea are a major factor that limits the economic cooperation between China and North Korea. Therefore, for the purpose of achieving large-scale economic cooperation, economic growth in North Korea has to reach a certain level. Economic development in North Korea also requires the establishment of a definite process. Until then, economic cooperation between both countries will remain at low levels comprised of only small-scale trade.

## **C. The Limits of China and North Korea's Unique Relationship**

The uniqueness of the relationship between China and North Korea means that it contains dual characteristics of a traditional alliance and normal diplomatic relations. What matters is that both sides have largely mismatched expectations of one another. To put it concretely, North Korea considers China to be an alliance partner, while China has made an effort to change North Korean relations into normal state relations, greatly disappointing North Korea. This sense of disappointment is demonstrated through North Korea's communication with China and is influencing economic cooperation in both countries.

Though North Korea unavoidably accepts the Chinese approach towards dealing with the logic of market economy, it has grievances with China itself. Since the economic circumstances of North Korea have become very poor, North Korea is now more dependant upon China. However, once the situation turns around and when its reliance upon China becomes weaker, it will change its approach to

I

II

III

IV

V

VI

VII

VIII

economic cooperation and pursue relations with Japan or states of the European continent. This is how North Korea expresses its discontent with economic cooperation. Although, this strategy will be the result of various factors, such as change in the existing structure and level of North Korea's economic cooperation with China, North Korea's ill feelings against China must also be regarded as a major factor.

#### **D. The Limits for Resolving the North Korea Nuclear Problem**

North Korean issues are directly affected by the complex geopolitical and historical circumstances that influence the interests of neighboring countries. Accordingly, issues involving the Korean Peninsula that relate directly to North Korea can be analyzed from the following different perspectives.

- The internal domestic situation and external policies of North Korea.
- North-South relations on the Korean Peninsula.
- The policies created by neighboring countries for the Korean Peninsula.
- The relations between countries that surround North Korea and the Korean Peninsula.

Taking all of these into consideration, issues related to North Korea are complicated and sensitive but always have a functional character. China's economic cooperation with North Korea has to be promoted from the standpoint of this complicated functional relationship. This point has been established on the basis of fact. North Korea necessarily pursues foreign economic cooperation in order to promote economic growth. In response to North Korea's



shift in attitude, international society including countries neighboring North Korea are showing a trend of developing economic ties with North Korea, already preparing for competition. The purpose of competition for economic cooperation with North Korea is to gain an upper hand in leadership and influence. Therefore, neighboring countries are closely watching China's economic cooperation with North Korea. There is a possibility that unnecessary diplomatic conflict or concern will be brought about by their circumstances, which may inevitably become an obstacle for further economic cooperation between China and North Korea.

#### 4. Conclusion

Despite the strategic importance, geographic proximity, mutual reciprocity and growth potential of economic relations between China and North Korea, the relationship is still at an early stage in development. This is mainly due to various North Korean factors, and also partly due to the wariness of neighboring countries to engage in economic relations with North Korea. Under these circumstances, there is adequate recognition about the strategic importance of developing economic ties, but the local governments and corporations are more active than the central government when it comes to the actual implementation of development plans.

On the other hand, the powerful influence of China in economic relations with North Korea is weakening as North Korea changes. Thus, China will eventually become an equal competitor like other neighboring countries when North Korea makes progress in development. The predominance of China is a passing phase which originated from North Korea's specific circumstances and from relations between both countries during a particular period. There-

I

II

III

IV

V

VI

VII

VIII

fore, if these unique circumstances disappear, so will China's position of dominance over North Korea.

As for economic relations, although the pace of progress may be slow, there is large potential for remarkable improvements and advancements to be made within the international economic system.

In order to encourage development of the North Korean economy, it is necessary to promote cooperation and collaboration among neighboring countries at each stage. China, North Korea and South Korea should build upon the structure for economic cooperation that already exists. Economic cooperation with Japan must also be promoted. This cooperation structure can be utilized as the basis for a breakthrough in efforts to further economic cooperation in Northeast Asia.

#### Notes

<sup>1</sup>- Free of charge support.

<sup>2</sup>- In year 2000, even though China-North Korea relations were still tense, the amount of economic support provided to the North by China was not small. The following are statistics that describe the amount of aid that went to the North from Dandong, China

- unglutinous rice: 80 times. 5000 train cars, total of 160,000t.
- lumber: 60times, 2000 train cars, total of 100,000m<sup>3</sup>.
- crude oil: 200times, 7500 cars, total of 300,000t.
- beans: 20times, 5000 train cars. total of 12000t.
- crude coal: 130 times. 5000 train cars, total of 180,000t.
- other: 500 cargo trucks, 20 passenger cars, 10000t cement, 200 computers, 200,000ℓ cooking oil, 5000 pigs, 2000 farming cattle, 220 machinery equipment, etc.



VI

# Recent Economic Relations between Japan and North Korea

**Mitsuhiro Mimura**

Associate Senior Researcher  
Research Division

Economic Research Institute for Northeast Asia





## 1. Introduction

The economic relationship between the Democratic People's Republic of Korea (referred to as North Korea throughout the paper) and Japan began with indirect trade conducted through a third power such as China in 1956.<sup>1</sup> Later, direct trade relations between North Korea and Japan were initiated in 1961 after overcoming many complicated obstacles. North Korea-Japan economic exchange started with private entrepreneurs, who were affiliated with the Communist bloc at that time and traded with the Soviet Union or China, these entrepreneurs either asked the government for trade approval or went against the government's orders.<sup>2</sup> It can be said that progress made in the North Korea-Japan economic relationship reflected the antagonism between the conservatives and progressives and the balance of power that existed in postwar Japanese society (the social atmosphere in which conservatives supported South Korea and the progressives North Korea).

However, on September 17th, 2002, when Prime Minister Koizumi visited and conferred with General Secretary Kim Jung-Il, who apologized for and admitted to the media about the kidnapping of Japanese citizens by North Korea, this totally destroyed the power balance between the conservatives and the progressives regarding North Korea-related issues. Since then, the progressives who have been negatively portrayed in relation to the kidnapping issue have lost a majority of their influence in Japanese society.

Thus, the conservatives who insisted on a hard-line policy toward North Korea gained greater social power and began to use their influence on North Korean policies. Now in Japan, the kidnapping problem occupies a high priority position among North-Korean issues, followed by denuclearization. There are few discussions about the efforts to incorporate North Korea into interna-

I

II

III

IV

V

VI

VII

VIII

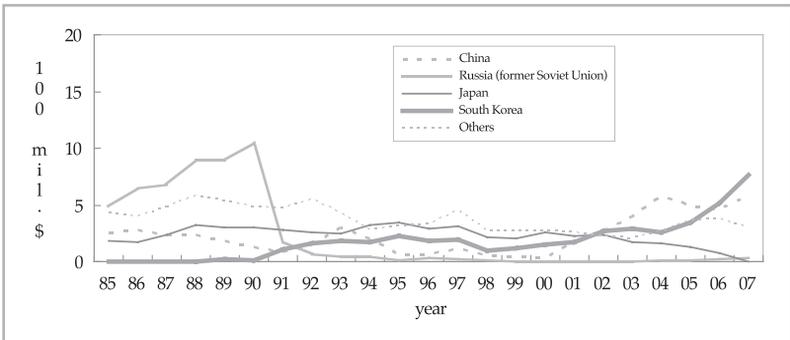
tional society.

In this chapter, first of all, I will explain about the progress and the present state of North Korea-Japan economic relations after the end of the Cold War and analyze briefly what effect this economic relationship has had on relations between North Korea and Japan. Then, I will show how the recent economic changes in North Korea affected North Korea-Japan economic relations. Lastly, I will analyze the prospects for economic relations five years from now and the effects that it will have on North Korea.

## 2. North Korea-Japan Economic Relations after the Cold War

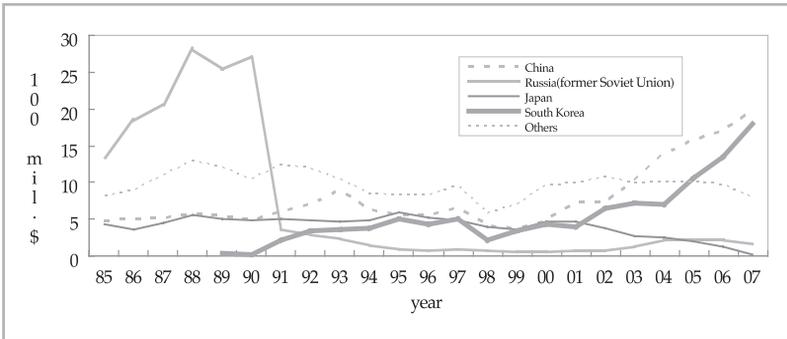
An analysis of foreign trade relations of North Korea demonstrates that many changes were made after the Cold War. As seen in <Figure VI-1> and <Figure VI-2>, the process of the socialist system collapse in the former Soviet Union and Eastern Europe, caused the foreign trade of North Korea to decrease sharply. Espe-

<Figure VI-1> North Korea's Exports to Major Countries



Source: KOTRA, Ministry of Unification.

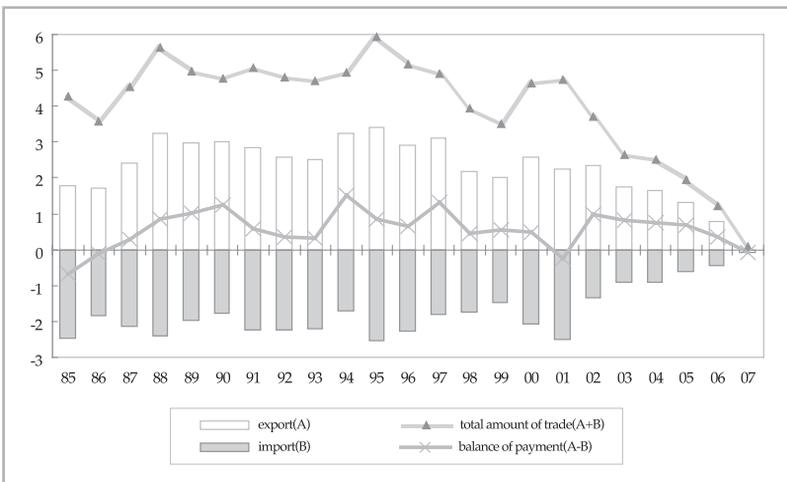
**<Figure VI-2> North Korea's Imports from Major Countries**



Source: KOTRA, Ministry of Unification.

cially, imports from the Soviet Union reached up to 19.2 billion dollars in 1989 but decreased to 1.9 billion dollars in 1991 and 0.4 billion dollars in 1996, which is a marked period of tribulation.

**<Figure VI-3> Trends of North Korea-Japan Trade**



\* It does not include the amount of money supporting North Korea rice by Japan in 2001.

Source: Japanese Treasury Trade Statistics.

I  
II  
III  
IV  
V  
VI  
VII  
VIII

The end of the Cold War, which accompanied the collapse of socialist regimes in the former Soviet Union and Eastern Europe, heavily damaged the North Korean economy.

However, as seen in <Figure VI-3>, North Korea-Japan trade was relatively unaffected by the end of the Cold War. Although Japan's trade balance with North Korea increased, the total volume of North Korea-Japan trade did not show any drastic changes around the end of the Cold War.

One particular thing about North Korea-Japan trade is that the number of exports to North Korea exceeded imports from 1987 to 2006. North Korea was the only market in which Japan could make a stable surplus and was guaranteed foreign currency earnings.

### **3. The State of North Korea-Japan Economic Relations**

#### **A. The History of North Korea-Japan Relations, Its Characteristics, and Significant Changes**

After the Second World War, the Japanese Socialist Party, representing the progressive power in Japanese society, was formed through a merger of the right-wing socialist party and the left-wing socialist party in 1995. The Liberal Democratic Party was established by uniting members of the Liberal Party and members of the Democratic Party comprised of conservatives under the leadership of the business sector who feared a strengthening of the labor movement. Thus, a two party regime comprised of the Liberal Democratic Party representing such issues as “an amendment to the constitution . conservation . security protection” and the Japanese Social Party representing “constitution support . innovation . anti-security” was born, and the so-called “55 years regime” was

formed.

The “55 years regime” collapsed during a change of regime in August 1993, but vestiges of the system still have influence among intellectuals even in the 21st century. Regarding issues related to the Korean peninsula, the conservatives consider Korea to have originally been a sovereign nation while the progressives believe that South Korea only became a proper sovereign nation in the post-war period. This trend continued even after the success of the Seoul Olympics bolstered recognition of the idea that South Korea represents the Korean peninsula in general.

These vestiges of the “55 years regime” influenced Japanese attitudes toward the North Korean kidnapping issue. There were many people in the conservative group who believed that the kidnapping was committed by North Korea. On the other hand, the progressives along with the Korean Residents Association in Japan (KRAJ as from now on) had many people supporting the viewpoint that the kidnapping never really happened. Thus, a balance was achieved between people in Japanese society who held positive and negative views of North Korea.

This changed dramatically after the General Secretary, Kim Jung-Il, admitted North Korean responsibility for the kidnapping issue. Domestically in Japan, it was strange that the kidnapping issue was perceived as a more serious problem than any other problem in the past. In addition, the international society’s attitude toward North Korea underwent considerable change over the past several years. The Six Party Talks, a mechanism created to help solve the North Korean nuclear issue, has encountered many obstacles and a great deal of uncertainty in getting North Korea to dismantle their program. However, resolving the kidnapping issue is still seen as the highest priority for North Korean problems and the denuclearization issue is often discussed second in Japan.

I  
II  
III  
IV  
V  
VI  
VII  
VIII

There are few discussions about the efforts to include the North Korea regime in international society.

## **B. Increase in Negative Public Opinion of North Korea and the Call for a Policy Based on “Pressure”**

Domestic concerns about North Korea were raised in Japan after Kim declared responsibility for the kidnapping issue. In order to meet domestic demand, Japanese mass media started broadcasting live reports on North Korea. Until then, due to lack of information about North Korea and pressure from the KRAJ, all the news stories about North Korea consisted of nothing more sensational than reports about the isolated status of the country.

However, after releasing the fact that most of the victims who were kidnapped by North Korea had died, media reports about North Korea have been filled with such striking words as “an abnormal country,” “a despotic state,” and “a country conducting espionage.” It turned that a majority of the reports emphasized that the kidnapping situation occurred because of the fact that North Korea is an abnormal state, and did not focus on the process necessary to accomplish the denuclearization of North Korea.

In the middle of October 2002 under these social circumstances, a few kidnaped victims returned to Japan from North Korea for a short time. According to the prior agreement between North Korea and Japan, the victims were supposed to stay in Japan only temporarily and eventually return to North Korea. However, once in Japan, it was decided that they should stay permanently in Japan because of strong public opinion which supported the viewpoint that there were no guarantees that the victims would be able to come back to Japan later. This heavily outweighed the view that diplomatic protocol should be observed. As a result, although

North Korea had demonstrated a flexible attitude regarding the kidnapping issue in the beginning, their attitude later hardened. North Korea took a tougher stance regarding the Japanese government's plan for normalizing diplomatic relations between North Korea and Japan, and negotiations went around in circles and made no progress on the kidnapping issue.

Under these circumstances, many Japanese thought that the reason that the normalization of diplomatic relations had failed was because "North Korea had not shown a faithful attitude." Based on this perception, efforts were made to pressure North Korea into changing its position. The pressure policy for North Korea was conducted in three phases. In the first phase, the Japanese government imposed substantial de facto sanctions by strictly applying the existing law. The second phase consisted of establishing legislation that facilitated the imposition of sanctions on North Korea. The third phase was the actual implementation of North Korean sanctions based on the legislation.

### **C. Substantial Economic Sanctions**

The government initially took steps within the existing legal frame to weaken economic relations with North Korea so that they could eventually legalize and execute the actual measures for exclusive economic sanctions. For example, they conducted exercises to intercept all economic relations with North Korea using a strict "Catch All" enforcement, or a measure to prevent the development of nuclear, biological, and missile weapons as a part of trade security or Port State Control (PSC). PSC ensures that foreign ships meet the safety standards set by IMO for the protection of harbors and vessels and the prevention of sea contamination.

Japanese businesses voluntarily cut back on exports to North

I

II

III

IV

V

VI

VII

VIII

Korea because the share of their profits was not high enough to compensate for the losses incurred by the execution and enforcement of the Catch All measures. Due to this, except for exceptional products and technology, they had moderate difficulty in exporting to North Korea. Even if an export business asked for an exception, the requests were often rejected if the product maker was North Korean. This became one of major reasons why the trade between North Korea and Japan decreased. Since September 2002, backed by strong public opinion against North Korea, the Japanese government has conducted strict PSC inspections upon the arrival of ships at the “Mankyungbong-#92” Japanese port. 147 North Korean ships arrived 1344 times in Japanese ports in 2002. PSC conducted inspections on only 40 of these ships. However, 50 ships in the first quarter of 2003<sup>3</sup> and 78 ships were inspected by PSC up to June 16th<sup>4</sup> of this year. This imposed huge limitations on North Korean ships that lack sufficient materials and foreign currency to enter into port in Japan.

#### **D. Legislation that Makes Exclusive Economic Sanctions Possible**

Despite the de facto economic sanction measures, the kidnapping issue was not resolved very easily because strong public opinion increasingly pushed for the application of more pressure on North Korea. The solution to this appeared to be the establishment of legislation that would enable Japan to impose exclusive economic sanctions against North Korea.

The first draft of this legislation was discussed and proposed by six assemblymen from the Japanese Liberal Democratic Party (LDP): Yamamoto Yichita, Sga Yoshihide, Kono Taro, Mashara Yoshitake, Kobayashi Yutaka, and Mizno Kenyichithe during the



gathering entitled “Group thinking on diplomatic cards for North Korea.”

Japanese sanctions imposed on North Korea regarding remittance regulation and trade control were based on the “foreign currency and foreign trade law” that was revised on February 16th, 2004. It clearly states in the former version of the law that a remittance or trade regulation will be imposed when the authorities find that it necessary for the execution of the treaty and for carrying out other international agreements which authorities have concluded will support international efforts for world peace. In order to impose economic sanctions, it states that “exceptional economic sanctions may be implemented when there are existing treaty obligations or when there is a connection to an international act such as the exercise of economic sanctions under a UN security council resolution.”

A legislative bill that could ban North Korean ships from entering Japanese ports was also discussed. Under international custom, ships are free to enter and depart from a port designated as an international port and the freedom to enter ports is generally recognized. However, the Japanese law entitled the “Special order on banning specific ships from entering the port” issued on June 18, 2004, contains a provision which may prohibit a ship from entering a port based on a certain nationality, or based on a stop-over in a particular nation, or because it is related to a specific country.

According to Article 3, clause 1 of this law “when it is deemed essential to ensure the peace and security of the state, according to a decision by the cabinet, the state can prohibit a certain ship from entering into any domestic port for a determined period of time.” The cause also states that the decision must reasonably include information regarding (1) the reason for the prohibition, (2) the

I

II

III

IV

V

VI

VII

VIII

specific country, (3) the specified ship, (4) time duration of the prohibition, (5) the standard for the stopover in cases when designating a ship that has stopped over in a specific country as the specified ship, (6) the time limit for preventing a specified ship that has entered Japan from departing, (7) other matters necessary for the implementation of the prohibition.

### **E. Exercising Japan's Independent Economic Sanction Measures**

North Korean ships were completely prohibited from entering Japanese ports for six months beginning on October 14, 2006. The "Special order on banning specific ships from entering the port" was based on a cabinet decision made on October 13, 2006. The law also restricted<sup>5</sup> the importation of goods that were originally from North Korea or that had been shipped there, even prohibiting the importation of shipments that were transferred to other foreign states but whose place of origin was North Korea or had been shipped to North Korea by service trade.<sup>6</sup>

On October 14, 2006, the UN Security Council passed resolution No.1718, criticizing North Korea's nuclear test and imposing economic sanctions that prohibited the import and export of weapons or shipments that were related to weapons of mass destruction that had to be registered with the UN Arms Register, the import of "luxury goods," and also banned good from passing through the territories of member countries.

### **F. Four Consecutive Extensions of Economic Sanctions**

In April and October of 2007, and again in April and October of 2008, the Japanese government decided to extend the application of



economic sanctions, four times in a row. Japan stated that the reason that it made the October 10, 2008 decision to extend North Korean economic sanctions was because no progress was made in the re-investigation of the kidnapping issue, agreed upon in August this year, and North Korea was showing signs of restarting its nuclear development program. The next day, October 11th, the U.S erased North Korea from the list of state sponsors of terrorism. Domestically, there was great astonishment regarding the U.S. decision to remove North Korea from the list at that particular time. Japan's opposition to the U.S. action was greater than public criticism of the decision made by the Aso cabinet to extend the sanctions.<sup>7</sup>

#### **4. The Influence of North Korea-Japan Economic Relations on North Korea**

##### **A. The Paralysed State of North Korea-Japan Economic Relations**

What kind of influence has Japan's series of pressure policies exerted on the bilateral relationship between the two countries? The major objective of the sanctions was to prohibit North Korean ships from entering Japanese ports and to restrict all kinds of goods that were exported from North Korea to Japan. The restrictions imposed on trade and the importation of expensive goods, have stopped North Korea from earning huge profits especially in minerals such as anthracite, aluminum bars, agricultural-marine products such as songi mushrooms, crab, short-necked clam, sea urchin, confections, or contracted processed goods such as electronic components.

North Korea-Japan trade was comprised of 225.6 million dol-

<Table VI -1> Trends in North Korea-Japan Trade in Recent Years

(Unit: million dollars, %)

	2000	2001	2002	2003	2004	2005	2006	2007
export(A)	256.9	225.6	234.4	173.8	163.4	131.1	77.8	0.0
import(B)	206.8	249.1	135.1	91.5	89.3	62.5	43.8	9.3
total amount of trade (A+B)	463.7	474.7	369.5	265.3	252.6	193.6	121.6	9.3
balance of payment (A-B)	50.1	-23.5	99.3	82.3	74.1	68.6	34.0	-9.3
export ratio to the previous year	26.82	-12.17	3.89	-25.85	-6.01	-19.74	-40.68	-100.00
import to the previous year	39.85	20.47	-45.74	-32.29	-2.45	-29.98	-29.90	-78.75
total amount of trade to the previous year	32.32	2.38	-22.15	-28.20	-4.78	-23.36	-37.20	-92.34

Source: Ministry of Finance Statistics.

lars in exports from North Korea, and 249.1 million dollars in imports, and a total of 474.7 million dollars in 2001 before the kidnapping issue arose. In 2002, this increased slightly to 225.6 million dollars in exports (87.8% compared to the previous year), 249.1 million dollars in imports (120.4%), and 474.7 million dollars (102.4%) in total. However, after the kidnapping issue rose to the forefront in September of the same year, exports fell to 173.8 million dollars (74.2% compared to the previous year), imports fell to 91.5 million dollars (67.7%), and the total fell to 265.4 million dollars (71.8%) in 2003.

The declining trend persisted throughout the fiscal years 2004 and 2005, showing decreased amounts of trade. In June 2006, North Korean ships were completely prohibited from entering “Mangyungbong-92” the Japanese port because of the North Korean missile launch. There was also a complete ban on imports in

October because of the nuclear test. Thus, the amount of trade rapidly spiraled downward in 2006. If we compare the values of 2002 and 2007, we can see that North Korea-Japan trade has been almost completely severed as exports dropped 95.5%, imports 100%, in total there has been a 98% drop.

The dramatic decline in trade, especially exports, can be explained by the Catch All regulation<sup>8</sup> which has been applied and simultaneously strengthened since it was initiated in April 2002. The sanctions are maintained on the basis of the kidnapping issue, publicized widely in the Japanese society after the North Korea-Japan summit in September, and North Korea's testing of a nuclear device in October. Subsequently, as Japan independently applied sanction measures against the Kim Jong-il regime, North Korea-Japan trade received a crushing blow.

All imports from North Korea were completely banned so this resulted in many economic relationships between North Korea and Japan being severed. These relationships were cut even though contracts other than trade were made for the purpose of processing of clothes or electronic components.

Firms founded on investments provided by North Korea, and run primarily by Japanese-North Koreans residing in the North, have mostly been forced to go out of business under such circumstances. Japan's independent sanctions have completely cut-off almost all previously existing economic relations between the two countries.

## **B. The End of Human Interactions between North Korea-Japan**

Foreign currency transferred to North Korea from Japan includes not only trade transaction money but also investment funds or

I

II

III

IV

V

VI

VII

VIII

employment funds for manufacturing in North Korea, cash sent to families who returned home, and cash carried out of the country. The money transferred to North Korea in the 2003 (April 1, 2003, to March 31, 2004) fiscal year, was reported to the Minister of Finance in the amount of 110 million yen, and the cash carried out was reported by people visiting North Korea to be 2,576 million yen.<sup>9</sup> This kind of money consists of funds that are brought in by Korean residents in Japan to cover the living expenses of returned parents, brothers, sisters, and relatives, and those that are part of an employment fund or investment expense controlled by Japanese-Koreans or Japanese that invest in North Korea in the form of co-managing, co-venture, or contracted processing.

However, after Japan's independent economic sanctions stopped ships from entering the 'Mangyungbong-92' port in Japan, new laws also started restricting Korean nationals from re-entering Japan from North Korea. As a result, human interactions and interchanges between the two states have decreased significantly.

Japan and North Korea did engage in trade before the kidnapping problem became an issue. However, after North Korean trade debts to Japan were lifted by trade insurance and North Korea stopped repaying them to Japan in the 1980s, direct transactions between Japan and North Korea's trading companies were almost completely cut off. After that period trade was arranged by Korean resident firms, mostly of Jochongnyeon origin, playing the middle man role. Thus, Japanese businessmen and North Korean parties did not directly negotiate with each other for more than 20 years. Japanese corporations made joint investments in North Korea and have conducted trade in processed goods but there has been no direct bargaining or investment by trading corporations that represent Japan.

Therefore, Japanese mainstream business circles lack the 'soft-



ware' needed for economic exchange with North Korea, such as knowledge of North Korea's system, administrative customs, and their way of thinking. Moreover, the generation who conducted business in the place of North Korea-Japanese trade and have had bargaining experiences or built networks with them are now starting to retire in both countries. That is, North Korea-Japan exchange will once again be cut off by the withering of human networks.

## **5. The Change in North Korean Economy and North Korea-Japan Economic Relations**

Here, I will examine what kind of influence the North Korea-Japan economic relationship has exerted on economic change in North Korea.

### **[Investments in North Korea by Korean Residents in Japan]**

In 1984, North Korea enacted the Joint Venture Law and in February 28, 1986, General Secretary Kim Il-Sung proceeded to encourage the establishment of joint ventures with Korean residents in Japan working in commerce and industry fields. Since then, the Committee for the Promotion of Joint Ventures was founded inside Jochongnyeon, providing Korean residents with the framework to invest in North Korea through this channel. Many firms invested in North Korea from 1987 to 1989. But the presence of these firms has not been well known to Japanese society. Interviews with Korean nationals that work in commerce and trade, have demonstrated that among the companies that invested in North Korea there were only a few that succeeded. However, Japanese society does not think of such investments as Japanese

I

II

III

IV

V

VI

VII

VIII

corporations investing in North Korea but recognizes this as the activities of foreign nationals residing in Japan. Among Japanese companies, those that tried joint ventures or contracted processing in North Korea actually do exist. Nevertheless, their size is not significant as a value included in Japan's trade statistics.

It seems true that such investments by Korean nationals gave North Korea a certain economic boost since it was their first encounter with the capitalist way of management. But because their counterparts were Korean national businessmen who could follow North Korea's orders well, it seems that in dealing with North Korean authorities, they have sparked internal debates about introducing a capitalist style system.

## **6. The Prospect of North Korea-Japan Relations for the Next 5 Years and the Effect of Their Economic Relationship on North Korea**

### **A. How will North Korea-Japan Relations Unfold?**

As seen above, North Korea-Japan relations are currently deteriorating, enough to be described as possibly the worst they have ever been. Under these circumstances, is there any possibility of improving North Korea-Japan relations? In order to renew North Korea-Japan relations, first of all, a realistic agreement with practical solutions for dealing with the kidnapping issue should be reached between North Korea and Japan. From the Japanese perspective, which asserts that the kidnapping issue was caused by North Korea, this is a problem that will be determined by the actions that North Korea takes first. On the other hand, North Korea seems to think that negotiations on the kidnapping issue have deteriorated because



Japan used the kidnapping issue as an excuse to delay the normalization of diplomatic relations, especially to deflect attention away from the issue of Japanese atonement for WWII, which is necessary for achieving normalization.<sup>10</sup> Because of that, North Korea views this as a problem in which Japan should take action first.

In order to overcome this obstacle, Japan and North Korea must encourage contact and dialogue between authorities with high levels of political will and power. Reinspection of the kidnapping issue and a partial lifting of economic sanction measures was discussed during the Fukuda regime, but after the resignation of Fukuda, North Korea showed signs of delaying action implying that there was some kind of contact between them.

For Japan to encourage North Korea to move towards the reopening of negotiations for normalizing relations, they should remove some proportions of the economic sanctions or all of them, and build trust between the negotiators from both states. However, to make this happen, the government must have enough legitimacy to persuade the public to support the further development of Japan-North Korea relations. Therefore, genuine improvement in Japan-North Korea relations will have to wait for a government that is trusted by the citizens and is able to run the government in a stable manner so that the foreign policies can receive wide support. It is impossible to predict when that will happen, but the nationwide general election to the House of Representatives was September 11, 2005, and their term of office is in 4 years, thus the next general election is September, 2009.

If North Korea proposes negotiations for normalizing the relationship, it will be because they desperately need the economic benefits that would result from normalization. Nevertheless, at this point it is hard to imagine them making a request for economic cooperation because this would harm their own political legitimacy.

I

II

III

IV

V

VI

VII

VIII

## **B. North Korea-Japan Normalization Summit and Japan's Economic Cooperation with North Korea**

Later, if normalization negotiations are reopened, what will happen? The 'North Korea-Japan Pyongyang Declaration' says that "under the basic recognition that, after normalization, for periods that both states think are appropriate, Japan will provide economic cooperation such as provision of capital, low interest long term loans and humanitarian assistance through international organizations. In terms of supporting private economic activities, allowing loans and mortgages from the Japan Bank for International Cooperation which corresponds to the spirit of this declaration, both states will faithfully discuss the specific scope and contents of the economic cooperation in the summit." According to the provision, Japan will provide economic cooperation funds to North Korea as Official Development Assistance (ODA).

Japan's ODA policies are prescribed by the 'Official Development Assistance Charter (ODA Charter).'<sup>11</sup> According to the charter, the basic principles of Japan's ODA are (1) supporting self-help efforts of developing nations, (2) 'human security' viewpoint, (3) ensuring fairness, (4) taking advantage of experience and knowledge, (5) cooperation and coalition with the international society.

Among them, in regards to (1) supporting the self-help efforts of developing nations, 'training talents to become the basis of national development; establishing the law and system; providing social infrastructure' to enable 'good governance' is the most important principle in Japan's ODA, and it claims to respect the sovereignty of the receiving state. At the same time, it insists on assisting 'efforts to build peace, foster democratization, and human rights' and other actions towards reforming their economic



and social structure.

In addition, in terms of (4) taking advantage of experience and knowledge, it provides that 'high technology, knowledge, talent and the system of Japan should be utilized' to make 'Japan's experience of economic-social development and economic cooperation useful to the growth of developing states.' It refers to the human resource aspect that provides the assistance, but suggests that participation of NGO's, volunteers, and local public institutions should be recognized. In future ODA's, it is likely that matters related to coalitions with NGO's, volunteers, and local institutions will take up certain proportions.

For (5) cooperation and coalition with the international society, it requires "strengthen[ing] the bond between Japan's ODA and international institutions with professional knowledge and political neutrality" while stressing the need to reflect Japanese policies in the management of such institutions. Also, it argues for assistance with 'broad cooperation across many countries.' This involves building a coalition within the regional cooperation framework, the policy states "Japan, by creating bonds with developing states in Asia and in other regions that achieved growth, actively promotes North-South cooperation." This is provided that the ASEAN region and others bear in mind that this may also be applied to Northeast Asian regional cooperation.

ODA for North Korea has characteristics not only like the ODA offered to the states in Southeast Asia, Africa, or Latin America, which Japan currently thinks are important, but also has a character like that offered to the Southeast Asian countries and China in the past. This is because economic cooperation with North Korea has been established under the section 'mutual abandonment of claims,' a particular relationship that helps it atone for its past colonial rule. Thus, Japan's economic cooperation with

I

II

III

IV

V

VI

VII

VIII

North Korea after normalization will have two aspects, one that compensates for the past colonial rule and the other that provides assistance for private economic activities related to the bilateral relationship.

### **C. Possibility for Investment in North Korea by Japanese Private Corporations**

Then, if the North Korea-Japan normalization of diplomatic relations is arranged, would Japanese companies invest in North Korea? This will pose some difficulties on several points.

First, referring to the economic situation of North Korea such as the shortage of electricity or harbor capacity and poor land transportation condition, industrial infrastructure is not set yet which enables Japanese large enterprises to produce cars or electronics in other developing countries. As for import and export of strategic goods, there will be various restrictions as long as North Korea-U.S. relations are not rapidly improved. Heavy industries such as electricity, electronics, machine, and automobiles will be nearly impossible to advance except for textile or food processing industries.

Second, it is difficult for investments in North Korea by Japanese corporations to achieve priority compared to Korean companies which have few language barriers and have advantages over investments in other developing countries such as China and Vietnam. The investments in North Korea which inevitably advance into foreign markets, have a higher degree of difficulty entering China or Vietnam because of the accumulated experience of existing companies already doing business in North Korea. The negative perceptions of North Korea held by Japanese might have harmful effects when it comes to assessing investment in companies.



Third, as for the Japanese minor enterprises, if they take on too many risks in investment, it will be much more reasonable to invest in other developing countries. Most Japanese companies do not make many connections with North Korea and advance into North Korea only if it is profitable. There is a possibility that companies which have already made advances into North Korea, have a market in North Korea, or have no serious impact will invest. However, Japan will not provide export insurance under conditions where North Korea has not redeemed government bonds to Japan. It is necessary to find companies willing to invest at high-risk and high-return under these conditions.

As seen above, there are few possibilities that Japanese companies will invest in North Korea. In order to attract investment by Japanese enterprises in North Korea, the country needs to increase its earning power and to decrease all sorts of barriers that prevent foreign companies from investing.

#### Notes

- <sup>1</sup>- 李燦雨, 『日朝經濟協力の方案』ERINA, August, 2002, p. 9. <<http://www.erin.or.jp/jp/Research/db/pdf13/01140.pdf>>.
- <sup>2</sup>- *Ibid.*, pp. 9-12.
- <sup>3</sup>- *Nihon Keizai Shimbun*, June 10, 2003, Evening edition.
- <sup>4</sup>- *Nihon Keizai Shimbun*, June 17, 2003, Evening edition.
- <sup>5</sup>- In principle, this can be thought of as an embargo.
- <sup>6</sup>- Service trade is about dealing not with goods but with services such as technical knowledge, labor, banking, and so on, and includes various kinds of commissions, insurance, transport, processing, or transfer of industrial rights.
- <sup>7</sup>- *Nihon Keizai Shimbun*, October 12, 2008.
- <sup>8</sup>- Other than exporting shipments or providing technologies that are subjected to “Catch-All regulation” (Provisions 1~15 of Annex 1 of Export trade management orders, and Annex of Foreign currency orders),

sometimes acquiring permission beforehand is needed. It is because it has the danger of being used to develop WMDs even if it is not a subject of the list. This is called the “Catch-All regulation” (Provision 16 of Annex 1 of Export trade management orders, and Annex of Foreign currency orders). See <<http://www.meti.go.jp/english/index.html>>.

<sup>9</sup>-The Director of the International Division at the Ministry of Finance gave testimony as to the amount of transferred capital and money carried out from Japan to North Korea at the ‘Special Committee for the North Korean Kidnapping Issue’ on February 24, 2004. “In regards to payments made abroad besides trade payments, under the current foreign currency law, those that surpass 30 million yen are subject to the duty of reporting to the minister. The amount of the two previous years, the transferred amount of money during 2003 was 101 million yen, and as for 2004, it is only calculated to include December, totaled at 92 million yen.

Also, in the case of carrying cash abroad, under the current law, those that are bigger than 1 million yen are subject to reporting to the minister, and to tell you the amount of the previous two years, cash carried out to North Korea was 25.76 billion yen, and 21.7 billion yen until December in 2004.” <[http://www.shugiin.go.jp/itdb\\_kaigiroku.nsf/html/kaigiroku/014216220\\_050224002.htm](http://www.shugiin.go.jp/itdb_kaigiroku.nsf/html/kaigiroku/014216220_050224002.htm)>.

<sup>10</sup>-“A state that knows no moral nor shame,” *Democratic Chosun*, September 24, 2008. <<http://www.kcna.co.jp/calendar/2008/09/09-24/2008-0924-006.html>>; “Light-headed bidding of political crooks,” *Rodong Shinmun*, October 28, 2008. <<http://www.kcna.co.jp/calendar/2008/10/10-28/2008-1028-007.html>>.

<sup>11</sup>-More information can be found at <<http://www.mofa.go.jp/policy/oda/reform/charter.html>>.



**VII**

# **Economic Relations between Russia and North Korea**

**Alexey Yu. Starichkov**

Director  
Department of International Programs  
Far Eastern National University

**Kyuryoon Kim**

Director  
Division of South-North Korean Cooperation Studies  
Korea Institute for National Unification



## 1. Foreword

The economic cooperation between the former USSR and DPRK (Democratic People's Republic of Korea; North Korea hereafter) began after North Korea's declaration of independence in September 1948. Official cooperation is presumed to have taken place by the time of the signing of the Treaty on Economic and Cultural Cooperation on March 17, 1949.

In the aftermath of the Korean War, North Korea established more than a hundred different firms with the support from the former USSR in the late 1980s before economic cooperation was curtailed. These operations played a pivotal role in North Korea's economic development. The Pyeongyang Thermal Powerplant, 'Seung-ri' crude oil processing plant, Youngheung coal mines, Kimchaek steel mine, Cheung-jin metal processing plant are only the names of a few of these projects. The USSR provided support by augmenting North Korea's productivity in the following areas: electricity by 40%, coal by 30%, steel by 30%, rolling steel products by 40%, and nitrogenous fertilizer by 40%, respectively.

Throughout the past half century, economic cooperation between the USSR and North Korea was crucial in the development of relations between the two countries. During this period, the USSR served as North Korea's largest partner in terms of its economy and trade. North Korea's trade with the USSR totalled 90% of its foreign trade. The USSR had been by far the biggest consumer of North Korea's magnesite powder, coil winding machines, barytes, chroma-metal, rolling iron, chemical products, metal cutting tools, agricultural products, and daily general products. Nevertheless, North Korea's export did not exceed 0.5% of Russia's total imports, and the items imported were less than 60 in number, although certain North Korean export items placed high in the rankings. According to the

I

II

III

IV

V

VI

VII

VIII

statistics on the external trade flows between the former USSR and North Korea, bilateral trade between the two countries showed substantive progress. The total trade volume was 32.9 million in 1970, 33.8 million in 1975, 57.2 million in 1980, 105.9 million in 1985, and 149.9 million in 1990 (in Russian roubles). The entire basic volume of North Korea's export products were transported to Yuandong (China) and Siberia.

The USSR continued its cooperative partnerships with North Korea by engaging in technology transfers and investing in social overhead capital (SOC) development. However, this created a severe debt imbalance that can be seen by looking at records of North Korea's external debt. According to Russia's estimates on June 1, 2007, North Korea's external debt totalled 800 million US dollars. The issue of debt repayment for this enormous debt has not been resolved yet, and it appears to be an obstacle to developing cooperative relations between North Korea and Russia. When Russia forgave the external debts of Iraq (US\$ 1.2 billion), Afghanistan (US\$ 1.01 billion), Algeria (US\$ 0.47 billion), and Lybia (US\$ 0.46 billion), North Korea also asked Russia to forgive its debts. However, this proposal has not been approved by Russia's Ministry of Foreign Affairs and Ministry of Economic Development and Trade. Russia sought to redeem North Korea's debts by merging some of North Korea's firms, but this proposal was rejected.

Meanwhile, current proposals for Russia's forgiveness of North Korea's debt and South Korea's forgiveness of Russia's debt have not been accepted by the South Korean government. In addition, Russia's reluctance to forgive North Korea's external debt is a result of its willingness to use the cause as a negotiating card in the negotiations for a trilateral cooperation between Pyongyang, Seoul, and Moscow.



## 2. Trade Relations of North Korea and Russia

Economic and business cooperation between North Korea and Russia in the early 1990s existed as a virtual stalemate situation. Trade for commodities between North Korea and Russia from 1992 to 1997 decreased by almost 10 times from US\$ 600 million to US\$ 65 million. Investment in the form of cooperation for technology development projects was also halted. As a result, Russia lost its economic partnership with North Korea. (Recent trade for commodities between Russia and North Korea are only around 5~6%.) After former Russian President Vladimir Putin visited Pyongyang in July 2000 and North Korean leader Kim Jong-il made his return visit to Russia in August 2001, bilateral economic and business relations were normalized with a certain level of success. From 2000 to 2005, the bilateral trade volume increased but has consis-

<Table VII-1> North Korea's Trade Relations with Russia

(Unit: US\$ 1000, %)

Category		Export	Import	Total Trade	Balance of Payments
2003	Amount	2,792	115,575	118,367	-112,783
	Fluctuations	-23.3	50	46.7	-
2004	Amount	7,177	206,240	213,417	-199,063
	Fluctuations	157.1	78.4	80.3	-
2005	Amount	7,873	224,429	232,302	-216,556
	Fluctuations	9.7	8.8	8.8	-
2006	Amount	20,076	190,563	210,639	-170,487
	Fluctuations	155.0	-15.1	-9.3	-
2007	Amount	33,539	126,068	159,607	-92,529
	Fluctuations	67.1	-33.8	-24.2	-

Source: KOTRA.

tently decreased every year since 2005.

Russia is an important provider of machines, equipment, crude oil products, lumber, coal, and fertilizers for North Korea. North Korea's list of exports to Russia include foodstuffs, glass, glass products, general products, machines and equipment, seafood, and human labor. Currently, there are about 25,000 North Korean workers in Russia engaging in the construction, agriculture, and forestry industries.

Elements impeding North Korea and Russia's trade relations and cooperation include the absence of transport methods by land between the countries, the low competitive power of North Korean products, no guaranteed dates for transport shipments, and lack of payment by North Korea for Russian products.

### **3. Russia's Plans for Investment in North Korea**

Investment cooperation between Russia and North Korea still has development potential to an extent, but there are many difficult obstacles that prevent the realization of plans that analysts and experts are presently discussing. Many of the main projects include: the crude oil pipeline currently under construction which utilizes the 'Northeast Siberian-Pacific' water pipe that passes through North Korean territory and leads to South Korea, the gas pipeline construction project from North Korea to South Korea that pumps in gas from Russia's Kobuikutsinsk in the Irkuzk province, and the electric cord 500 for Russia's export of electricity to North Korea and South Korea. All of these projects must overcome large obstacles which prevent them from making further progress at the moment.

The halted progress can be explained by several reasons: politi-



cal confrontations between the two Koreas since the inauguration of the Lee Myung-bak administration, the absence of a peace treaty and an organization for consistent dialogue between the two Koreas, feeble economic integration between the two Koreas, lack of cooperation on investment opportunities between Russia and South Korea, and the remaining issues of external debt repayment (North Korea owing debt to Russia and Russia owing debt to South Korea's).

Just by looking at the halted progress on the Kaesung Industrial Zone, it is easy to conclude that the potential for realizing larger scale projects is very minimal. Nevertheless, it would be a fallacy to state that the two Koreas are to blame for the stunted economic cooperation. Some of the political and economic ironies underlying Russia's federal and provincial linkages were revealed through Russia's participation in discussions on energy projects with China, Japan, and the United States. The pursuit of geopolitical or economic interests inevitably turned out to be a detrimental step for realizing some of the aforementioned projects. Under these circumstances, the construction of water pipelines from North Korea's Port Najin to Hasan Station towards the TranSiberian Railroad is a great leap forward for cooperation between North Korea and Russia. On April 24, 2008, 'Torgovuy dom Russia Railroads,' a subsidiary firm of Yuhan, Inc. Russia Railroads and Port Najin signed a treaty for the establishment of Hab-young Company. Prior to this arrangement, the head of Russian Railroads, Ulajimir Yakunin and North Korean Railway Minister Kim Yongsam signed an agreement for cooperation. Hab-young Company will be constructing a container terminal way at Port Najin, and extending it to the 52 km Dooman gang-Najin Railway in order to modernize this infrastructure, thereby realizing the 'Hasan-Najin' Plan.

In addition, the Port Najin container terminal will be managed

I

II

III

IV

V

VI

VII

VIII

by Yuhan, Inc.'s Russian Railroads. The current capacity of the terminal is approximately 400,000 TEU, and is to be further increased to 600,000~700,000 TEU (Twenty-foot equivalent unit). The terminal's first goal is to augment the current capacity of the terminal to 200,000 TEU yearly. From an investor's point of view, this will become another of Yuhan, Inc.'s subsidiary branches. North Korea has provided a long-term lease of the Doomangang-Najin site for construction. The efforts to push for the project have already begun.

The Hasan-Najin railroad project was officially launched on October 4, 2008. Railway Minister Chun Kil-soo commented on the meaning of the project, stating that its development sprang from the North Korea-Russia Moscow Declaration in 2001 and that the intent is to create a large-scale mutual cooperation project for the peoples of the two countries. With the Hasan-Najin Railway Project currently underway, it came to light that Russia is seeking to utilize the cargo transported into Port Najin for sending shipments to Europe. North Korea has also been said to have high expectations about the facilitation of the free economic trade zone that resulted from the launching of the current railway project.

#### **4. Cooperation with North Korea in the Russian Far East**

The Maritime Province of Siberia is an important venue for cooperation between North Korea and Russia. However, there hasn't been a substantial amount of progress with regard to cooperation. Trade for commodities between North Korea and the Maritime Province of Siberia decreased by 8% in 2007, remaining at US\$ 7.2 million. In this figure, exports totalled US\$ 4.5 million and imports US\$ 2.7 million. Approximately 77% percent of exports



(US\$ 3.5) from the province to North Korea are crude oil and related products. Main products for export are glass and related products, totalling US\$ 2.6 million (96% of the total). Trade volume in the first quarter year of 2008 decreased by 3 times (US\$ 0.6 million). Judging from the reduction of crude oil exports and related products to North Korea, the total amount seems to have decreased from US\$ 0.8 million to US\$ 0.6 million. The decreased amount of exports (US\$ 0.3 million) has a lot to do with the declining amount of glass being imported in the province.

To enhance trade and businesses in the economy, several agreements have been reached between the maritime province and North Korea's external economy commission.

North Korea has proposed several products that increase exports to the province including multifunctional machines and equipments, honing processing machines, boring machines, cement, magnesia clinkers, talc powder, barite powders, steel rolling boards, electric zinc, electric cords, batteries for automobiles, motor equipment, insulated materials, coated materials, knitted materials, sandpaper, and sea tangles. However, most of these proposed products have not found an appropriate market for demand.

## 5. Far Eastern National University and North Korea

The history of the establishment and development of the Chosun Language Department at the Far Eastern National University stems from the year 1900 when a North Korean language course was introduced at the Eastern University. Established in 1899, the Eastern University in Vladivostok first gave courses on North Korean language, culture, history, and economy under the supervision of the Russian Tsar Nikolai II. The founder and director of these courses

I

II

III

IV

V

VI

VII

VIII

es and projects was Grigory Podsdavin, a North Korea expert, who later became the dean of the university. In the aftermath of the 1917 Bolshevik Revolutions, he had no choice but to seek for exile in Chosun and later in China. The fate of the Chosun Language Department at the Far Eastern National University was tragic just as the that of Russia's history in the 20th century. The university closed down in 1939 and faculty members of the university faced oppression. After the Second World War, the Far Eastern National University was not reopened until 1956, and the Chosun Language Department was able to reopen 19 years after that in 1975. After the reestablishment of the university, the Chosun Language Department formed connections with Kim Il-sung General University. At the time, the former USSR did not formally recognize South Korea's existence, and normalized relationship between the two countries was absent. The former USSR did not take South Korea into consideration in its policies at all, or even if it did, it regarded South Korea as an enemy state whose politics and economy were under the control of the United States and as a state threat to North Korea, a strategic ally of the former USSR. Students of the Chosun Language Department were not taught anything specific with regard to South Korea. The contents taught were North Korean language, as North Korea was a vital element in the growth process of the Far Eastern University. Beginning in 1985, students and faculty of the university started conducting research at the Kim Il-sung General University, and North Korea's faculty came to the Far Eastern National University for research. However, after relations between the former USSR and South Korea were normalized on September 30, 1990, cooperation with North Korea almost completely ceased. It was not until 2004 that a treaty was signed for cooperation between the Far Eastern National University and the Kim Il-sung General University. During the signing of the treaty, former Dean Song Cha-rip of the



Kim Il-sung University visited the Far Eastern National University in October 2004 and participated in the 105th anniversary of the establishment on October 21, 2004. Professor Wun-chan Chung, Dean of Seoul National University (South Korea) was also present at the event and was awarded an honorary doctoral degree from the Far Eastern National University. Thus, the Deans representing the most acknowledged academic institutions of the two Koreas were able to meet at the Far Eastern National University. The encounter of the two deans clearly reveals the policies of the university: facilitating the globalization of education in conjunction with the cooperation of the two Koreas, and striving to attract elites of the two Koreas' such as politicians, academics, scientists in order to facilitate participation in cooperative dialogues. Currently, the students of the Far Eastern National University are conducting research at the Kim Il-sung General University. Debates on scientific issues by scientists from the two Koreas are held annually at the Far Eastern National University. The Korea Fund and the Korea Science and Culture Exchange Fund are currently supporting these academic conferences. In 2005, the Association of Scientists at the Far Eastern National University decided to award an Honorary Doctoral Degree of Political Science to Kim Jong-il, Chairman of the National Defense Commission of North Korea. Dean Kurilov of the Far Eastern National University awarded the North Korean leader in person in Pyongyang.

We now can conclude that North Korea is a vital partner for Russia's political and economic interests in Northeast Asia. The cooperative relations between North Korea and Russia since the former USSR period, massive investment in North Korea by the former USSR, potential mutual interests that can help overcome the obstacles to development, bordering geographic proximity, and shared experiences in history are just a few of the positive ele-

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

ments in assessing further cooperation in trade and business between the DPRK and Russia.

## **6. Conclusion**

Russia played a vital role in the establishment of North Korea after the Second World War, and maintained an intimate relationship with North Korea until the end of the Cold War in the late 1980s. Russia was also a virtual economic sponsor for North Korea during the Cold War period, contributing to North Korea's industrialization. However, with the breakdown of the Cold War system and the Socialist Regimes, Russia stopped providing economic aid to North Korea in the 1990s. Afterwards, North Korea and Russia's estranged economic relations have gradually changed owing to the recovery of Russia's economy, and have created the potential for bilateral economic cooperation.

With Russia sharing its borders with North Korea, its political and economic stability is also a significant issue for Russia. Economic cooperation between Russia and North Korea will expand further as Russia transforms itself from a socialist economy to a market economy.

Asian economic development is also very crucial for Russia since Russia is a European state as well as a distinct Asian state. In this context, North Korea's transformation into a market economy is an issue of interest for Russia. Furthermore, North Korea's reform and openness accompanied by its active participation in Northeast Asian regional cooperation is desirable for today's Russia.



# North Korea's External Economic Relations: Past, Present, and Future

**Kyuryoon Kim**

Director  
Division of South-North Korean Cooperation Studies  
Korea Institute for National Unification

\* This article is a revised and recomposed version of Kyuryoon Kim, "Open-door Policies of North Korea and International Cooperation," *Visions and Direction of North Korean Policies of the Lee Administration*, pp. 165-184, translated into English.



## 1. Introduction

Since the founding of the country, it is a well known fact that North Korea has consistently sought to develop an independent economic system based on the fundamental ideas of the socialist economy. As a result, North Korea's economic exchanges with other countries have been limited to acquiring resources required for production that cannot be obtained domestically. This kind of economic management, involving enormous amounts of state-control, demonstrates that North Korea still intends to pursue the goal of creating a socialist state. However, it can also support the conclusion that the leaders of North Korea have determined that this independent economic system is the most valid method of preserving the survival of the North Korean state.

Assessments of North Korea's open-door reform policies and the surrounding policy environment are fairly pessimistic from an international perspective. First of all, North Korea is not only the most reclusive state in the world but it is also the only state to reject the adoption of a market-based economic system. As a result, there are not many countries and international companies that actively cooperate or willingly participate in developing North Korea's economy based on the economic factors alone. Since the end of the Cold War many former socialist states have tried to convert their economic systems, these changes have led to the concentration of remaining global investment capabilities in the newly developing states of Eastern Europe, as well as China and Russia. Due to the investment of resources elsewhere, successful pursuit of open-door reform policies for North Korea has not occurred, especially because the country does not possess any particular investment advantages or opportunities, even if it might have been able to promote them under normal circumstances. Furthermore, though

I

II

III

IV

V

VI

VII

VIII

North Korea may have gained the interest of the international society through its alleged nuclear weapons program, it has been unable to overcome the economic difficulties it has faced by not being actively engaged in foreign exchange.

Meanwhile, North Korea is surrounded by neighboring countries that are growing and developing at an extremely rapid pace. South Korea has achieved levels of economic growth unprecedented in the history of the world, China has also surfaced as one of the world's strongest economic powers based on its astonishing economic growth from the 1990s, and Russia, after converting its economic identity, is gaining economic power by utilizing its rich natural resources. The economic growth in Northeast Asia over the last 20 years and the subsequent development of stronger economies in the region is, to some extent, providing numerous opportunities for North Korea to revitalize its stagnant economy. However, because it is refusing to adopt a full-scale open-door policy based on the principle of marketization, North Korea is missing the opportunity to engage in international economic cooperation fostered by the collapse of the socialist bloc.

Another issue that we should consider, along with the state of international affairs, is the fact that over the last 10 years South Korea has played a chief role in North Korea's economic revival by supporting and funding several economic cooperation projects. In the last 20 years since South Korea first expressed its intent to cooperate with the North Korean economy, as outlined in the 'Special Declaration on National Self-esteem, Unification and Prosperity (the 7.7 declaration)' of July 7, 1988, South Korea has consistently expressed a desire to contribute to the revitalization of North Korea's economy as well as to promote and execute large scale economic cooperation projects. Cooperation among the two states has been on the rise, regardless of the fact that the inter-



Korean economic cooperation projects of the 1990's encountered many problems due to numerous non-economic factors. In the early 21st century, considerable results were produced by promoting the development of large projects such as the Mt. Geumgang tours and the Kaesong industrial complex. Taking into account these facts, South Korea should be considered the most important partner for the revitalization of the North Korean economy.

First and foremost, this paper will analyze the direction of development for North Korea's open-door reform policies by concentrating on the possibilities of bilateral and multilateral cooperation. Second, based on this analysis, this paper will introduce a new model for engaging in international cooperation with North Korea. Finally, this paper will address the possible role South Korea might play in promoting such international cooperation and reform policies. To achieve these goals, we must execute a comprehensive evaluation of the foreign economic reform policies in relation to various factors including the situations in South and North Korea, as well as the international society. However, because these aspects have been thoroughly analyzed in other studies, this paper will briefly cover the more important issues on the matter. First by examining the North Korean desire to pursue open-door reform policies, which is the most important factor, it can be said that North Korea is not too keen on engaging in foreign trade. This is because North Korea prioritizes the preservation of its system, and fears that opening its doors to the outside world might endanger the system and will force an unwilling North Korea to promote a full-scale reform. Resolve to pursue economic reform policies for North Korea is quite firm in South Korea, however, it can also be said that a national consensus on ways to pursue this goal remains difficult to achieve. This is due in part to the controversial 'Initiative for Denuclearization, Openness and 3000' that was introduced

I

II

III

IV

V

VI

VII

VIII

at the start of a new administration under president Lee Myong-bak. In other words, during the last 10 years of progressive-minded governmental rule, policies prioritized an increase in the amount of inter-Korean cooperation, with the understanding that inter-Korean cooperation could be achieved through various routes. However, the new Lee administration is trying to achieve a more open North Korean system by relying on the premise that inter-Korean cooperation must first help achieve denuclearization on the Korean peninsula. This would result in improved inter-Korean relations that would exert a positive effect on the lives of North Koreans. Consequentially, it is yet to be seen what kind of change this policy will bring about in North Korea since the country is still not willing to open its doors. As for the international perspective, if North Korea declares that it will open its doors to other nations through domestic economic reforms, many countries including the four surrounding powerhouses, the United States, Japan, China, and Russia, will promote economic cooperation with North Korea. Even in this case, however, the amount of progress achieved in the Six Party Talks on North Korea's nuclear weapons program will likely determine the magnitude and level of economic cooperation. Also, the willingness of other countries to engage in economic cooperation with North Korea and the activities of various working groups that have been agreed upon in the Six Party Talks will be factors determining the overall progress of economic cooperation. Furthermore, considering the influence that the United States has over several international organizations that provide economic assistance to North Korea, multilateral cooperation will depend on how fast relations between North Korea and the United States can be normalized. The following part of the paper will analyze the foreign exchange policies of North Korea in reference to these comprehensive conditions for policy making.



## 2. North Korea's Foreign Economic Relations

The history of North Korea's international economic relations for each period can be summarized as follows. Up until the 1980s, North Korea's international relations consisted of economic exchange and cooperation with the socialist bloc, namely the Soviet Union and China. During this period, North Korea's economic relations were not based on economic efficiency, and were mostly a part of the Soviet Union's and China's aid policy. The provision of friendly economic assistance was primarily based on North Korea's strategic importance. Later these relationships had to be restructured after the sudden collapse of the Soviet Union and the socialist bloc. From then on, North Korea's international relations mainly centered on China, Japan, and South Korea, and along with North Korea's own economic difficulties, foreign trade showed signs of rapid decrease. In the early 21st century, North Korea's economic relations consisted mainly of exchanges with South Korea and China, and with the increase of inter-Korean economic cooperation, the importance of South Korea in particular grew considerably. North Korea's foreign trade amounted to approximately \$4.1 billion in 1990, but decreased 38% to \$1.5 billion in 1991, right after the collapse of the socialist bloc. Afterwards, when the North Korean economy was at its lowest point in the mid 1990s, foreign trade fell to \$1.9 billion and during the Asian financial crisis of 1998 it fell to approximately \$1.4 billion. Since then, North Korea's foreign trade has recovered slightly to record \$3.0 billion in 2005.<sup>1</sup>

Inquiring into the changes in North Korea's major trade partners, it should be pointed out that China and Japan were important trade partners in the 1990s. In particular, trade with China comprised one third of all North Korean trade from 2001, and this

I

II

III

IV

V

VI

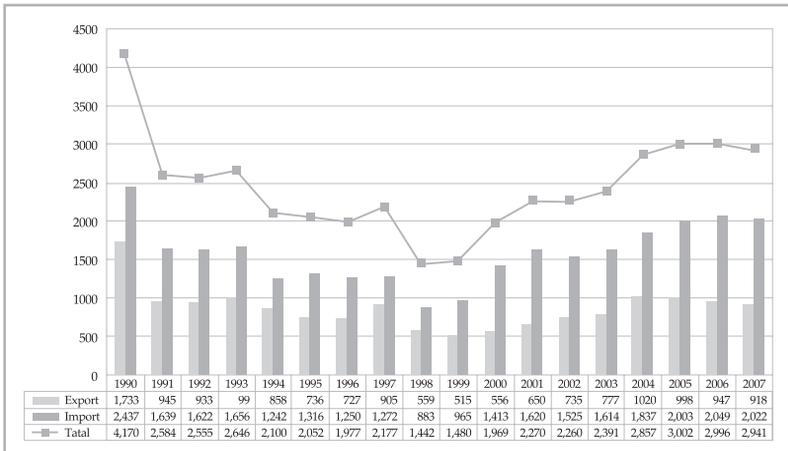
VII

VIII

amount kept increasing in amount to 67.1% in 2007. On the other hand, although the amount of goods traded with Japan ranked second among all trading partners up until 2003, trade between North Korea and Japan started to decrease rapidly from 2004, and Japan has not been one of the ten major countries that have engaged in trade relations with North Korea since 2006. In other words, although the increase in North Korean trade with China is an issue, Japan's decision to cut off trade with North Korea due to rough diplomatic relations between the two nations can be considered as another factor responsible for the increase in the proportion of North Korean trade with China.

<Figure VIII-1> Changes in North Korean Foreign Trade per Year

(Unit: \$1,000,000)



Source: KOTRA, "Trends of North Korean foreign trade 2007," (Seoul: KOTRA, 2007), p. 5.

Taking a look at the amount of trade for each trading partner of North Korea including that of South Korea, Japan was the second largest trade partner and South Korea was the third largest partner up to 2001. However, after 2002 South Korea became the second

largest trade partner and Japan became the third largest. Although this result is partly due to the increase in inter-Korean trade, it is also because Japan's trade with North Korea was reduced by 22% from \$4,700,000 in 2001 to \$3.6 billion in 2002. Inter-Korean trade covered more than 20% of all North Korean trade, and it increased to 37.9% in 2007. On the other hand, while Thailand has been recorded as one of the largest trading partners for North Korea, relations between the two countries do not seem to be that considerable. This seems to be the result of South Korean food assistance for North Korea mostly consisting of rice from Thailand. A traditional ally of North Korea ever since it was a socialist state, the total trade between neighboring Russia and North Korea amounts to \$200 million and the possibility exists that trade between the two states may increase if the economic status of North Korea improves.

To summarize the history of North Korean foreign exchange over the last 20 years, it seems that trade has always been initiated not by North Korea but by the states that needed to engage in relations with North Korea for strategic reasons. Also, it can be said that only China and South Korea carried out meaningful economic exchange with North Korea. China, in particular, is officially known to be providing petroleum and crops on a consistent basis. It has been announced that China is annually exporting approximately 500,000 tons of crude oil and 100,000-300,000 tons of crops. If the amount of assistance provided by China is fully considered, North Korea's reliance on China is readily apparent.

---

I

---

II

---

III

---

IV

---

V

---

VI

---

VII

---

VIII

### **3. Development of International Cooperation for North Korea**

#### **A. Bilateral Cooperation**

North Korea basically rejects the adoption and management of an open economy. However, there will be a push to promote greater exchanges with North Korea if the international community can make visible progress on the North Korean nuclear problem through proposals for cooperative action. Therefore, this section of the paper will be dedicated to evaluating the future possibilities for developing economic cooperation with North Korea.

As mentioned above, Northeast Asian states such as China, Russia and Japan have maintained an economic relationship with North Korea, so these countries are expected to play a large role in supporting future economic reform measures made by North Korea.

First of all, based on a deep understanding of North Korea's strategic importance, China has continuously promoted economic cooperation with North Korea, and during North Korean leader Kim Jong-il's visit to China in 2006 the two states agreed upon the principles of "governmental transfer, private participation, and market application (政府引導, 企業參與, 市場運作)." The adoption of these principles by the Chinese can be explained as the result of the impractical promotion as well as unsatisfactory execution of various economic cooperation projects pushed forward by private Chinese companies since the beginning of the 21st century. Beijing also clearly stated that the government would intervene in economic cooperation projects being conducted with North Korea while still supporting the idea that this economic cooperation should be managed by companies that follow fundamental market



principles. This somewhat contradictory attitude of the Chinese government can be considered evidence of the concern that the government has when dealing with the problems of economic cooperation with North Korea. In other words, China is taking notice of the fact that as a state it is recording a surplus in trade with North Korea, but several private companies suffer losses when the actual transactions are carried out. Since North Korea is more or less unfamiliar with the ideas of a market economy, there are many cases where it is making demands that are incongruent with market economic fundamentals as well as cases where the potential for unnecessary costs are looming. These facts have always been indicated as problematic. There have been cases where North Korea has placed several Chinese companies in competition with each other over a single project, and a project to exploit underground resources by a Chinese company that resulted in low production have contributed to spreading a negative perception of investment in North Korea. Furthermore, failure to eliminate discord regarding construction of the Sinuiju special administrative region is also acting as a factor that is chasing away large scale investment by the Chinese.

Even though China believes that North Korea is strategically important, the basic perception in China is that it is too soon to be investing heavily in North Korea because of its poor economic situation. In other words, in order for China to gain profits from investments, more basic economic infrastructure must be built in North Korea, and insufficient infrastructure in the fields of power and transportation are still disabling normal economic operations. However, initiatives at the regional governmental level are still being proposed, such as the three northeastern provinces (東北三省), to promote an economic development plan that includes areas bordering North Korea. Meanwhile, Beijing is advocating a plan to

I

II

III

IV

V

VI

VII

VIII

promote economic cooperation with North Korea, one that emphasizes economic efficiency because of the fact that investments made in North Korea are not fulfilling their expectations. Beijing is also cautiously deciding which projects need governmental assistance in order to prevent Chinese investments in North Korea from becoming too disorderly. Thus, there are both positive and negative factors that influence China's efforts to engage in cooperation with North Korea. While interest in economic cooperation with North Korea promoted by the three northeastern provinces (東北三省) and the Chinese government's understanding of North Korea's strategic importance are positive factors, numerous problems deriving from North Korea's poor investment environment and a lack of understanding of the market economy are negative ones. Under these conditions, economic cooperation between China and North Korea will in the short-term continue to maintain the same levels and the current form of trade, which is namely the provision of Chinese assistance for insufficient commodities in North Korea. In the long term, China, with an understanding of North Korea's economic importance, will pursue more progressive forms of economic cooperation with North Korea if the North Korean nuclear problem is resolved and conditions on the Korean peninsula improve. However, even if all these events occur, China will still promote economic cooperation projects with North Korea strictly based on market principles, and therefore it will be difficult for the relationship between the two countries to mature into a normal and genuine economic relationship unless North Korea marketizes its economy. Furthermore, China still provides North Korea with the food and crude oil that it needs, and this kind of assistance will continue due to the strategic value of North Korea.

Second, it is common knowledge that Russia offered assistance in the form of supplying infrastructural goods such as power and



roads, as well as construction of industrial oil refineries, iron manufacturing facilities and chemical industries up until the collapse of the old Soviet Union. During the process of state transition and transformation into the new Russia, several projects including the construction of the Trans-Siberian/Trans-Korean Railways (TSR-TKR), construction of an oil pipeline that runs through the Korean peninsula, and transmission of power resources from the maritime province of the Russian far east (Yonhaeju) to North Korea were discussed as ideas. Yet, since Russia did not have the ability to engage in economic cooperation with North Korea due to its own domestic economic hardships, the result was economic cooperation between the two countries became stagnant. Cooperation between the two has been moving forward ever since the two states agreed to construct TKR-TSR, to modernize North Korea's power plants, and to engage in reasonable mediation regarding the North Korea nuclear problem during Russian president Vladimir Putin's North Korea visit in 2002. Also, Russia announced a plan to cancel debts that amounted to \$8 billion in 2007, and the plans to build the railways are making actual progress after Russian Railways (RZD) and the North Korean railway ministry agreed to renovate railroads that link Russia's city of Hatsan and North Korea's Najin in 2008. Plans to renovate the North Korean railroads as well as the port of Najin indicate that Russia is well aware of North Korea's strategic importance.

Under these circumstances, Russia in the short-term will promote trade in the maritime province of the Russian far-east region as well as other bordering areas and will also pursue development by utilizing the workers of North Korea. In the long-term, it will show more interest in developing the infrastructure of the North Korean east coast as well as modernizing the industrial facilities it first provided, while promoting in whole a larger scale of economic cooperation.

I

II

III

IV

V

VI

VII

VIII

Third, Japan has to, some extent, maintained an economic relationship with North Korea even during the Cold War period, and after the end of the Cold War it rose to become the second largest trading partner of North Korea, occupying an important position in North Korean foreign exchange. North Korea and Japan even held summit talks in 2002 and agreed upon the Pyongyang declaration.<sup>2</sup> This declaration states as a basic principle for normalization of relations that both countries and the people of both countries will renounce all property claims related to events that happened before Korean liberation. It also includes directions for economic cooperation between the two states in the form of offering free capital and long-term low interest loans after normalization of relations, as well as providing fund advances from international banks and credit to help the economic activities of the North Korean people. However, the relationship between the two nations is deteriorating due to increasingly negative public opinion about the problem of the North Korean abductions of Japanese citizens as well as the experimental launches of missiles and the nuclear problem. Due to the unsolved abduction problem, Japan has decided to control all transactions with North Korean ships through the Ports and Harbors Bureau, and is also currently the most active country reinforcing economic sanctions for North Korea according to United Nations Security Council (UNSC) resolution 1718. As a result of these obstacles it is likely that the resumption of economic cooperation between Japan and North Korea will not be realized soon.<sup>3</sup>

Currently, Japan is not participating in the economic and energy supply plan agreed upon at the Six Party Talks and the abduction issue remains unsolved. Therefore, if the nuclear and abduction problems are not drastically resolved, Japan will not promote economic cooperation with North Korea any time soon. In the long term, the magnitude and future direction of economic cooperation



between Japan and North Korea will be determined by the course of negotiations to normalize relations, and it is estimated that a maximum of \$10 billion in funds will be provided if relations are normalized. Therefore, Japanese companies have been watching carefully for signals of how these funds will be invested or directed, but interest has been falling due to the stalled nature of the normalization talks. However, Japan, with its world-renowned economic power, is expected to play an enormous role in the rebuilding and revitalization of North Korea's economy, and it is because of this fact that the progress and direction of Japan-North Korea economic relations is important.

Lastly, although trade between North Korea and the United States is practically non-existent, the role of the United States is being reconsidered since the provision of humanitarian aid was resumed in light of the improvement in inter-Korean relations.

In addition, the United States is considered the pivotal state in revitalizing the North Korean economy, so the current state and future direction of United States policies toward North Korea is very important. Currently, the proposed U.S. economic policies towards North Korea are directly connected to the Six Party Talks and the solutions that emerge for dealing with the North Korean nuclear problem. For example, North Korean economic sanctions are being lifted in accordance with the 13 February agreement of 2007 which addresses the denuclearization of North Korea. Until North Korea becomes a normal state, the economic policies of the US towards North Korea should remain different from the US economic policies towards other friendly nations. This appears to fit with goal of the US to persuade North Korea to relinquish its nuclear program in the short-term, while in the long-term trying to convert negative perceptions of the US in North Korea. Furthermore, the US policy towards North Korea has a direct effect on that

I

II

III

IV

V

VI

VII

VIII

of Japan and South Korea, so the US plays a critical role in determining the overall atmosphere of relations toward North Korea.

Recently, the US started procedures to lift economic sanctions for North Korea such as erasing it from the list of 'State sponsors of Terrorism' as well as the list of nations that are subject to the 'Trading with the Enemy act' in accordance with the North Korean agreement to submit a full declaration of its nuclear activities and program. The US had already partially lifted sanctions against North Korea following the Geneva agreement in the 1990s, and if the current procedure of lifting the sanctions is successfully completed, the US and North Korea will gain a foothold for working on normalizing relations. However, because the magnitude of US sanctions imposed on North Korea is vast, the economic effects of these measures are only symbolic. In other words, the US has various other sanctions applied against North Korea including the economic ones mentioned above, and many other issues will remain between the two states, so it has been pointed out that North Korea will be able to normally participate in the world economy only if these many sanctions are lifted.<sup>4</sup>

The future of economic cooperation between North Korea and the US will first consist of a phase where the current sanctions are lifted, and after that the two nations will pursue a limited form of cooperation while the process of verification and denuclearization is underway. If it is determined that an irreversible North Korean denuclearization process will eventually be achieved, the US is expected to take measures to lift the prohibitions of trade with North Korea and to provide assistance for North Korea's participation in international finance organizations. Finally, after the denuclearization of North Korea is complete the US is expected to normalize relations with North Korea as well as assist in its application to the World Trade Organization (WTO).



## **B. Multilateral Cooperation**

In the short-term, multilateral cooperation that engages North Korea is currently underway and is being handled by working groups. These groups established during the Six Party Talks, focus on economic cooperation and evaluating projects expected to expand in the future. From a mid-term to long-term perspective, new forms of economic aid are being envisioned which include the participation of North Korea in existing financial organizations and the formation of new organizations designed to help the North Korean economy.

First of all, according to the agreement reached on February 13, 2007, South Korea was designated the chair of the working group on energy that is operating under the framework of the Six Party Talks. During the sixth round of negotiations for the Six Party Talks that were held recently, the participating countries created a timeline for the dismantlement progress for the facilities in Youngbyun along with economic and energy assistance. In return, all the participants agreed that they would work to complete the provision of crude oil and other forms of support to North Korea by the end of October 2008. Meanwhile, Japan declared that they would provide aid to North Korea as soon as the right conditions were achieved.

Second, multilateral cooperation based on an improved version of the Korean Peninsula Energy Development Organization (KEDO) can be envisioned. KEDO was first established in 1995 with the leadership of South Korea, Japan and the US in accordance with the spirit of the Geneva agreement, and later many other countries joined the multilateral organization such as Australia, Canada, New Zealand, Argentina, Chile and Indonesia in 1996, the European Union (EU) and Poland in 1997, the Czech Republic in 1999

I

II

III

IV

V

VI

VII

VIII

and Uzbekistan in 2000. After the North Korean nuclear problem resurfaced in 2003, KEDO halted construction of the light-water reactors in North Korea, and in 2006 it declared an end to the light-water reactor project and withdrew from every construction site in North Korea. Though KEDO started out as a reciprocal gesture in exchange for the North Korean promise to freeze its nuclear program, it showed potential signs of a multilateral cooperative effort as different member states joined later on. In other words, if a specific project is promoted regarding North Korea, states with larger interests such as South Korea, the US and Japan will take the initiative while numerous other states with a bit of interest will be invited to join during the process of managing the project.

Third, international cooperation can be discussed further after North Korea joins an international organization or during the last stages of application. In the past, North Korea has examined the possibilities of joining international finance organizations such as the Asian Development Bank (ADB) and the World Bank (WB). It is a well-known fact that in order for North Korea to join these international finance organizations, the US must comprehensively lift economic sanctions against North Korea. If the relations between the US and North Korea enter a stage where the US will lift economic sanctions in general, North Korea could start procedures to join international finance groups like any other developing country and in the process gain various forms of financial aid. Although the organization that North Korea has the biggest possibility of joining is the ADB, considering the fact that Japan and the US have tremendous influential power when discussing the admission of new member states, North Korea joining the ADB at this point in time is considered extremely difficult. Also, the ordinary route for developing countries when joining international finance organizations is to first join the International Monetary



Fund (IMF) and then to join the WB, but in order to join these organizations the approval of the US is necessary. The US currently holds 16.77% of the IMF's voting power, so it is impossible to join the IMF without the consent of the US.<sup>5</sup> The same goes for joining the WB because there is a precondition that all states must be a member of the IMF in order to join.<sup>6</sup> The WB group consists of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), and it runs the International Finance Cooperation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID) as accessory organs.<sup>7</sup> If North Korea receives assistance from international finance organizations, North Korea could be the recipient of assistance from the IDA, which specializes in financial aid for education, health, infrastructure, and communication for the world's poorest nations. Even though the consent of the US is imperative for North Korea to join in these international financial groups, North Korea must ultimately prove first that it can function as a normal member of the world economy through economic reforms and open-door policies.

#### **4. New Solutions for International Cooperation with North Korea**

Unless North Korean reforms and open-door policies become a prerequisite, full-scale international cooperation will not easily be put into effect. But economic assistance in accordance with the denuclearization of North Korea and financial aid carried out in the spirit of humanitarian aid are both currently being provided. Even in this case there are no full-scale aid programs that are being ex-

I

II

III

IV

V

VI

VII

VIII

cuted, and only various forms of financial aid from numerous international NGOs and food support being supplied as urgent relief by the World Food Program (WFP). Under these circumstances, it can be said that arranging a new framework that promotes North Korean reforms and open-door policies while improving the quality of life of the North Korean population is imperative.

First, it must be noted that North Korea has an economic partner South Korea that has achieved unprecedented economic growth worldwide. The help of South Korea is pivotal for the economic revitalization of North Korea, and in order for the provision of greater levels of financial aid and economic assistance from the international society to become more feasible South Korea must provide guarantees towards that end. From this standpoint, developing the bordering area of Shinuiju with a trilateral cooperation model that involves the two Koreas and China might be introduced as a new idea. Another trilateral model that can be proposed involves the two Koreas and Russia executing the renovation of North Korean railways and the modernization of the port of Najin. These different forms of development models can be expected to not only have practical effects on the reconstruction of the North Korean economy but also may lessen North Korean fears of subordination to South Korea. In other words, by proposing trilateral cooperation models that involve neighboring countries and states with interests on several levels, the problems that arise from only bilateral cooperation can be solved.

Second, there is a need to consider ways to reorganize the pre-existing frameworks of international cooperation that deal with North Korea. That is to say, with the foundation created by the working group on energy in the Six Party Talks, propelling regional development programs such as the Tumen River Area Development Programme (TRADP) that were proposed during the early



1990s can be discussed as a feasible alternative plan. The United Nations Development Programme (UNDP) has tried in the past to propel the regional development programs by dividing bordering states and non-bordering states through the TRADP. Therefore, there is a need to design a comprehensive framework for the development of the North Korean economy by organizing a North Korean development group that consists of the directly affected states of South Korea, the US, Japan, China, and Russia. This framework may be reinforced by inviting states, such as those in the EU, that have experienced working on economic cooperation issues with North Korea, perhaps building on the lessons learned from KEDO. This organization could play the role of not only expanding the economic support of the current working group on energy, but also preparing an overall blueprint for the development of North Korea. Here, preparing a comprehensive framework that can fully utilize the abundance of North Korean experts that have sprung up since the end of the cold-war is important.

Finally, in relation to the reinvigoration of international cooperation focused on North Korean issues, it must be noted that a more in-depth understanding of North Korea's strategic importance as well as a search to find a future-oriented growth model is necessary. North Korea, faced with the threat of survival that arose since the end of the Cold War, is looking to preserve its political system by possessing nuclear capabilities. The negative perception that it has derived from these actions has prevented the international community from acknowledging the economic importance of North Korea. In other words, even though the international society understands the strategic importance of North Korea from the standpoint of military and security issues, it is taking the geopolitical value of North Korea lightly. Therefore in order for international cooperation to be fully functional, North Korea not only has to

I  
II  
III  
IV  
V  
VI  
VII  
VIII

actively work towards reforming itself and adopting open-door policies, but it should also inform the world that it is willing to engage in various economic cooperation projects that utilize the geopolitical importance of North Korea within Northeast Asia.

#### Notes

- <sup>1</sup>- KOTRA, "Trends of North Korean foreign trade 2007," KOTRA data 08-015 (2008).
- <sup>2</sup>- 2002.9.17 2002 Japan-DPRK Pyongyang Declaration.
- <sup>3</sup>- <<http://daccessdds.un.org/doc/UNDOC/GEN/N06/572/07/PDF/N0657207.pdf?OpenElement>> Resolution 1718, Adopted by the Security Council at its 5551st Meeting, October 14, 2006.
- <sup>4</sup>- Atlantic Council, *U.S.-North Korea Relations: An Analytic Compendium of U.S. Policies, Laws & Regulations* (Washington D.C.: The Atlantic Council of the United States, 2007).
- <sup>5</sup>- <[www.kedo.org](http://www.kedo.org)>.
- <sup>6</sup>- <[www.imf.org](http://www.imf.org)>. IMF Member's Quotas and Voting Power, and IMF Board of Governors. Last Updated: June 20, 2008.
- <sup>7</sup>- <[www.worldbank.org](http://www.worldbank.org)>. Basic Facts; IBRD Articles of Agreement: Membership in and Capital of the Bank.

**KINU Research Monograph 08-11**  
North Korea's External Economic Relations