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Developing Inter-Korean Economic Relations for the Advancement of the Korean Peninsula

Kang-Teag Lim, Kyuryoon Kim,
Hyungsoo Zang, Hanbum Cho, Taeuk Choi



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

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I . Introduction

1. Background

Prospects for inter-Korean relations are unclear at present, as tensions in North-South relations have increased with the inauguration of the new South Korean government and the deadlock over the North Korean nuclear issue. The Obama administration took office under the banner of economic recovery but the U.S.-generated financial crisis is still affecting the world. The unstable economic outlook still burdens the ability of the Obama administration to create policy initiatives. In addition, increasing uncertainties concerning North Korea due to Kim Jong-il's ailing health create strenuous challenges for the Lee Myung-bak government, whose goal is to establish a peace regime on the Korean peninsula and a mutually beneficial inter-Korean relationship.

Inter-Korean dialogue is at a stalemate as North Korea resists the Lee administration's hard-line policy towards the DPRK, which marks a departure from the softer policies of previous governments.

The Lee administration's position to stick to principles in establishing inter-Korean relations is a challenge. In this situation, the government is urging North Korea to come back to the negotiation table. To make this viable, a more systematic and comprehensive approach is required.

II. Implication of Lee's 'Advancement of the Korean Peninsula' and inter-Korean economic relations

1. Implication of 'Advancement of the Korean Peninsula'

Since Lee Myung-bak took office, 'advancement' has been one of the most frequently mentioned concepts South Korea's new goal. Pursuing the 'advancement' of the South Korean society is considered optimistic because South Korea has achieved quantitative development through the process of industrialization and democratization and should now focus on quality development. There is not enough consensus on how to make these improvements, and therefore the South Korean government should work to achieve a new consensus.

The advancement of the Korean peninsula should be accomplished through the mutual advancement of the two Koreas and through the process of establishing healthy relations between them. The advancement initiative should contain the advancement of both North Korea and inter-Korean relations. The issue to consider is how the goal of the advancement of North Korea and inter-Korean relations is defined within the parameters of the present situations in the

two Koreas.

- Advancement of inter-Korean relations: setting up a permanent peace infrastructure by resolving the North Korean nuclear issue and achieving a peace agreement; expanding the infrastructure of economic cooperation (economic integration) including the liberalization of transportation, communication and customs clearance; forming a social and cultural community based on the liberalization of human resource exchanges; establishing a cooperative system between the two Koreas so that they act in concert with each other from a global perspective.
- Advancement of North Korea: preparing a national growth base through the opening and reform of the economy; expanding political freedom and democratic procedures; stepping out of extreme poverty and improving human rights abuses; participating in the world community as a global member by transforming to a market economy.

It is necessary to pursue the ‘advancement of the Korean peninsula’ based on the development of inter-Korean economic relations. In this case, the ‘advancement of the Korean peninsula’ can be defined as a “situation in which the two Korean societies make political, economic, social and cultural developments in balance while the two strive to peacefully achieve unification.”

Implications of Advancement of Korean Peninsula

- **Economic Aspect** : South Korea’s economy meets the levels of other advanced nations and North Korea is incorporated into the world economy by transforming itself into a market economy system.

Ultimately, based on these situations, the economies of the two Koreas merge.

- **Political Aspect** : Would the two Koreas' democracies develop so that the basic rights of North Koreans are protected; a civil society is formed and its role expands; harmonized and balanced roles emerge in the government and civil society.
- **Social and Cultural Aspect** : Conflicts among different ideologies, regions, generations and class are alleviated throughout the Korean peninsula; the legacy of national division and the Cold War disappear; a cultural community is formed through the rediscovery of the Korean culture.

2. Advantages of the concept - 'Advancement of the Korean peninsula'

The fact that the Lee government emphasizes the 'advancement of the Korean peninsula' as a national vision is meaningful in various aspects. First, this vision covers the whole Korean peninsula, and may include the process of economic integration. Second, the concept of advancement does not divide progressives and conservatives, and therefore a consensus can easily be made. Similarly, it offers easier ways to collaborate with the international community and North Korea. Third, it is an appropriate goal for South Korea as the advancement initiative is relevant to the policy line of the current government. Fourth, by pursuing balanced economic and social developments in the two Koreas, an integration of the economy and civil society of both Koreas after the reunion can be accelerated. Fifth, the concept of advancement is in line

with the pursuit of the South Korean society and the international community, which aims for a gradual and peaceful reunion between the two Koreas. It can also alleviate the North Korean concern of being absorbed by South Korea.

III. Evaluation of the establishment of inter-Korean economic relations

1. Evaluation of the results of assistance to North Korea from the perspective of development and cooperation

A. Characteristics and types of assistance to North Korea

(1) Characteristics of assistance to North Korea

Since the division of the Korean peninsula until the mid 1990s, assistance to North Korea did not have significant implications because the underlying limitations of the Cold-War affected overall inter-Korean relations for decades. However, with the collapse of the Cold War, the competition between the two Koreas became meaningless and the character of inter-Korean relations changed. Under those new circumstances, the North Korean policy transformed its paradigm from ‘Cold-war confrontation’ to ‘engagement’. Owing to such an engagement policy that aimed at reconciliation and collaboration between the two Koreas, it was possible to promote

inter-Korean exchange and assistance to North Korea. As a result, the new paradigm of North Korea policy aims at actively carrying out reconciliation and collaboration on the Korean peninsula.

A new turning point for assistance to North Korea was drawn in the process of the paradigm shift by South Korea on its North Korea policy. What is note worthy is that South Korean assistance to North Korea is somewhat different from ordinary humanitarian assistance because it is affected by the conditions of inter-Korean relations.

(2) Types of Assistance to North Korea¹

Until the middle of this decade, the South Korean society used the term “humanitarian aid” for assistance to North Korea. There was no discussion over the types of assistance being issued until 2005 when the discussion on development assistance started. Since then, the prevailing opinion was that assistance to North Korea should be outlined and categorized more specifically. Thus, the principles and content of each form of assistance were also established. The differences between emergency relief, restoration, and development assistance are described in the table below.

¹ Jong-mu Lee, “Plan for Private-public Partnership in Development Assistance to North Korea,” *Issues and Tasks of Cooperation on Public Health and Medical Support to North Korea* (K-FIH, International Conference Publication, July 28 2008)

[Table 1] Types and description of assistance to North Korea

	Emergency Relief	Restoration (Development & Relief)	Development Assistance
Purpose	humanitarianism	humanitarianism	humanitarianism and improving welfare
Goal	saving the lives of those in urgent need	restoring facilities and improving capabilities to cope with disaster	improving the quality of life for residents
Principle	unconditional assistance under humanitarian principles	unconditional assistance under humanitarian principles	conditional assistance to meet objectives
Period	short term (within one year)	mid-term (within two years)	long term (more than two years)

B. Evaluation of assistance to North Korea

(1) An increase in North Korea’s dependence on South Korea

Since the North Korean request in 1995, South Korea has continually provided assistance. As South Korean contributions increased, North Korea’s dependence on South Korea has also increased. Despite strained inter-Korean relations and North Korean diplomatic and military provocations, South Korea’s the ant of South Korea assistance has maintained an upward trend. It is notable that even though tension between Seoul and Pyongyang increased rapidly in 2004, both government and non-government assistance for North Korea increased that year. South Korea’s share of assistance continues to follow an upward trend. In 2000, when the inter-Korean summit was held, South Korea’s portion in food assistance to North Korea reached half of the total amount of assistance received by the North Korea for the first time. Since then, South Korea has continually contributed the highest portion of assistance to North Korea with the exception of the year 2001.

[Table 2] Countries that provide the highest portion of food assistance to North Korea

(Unit: %)

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Country	Japan	China	China	US	US	South Korea	Japan	South Korea	South Korea	South Korea
Portion	39	52	53	45	56	50	36	50	63	59

* The total amount of food delivered to North Korea is the sum of imports and aid.

Reference: Park Hyung-joong, “Status of demand and supply of resources in North Korean economy and their political implications” unpublished article, 2005.

(2) Shift from emergency relief to restoration assistance

South Korea started providing assistance to North Korea after the emergency aid request in 1995 and provided items such as corn, medicine, and clothing. Since 1998, the international aid community tried to transform such forms of aid into restoration assistance with private organizations at the center. Tough provisions of food and medical products continued, and assistance started to focus on the restoration of agricultural productivity and medical facilities with the belief that doling out food aid was unproductive. In the agricultural sector, projects include improving seed quality and providing fertilizer, agricultural machinery, and livestock in order to restore the productivity of collective farms. Projects carried out in the medical sector, aim at modernizing hospitals and pharmaceutical factories.

(3) Narrowing the “distance” between South Koreans and North Koreans

The constant provisions to North Korea since 1995 aided in familiarizing South Korea with a reclusive North Korea. It also gave North Koreans an opportunity to directly and indirectly experience South Korea, something that is prohibited in North Korea. Therefore, the assistance also contributed to narrowing ‘the concept of distance’ between the two Koreas.

2. Evaluation of promoting changes to the North Korean economic system

A. Situation of changes in the North Korean economy

(1) Progress and retreat of the changes in North Korea

The North Korean economy has changed during the past decade, although these changes have been forced by the lower class. The foundations for additional changes in the formal sectors has been established through government institutionalization and official announcements. Changes also occur in informal sectors with the tacit permission of the government.

Since the ‘July 1 Economic Management Improvement Measure,’ the North Korean government has announced several measures to promote economic activities on a national scale and improve the efficiency of economic management. The fact that North Korea opened a ‘General Market’ and allowed people to trade hints that changes in North Korea can progress quicker than expected, and that there will be an advancement of the market in the center of such changes. This is the widespread opinion of North Korea watchers.

[Table 3] Improvement measures for the economy since the ‘July 1 Measure’ in 2002

Special economic zone and expansion of economic cooperation	Sinuiju is designated as a Special Administrative Region in September 2002. The Mount Kumgang International Tourism Zone and Kaesong Industrial Zone were established in October and November. The ‘South-North Korea Economic Cooperation Act’ was enacted in July 2005.
Finance	Spearheaded by the enactment of the Accounting Act in March 2003, the Currency Circulation Act (’03.6), Finance Act (’04.4), Central Bank Act (’04.9), Trade Act (’04.12), State Revenue Act (’05.7) and the Commercial Bank Act (’06.1) was revised.
Commerce and Distribution	The North Korean government opened the ‘General Market’ in March 2003 and implemented a reform in the distribution sector by allowing institutions or companies to rent state-owned shops.
Reform of enterprise	More autonomy was given to enterprises beginning January 2004 (by reducing the state’s scope of plans, improving procurement conditions of resources, allowing expanded rights for local finance operations, encouraging effective usage of funds, allowing more autonomy for wage payment, and labor management).
Reform of collective farm	In January 2004, North Korea focused on improving the efficiency of collective farms (land distribution, abolition of equality principles, and pilot family-run farms).

Reference: Young-hoon Lee, “Status and Prospects of the North Korean Economy,” and “Status Evaluation and Prospects of the North Korean Economy” (International Conference co-hosted by the Asia Foundation and the Institute for Far Eastern Studies - Kyungnam University - Nov. 11 2008).

Since the establishment of the ‘General Market’ by the North Korean government in March 2003, the number of small businesses and individual merchants in North Korea has gradually increased. Yet, the North Korean regime has recently rejected the expansion of small, private businesses by criticizing that “manual trade is a selfish behavior stained by Capitalism.” So far, North Korea has tacitly permitted such market trade because it supplies necessities

to citizens and increases state revenue.²

North Korea is also increasing its control over market expansion. Since August 2007, North Korea has regulated the operating hours and location of the general market, the age of merchants, the sale items, and the number of items of each vendor. Recently, there was a rumor that new market management rules would be implemented from January 3, 2009 and that food would be sold only by the Grain Policy Division from January 1, 2009.

(2) Limitations of North Korea's economic policy changes

The perceived delayed or rescinding of changes in North Korea can be summarized in three key points.

First, allowing market trade promoted individual economic activities but did not result in an increase in productivity of the planned sectors in which North Korea expected growth. Rather, allowing market activities weakened the control of the government and threatened the stability of the regime.

The second reason is that there are limitations to the North Korean concept of a market economy. The concept of a 'market economy' in North Korea is different from the one understood in a capitalist market economy culture. The North Korean understanding of a market economy is limited to 'products.' The Markets that the North Korean authorities allow are restricted to consumer goods and raw materials. In this respect, recent trends in market expansion in North Korea seem to go beyond what the North Korean regime expected. That is why the regime is tightening control over the market activities of citizens.

Third, North Korea is reducing the pace of change because of restored confidence in economic achievements in the planned

² *Yonhap News Agency*, June 30, 2008

sectors. Generally, the demand of non-economic sectors regarding both marketization and economic reform create tensions within the planned sectors run by the government. In this case, once the government secures enough resources, it usually regulates non-economic sectors.

B. Effects of promoting changes in inter-Korean economic cooperation

(1) Effects of promoting changes in the North Korean economy

It can be argued that inter-Korean economic cooperation can promote, inhibit, or be irrelevant to economic changes in North Korea. However, in actuality, both in neutral relation to each other. It is difficult to find a close relations between inter-Korean economic cooperation and economic changes in North Korea because of the ‘7.1 Economic Management Improvement Measure.’

The North Korean channel for economic cooperation with South Korea is classified into sectors of the planned economy and most are mixed with the market economy sectors in various forms, but the foundation rests on a planned economy. Therefore, resources delivered to North Korea under economic cooperation will be used to maintain the planned economy and to sometimes inhibit the market economy and normalize the planned economy.

In contrast, inter-Korean economic cooperation can accelerate changes in the North Korean economy in some aspects. Resources that North Korea receives through economic cooperation with South Korea are used for the planned economy in the beginning but later most of them naturally flow into market economy sectors. The resources provided by South Korea contribute to North Korean education and implementation of the market economy, as well as the expansion of markets in North Korea.

(2) Effects of accelerating the opening of North Korea to the outside world

The inter-Korean economic cooperation cannot be seen as a core variable that affects North Korea's opening to foreign countries. Economic cooperation between the two Koreas and North Korea's opening remain independent of each other. Economic cooperation has largely contributed to accelerating the opening of North Korea considering that Pyongyang tried to resolve economic hardships through opening rather than reform.

From the North Korean perspective, economic exchanges and cooperation with South Korea are part of the expansion of opening up to the outside world. Inter-Korean economic cooperation is one of the most difficult cooperative initiatives for North Korea considering the North Korean concern of being absorbed by South Korea. The expansion of economic exchanges between the two Koreas means an expansion of the overall North Korean policy to further engage the rest of the world.

3. Evaluation of accelerating the economic integration between the two Koreas

In order to evaluate how the cooperative projects between the two Koreas contributes to the integration of the economies, an evaluation has been carried out regarding both institutional and functional aspects. The institutional aspect contains the preparation of formal devices agreed to advance economic integration. The functional aspect includes the results of increased mutual dependency through exchanges and cooperation in economic sectors, as well as a greater correlation between industrial structures and production sectors.

A. Institutional Aspect

The effects of inter-Korean economic cooperation on economic integration within institutional aspects are still minimal but making progress.

Basic Agreement

- South-North Korea Basic Agreement on Reconciliation, Non-aggression, and Exchanges and Cooperation (December 13 1991)
- Attached agreement for Chapter 3 (Implementation and Compliance of Inter-Korean Exchanges and Cooperation) of the ‘South-North Korea Basic Agreement on Reconciliation, Non-aggression, and Exchanges and Cooperation’ (September 17 1992)
- 6·15 North Korea-South Joint Declaration (June 15 2000)
- 10·4 North Korea-South Joint Declaration (Declaration for Development of Inter-Korean Relations and Peace and Prosperity) (October 4 2007)

Four Inter-Korean Economic Cooperation Pacts

- Agreement on Account Settlements (2000.12.16)
- Agreement on Avoidance of Double Taxation (2000.12.16)
- Agreement on Business Dispute Arbitration (2000.12.16)
- Agreement on Investment Protection (2000.12.16)

Agreements with respect to the Kaesong Industrial Complex

- Agreement on communications in the Kaesong Industrial Complex (December 8 2002)
- Agreement on customs clearance in the Kaesong Industrial Complex (December 8 2002)
- Agreement on quarantine in the Kaesong Industrial Complex (December 8 2002)
- Agreement on the entry and stay of South Koreans in the Kaesong Industrial Complex and the Mount Kumgang tourist resort (January 29 2004)

Other Agreements

- Basic Agreement on vehicle transit between the two Koreas (December 6 2002)
- Tentative Agreement on providing military guarantees for traffic on temporary roads in the areas of the East and West districts (January 27 2003)
- Agreement on procedures for assessing origin of products traded between two Koreas (July 31 2003)
- Agreement on Formation and Operation of the South-North Korea Business Dispute Arbitration Committee (October 12 2003)
- Agreement on Establishment of the Mount Kumgang Reunion Center (November 16 2003)
- Agreement on the Prevention of the Imjin River from flooding (March 5 2004)
- Basic Agreement on inter-Korean Railway Transport (April 13 2004)
- South-North Korea Agreement on Maritime Transportation (May 28 2004)
- Agreement on inter-Korean Cooperation in light industry and the development of mineral resources (June 6 2006)
- Tentative Agreement on providing military guarantees for the pilot operation of inter-Korean railway transport in the areas of the East and West districts (May 11 2007)
- Agreement on Pilot Operation of Inter-Korean Railways (May 13 2007)
- Agreement on providing military guarantees for transport, communications and customs clearance in the controlled areas of the East and West districts (December 13 2007)

It was possible to create the institutional mechanisms to promote South-North Korea economic cooperation thanks to the first inter-Korean summit in 2000. Through the summit, both governments appeared as key players in inter-Korean economic projects. The process of preparing institutional devices that require the agreement of both governments was also accelerated.

On November 12 2008, North Korea notified that it would, “take steps to strictly restrict and block border crossings over the military demarcation line.” There is no institutional device installed to prevent such actions despite the potential damage it might afflict on inter-Korean economic cooperation projects. The current level of institutionalization is not enough to prevent such consequences. In order to improve institutionalization for economic cooperation in the future, the two Koreas should (at minimum) set up a permanent body to overlook matters concerning inter-Korean economic cooperation.

B. Functional Aspect

The mentioned functional aspect of economic integration between the two Koreas still needs progress, but it has made more progress than the institutional dimension. The dependence of North Korea on South Korea has increased as economic cooperation and assistance to North Korea has expanded. This expansion is in terms of quantity, but the relationship between the two economies has not yet reached a satisfactory level.

One of the most standard cooperative structures between countries with different economic powers is to combine the comparatively advantaged production factors of each country. This can be applied to the two Koreas with (for example) South Korea’s capital and technology and North Korea’s land and labor force. In this regard, the two Korea’s economies can form a mutually-benefitting cooperative relationship. Accordingly, the economic integration of the two Koreas can be quickly accelerated if political conditions and institutional devices improve. For example, the trade in processing of brought-in materials between the two Koreas represents the early stage of the role division. In fact, regarding the processing of brought-in materials, labor-intensive industries such as textiles are given more

importance compared to industries like electronics.

The Kaesong Industrial Complex should be closely scrutinized during functional economic integration. The complex is expected to serve as a foundation to promote functional economic integration between the two Koreas by forming a divisional structure of labor and resources, in addition to correlating the two economies.

[Table 4] Quantity of South-North Korea trade by types (for the past 4 years)

(Unit: Million USD)

Types of Inter-Korean Trade		2004	2005	2006	2007
In	General trade or processing of brought-in materials	258	320	441	645
	Economic Cooperation (Kaesong Industrial Complex, Mount Kumgang tour, and other cooperation)	0	20	77	120
	Non-commercial transactions (government or non-governmental assistance/social and cultural cooperation/light-water reactor projects)	0	0	1	0
	Total	258	340	519	765
out	General trade or processing of brought-in materials	89	100	116	145
	Economic Cooperation (Kaesong Industrial Complex, Mount Kumgang tour, and other cooperation)	89	250	294	520
	Non-commercial transactions (government or non-governmental assistance/social and cultural cooperation/light-water reactor projects)	261	366	421	367
	Total	439	716	831	1,032

Source: Website of the Ministry of Unification, ‘Statistics’

The Mount Kumgang tourism project is a meaningful achievement considering the combined North Korean tourism potential and labor force with the South Korean capital and technology. The two Koreas established an infrastructure for inter-Korean economic

integration, and roads and railways between the two Koreas have been built to maximize the efficiency of the Kaesong Industrial project and the Mount Kumgang tourism project.

IV. A Theoretical Study on Inter-Korean Economic Relations

1. Basic approach

In order to seek alternatives to inter-Korean economic relations, this research reviewed the theories of economic integration, regime change, development, and cooperation. It then generalized these theories into one framework, applying it to the development of inter-Korean economic relations.

A. A Theory of Economic Integration

The case of South and North Korea is an example of economic integration between two countries that have totally different political systems, economic systems, and ideologies. According to the ‘Comparative Regional Economic Integration Theory’ the integration of the two Korean economies is classified into a category that has a very low chance for success. However, the outcome may be different from the perspective of liberal intergovernmentalism.

When analyzing institutional problems of economic integration

based on the theory of liberal intergovernmentalism, the primary independent variable is the character of the majority coalition that rules over domestic politics. The people who form the majority coalition and the controlling power determine the level of the institutionalization of economic cooperation. If the domestic politics of countries develops in this manner, institutional integration among nations would be easy. Economic integration is the result of the preference-convergence among the dominating powers of nations concerned.

If domestic political variables determine the level of institutionalization of economic integration by affecting the driving forces and negotiation capabilities of a government, the primary implication is to get out of the determination theory. The level of the institutionalization of economic integration is influenced by changes in domestic political situations, governmental will, and capabilities, not by the regime, ideology, or culture. This theory is also applied to inter-Korean economic integration as well as regional economic integration in East Asia. Considering the dynamics of domestic politics, South and North Korea, in addition to the whole East Asian region, have a great potential to achieve a high level of institutionalization for economic integration, which is a product of politics. Political decisions can be made whenever political interests are satisfied. The most important thing in achieving inter-Korean economic integration is the intentions and capabilities of the governments of South and North Korea. Integration can be achieved even if other variables are unfavorable, as long as there is motivation to continue.

B. Regime-Change Theory

When socialism in Eastern Europe and the Soviet Union collapsed, the theory of regime change from a socialist economy to a capitalist

economy was often suggested as a remedy for socialist countries to join the world economy.

Cases of countries that went through regime change demonstrate that the success of regime change is not determined solely by the manner of the change. The structural characteristics of each country as well as other various variables affect the manner of change and policy implementation. Therefore, previous cases of countries with differing conditions will serve as a useful tool for analyzing other transformations of socialist economies.

These lessons are as follows. Regardless of what kind of economic reform North Korea adopts, success depends on how far it realizes economic liberalization (marketization and privatization). In order to make economic reform successful, North Korea should advance marketization and privatization rather than increase the 'efficiency' of the socialist economic system. A key point in reform is not the speed but rather the content, scope, and level of reform. It is inevitable that a centrally planned economic system will be abandoned if North Korean authorities proceed with regime change in earnest. This will significantly reduce government intervention. Decentralization in the socialist economic structure can bring transitional chaos. It is likely that conservatives will hamper the efficiency of the regime change with opposition and resistance. With the formation of the market system, the flow of social resources will change, and there will be a reshuffling in the social structure. During this process, elite groups will most likely demand the right of rent-seeking, thereby eliciting corruption. This can result in the emergence of new economic entities and the expansion of unprivileged groups. Elite groups can emerge as key political powers, though this can be affected by how regime-change progresses.

C. Development and Cooperation Theory

A theory of development and cooperation has developed as advanced and rich nations started to assist poorer nations. In the beginning, most assistance was directed at achieving political motivation for the donor country. However, after evaluation of the repercussions felt by recipient countries, the donor nations decided to make some changes. Donors now focus assistance towards reducing poverty as well as one that seeks more efficient ways to provide aid. This led to the theory of development and cooperation. To apply this theory to inter-Korean relations, it is necessary to pay attention to the dual characteristics of the theory. An optimistic view is that the active intention of the South Korean government is reflected in inter-Korean economic relations through specific assistance and cooperative projects. The other is a relatively pessimistic view that the intention and roles of recipient countries for development are inevitable. A critical variable in developing inter-Korean economic relations is the intention of North Korea to improve the economic system through inter-Korean economic relations.

If North Korea is incorporated into the international community and joins international financial bodies such as the International Monetary Fund (IMF), the World Bank, and the Asian Development Bank (ADB), it will be classified into a group that needs assistance from the International Development Association (IDA). It is unlikely that North Korea will achieve satisfactory development with concessional loans by the IDA and ADB and it is highly likely that North Korea will be regarded as a ‘fragile state’.³ Fragile states

³ More detailed information can be found in Hyung-soo Jang’s “International Cooperation for Development Assistance to North Korea: centering around resources procurement,” *Korean Journal of Unification Policy* Vol, 17 No. 1 (KINU, 2008).

indicate countries with low levels of developmental achievement that usually receive reduced assistance. Only technological assistance was provided according to the international practice before the 9/11 attacks in 2001. However, since 9/11, the international community strives to prepare effective assistance measures for fragile states to alleviate the pain of the poor in those countries and to prevent them from threatening neighboring countries.

South Korea's assistance to North Korea should conform to the principles and rules of the international community and at the same time take into consideration the unique situation of the relationship. There are discussions regarding the extent to which South Korea should reflect this unique situation and experts in various fields are to review this issue carefully.⁴

D. Conclusion

Overall, the three theories can explain how to accomplish a vision to form an economic community through integration while developing economic relations between the two Koreas. First, a theory of economic integration will contribute to setting directions for the mid-term policy goals. A theory of regime-change will allow South Korea to think about what inter-Korean economic policies should achieve. Lastly, a theory of development and cooperation is expected to provide lessons on policy measures and implementation methods.

⁴ Please refer to Hyung-soo Jang's "Inter-Korean Economic Cooperation from the Perspective of International Norms," *Korean Journal of Unification policy* Vol, 17 No. 1 (KINU, 2008). He has drawn implications for inter-Korean economic cooperation by applying international norms.

2. Dynamic Approach

As there are some limits to inter-Korean economic relations, possible future situations should be considered in order to apply the implications of these three theories to the development of economic relations. In this respect, these three theories will be applied in each phase as follows.

First, the regime change theory will be more helpful in the beginning stage, in which the main task is to create conditions for economic reform. This theory strongly suggests that North Korea proceed with marketization to improve economic relations with South Korea. Second, a theory of development and cooperation is believed to contribute more to tasks that deal with mid and long-term projects and aim to bring economic reform through economic cooperation. This theory, which attempts to enhance the capability of the recipient country and projects (such as the development of infrastructure in North Korea), has significant implications. Third, a theory of economic integration has more implications in suggesting the goals and directions of a policy rather than policy measures. This theory is based on a vision that higher levels of economic development can be achieved by removing various trade and investment barriers so that leaders can achieve integration by sharing this vision with citizens.

3. A Comprehensive Theoretical Framework: Pursuing Universality in Distinctive Features

Currently, the inter-Korean economic relationship is defined as temporary and reflects the feature of two Koreas pursuing unification. The relationship has dualistic features that will remain until unification takes place. Against this backdrop, this study suggests a comprehensive framework that takes into consideration the

features of universality and distinctiveness.

First, if the development and cooperation theory is applied to inter-Korean relations, then international cooperation and inter-Korean cooperation should be carried out together. Second, the regime-change theory suggests that the North Korean economy adopt marketization to develop inter-Korean economic relations. The basic framework of economic exchanges between the two Koreas should be based on the principles of a market economy. Third, the economic integration theory suggests the convergence of South and North Korean economies. Yet, in reality, the development of inter-Korean economic relations can be achieved within a new framework by resolving the weaknesses of the South Korean economic system.

[Table 5] A Comprehensive Theoretical Framework

	Implications based on universality	Implications based on distinctive features
A Theory of Development and Cooperation	progressing international cooperation and inter-Korean cooperation together	enhancing the capacity of recipient countries
A Theory of Regime-change	accelerating the marketization of the North Korean economy	is this a word or radicalism
A Theory of Economic Integration	convergence and integration of regimes	political situations in South Korea and North Korea

V. Development Plan for inter-Korean Economic Relations

1. Goals of the Economic Policy towards North Korea

Goal: To form an economic community on the Korean peninsula by accelerating the opening of the North Korean economy.

A. What does ‘the opening of the North Korean economy’ mean?

If economic cooperation with North Korea aims at opening North Korea to the outside world, it is necessary to define what ‘the opening of North Korea’ means. First, from a national perspective, it means that North Korea must become a country that does not rely on illegal trade and complies with universal economic laws as a member of the international community. Second, regarding the economic system level, North Korea’s opening means ‘marketization’ and the expansion of communications with capitalist markets

around the world. Third, regarding economic life, opening North Korea to foreign countries means liberalization or democracy, where people have expanded rights to make independent decisions as consumers or producers.

The emphasis is that North Korean citizens should be a major consideration in South Korean policy. North Korea has experienced constant and chronic food shortages since the mid 1990s and those born in this difficult period are now advancing into society as key figures.

B. What has to be pursued as, ‘the features of economic community’?

North Korea will inevitably have to pursue an economic community based on liberal democracy and a market economy, as is the pattern throughout history. Yet, it will have to figure out how to implement gradual changes to the fragile North Korean economy. The economic community should aim for welfare states by complementing socialistic features.

In this regard, the ‘Yeonriji community’ would be an alternative economic community that South Korea should pursue while completing the unification process. At the same time, it is necessary to consider a ‘Social Economy’ as an alternative of the economic system. It would be interesting to consider the usefulness of these social enterprises as a specific practical mechanism.

The unique situations regarding the two Koreas should be reflected upon in an economic community. For this reason, this research recommends considering a ‘Yeonriji’ community as the third model for the inter-Korean economic community.⁵

⁵ Kang-Taek Lim, “Strategies to Develop Inter-Korean Relations and to Form a Korean Peninsula Economic Block,” *Northeast Asia Initiatives and Development Strategy for the Inter-Korean Relations* (Seoul: KINU, 2006), pp. 176-177.

With the ‘Yeonriji’ model, the two Koreas can create an economic community where they share progress, pursue mutual prosperity, and respect each other’s characteristics until unification is accomplished. The ‘Yeonriji’ community’s greatest asset is that it allows time for both nations to find a local economic development model which will suit individual economic, social, and political environments, while expanding economic cooperation with each other. In this respect, this model will alleviate the concern of North Korea being absorbed by South Korea and will reduce costs. As a result, it will be easier for both Koreas to reach an agreement on economic integration.

Yeonriji(grafting)

Yeonriji (fused or joined trees) indicates two different trees fused together via branches or trunks. Generally, if two different trees grow too close together, one of them usually dies. However, fused trees share their nourishment. For example, joined branches can grow even stronger than if they were separate. An advantage of fused trees is that each specimen’s features remain though they are joined together. A tree with a white flower and a tree with yellow flower still bloom white and yellow flowers though they are joined. Two different specimens grow together in harmony while each acknowledges the others’ unique characteristics.

C. Alternatives for Marketization in North Korea: Social Economy and Creative Capitalism

If North Korea's marketization progress is an effort to form an economic community on the Korean peninsula simply with an introduction of the market economy system, it will be difficult to achieve the intended results because North Korea will be a weak state in the capitalist market. In an extreme case, North Korea may become an area of speculation for foreign funds. North Koreans (with relatively low effort) can fall into a low-income bracket, creating a gap between South and North Koreans that would result in serious social problems.

At the same time, an introduction of a complementary system within a capitalist market system should be considered, in this respect, the concepts of a 'Social Economy' and 'Creative Capitalism' provide many implications in setting up the institutional framework necessary for tackling possible marketization problems.

(1) Social Economy

The concept of a 'Social Economy' has been used to embrace trends of theories that economic activities originate from a social connectedness that economic activities should re-examine, 'Social Economy' is used together with various terminologies such as 'the Third Sector,' 'Non-profit Sector,' 'Voluntary Sector' or 'Solidarity Economy,' and is also used for 'economic activities with a social purpose.'

(2) Creative Capitalism

The concept of 'Creative Capitalism' is to create a strong system that can help the poor and underprivileged by using the principles of market forces. This concept goes beyond traditional donations

and charity. ‘Creative Capitalism’ is closely related to corporate social responsibilities and contributions to society. This alternative can resolve the intrinsic contradictions of capitalism. The corporate pursuit of profit and social responsibility are not mutually exclusive.

2. Strategy

Pursuit of balance, harmony, and expanded communication

A. Gradual Cooperation and Integration

To South Korea, an economic relationship with North Korea will mean that it will face struggles with ever changing domestic and international political economic environments. Along with long-term direction, purpose, and vision South Korea needs to secure strategic flexibility to deal with situational changes. Additionally, the purpose, strategy, and priority of policies should be classified by stages.

In the short term, the priority should center on resolving pending issues regarding the economy in South and North Korea. However, the two Koreas should focus on establishing an infrastructure for economic integration that can be created with the procurement of more resources, greater security of human resources, and the preparation of legal and institutional devices.

B. Practical Separation between Economics and Politics

Inter-Korean relations are not free from regular strains due to changing political situations and the South Korean government should make a breakthrough in inter-Korean relations through economic cooperation. North and South Korea should form a virtual circle of cooperation in both political and security sectors along

with economic and social sectors. In this regard, it is necessary to consider how to effectively separate economics and politics.

First, the two governments need to discuss political and economic issues separately. Second, the roles among promotion entities should be clearly divided. Third, humanitarian assistance should continue regardless of political situations, with longer and more systematic plans to fundamentally resolve food shortages.

C. Networks by Areas and Sectors

For the advancement of the Korean peninsula through the development of inter-Korean economic relations, South Korea should develop domestic issues, inter-Korean relations, and international relations together and in balance. First, it needs to work on harmonizing and balancing the development of these three issues with the close relationship of concerned parties. Second, various networks should be created. When establishing multi-layered networks of regions, industries, and classes, the initiators and doers in the process of economic integration should be diversified and the decision-making process should be decentralized.

3. Development Plan for Main Sectors

A. Development Assistance for the North Korean Economy

(1) Directions

This research suggests several minimum principles that should be applied to inter-Korean economic relations from the standpoint of the international community's development assistance theory.

First, the priority of development assistance should be placed in creating a social infrastructure to alleviate poverty. In the case of assistance to North Korea, easing the poverty of the poorest

citizens should be a priority. In this respect, more weight should be given to the development of a social infrastructure that will have a direct effect on reducing poverty.⁶ In order for this to happen, it is necessary to allot enough funds to develop social infrastructure: medical facilities, rural development, hygienic facilities (potable water), flood control, education, electricity, and housing. All of these will improve the quality of life. This is also in line with recent efforts of the international community to reduce poverty.

Second, assistance for economic infrastructure development should be carried out in the direction of relieving poverty. As building an economic infrastructure will have positive and direct effects on economic growth,⁷ assistance for economic infrastructure build-up should also be expanded. As resources for development assistance are limited, donor companies should make certain priorities. The sectors that have direct and indirect effects on poverty alleviation should have first priority. For instance, roads for North Koreans should come before roads for tourists.

Third, humanitarian and development assistance should be carried out according to basic principles. It is important that humanitarian aid be provided without conditions. In order to ensure that aid shipments are delivered to those in need, a monitoring system is essential. If South Korea claims that the food supply to North Korea is for humanitarian purposes, it should increase the monitoring

⁶ Many researchers on development assistance to North Korea suggested similar opinions. Please refer to Seok-jin Kim's "Tasks and Directions of Development Assistance to North Korea," *KIET Industrial Economy Review* (May 2006). Jong-mu Lee's "Accomplishments and Tasks of Assistance to North Korea," *North Korea Channel* (2007) and Hyung-soo Jang's "Inter-Korean Economic Cooperation from the Perspective of the International Norms." *Korean Journal of Unification* Vol, 17 No. 1 (KINU, 2008).

⁷ Regarding the concept and measures of pro-poor growth, please refer to Hyung-soo Jang and Tae-wan Kim's "Analysis of South Korea's Pro-poor Growth," *Social Security Studies* Vol, 24 No. 2 (May 2008).

system. Monitoring should also be done in the case of development assistance should also be monitored to see whether provided resources were used for the original purpose. It is important to have strict inspections and post-evaluation systems. If funds or products are given without monitoring plans, they must be regarded as political assistance, and not development assistance. Regarding development assistance, donor countries should not ask for any forms of political rewards (at least not explicitly). Like humanitarian assistance, reciprocity should not be applied to development assistance. In many development assistance cases, both donor and recipient countries implicitly ask for privileges, but at minimum they should not explicitly ask for specific requests.

(2) Major Tasks

(A) Short-term tasks

The international community's technical assistance to North Korea

South Korea has an advantage in providing technical assistance since the two Koreas share the same language, culture, and customs. Yet, as North Korea is reluctant to receive South Korean assistance, it is quite difficult to carry this out alone. It would be more efficient and realistic to cooperate with the international community to deliver knowledge to North Korea and strengthen the development capacity.

North Korea has been very open to receiving technical assistance in the agricultural, health, medicine, and information technology sectors from international private organizations. These organizations include universities, institutes, and non-governmental organizations, but they are relatively less interested in enhancing development capability such as education, or the working of the market economy, and institution building. As North Korea is reluctant to embrace

a ‘market economy,’ only international trade can serve to educate the North Koreans. However, North Korea’s public officials and scholars who attend education programs in Vietnam or China have already learned about the principles of a ‘market economy.’⁸

Technical assistance toward North Korea can be carried out without largely affecting the progress of the Six-Party Talks. International financial institutions such as the World Bank are expressing an interest to share with North Korea their experiences in countries such as Vietnam, China, and the Middle East. The IMF and the World Bank have declared several times that if they approve of North Korea, they are willing to provide technical assistance to North Korea even before it joins international financial institutions⁹. Additionally, the establishment of a technical assistance trust fund should be made in order to provide funds for assistance to North Korea by United Nations (UN) bodies such as the UN Economic and Social Commission for Asia and Pacific (ESCAP) and international private sectors.

Expanding assistance for developing social infrastructure which improves the basic quality of life for North Koreans

The primary goal of development assistance by South Korea should be the reduction of poverty. The South Korean government should place more importance on assistance that aids infrastructure development. Social infrastructure includes sectors such as health and medicine, rural development, hygienic facilities (potable water), flood control, education, electricity, and housing.¹⁰ To prioritize

⁸ Interview with Vietnam Central Institute of Economic Management (CIEM) (January 7 2007).

⁹ Hyung-soo Jang and Young-kon Park, ‘Development Assistance to North Korea within the International Cooperative Framework’ (Seoul: KIEP, 2000), p. 29.

these agendas, the government should encourage private assistance to North Korea and strengthen public-private partnerships. Regarding overseas assistance, public-private partnerships tend to increase in the area of development assistance. Rural development should be considered primary among social infrastructures, when discussing North Korea's food crisis.

(B) Mid-term tasks¹¹

Participating in mapping out a development strategy for the international aid community

International financial institutions can help North Korea build a capacity through technical assistance even though North Korea is not a member of any of these financial institutions. If North Korea joins these organizations, the scope of technical assistance to North Korea will broaden. International financial institutions and Official Development Assistance (ODA) will determine sector development strategies regarding the North Korean economy and social infrastructure development.

In the international aid community, it is customary that donor and recipient countries agree on a development strategy before commencing on large-scale assistance (usually under the active cooperation of international financial institutions). Since North

¹⁰ Quite a few researchers on development assistance to North Korea suggested similar opinions. Please refer to Seok-jin Kim's "Tasks and Directions of Development Assistance to North Korea," *KIET Industrial Economy Review* (May 2006) Jong-mu Lee's "Accomplishments and Tasks of Assistance to North Korea," *North Korea Channel* (2007) and Hyung-soo Jang's "Inter-Korean Economic Cooperation from the Perspective of the International Norms". *The Korean Journal of Unification policy in Korea* Vol, 17 No. 1 (KINU, 2008).

¹¹ This refers to the second stage where North Korea joins international financial institutions.

Korea is not likely to discuss development strategies directly with South Korea, it is necessary to prepare realistic measures to influence development projects from the international aid community or international financial institutions. Unnecessary tension may arise between the international aid community and North Korea due to a lack of understanding North Korea's distinctive characteristics.

Implementing the development of economic infrastructure for poverty reduction: Small-scale and pilot projects

This is the stage where the international aid community does not provide full scale funds for the build-up of North Korea's economic infrastructure. In this situation, South Korea has to determine whether it will be one step ahead of the international aid community in assisting North Korea to develop economic infrastructure such as roads, railways, bridges, ports, airports, communication facilities, electricity facilities, and the development of water resources. In this case, assistance should start with small-scale and pilot projects. Large-scale development projects should be carried out on a long-term basis when North Korea has the capability to do so.

(C) Long-term tasks¹²

Providing development assistance to North Korea on a full scale

When North Korea adopts international customs and alleviates

¹² This refers to the stage where North Korea is back on track in terms of cooperation with international financial institutions such as the IMF, World Bank, and ADB, and receives full-scale development assistance and bilateral ODA. At this stage, international private funds also investigate investment opportunities through co-financing with international financial institutions.

the concerns of the international community, the South Korean government should cooperate with the international aid community to ensure that North Korea receives development assistance. Regarding the assistance for economic infrastructure development, international financial institutions usually funnel funds towards projects that require large-scale initial investments and create low profits. Such projects include building railways, roads, potable water, flood control, ports, and energy. The private sector usually invests in areas that return respectable profits such as electricity or communications, while diversifying risks through joint financing with international financial institutions. Bilateral Official Development Assistance (ODA) organizations also prefer joint financing in the case of large-scale infrastructure development projects. South Korea should accept the responsibility of a special role as the largest bilateral ODA donor for North Korea.

B. Accelerating North Korea's Opening and Reform

(1) Directions

First, an environment in which North Korea can implement independent change should be created. North Korean reform and the long process to improve the North Korean economy cannot be brought upon by external pressures and is not desirable. In terms of consistency and efficiency, it is important for North Korea to play a leading role in local reform and the determination to open up to the world. Accordingly, South Korean efforts should also focus on creating internal and external environments in which North Korea can perceive the necessity of change and progress and create a more open environment that systematically nurtures reform. For this, the North Korean nuclear issue should be resolved first in order to create a secure cooperative system in Northeast Asia. Such a device will alleviate North Korea's concerns over regime security.

At the same time, it is necessary to persuade North Korea that neighboring countries and the international community are ready to provide the country with financial assistance if they are willing to carry out reform and open up to the outside world.

Second, North Korea should be assisted to strengthen the local capacity to carry out reform. For efficient progress and reform, North Korea should map out a systematic and comprehensive plan to deal with various problems that might occur during the process of reform. For this, North Korean officials and professionals need to be educated about the workings of the market economy. It is also important to increase the ability of ordinary North Koreans to adapt to the process of regime change. North Korean efforts to push forward reform should be carried out in a stable and efficient manner with the cooperation of the international community. It is a prerequisite for North Korea to strengthen its internal human resources capacity that improves local institutional and structural systems. For this, the international community (including South Korea) should work closer with North Korea from the perspective of mapping out a plan and strategy for reform.

Third, economic cooperation projects should be implemented in a way that accelerates North Korean marketization. Based on the examples of past socialist countries that have undergone regime change, the changes in North Korea are likely to progress based on marketization, which is the most efficient way to induce changes from within North Korea. North Korea's marketization can be promoted in three aspects; 1) by expanding North Korea's communication channels with other capitalist markets. (For this, the international community needs to support North Korea to invigorate the economy through overseas trade); 2) by expanding the role of the market in the North Korean economy and improving the efficiency of the economy by reducing the function of the planned economy; 3) by assisting North Koreans to maintain and develop physical and

mental conditions so as to play a key role in the development of the economy.

Fourth, the planned and market economies coexist with an expanded market economy. In a transitional period, the planned economy needs to coexist with the market economy in the short run. However, the roles of the planned economy should decrease in the long run. It is important that regime-change should be in accordance with the current situations in North Korea to maximize benefits while minimizing side effects. Case studies might be useful for this, but the ideal path should take into consideration the political and economic situations of North Korea.

(2) Major Tasks

(A) Short-term tasks

Seeking a new model of economic cooperation to accelerate marketization in North Korea¹³

Economic cooperation between the two Koreas should create a new growth engine to accelerate marketization in North Korea in order to achieve the long-term goal of advancing the Korean peninsula through the development of inter-Korean economic relations. A possible economic cooperation model would be joint businesses that target the North Korean consumer market with North Korean capital. This model will vitalize the North Korean consumer market and will attract domestic and foreign investment in the production sector of North Korea. Ultimately, it will create a circle of consumption and production.

¹³ Kang-Taek Lim, "Economic Cooperation Strategy to Accelerate Opening of North Korea," *The Myung-Bak Lee Government's North Korea Policy and the Future Prospects for the Korean Peninsula* (Seoul: KINU, 2006), pp. 157-158.

Considering the fragility of the industrial infrastructure and the absence of investment resources in North Korea, a second possible model would be to promote cooperative industrial complexes such as the Kaesong Industrial Complex. Considering the current difficulties facing the North Korean economy, pursuing economic cooperation through a comprehensive investment that includes Social Overhead Capital (SOC) into a certain area might be the best choice.

A third model would be to promote cooperative projects by utilizing the North Korean human resources in overseas projects. These projects would include forestry, construction work, and the operation of large farms in the far east of Russia, the Middle East, or Mongolia. Trilateral cooperation among South and North Korea and a corresponding country would be desirable.

A fourth model is the joint inter-Korean development of natural resources that are currently led by Chinese companies. These could be imported into South Korea or exported to China or Russia. Yet, the problem is that it is difficult to find mines that can guarantee profits within the current SOC system. The conservative attitudes of the North Korean government and insufficient institutional measures are making the situation more difficult, and a more careful approach is necessary.

(B) Mid and Long-term Tasks: North Korea adapts to the international market order

Simultaneously carrying out the improvement of relations with the United States and the transformation of the economic regime

It is expected that the advancement of North Korea into the international community will progress slowly based on relations with the United States. The speed of this process will be directly influenced by the characteristics of the North Korean regime.

Relations between the United States and North Korea would improve while going through the procedures of lifting economic sanctions on North Korea, normalizing bilateral relations, concluding the bilateral trade agreement, and applying a Generalized System of Preferences (GSP) to North Korea. During these procedures, North Korea should be qualified to meet the diplomatic requirements needed to join international financial institutions. If North Korea is to become a member of these institutions then economic assistance to North Korea must increase accordingly.

The last step for North Korea would be to join the World Trade Organization (WTO). When North Korea joins the WTO, inter-Korean economic relations are also expected to develop accordingly. However, North Korea joining the WTO would only be possible after significant changes to the regime; in addition, the constant assistance of the international community and cooperation would remain necessary. It is not possible to change North Korea by only taking care of economic factors. It is necessary to establish an international cooperative framework to support the North Korean economy. Such a framework might include a security cooperation framework through the Six-Party Talks, as well as a consultative body framework.

It is also worth considering the promotion of changes in North Korea by forming an economic community in Northeast Asia similar to those in Eastern European countries. In this case, the community could require that North Korea develop its economy in order to obtain membership. However, considering that forming an economic community in Northeast Asia is not easy, the formation of Association of Southeast Asian Nations (ASEAN) Plus Three framework should be considered as an alternative.

Accelerating the reform and opening of North Korea

From the perspective of South Korea, the advancement of the Korean peninsula will face large obstacles and will be meaningless without the involvement of North Korea. As the advancement and regime change in North Korea cannot be carried out separately, the development of inter-Korean relations for the advancement of the Korean peninsula must evolve on par with North Korean reforms. Efforts to accelerate North Korea's regime change (reform and opening) have three implications.

First, South Korea should create an environment where North Korea can be assured success upon reform and to alleviate concerns over confusion (political burdens) which might be caused by changes. For this, South Korea needs to set up a harmonized and integrated cooperative system and enhance the capacity to cooperate with the international community.

Second, South Korea needs to assist in the infrastructure development of North Korea for situations where regime change progresses more quickly than expected. An infrastructure is necessary for efficient and active regime change. The development of better infrastructure will indicate a new North Korean attitude that points to the acquirement of professionalism among the core officials and economists of North Korea.

Third, South Korea needs to develop an environment where regime change in North Korea can be accelerated through the expansion of inter-Korean economic cooperation. It is necessary to make efforts to strengthen the institutional infrastructure so that inter-Korean economic relations can develop through various channels.

C. Establishing the infrastructure for inter-Korean economic integration

(1) Suggestions

First, the pursuit of socio-economic integration is crucial to narrow the differences between the two Koreas when pursuing economic integration. The two different levels of differences are the economic gap between South-North Korea and the internal differences within each country. In any case, widened differences threaten stability and consistency within the attempts at economic integration. The driving forces behind economic integration will dissipate if the gap between the two Koreas continues to widen. Even more seriously, inter-Korean relations may be strained due to dissatisfaction, opposition, and resistance by North Korea. At the same time, the widening gaps within each country can also damage the driving forces behind economic integration. Stable social integration on the Korean peninsula is a prerequisite for developing institutions for economic integration. Inter-Korean economic integration should be based on social integration.

Second, the pursuit of an economic integration that corresponds with the inter-Korean coalition level. Inter-Korean economic integration (though limited) is desirable for slow progress on a long-term basis. In this situation, regimes can converge smoothly with complete social integration. This process is in line with the mid-term goal of the unification plan to form an inter-Korean coalition. As this unification plan was agreed upon by the two Koreas. The Korean government should map out the scope and depth of economic integration that is equivalent to the level of the inter-Korean coalition.

Third, the establishment of an ‘open’ economic bloc on the Korean peninsula. The primary purpose of inter-Korean economic

integration is to form a single economic bloc on the Korean peninsula. However, this bloc should extend to and be connected with other economic blocs in the world. Forming an economic bloc is possible only when North Korean reform has advanced enough to meet international standards and the North Korean economy is incorporated into the global economic system. Economic integration should be carried out in a way that promotes the opening, reform, and incorporation of North Korea into the global economy. In order for this to occur, inter-Korean integration should develop primarily as part of a regional economic integration project.

(2) Major Tasks

(A) Short-term tasks

Forming and strengthening pro-economic integration forces

The successful integration of regional economies commonly began with requests by private industries or companies with ‘increasing returns to scale.’¹⁴ Opportunities for exports and investment expand with technology development. Companies envision profits as increasing, at which time they will call for the government to play a role in order for those potential profits to materialize. Companies ask governments to reduce transaction costs by removing obstacles. The most effective and systematic way to reduce transaction costs is through the institutionalization of economic integration such as a Free Trade Agreement (FTA). Companies would also pursue economic integration. The acceptance by governments to the requests of companies is the first step toward forming a national preference.

¹⁴ Walter Mattli, *The Logic of Regional Integration: Europe and Beyond*, (Cambridge: Cambridge University Press, 1999), pp. 46-50.

In order to make economic integration a national preference, there must be companies that are positive that economic integration with North Korea would benefit them. With these company groups in the center, consumer groups, and civil society organizations can form pro-economic integration forces. If they have strong political influence then economic integration with North Korea can become the national preference of the South Korean government. If the South Korean government would like to set economic integration as a national goal, it needs to first form and strengthen pro-economic integration forces.

Establishing an infrastructure for economic integration

As part of efforts to step up pro-economic integration forces, the South Korean government should prepare institutional devices that allow companies to run businesses in a stable manner. They should also expand profit-making opportunities by investing in industrial infrastructure sectors that are difficult for private companies to invest in. Most investment and assistance at the beginning of economic integration is usually made by governments or public corporations rather than by private companies. However, the government should encourage the involvement of private companies as well. At first, it would be desirable to start cooperative projects from special economic zones such as the Kaesong Industrial Complex, special tourism zones such as the Mount Kumgang International Tourism Zone, and the joint development of North Korean mineral resources by public corporations. On a long-term basis, there should be an expansion of business networks among private companies. During this process, cooperation between the two Koreas on establishing an infrastructure for inter-Korean economic integration such as liberalizing transportation, communication, and customs clearance should continue.

Persuading Anti-economic Integration Forces

In a pluralistic society (such as South Korea) weakening the opposing faction is as important as strengthening support groups. The government should provide enough compensation and support or vocational training to companies or workers in non-trade sectors or declining industries. Those who oppose this citing security reasons would be more difficult to deal with than those who oppose it for economic reasons. If a peace regime project is not carried out together with an economic cooperation project, there will be no way to persuade those who oppose it for security reasons. The progress of a peace regime on the Korean peninsula is a critical requirement for inter-Korean economic integration.

(B) Mid-term tasks

Forming pro-economic integration forces

In the case of North Korea, the higher the profit expectations from economic integration, the quicker it will adopt it as a national preference. For instance, expectations that resources and technology (which will flow into North Korea during the integration process) will contribute to restoring the North Korean economy will help North Korea decide to pursue economic integration as a national preference. In order to convince North Korea, the South Korean government needs to create a blueprint that shows how quickly and effectively inter-Korean economic integration will help the North Korean economy. Furthermore, this blueprint needs to promote the growth of the North Korean economy and promote mutual prosperity on the Korean peninsula. Possible cooperative projects include fostering a logistics industry with open overland routes, developing North Korean mineral resources evolving into Russian-led projects of energy development and pipeline construction,

and specializing in the Information Technology industry using South Korean capital, technology, and the productive labor force of North Korea. These projects would significantly contribute to forming a consensus regarding the appeal of economic integration for North Korea¹⁵.

Alleviating Anti-economic Integration Factors

Even if increasing support for the economic integration in North Korea exists, the North Korean government cannot easily accept it unless the concerns of losing political and economic control and of being absorbed into South Korea are alleviated.¹⁶ The first and most important task of South Korea would be to think about how to alleviate or remove these concerns. It also needs to secure support from neighboring countries as well as to prepare clear and reliable plans for economic integration and unification.

(C) Long-term tasks

Strengthening the ability to deal with variables regarding international regimes

How well South Korea deals with variables regarding international regimes is also a critical factor, as this will affect the second stage of negotiations and the third stage of the institutionalization processes. The capacity of South Korea to lead a situation and the determination to do so are especially important. How well South Korea performs a leadership role will determine the success of each

¹⁵ *Ibid*, pp. 117-118.

¹⁶ Moon-su Yang, "Direction and Strategy of forming the Inter-Korean Economic Community" (Presented in the inter-Korean industrial resources forum, November 25 2008).

stage. During economic integration, it is likely that South Korea will invest more into progressing integration with North Korea. During the course of integration, it is important to minimize the negative effects while maximizing the positive effects for both Koreas. The priority and the speed of the integration should be determined accordingly.

Drawing Cooperation from Countries Concerned

It is also important to adjust power relations among the United States and neighboring countries such as China, Japan, and Russia. Even if South Korea is successful in drawing a national preference and bringing North Korea back to the negotiating table, the negotiations will be influenced by the cooperation of those countries. In this respect, inter-Korean economic integration should also satisfy the interests of these countries. To achieve this, South Korea can design the blueprint for economic integration between the two Koreas in a manner that raises the level and scope of regional cooperation in Northeast Asia. Some of these projects may include restoring the Trans-Korea Railway (TKR) and connecting it with Trans-Siberian Railway (TSR), and Trans-China Railway (TCR) so that railway networks are available across the region. The two Koreas could actively be involved in Russian-led projects of energy development and pipeline construction that allow these projects to progress within a regional cooperative framework. South Korea can also design an economic integration with North Korea within a more extensive framework, involving East Asia. The two Koreas can participate in various economic projects that are carried out under the ASEAN Plus Three framework. In this case, the progress and outcome of inter-Korean economic integration will be absorbed by the economic institutions of the East Asia. This will improve the stability of efforts regarding inter-Korean economic integration.

If the integration is carried out within a framework of 'East Asia', the two Koreas will be able to draw regional support.

Utilizing Multilateral Bodies

If there are transnational mechanisms such as international bodies that can be utilized in different stages of international negotiation and institutionalization, they will be as helpful as the capacities and intentions of both Korean governments for the economic integration between the two Koreas. For example, Mattli emphasizes that countries which pursue economic integration first need to establish 'Commitment Institutions' which allow transnational bodies to monitor the cooperative or non-cooperative behavior of governments or non-governmental organizations that affect the integration process. These also encourage international cooperation among countries concerned. Such transnational bodies increase the chances of successful integration¹⁷. The function of the transnational body to promote economic integration is well emphasized in neo-functionalism. In the case of inter-Korean economic integration, a 'transitional cooperative body' that goes beyond the interests of the two Koreas will be required for international negotiations that manage the integration process.

¹⁷ *Ibid*, pp. 54-55.

VI. Conclusion: Tasks and Political Considerations

1. Tasks

Kim Jong-Il's ailing health indicates that North Korea is at the starting point of expansive and full-scale changes. Such changes can be carried out either gradually and with stability or rapidly in an unstable manner. The tasks of the South Korean government at this critical moment can be summarized in three points.

First, the South Korean government should predict all the possible situations that might occur within the North Korean regime during the changes and prepare measures against them. This would be especially important in the case of rapid and unstable changes. Appropriate countermeasures should be prepared for possible situations such as political instability, large-scale famine, a massive flood of refugees, widespread social unrest, riots, the breakdown of the government, and military intervention by neighboring countries. Such situations also threaten the security of neighboring countries and affect the security of Northeast Asia, it is very important to

form a close cooperative system with the concerned countries.

South Korea should increase the influence over North Korea in order to instigate changes that favor South Korea. There must be a widespread agreement amongst North Koreans (including government officials) that South Korean cooperation is necessary and important, and that South Korea is a reliable partner with which to discuss the future together. The most effective way to make this possible would be a gradual expansion of inter-Korean economic integration in various areas. This second task is especially important in the case of relatively gradual and stable changes.

Third, the South Korean government needs to be prepared to shoulder an increased burden should economic integration speed up because of changes in the North Korean regime. As it would not be easy for both South and North Koreans to assimilate, attention should be paid to human and emotional integration as well as institutional and material integration. As seen in the unification process of Germany, integration between the two Koreas would include facing and overcoming various difficulties. If patience and hope is lost, the process will become an obstacle to the development of the Korean peninsula. The South Korean government should suggest a vision for both unification and integration and enhance the capacity to effectively deal with various intricate problems as they arise.

2. Political Considerations

Progress on the Korean peninsula can obtain excellent results together with changes in North Korea. This advancement can only be realized once institutional, material, and emotional barriers are removed between the two Koreas. In this respect, the advancement of economic relations between South and North Korea should be developed into cooperative, harmonized, and balanced relations.

The two Koreas should confer on how to peacefully integrate while minimizing associated problems.

A. Playing a leading role in public opinion while pursuing national consensus

It is of paramount importance that progress regarding policy on North Korea is based on public support and transparency. However, it is inevitable that some policies regarding North Korea should be discussed ‘in camera’ due to their sensitive nature. For the same reasons, South Koreans will likely form misinformed opinions based on limited information. Due to enormous uncertainties, it is difficult to predict the course of development in inter-Korean relations and if the South Korean government relies only on public consensus, it will face difficulty in implementing necessary policies.

If there are policies that can maximize national interest in the long run even though they may be rejected by the public, the government should be determined to execute them regardless of public opinion. It is possible that the public in South Korea will not welcome any progress regarding economic integration with North Korea. Accordingly, the government needs to shape public opinion while achieving a national consensus in order to accomplish successful economic integration.

B. Pursuing a connection between economic and non-economic cooperation

As history demonstrates, cooperation between nations in conflict constantly faces challenges unless a peace treaty is established. Hasty economic integration between two countries that have huge economic disparity can also cause social chaos and conflict. Economic and non-economic cooperation aimed at a peaceful

regime is complementary. The most desirable result manifests itself when these two types of cooperation are carried out together. With increasing uncertainties on the Korean peninsula, the South Korean government should constantly form a social and cultural consensus and develop the potential for economic cooperation with North Korea.

Inter-Korean talks are currently no longer being held, however it is inevitable that they will resume some day. As such, South Korea needs to maintain the current momentum until the appropriate divisions of the public and private sectors are allowed to resume a dialogue.

C. Increasing ability to adapt to changes

The integration process between the two Koreas will be a long process of continued changes. As the scope and depth of the changes are expected to be colossal, how well North Korea adapts to these changes will be a decisive factor. Gradual changes within the realm of what is possible for North Korea would be desirable. In this regard, if the North Korea is the one that aims at integration and unification by promoting change in North Korea then it is important that South Korea enhance the adaptability of North Korea.

Regime change in North Korea's and inter-Korean integration will heavily affect South Korean society, especially if the changes occur quickly. For South Korea to be readily adaptable to the changes necessary to promote change in North Korea and further develop inter-Korean relations it needs to work on the following seven points: 1) establish a national and political consensus on North Korea policies, 2) secure economic power to cope with the burden of economic cooperation, 3) alleviate hostility in North Korean society through constant exchanges, 4) secure independent national

security capabilities, 5) increase the ability to reduce social conflicts in South Korea, 6) increase risk management capabilities and establish and implement relevant government policies, and 7) form an international cooperative framework.

Along with these tasks, there are innumerable items that need to be accomplished in order to improve the economic relations between the two Koreas. However, the primary focus for the two Koreas should be to form a national consensus on the importance of the inter-Korean cooperative relationship and relevant policies.

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