

BEYOND BALANCING: ECONOMIC COOPERATION ON THE KOREAN PENINSULA

Peter M. Beck

This article attempts to answer the question of how we can best deal with the security threat posed by North Korea. It argues that the most effective way to ease tensions on the Korean Peninsula and lower the security threat to the region is to engage North Korea economically in the context of a strong defense posture. In the first section, it makes the case for a broad-based and flexible approach to economic engagement. It then provides a comprehensive review and assessment of North Korea's external economic linkages and the steps undertaken to economically engage North Korea to date. These activities include trade and investment, humanitarian assistance and the light water reactor project undertaken by the Korean Peninsula Energy Development Organization (KEDO). It concludes by examining the prospects for sustaining and deepening economic cooperation with the North.

I. Introduction

One of the most formidable challenges facing policy makers in the Asia-Pacific has been how to deal with North Korea. North Korea remains one of the most serious threats not only to South Korea's security, but also to regional security in the Asia-Pacific region due in no small part to its suspected nuclear and ballistic missile activities. As if any reminders were needed, the North's testing of the Taepodong I ballistic missile in late August 1998 raised tensions as well as the specter of an arms race in the region. How can we best deal with the challenge posed by North Korea?

I argue that the most effective way to ease tensions and lower the security threat to the region is to engage North Korea - diplomatically, socially and most importantly, economically. In the first section, I make the case for a broad-based and flexible approach to economic engagement. I then provide a comprehensive review and assessment of North Korea external economic linkages and the steps undertaken to economically engage North Korea to date. These activities include trade and investment, humanitarian assistance and the light water reactor project undertaken by the Korean Peninsula Energy Development Organization (KEDO). There have been a flurry of conferences and articles on engagement with North Korea but the vast majority have focused on one specific area of cooperation, be it trade, investment or KEDO. However, in establishing the potential efficacy of economic engagement, we must look at the overall picture rather than one narrow aspect. I conclude by examining the prospects for sustaining and deepening cooperation with the North.

Few would disagree over the desirability of engaging North Korea, the question is, what should be the extent of that engagement? To what degree should it be conditional or reciprocal? The Kim Dae Jung Administration has undertaken the boldest engagement policy ever in South Korea and has proclaimed the separation of economic and politi-

cal issues (*jeon-kyeong bun-ri*) when dealing with North Korea. In reality, it may be almost impossible to separate the two. Nevertheless, the current policy of comprehensive engagement initiated by the Kim Administration offers an unprecedented opportunity to reduce tensions on the Korean Peninsula. Questions have been raised about the sustainability of the engagement policy. The course ahead is far from clear. A sufficiently provocative act by the North could derail engagement efforts and force governments to adopt more confrontational stances. Elections in South Korea and the US could adversely impact the prospects for economic cooperation. Nevertheless, until the North proves otherwise, economic engagement remains the best option available to policymakers.

II. Moving Beyond the Zero-Sum Game

The dilemma of whether to pursue engagement, confrontation or benign neglect on the Korean Peninsula echoes the debate within the international relations literature which pits realists against neo-liberal institutionalists. Realists, with Kenneth Waltz leading the charge, have argued that interactions among nation-states are characterized by competition and confrontation.¹ States are continually vying with each other for hegemony. Interactions between states are zero-sum - one country gain is another country loss. Nations or blocks of nations invariably attempt to balance against one another. The realist approach provided a parsimonious and seductive explanation for the Cold War, but was ill equipped to predict or explain the Soviet Union decision to stop balancing against the United States. In other words,

1 Kenneth N. Waltz, *Theory of International Politics* (New York: McGraw-Hill, 1979) and "Realism and Globalism: Is International Politics Becoming Obsolete?", Presented at the annual meeting of the American Political Science Association, Atlanta, September 2-5, 1999.

realism provides a persuasive explanation for past relations between North and South Korea, but fails to explain how the Koreas can move beyond balancing.

The interdependence school contends that states can indeed cooperate and interact in ways that are mutually beneficial or “positive sum.” Where realists like Waltz see growing economic interdependence leading to confrontation, neoliberal institutionalists see less confrontation and conflict because the cost of war becomes greater and greater; trade and investment concerns raise the cost of military conquest.²

Over the past decade, the forces of globalization have only strengthened the interdependence approach. More recent interdependence writings have made more nuanced arguments about the forms of interdependence most conducive to cooperation. One finding is particularly pertinent to the Korean case. Goldstone finds that asymmetrical bilateral trade relations are more likely to lead to conflict and even war than symmetrical relations.³ In other words, when one country depends on another for trade and investment but the other country does not depend on the first, the dependent country is more likely to opt for a policy of confrontation.

The Korean Peninsula represents one of the last vestiges of the Cold War, with the two sides locked in a military rivalry that at times grows extremely tense. President Kim Dae Jung has pledged to “end the Cold War on the Korean Peninsula” during his term of office. At recent conferences, some analysts have described Kim’s bold engagement policy as a paradigm shift.⁴

2 For a succinct application of this debate to Northeast Asia, see Mike Mochizuki, *Security and Interdependence in Northeast Asia*, Asia/Pacific Research Center (Stanford University: May 1998)

3 P.R. Goldstone, “Economic Interdependence and Peace: Hollow at the Core?”, presented at the annual meeting of the American Political Science Association Atlanta, September 2-5, 1999.

4 For a strong assertion of the “paradigm shift” view, see Kim, Ki-jung, and Deok Ryong Yoon, “beyond Mt. Kumkang: Social and Economic Implications,” presented

While the policy clearly represents a sharp departure from that of past administrations, North Korea remains a clear and present danger that cannot be ignored. Even one of America's foremost champions of globalization, *New York Times* columnist Thomas Friedman stresses the need for maintaining security. Building on his thesis that countries with McDonald's rarely go to war against one another, Friedman argues, "the fact that no two countries have gone to war since they both got McDonald's is partly due to economic integration, but it is also due to the presence of American power and America's willingness to use that power against those who would threaten the system of globalization - from Iraq to North Korea. The hidden hand of the market will never work without a hidden fist".⁵ South Korea and the United States must work more closely than ever to deter potential North Korean aggression.

Nevertheless, Kim Dae Jung was the first leader to recognize that from a position of strength, South Korea and the rest of the world have the opportunity to engage North Korea economically without compromising South Korea's security interests, and ultimately lower tensions, not only on the peninsula, but also in the region. In the words of Unification Minister Lim Dong-won, "We can introduce the engagement policy because we are strong".⁶ The Council on Foreign Relations's North Korea Task Force reached a similar conclusion, "We are strong enough to test inducements for change in the North".⁷ In a sense, the Perry Report represents an affirmation of Kim's policy choice. In a

at the conference on "Kim Dae Jung's Sunshine Policy: Its Conceptual Promise and Political Challenges," Georgetown University, May 1999.

5 Thomas L. Friedman, *The Lexus and the Olive Tree* (New York: Farrar Straus Giroux, 1999), p. 373.

6 Dong-won Lim, "How to End Cold War on the Korean Peninsula," presented at a working breakfast meeting hosted by Korea Development Institute, Seoul, April, 1999.

7 Council on Foreign Relations, "U.S. Policy Toward North Korea: A Second Look," New York: July 1999.

word, the Kim and Clinton administrations are attempting to move beyond balancing.

One of the benefits of William Perry's review of U.S. policy toward North Korea has been more effective policy coordination between the United States, South Korea and Japan. Each country's interests diverge at times, but for the first time there is now a basic consensus among the three on dealing with North Korea.

After South Korea, the United States is the key to economic engagement with North Korea. China and Japan provide critical financial lifelines to North Korea both in terms of trade and unilateral transfers (see Table 2), but neither is likely to take a proactive stance toward engaging North Korea for the foreseeable future. Chinese authorities appear satisfied with the status quo. Despite the tremendous potential windfall for the North, negotiations between the North and Japan to normalize relations remain at an impasse. The main sticking point has been the North's failure to adequately address the kidnapping of Japanese nationals. The test firing of the Taepodong missile in August 1998 led to a hardening of views in Tokyo.⁸ As a result, the biggest economic engagement prize of all for North Korea, wartime reparations of \$10-\$20 billion for normalizing relations with Japan,⁹ may be out of reach for the foreseeable future.

Even the leading proponents of engagement with North Korea, Seoul and Washington, face the challenge of coordinating the interests of each country as well as reconciling differences of opinion within each country.¹⁰

Perry made this clear in his report, "No U.S. policy can succeed

8 Masao Okonogi, "Beyond the Status Quo: A View from Japan," presented at the conference "Kim Dae Jung's Sunshine Policy: Its Conceptual Promise and Political Challenges," Georgetown University, May 1999.

9 Mike Mochizuki, *op. cit.*

10 For a summary of Congressional Republican views on U.S. policy toward North Korea, see Benjamin A. Gilman, "Speech to the Asia Society," manuscript, October 1999.

unless it is coordinated with the ROK's policy".¹¹ For the United States, North Korea policy has been guided by nuclear and ballistic missile proliferation concerns, while for South Korea, the paramount concern is maintaining peace on the Korean Peninsula; proliferation has been a secondary concern. Nevertheless, both countries have arrived at the conclusion that engaging North Korea economically is the best way to reduce tensions.

This essay makes an important assumption. I assume that North Korea will not collapse in the short to medium term. In a few weeks, yet another prediction by Aidan Foster-Carter about the imminent demise of North Korea will be proven wrong. After predicting in the early 1990s that the North would collapse within a few years, he went on to predict that Kim Jong Il would not survive the 1990s as head of North Korea. While a sudden implosion/explosion cannot be entirely ruled out, most analysts believe the current regime will remain in power for the foreseeable future.¹²

The U.S. and South Korea tried a confrontational approach in the early 1990s and it almost lead to war.¹³

III. The North Korean Economy

Before delving into North Korea's international economic linkages,

-
- 11 William J. Perry, "Review of United States Policy Toward North Korea: Findings and Recommendations," United States Department, October 1999, p. 2.
 - 12 A May 1999 survey of participants at a conference on North-South Korean relations found that 71% believe that it will be more than ten years before the Koreas reunify. Peter M. Beck, "Engagement or Confrontation: American, Asian and European Views on the Two Koreas," *Korea Approaches the Millennium* (Washington, D.C.: Korea Economic Institute of America 1999).
 - 13 Oberdorfer and Sigal provide the most telling accounts of the perils of confrontation. Don. Oberdorfer, *The Two Koreas* (Massachusetts: Addison-Wesley, 1997) and Leon V. Sigal, *Disarming Strangers: Nuclear Diplomacy with North Korea* (New Jersey: Princeton University Press, 1998)

it is important to have a sense of North Korea's economic situation and the prospects for reform. Given the opaque nature of the regime and paucity of hard data on the North Korean economy, at best we can only guess what conditions are like, much less fathom the calculations of policymakers. As Perry put it, "the unknowns continue to outweigh the knowns."¹⁴ What we do know is that the North Korean economy experienced profound economic distress during the 1990s. As Table 1 indicates, the 1990s were a "lost decade" for the North Korean economy. Estimates vary, but the North Korean economy shrank by roughly one-half or more during the 1990s. In contrast, South Korea grew by the equivalent of the entire North Korean economy each year during the 1990s. Many factors have been cited for the North's dismal economic performance. The collapse of the Soviet Union, one of the North's leading trade partners and sources of foreign assistance, likely triggered the downturn. The limitations of a command economy, droughts and floods have also contributed. Despite the North's *juche* ideology, the economy has experienced shortfalls in grain production and energy imports of 20-30% in recent years. Some analysts have declared that the North Korean economy has collapsed. The only potential bright spot is growing signs that the economy may have bottomed out, due in part to increased foreign assistance.

North Korea's *juche* ideology has become increasingly anachronistic as the world grows increasingly interdependent. Ironically, North Korea is more dependent than ever on outside assistance from its traditional adversaries, South Korea, the United States and Japan, than ever before.

14 William J. Perry, *op. cit.*, p. 5.

IV. Prospects for Reform: Neither Vietnam Nor Albania?

In finding a way out of its economic tailspin, the North Korean regime faces a Catch-22: to rescue the economy and ensure the survival of the regime, the North must undertake economic reform, yet these same reforms could destabilize the country and ultimately threaten the regime, much like the Tienanmen Square Democracy Movement in China in 1989. At times it can be difficult to separate North Korean rhetoric from reality. Nevertheless, it is important to briefly assess the prospects for economic reform in North Korea. If the North were to undertake fundamental economic reforms, the payoff/returns would be tremendous. By one estimate, the North would experience an almost unprecedented jump 20-40% in economic output if economic distortions were eliminated.¹⁵

Given the North's opaqueness, it is impossible to draw any conclusions about the regime's level of commitment to economic reform. Nevertheless, there are modest signs of change. For example, the North adopted a revised constitution in the fall of 1998 which includes market-oriented laws relating to price reform and profit incentives.¹⁶ Some analysts dismiss North Korea's tentative reform efforts. Eberstadt argues, "North Korea today appears to be guided by an aid-maximizing economic strategy".¹⁷ Oh and Hassig arrive at a similar conclusion.

15 Marcus Noland, "The North Korean Economy," *Joint U.S.-Korean Academic Studies*, Vol. 6, 1996 (Washington, D.C.: Korea Economic Institute of America) and "The Implications of Increased Economic Integration," presented at the conference "Two Koreas: Toward One Economy," Korea America Economists Association: Washington, D.C., October 4-5, 1999.

16 Jin-wook Choi, "Changing Relations Between Party, Military, and Government in North Korea and Their Impact on Policy Direction," *Discussion Papers*, Asia/Pacific Research Center, Stanford University, July 1999; In-duk Kang, "Challenge and Response: The South Korean Policy Toward North Korea," *East Asian Review*, Vol. 11, No. 3 (Autumn 1999).

17 Nicholas Eberstadt, "U.S.-North Korea Economic Relations: Indications from North Korea's Past Trade Performance," Tong-whan Park, ed., *The U.S. and the Two Koreas*

They suggest that the reforms undertaken so far are "half-hearted and peripheral".¹⁸ The Council on Foreign Relations concludes, "there is little clear evidence that North Korea is embracing a more open economic system from the top".¹⁹ In a survey of 40 recent works on the North, Oh and Hassig find that the vast majority support the view that the North will continue to adopt a "muddling through" approach.

However, the muddling through assessment contains the implicit assumption that the North will not close its doors to the outside world and stamp out all market-oriented initiatives. It is reasonable to conclude that the North is likely to take tentative steps to promote trade and investment which are viewed as non-threatening to the regime survival and national security. Whether these steps are incremental or ad hoc, there will likely be increased opportunities for engaging North Korea.

V. Engaging North Korea

Kim Dae Jung's policy of comprehensive engagement with North Korea represents a clear departure from the past. By dropping the requirement that all engagement must begin and end at the government-to-government level, he has managed to break the logjam in inter-Korean relations. Moreover, President Kim has shown a consistency, even single-mindedness about engagement with North Korea that has surprised many analysts. This is in sharp contrast to his predecessor, who became known for an erratic (*naegtang ontang*) approach. Moreover, given South Korea's economic difficulties, engaging North Korea and lowering tensions on the peninsula would facilitate the

(Lynne Rienner Publishers: 1998), p. 131.

18 Kongdan Oh and Ralph Hassig, "North Korea Between Collapse and Reform," *Asian Survey*, Vol 39, No. 2 (March/April 1999), p. 289.

19 CFR, *op. cit.*, p. 8.

South's economic recovery. A senior Blue House official rhetorically asked, "What foreigner would want to invest in an uncertain South Korean market if North-South relations are also tense?"²⁰ Mochizuki notes, "What economic interdependence can do is to make North Korea somewhat less desperate and therefore less prone to acts of terror and sabotage".²¹ In other words, the North must be shown that the benefits of engagement outweigh the costs of provocation and confrontation.

The Kim Administration's engagement policy is not without its critics. Some charge that without improvements at the governmental level, at best engagement rewards North Korea for bad behavior and at worst it is turning the North into an inveterate extortionist. However, as mentioned above, it is important to bear in mind that rewards can be taken away, which also creates a form of leverage for North Korea's negotiating partners. A second criticism is that despite the Administration's vigorous efforts, all the government really has to show for its engagement policy is the Hyundai deals. *Dong-a Ilbo* even ran a political cartoon on October 3 that showed the sign for the Ministry of Unification and underneath the sign it read "A Division of the Hyundai Corporation." Critics contend that such a policy amounts to getting the cart in front of the horse: without agreements and understandings at the governmental level, investment projects will invariably falter without sufficient protections for South Korean citizens, for example. The detention of a South Korean tourist during a tour of Mt. Kumgang provided a vivid example of this. However, the China-Taiwan experience demonstrates that economic relations can flourish even when state-state relations remain essentially frozen. A final criticism made is that Kim engagement policy lacks a clear ultimate goal. However, when dealing with the North, having the modest goal of reducing tensions and increasing cooperation may be the most realistic approach to take.

20 *News Plus*, November 19, 1998.

21 Mike Mochizuki, *op. cit.*, p. 23.

VI. North Korea's External Economic Linkages

Foreign Trade

Foreign trade represents North Korea's biggest economic link to the outside world. Like the economy, the North's foreign trade has contracted in the 1990s, but trade still accounts for more than 10% of GDP, totaling an estimated \$1.44 billion in 1998.²² Japan and China are North Korea's top two trade partners, but since trade with the South began in 1988, South Korea has quickly risen to third (Table 4).²³

After contracting in 1997 by 30% due largely to the South's economic difficulties, North-South trade recovered in 1999, with trade during the first eight months of 1999 exceeding the total for all of 1998. The largest share of items traded were primary goods such as metals and marine products from the North and heavy fuel oil and food from the South, but textiles have become the single leading item in bilateral trade as a result of processing on commission trade.²⁴

POC trade has risen dramatically since the North adopted a law in 1992, accounting for nearly 30% of North-South trade. It is also important to point out that non-commercial transfers make up an increasingly large portion of official South Korean "export" figures.²⁵ During the first half of 1999, less than one-quarter of exports consisted of commercial transactions. Nevertheless, Noland estimates that South Korea would rise to become the North's leading trade partner (35%) if the

22 *Bank of Korea*, 1999.

23 Several analysts have noted that South Korean trade figures overstate the actual level of trade by including unilateral transfers such as humanitarian assistance and KEDO oil shipments.

24 Processing on commission trade consists of enterprises in the South shipping raw materials to the North, where they are then processed and exported.

25 Hong-tack Chun, "Intra-Korean Economic Relations under the Sunshine Policy," presented at the conference "Two Koreas: Toward One Economy," Korea America Economists Association: Washington, D.C., October 4-5, 1999.

North were to become a "normal" country.²⁶ This is perhaps the clearest indicator of the potential for North-South economic cooperation. However the interdependence literature helps alert us to one potential problem: trade relations between the North and the South are likely to remain asymmetrical, which could pull the North in the direction of confrontation rather than cooperation. At the appropriate time, care will have to be taken to relieve the North's concerns.

Investment

External investment in North Korea has been negligible despite its efforts to attract investors in the 1990s. Total foreign investments through 1998 were estimated to be less than \$350 million. However, there are growing signs that this could soon change, especially in the wake of Hyundai's North Korea initiative and the partial lifting of sanctions by the United States. The North began to take concrete steps to attract foreign investment in 1984 with the passage of the Foreign Joint Venture Law, but this effort languished until 1991 with the creation of the Foreign Economic and Trade Zone in Rajin-Sonbong and passage of a new foreign investment law in 1992.²⁷

This represents the biggest step taken by North Korea to date to open up its economy as well as one of the most effective means for transforming the North Korean economy and introducing market principles. However, the North chose an extremely remote and undesirable location so as to minimize the potential "contamination" from the zone on the local population. A major international investment conference held in 1996 in the zone only resulted in a handful of investments, with

26 Marcus Noland, *op. cit.*

27 For a detailed review of North Korean investments policy, see Brendon A. Carr, "Ending the Hermit Kingdom's Belligerent Mendicancy: New Openness, New Foreign Direct Investment Laws of the Democratic People's Republic of Korea," *Manuscript*, University of Washington School of Law, 1997.

Hong Kong's Empire Hotel leading the way with a *reported* \$200 million tourist hotel project.

However, there appears to be a growing recognition among the North Korean leadership that the Rajin-Sonbong SETZ is proving to be inadequate. The clearest indication of this has been news reports in October suggesting that Haeju might be designated as a SETZ. Location alone would make it a vast improvement, but there would still be infrastructure questions. As a result of the lifting of U.S. sanctions in September, the American Chamber of Commerce in Seoul announced in mid-October that it would send a group of ten American businessmen to Pyongyang in November. Even more surprisingly, AmCham received over 90 requests to participate. The Korea Society President, Donald Gregg, has also publicly stated that he has a group of leading American companies that are ready to visit the North. As with all projects involving the North, expectations should not be raised too high. In dealing with the North, the devil is often in the details.

South Korean firms were not allowed to invest in the North until a law was passed in the South in 1994. The first investment was by Daewoo in a \$5.1 million POC textile venture in Nampo. As of September 1999, a total of 42 firms have been approved to invest in North Korea, and of these, 15 have also had their actual investment projects approved, nine since Kim Dae Jung became president (Table 5). However, as Flake points out, even "approved projects" do not necessarily lead to actual investments.²⁸

Due to the inherent risks and uncertainties involved with investing in North Korea, investment in the North is likely to remain modest. The impediments to trade and investment should not be dismissed - an often bellicose regime, investment restrictions, inadequate infrastructure and a lack of legal protections and guarantees for investors and

28 Gordon Flake, "Inter-Korean Economic Relations under the Sunshine Policy," *Korea's Economy 1999*, Vol. 15 (Washington, D.C.: Korea Economic Institute of America, 1999)

their investments. Nevertheless, a number of reasons can be found to consider North Korea as a potential foreign investment recipient. Obviously, the North is most attractive to South Korea, given a common language and considerable complementarity. The North's cheap labor and natural resources, when combined with the South's investment and technology, could lead to synergistic economic relationship.²⁹ While the most risky form of economic engagement, foreign investment also represents the greatest catalyst to economic change by introducing foreign business practices to the North. As with trade, South Korea's investments in North Korea pale in comparison to Taiwanese investments in China. By 1996, Taiwan's cumulative investments in China exceeded \$30 billion.³⁰ By becoming one of China's leading sources of trade and investment, Taiwan has dramatically raised the cost of war for China. South Korea can follow Taiwan's example.

The most ambitious project undertaken between the two Koreas since partition is the Hyundai-led tours of Kungang-san. The tours have proven to be the most tangible and controversial product of South Korea's engagement policy. In exchange for paying the North roughly \$1 billion over a six-year period, Hyundai has been granted exclusive rights to develop tourism facilities in the legendary national park. As with all North Korea initiatives, the project is not without its critics. Some are uncomfortable with the thought of providing the North with large sums of cold hard cash. This view only hardened when news reports emerged that the North had purchased MiG fighter planes from Kazakhstan - in cash. One scholar suggests that until the North relinquishes its weapons of mass destruction program that payments be made in goods rather than cash.³¹ Critics also question the economic

29 Youn-suk Kim, "Economic Cooperation Between the Two Koreas: Historical Analysis," presented at an Economic Outlook Conference on "Two Koreas: Toward One Economy," Washington, D.C., October, 1999.

30 Mike Mochizuki, *op. cit.*

31 Hong-nack Kim, "The Kim Dae Jung Government's North Korea Policy: Problems

viability of the project. Kim and Yoon estimate that the project is losing \$127 million per year. There have also been suggestions that the South Korean government has provided Hyundai with unspecified "favors."

Humanitarian Assistance

Last, but far from least, humanitarian assistance to North Korea represents an increasingly significant portion of North Korea's external economic linkages (see Table 2). In 1995, North Korean authorities took the unprecedented step of requesting humanitarian assistance in order to address its chronic food shortages. Since 1995, the international community has contributed an estimated \$1 billion in famine relief.³² Food aid now accounts for roughly 20% of North Korea's foreign economic linkages. While the United States and China are the two biggest contributors, a host of NGOs (led by the World Food Program) also contribute and handle most of the distribution. Much to the dismay of some Republicans, the North is now America's leading aid recipient in Asia. Humanitarian assistance can help establish the sincerity of the international community to both the North Korean government and North Korean people. The American flag is emblazoned on all corn and grain contributions from the United States. Monitoring food aid distribution remains an on-going concern, but the World Food Program contends that there are no significant diversions.

From KEDO to KADO?

The Korean Peninsula Energy Development Organization (KEDO) was established in 1994 as the implementing organization for the Agreed Framework between the U.S. and North Korea, which halted

and Prospects," presented at the 1999 annual meeting of the Korea American University Professors Association, October, 1999, p. 21.

32 Kongdan Oh and Ralph Hassig, *op. cit.*

the North's nuclear program in exchange for two proliferation-resistant reactors. KEDO also represents the most sustained and extensive case of economic cooperation between the North and its former adversaries, the United States, Japan and South Korea.³³

Though reluctant partners initially, South Korea and Japan have come to view KEDO as a means to avoid crisis and promote economic cooperation with North Korea. Consequently, KEDO has quickly grown to become one of the cornerstones of the United States, Japan, and South Korea's trade and investment with North Korea. Since early 1995, KEDO has provided the North with roughly 500,000 tons of heavy fuel oil and has conducted a site survey and site preparations. This has amounted to a unilateral transfer of \$50 million per year in oil and project activities, which many analysts consider a small price to pay for halting the North's nuclear program.³⁴

Several analysts have cited KEDO as a model for other forms of economic engagement with North Korea, including a potential "KADO," which would focus on addressing North Korea's agricultural problems. While KEDO can be viewed as a model for engaging North Korea economically in a coordinated manner, the on-going funding difficulties underscore the challenge of sustained cooperation. Administration officials have at times likened the bargaining process to secure funding from Congress and obtain financial commitments from Japan and Korea to negotiating with North Korea. Though far behind schedule in terms of constructing the reactors, KEDO has still managed to thrive under adverse conditions. KEDO's executive director, Desaix Anderson insists, "KEDO can be a vehicle to begin the process whereby Pyongyang might be enticed from its isolation and brought into the broader regional and international community".³⁵

33 For a comprehensive review of KEDO and the Agreed Framework, see Ralph Cossa, *op. cit.*

34 For KEDO's financial particulars, see Korean Peninsula Energy Development Organization, *Annual Report 1998/1999* (New York: 1999)

VII. The Next Level: Joining International Financial Institutions

If North Korea's leaders decide to continue down the path of economic engagement with the outside world, participation in international financial institutions would become one of the most promising as well as least threatening forms of development assistance. According to the World Bank's Bradley Babson, North Korea has expressed an interest in joining international financial institutions, including the Asian Development Bank.³⁶ The North hosted fact-finding missions from the International Monetary Fund in September 1997 and the World Bank in February 1998. North Korea also took the important step of receiving technical assistance from the UN Development Program by allowing some of its officials to receive training in market economics in Beijing, but since then there has been little progress.

The World Bank attempted to initiate a training program for North Korean economic officials in either Pyongyang or Beijing, but the North has temporized on making a final decision and following through with it. Such a move would be a modest step in the right direction, but numerous obstacles remain before the North could actually join IFIs. First, the North is reluctant to provide the quality of economic data necessary for meeting membership requirements.³⁷ Second, some IFI contributors would not support such an initiative until certain political conditions have been met.³⁸ For the United States, this would include having the remaining sanctions against the North lifted. Third,

35 Desaix, Anderson, "KEDO in the Strategic Context of Northeast Asia," *Korea's Economy 1999*, Vol. 15 (Washington, D.C.: Korea Economic Institute of America, 1999), p. 110.

36 Bradley O. Babson, 1999. "North Korean Economy Today," *Manuscript*, (World Bank, 1999)

37 Danny M. Leipziger, 1998. "Thinking about the World Bank and North Korea," *Economic Integration of the Korean Peninsula*, Marcus Noland, ed. (Washington D.C.: Institute for International Economics, January 1998)

38 Bradley Bobson, *op. cit.*

some resolution of the North's sizable external debt, largely in the form of defaulted loans from the 1970s, would also have to be undertaken. The potential benefits for North Korea would be considerable. Using Vietnam's experience as an example, assistance from international development banks to North Korea could total \$250-\$500 million per year.³⁹

VIII. Conclusions

We face an unprecedented opportunity to engage North Korea economically. Ironically, the opposition parties in South Korea and the United States are proving to be some of the biggest impediments to a policy of economic cooperation. President Kim has steadfastly maintained a policy of economic engagement, even in the face of harsh criticism in the South and military provocations by the North, which most analysts expect will continue. Kim seems to have mastered the art of turning the other cheek. However, it is valid to question whether or not the policy will work in the short to medium term. Based on the China-Taiwan experience, we can conclude that even sustained economic engagement is unlikely to lead to significant North-South political engagement. Even though the Chinese leadership has committed itself to gradual economic opening and liberalization over the past two decades, including Taiwan during the past ten years, political relations between the two remain as frozen as ever. Nevertheless, the thriving economic relations between the two provide one of the strongest arguments against a military confrontation.

Over the past five years, there has been an unprecedented level of cooperation between the North and the non-communist world. Yet, most of these efforts have been unilateral transfers, such as humanitari-

39 Danny M. Leipziger, *op. cit.*

an assistance. One of the challenges for future engagement efforts will be to shift from unilateral transfers to bilateral and multilateral exchanges. Nevertheless, both forms of economic cooperation can help provide the incentives for the North to forgo the path of confrontation. This does not mean that the South and its allies should pause in their military deterrence activities or give in to blatant attempts at extortion. Admittedly, drawing a line between cooperation and extortion will be a difficult task. North Korea may ultimately view the South's engagement policy as a "Trojan Horse" designed to destabilize the North.⁴⁰ Gordon Flake calls it "the most dangerous policy [the North] has ever faced."⁴¹ Yet, this will not be known until a sustained effort has been made to try to coax the North with enough carrots to come out of its shell.

This paper has argued in favor of economic engagement with the North in the context of a strong defense posture and suggested that there are a variety of different forms of economic cooperation and inducements available. Taken in their entirety, these efforts represent a modest but significant commitment on the part of the North to engage the international community. Invariably, there will be setbacks, but economic cooperation will likely remain the surest path to peace and reconciliation on the Korean peninsula.

40 Hong-nack Kim, *op. cit.*

41 Gordon Flake, *op. cit.*, p. 101.

Table 1. North Korean Economic Indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Growth Rate (%)	-3.7	-5.1	-7.7	-4.2	-1.8	-4.6	-3.7	-6.8	-1.1	1.0*
GNP (\$ trillion)	23.1	22.9	21.1	20.5	21.2	22.3	21.4	17.7+	12.6+	-
Per Capita GNP (\$)	1,064	1,038	943	904	923	957	910	811+	573+	-

Source: KOTRA (1999), Bank of Korea (1999)

*estimate + gross national income

Table 2. North Korea's International Economic Linkages

Foreign Trade	\$1-3 billion/year
Foreign Investment (cumulative)	\$50-80 million
Kumgangsan Tours (Hyundai)	\$150-200 million/year
Remittances from Japan	\$200-600 million/year
Humanitarian Assistance	\$300-500 million/year
KEDO Heavy Fuel Oil	\$50 million/year
Overseas Weapons Sales	\$50 million/year
Future	
Foreign Loans in Default	\$12.1 billion
Normalization with Japan	\$10-\$40 billion
Trade and Investment from U.S.	\$30-100 million/year
KEDO Reactors	\$4.5 billion
Humanitarian Assistance from Japan	\$5-30 million/year
Pyongyang Gymnasium Project (Hyundai)	\$34 million

Sources: Eberstadt (1998); Mochizuki (1998); *Vantage Point* (September 1999); *Oh and Hassig* (1999) *Korea Economic Weekly*; author's estimates

Table 3. North Korea's Leading Trade Partners (1995, \$ Million)

Country	Imports	Exports	Total
Japan	255	340	595
China	486	64	550
South Korea	64	223	287
World Total	1,380	959	2,339

Source: Flake (1996)

Table 4. North-South Trade in Comparative Perspective (\$ Million)

	North-South			China-Taiwan		
	S to N	N to S	Total	T to C	C to T	Total
1990	1.2	12.3	13.5	2,254	320	2,574
1992	10.6	162.9	173.5	5,881	698	6,579
1994	18.2	176.3	194.5	14,085	2,242	16,327
1996	69.6	182.4	252.0	16,182	2,803	18,985
1997	115.3	193.1	308.4	-	-	-
1998	129.7	92.3	222.0	16,630	3,870	20,500
1998 Jan-June	43.9	32.0	75.9	-	-	-
1999 Jan-June	119.4	45.5	164.9	-	-	-
East-West Germany (1987)	-	-	14,014	-	-	-

Sources: Ministry of Unification (1999); Chun (1999)

Table 5. Leading South Korean Investment Projects

Company	Description	Investment (\$million)	Date Approved
Kohap, Inc.	Clothing/Textile	6.9	5/17/95
Hanil Synthetic Fiber Co.	Clothing	9.8	6/26/95
Kukje Corp.	Shoes	3.5	6/26/95
Korean Green Corp.	Medicine	3.0	9/15/95
Tong Yang Cement	Cement Factory	3.0	9/15/95
Dong Ryung Marine	Shipping facilities	3.0	9/15/95
Samsung Electronics	Telecommunications	7.0	4/27/96
Taechang	Spring Water	5.8	4/27/96
Daewoo Electronics	Electronics	6.4	4/27/96
Korean Gono	Water Projects	45.0	7/19/96
Shinil	Clothing	3.0	5/22/97
LG Electronics	Electronics	4.5	5/22/97
Samsung Electronics	Communications	5.0	8/1/97
Kolong	Textiles	4.0	8/1/99
Daesang	Distribution System	4.2	10/14/99
Samchunli Bicycles	Bicycles	8.0	10/14/99
Ace Furniture	Furniture	4.3	1/9/98
Lotte Confectionery Co.	Confectionery	5.8	2/18/98
Kwangin	Outdoor Advertising	2.5	2/18/98
Dooraee Maeul	Farming	8.0	3/13/98
International Corn Foundation	Corn Research	2.2	6/18/98

Source: Ministry of Unification (1999)