

THE RUSSIAN ROLE IN CONSTRUCTING A SOUTH-NORTH KOREAN ECONOMIC COMMUNITY

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Expansion of South-North Korean economic cooperation would give an opportunity for Russia to increase trade, investment and technological exchanges with Korea. Because Russia has already constructed about 70 large factories and power stations in North Korea, it would be possible for Russia to take part in the modernization of North Korean industry and infrastructure. Also, a South-North Korean Economic Community would have more opportunities to take part in the development and reconstruction of the Russian Far East. Human resources from the North and highly-skilled management from the South, financial resources from East Asia, Russia's mineral resources and high technology could be successfully combined in a cooperative effort that would be fruitful for all participants.

The process of the establishment and improvement of an institutional framework for inter-Korean relations could develop successfully if both sides are involved in the process of preparing and establishing the essential institutional arrangements. On a large scale this process depends on North Korea's transition to a market economy. However, Pyongyang is still afraid that every radical transition towards a market economy, including the establishment of domestic market institutions, could undermine political and ideological stability in the North. Thus,

institutional arrangements stimulating inter-Korean cooperation are expected to be introduced very slowly.

The modernization process of North Korean infrastructure may be the first real step to the establishment of a South-North Korean Economic Community. As both the ROK and DPRK are interested in a stable supply of energy, oil and gas, timber, sea products and other raw materials, as well as technology from Russia, this triangular cooperation has a good chance of stimulating inter-Korean exchange positively. One of the most important principles of inter-Korean as well as multinational economic cooperation on the Korean peninsula may be gradualism. One of the main obstacles to direct inter-Korean cooperation is the lack of mutual confidence. Under these conditions other countries, including Russia, could support inter-Korean economic exchanges. It is necessary to note that Russian foreign policy will follow a more pragmatic course. Russia is interested in developing North Korea's infrastructure and has a real opportunity to participate in these international projects.

I

There are two aspects (or two levels) of inter-Korean economic relations: bilateral and international. The development of inter-Korean relations towards constructing a South-North Korean Economic Community (SNEC) will depend on the domestic situations in both countries as well as principles of the security strategies and the foreign policies of the countries in North-East Asia. Besides, Seoul's and Pyongyang's bilateral economic and political relations with the four powers (Japan, China, the USA, and Russia) will also be crucial for inter-Korean dialogue on economic issues, including negotiations on SNEC.

The North Korean economy has been in a deep crisis since the beginning of the 1990s. The production of electric power, coal, steel, fertilizer, textile and some other products decreased more than 50 percent during that period. The factories produce low quality goods. The daily food distribution has been reduced from 0.9kg to 0.2kg per capita. It is therefore necessary for North Korea to import about 1.0-1.6 million tons of food annually. The United States supplied North Korea with 900,000 tons of food, China's contribution was about 150,000 and the European Union 100,000 tons.¹

Last year the Supreme People's Assembly held its first budget session since 1994. According to North Korean official data the national economy had shrunk 50% in five years. The Assembly passed a state budget of \$9.38 billion, which is 2% increase from 1998, but in 1994 the SPA had passed a state budget of \$18.7 billion.²

The foreign trade crisis is more evident, characterized by a decrease in the amount of exports and a large trade deficit. The foreign trade crises is evidence that the domestic economy is unbalanced and not adequately suited to the world market. The North Korean export sector is very small, but at the same time the country depends on imports of fuel, capital goods, foods, etc.

North Korea received about \$350 million from the United Nations relief aid in 1999. Bilateral aid totaled \$200 million. Also, after delays in the wake of the North's missile test in August 1998, the KEDO project to build two light-water nuclear reactors for North Korea has been resumed. At the very least, preparations for the main construction work on the reactor are continuing.

Nevertheless the situation in the North Korean economy improved slowly in 1999. For the first time in several years agricultural, marine and forestry output increased. For example, food production last year exceeded 4 million tons thanks to good weather conditions and the

1 *Far Eastern economic review*, Asia 2000 yearbook, p.141.

2 *Ibid.*

increased import of fertilizer.

Although bilateral inter-Korean relations were fluctuating constantly, economic trade (including aid relief) between the North and the South increased from \$80 million in 1989 to \$300 million in 1999. Hyundai's Mount Kumkang tourism project provided an estimated \$150 million. South Korea signed a loan agreement for the realization of the KEDO project. Humanitarian exchanges increased significantly, and thousands of South Korean residents (tourists and businessmen) visited North Korea.

II

Russian-North Korean relations were frozen during the first half of 90s. Russian-North Korean trade decreased from \$600 million in 1992 to \$70 million in 1997. Because the problem of North Korean debt to Russia hasn't yet been resolved successfully, Russian investment to the DPRK has shrunk and there have been no new Russian loans to Pyongyang. Political consultations have also been interrupted. As a result Moscow had a limited opportunity to negotiate with its neighbor and to play a positive role on the Korean peninsula. Other countries involved in negotiations on the Korean Peninsula' problems refused to treat Russia as a an equal partner. Moscow tried to change this negative trend and to improve bilateral relations with North Korea in order to play a more positive role on the Korean peninsula. Russian-North Korean exchanges began to restore slowly during the second half of the 90s.

Russia and North Korea improved conditions for development of bilateral institutional arrangements by signing an investment protection agreement on avoidance of double taxation; an agreement on technical and economic cooperation; and various agreements on cooperation in agriculture and wood industry. The North Korea-Russia Joint

Committee on Economic, Science and Technological Cooperation resumed session in 1996 in Pyongyang and in 1997 in Moscow. Nevertheless, economic relations between Russia and North Korea are developing very slowly, for example, bilateral trade was no more than \$100 million in 1999 and unbalanced in Russia's favor (Russian exports - \$75 million, imports - \$25 million). Russian foreign minister Igor Ivanov visited Pyongyang in February 2000 (the first visit of a Russian foreign minister to North Korea in the decade since Mr. Shevardnadze's visit to Pyongyang in 1990) and signed a new Friendship and Cooperation Treaty between Russia and North Korea. Mr. I. Ivanov emphasized "Russia wants to participate in the process of the normalization of the situation on the Korean peninsula."³ The visit provided incentives for more political dialogue between the two countries, but economic cooperation is still at the stage of stagnation.

The main reason for this is Pyongyang's old-style economic policy at home and abroad. A transition from the existing economic system towards at least a quasi-market system is the only chance for the ruling hierarchy to remain as the dominant political group in the North. For Pyongyang the alternative to beginning reforms is dependence on the food and humanitarian aid being delivered by the ROK, the USA, and some other countries and international organizations.

Some Russian and foreign experts believe that there are limited opportunities for Moscow to exert influence in the world's power politics. Russia has not played any significant role on the Korean Peninsula until now and will not in the near future. Some others believe (some of them hope) that the main reason for the recent successful development of relations between Russia and China, as well as improvement in Russia-North Korea relations, is due to Moscow's desire to counterweight growing American influence in the region and all over the world. Indeed there are some political forces (left wing and nationalist mainly)

3 Itoji, Moscow, February 22, 2000, p. 35 (Russian).

that insist on changing Russian foreign policy to an anti-American bias. But, as the last parliamentary elections show, the influence of these groups is limited and these forces are not determining Russian foreign policy.

In spite of some fluctuations in Russian foreign policy at the end of Yeltsin's era, Moscow is in the process of elaborating a more pragmatic strategy for the establishment of predictable and long-term cooperation with the USA and European community, as well as with the Asia-Pacific region. The Security council adopted on March 24 a new concept of Russian foreign policy. Minister of Foreign Affairs I. Ivanov described the conception as "more realistic."⁴ The domestic economic factor is determining the Kremlin's foreign policy as not pro-West or pro-East, but pro-Russian. It means that Russia has to resolve its domestic economic problems while taking into account Russia's role in the world.

The beginning of the process of economic recovery has stimulated Russia's foreign economic policy. It is necessary to stress that at this stage, the beginning of economic growth, one can see an absolutely new factor within Moscow foreign policy - the growing influence of Russian business groups on the development of foreign economic relations.

Russian businessmen are paying more attention to Northeast Asia. During 1999-2000 some Russian leading corporations began to develop economic relations with China, Japan and Korea. One leading Russian oil company, "YUKOS" is going to construct an oil pipeline running from West Siberia via Mongolia to China. The Gas monopoly "GAZPROM" is going to construct a gas pipeline to neighboring countries. Such Russian companies as "Surgutneftegaz," as well as foreign companies such as TNK, and British BP Amoco also may be involved in the realization of these huge projects. As a result of the aggressive

4 Kommersant, Moscow, March 25, 2000, p. 2 (Russian).

activity “YUKOS” and “GAZPROM” the Russian Minister of Fuel and Energy has to take an active part in elaborating and realizing a long-term program of cooperation between Russia and Northeast Asian countries on energy issues.⁵ At the same time the Russian state power corporation is interested in establishing an energy bridge connecting Siberia and Russian Far East power stations with the Northeast Asia region.

In initiating all of these projects Russian big business must take into account the possibility of becoming involved in the Korean energy market. Besides, Russian business groups are interested in rebuilding the railroad connecting the Russian Trans-Siberia railroad with South Korean railroads via North Korea. The economic factor has become one of most important elements of Russian foreign policy towards Northeast Asia. Isolated North Korea is the most serious obstacle to Russian economic expansion into Northeast Asia.

III

Expansion of direct North-South Korean economic cooperation would give an opportunity for Russia to increase trade as well as investment and technological exchanges with Korea. It would be a new growing market for Russia’s traditional export good, such as oil, gas and coal, mineral resources, lumber, fish and marine products, etc. On the other hand, SNEC could supply Siberia and the Russian Far East regions with food stuffs and consumer goods. Because Russia constructed about 70 large factories and power stations in North Korea, it will be possible for Russia to take part in the modernization of North Korean industry and infrastructure. Besides, Russia has experience in the transition from a military industry to civilian production. The

5 Kommersant, Moscow, March 21, 2000, p. 4 (Russian).

reconstruction of transport and communication networks in North Korea would make it easy for Russia to cooperate directly with South Korea. On the other hand, SNEC would have more opportunity to take part in the development and reconstruction of the Russian Far East. Human resources from the North and high-skilled management from the South, financial resources from East Asia, Russian mineral resources and high technology may be successfully combined for fruitful cooperation.

On March 9, President Kim Dae-jung delivered a speech under the title of "Lessons of German Reunification and the Korean Question" at the Free Berlin University. In the course of this speech President Kim made a declaration addressed to North Korea which encompassed some important issues. In order to jump-start inter-Korean economic relations President Kim proposed 1) improving [North Korean] basic infrastructure, such as the roads, ports, railways, electricity and communications; 2) putting in place essential institutional arrangements, including an investment protection agreement, an avoidance of double taxation agreement and an agreement for communications, travel and trade.

Indeed, the establishment of adequate institutional arrangements is the most urgent factor which could improve conditions for inter-Korean economic cooperation radically. It has been very important that South Korea tries to institutionalize its economic relations with the North and to develop bilateral relations on a solid legal basis since the beginning of the 1990s.

According to this policy the ROK government adopted the inter-Korean Exchange and Cooperation Act in August 1990. It is necessary to stress that it was given "priority over any other existing system of laws when applied to any activities that are conducted for inter-Korean exchanges and cooperation and deemed justifiable under such objectives."⁶ It was a significant contribution to the legal background of the North-South dialogue. Of course it was only the beginning of the

creation of a legal framework for the ROK's economic policy towards the North, but even the existence of the Act changed the climate of inter-Korean economic cooperation positively. Meanwhile the process of the establishment and improvement of the institutional framework of inter-Korean relations can develop successfully if both sides are involved in the procedure of preparing for the establishment of essential institutional arrangements. On a large scale this process depends on North Korea's transition to a market economy.

As a matter of fact, Pyongyang is still afraid that every radical transition towards a market economy, including establishment of domestic market institutions, could undermine political and ideological stability in the North. A step back will follow every step and a half forward. The Pyongyang government established the special Rajin-Sunbong economic zone, adopted more flexible legal rules on foreign trade and investment and then tried to control economic processes rigidly. Rising revenues from blackmail policy have allowed North Korea to slow down realization of radical economic reforms. One of the most recent examples of Pyongyang's orthodox socialist economic policy is the Law on the Plan of the National Economy, which eliminates market forces and emphasizes a socialist planning system. It looks like evidence of fluctuations in Pyongyang's economic policy: continued disputes among party elites on economic issues, or North Korean leader Kim Jong-il's opposition to the early introduction of market reforms. It seems that institutional arrangements stimulating inter-Korean cooperation will be introduced very slowly because North Korean leaders regard the introduction of pro-market institutions as a concession to Seoul's pressure on Pyongyang.

North Korean leaders are seemingly satisfied with the results of their blackmail foreign policy. According to Former US Defense Secretary William Perry's recommendations, the USA began face-to-face

6 *White paper on Korean Unification, 1996* (Seoul, 1996), p. 139.

negotiations with Pyongyang in order to postpone the second North Korean missile test. After a long period of bilateral talks Pyongyang agreed to invite American inspectors to examine a large underground construction site in return for supplementary food aid. Last September the United States lifted some trade, banking and other economic sanctions that it had imposed on North Korea for half a century. At last, this March a North Korean deputy foreign minister, Kim Gye Gwan and a U.S. delegation led by Charles Kartman have been discussing final arrangements for high-level talks between the two countries.

Meanwhile North Korea is going to increase diplomatic activity and organize a dialogue with the international community as a whole. Reopening diplomatic ties and improving bilateral relations with Australia, the Philippines and Italy, and the resumption of diplomatic discussions with Japan are among the most recent examples of Pyongyang's foreign policy. Besides, the country is finding out ways to develop bilateral relations with Canada and the United Kingdom. At the same time North Korea joined the Association of South East Asian Nations. As a rule North Korea is improving relations with countries which have the possibility of giving assistance to Pyongyang. But it isn't clear yet whether these measures are coordinated and linked with domestic policy in order to reform the North Korean economic system in general.

At the same time both North and South Korea as well as neighboring countries are objectively interested in improving the basic infrastructure in North Korea. That is why this very pragmatic idea may give incentives to inter-Korea cooperation in the near future. The process of modernization of North Korea's infrastructure may be the first real step toward the establishment of a North-South Korean economic community.

Russia's business interests coincide with the economic interests of neighboring countries. For example, as both the ROK and DPRK are interested in a stable supply of energy, oil and gas, timber, sea products

and some raw materials as well as technologies from Russia, this triangular cooperation has a good chance to stimulate inter-Korean exchanges positively. Beijing has to modernize domestic energy and transport systems in order to develop China's Northeast provinces, to resolve social issues and radically improve the environment in this part of the country. Japan is a huge market for Russian fuel, and Tokyo may be interested in modernizing the energy systems of its neighboring Northeast countries because of pollution problems. Japanese business would benefit from the modernization of regional transport networks.

North Korea is the only country in Northeast Asia isolated from the regional integration process. DPRK trade and foreign economic relations with its main partners, except the ROK, are shrinking or under stagnation because of deficits in foreign exchange and export goods. It is impossible for Pyongyang to improve significantly bilateral cooperation even with its old economic partners of Russia and China, because in both of these countries private companies as well as public organizations prefer to participate in profitable business and are not ready to be involved in North Korean projects with unpredictable results.

IV

One of the most important principles of inter-Korean as well as multinational economic cooperation on the Korean peninsula may be gradualism. Realization of a gradualist strategy may be especially important to avoid the linkage of economic cooperation policy and the political situation in the North and in the South.

That is why President Kim's proposals on a great scale are significant toward achieving a positive change in the climate of bilateral dialogue. For the South the main goal in the short-run would not be profits from trade or investment, but in establishing a favorable climate, modern infrastructure and adequate institutions as a base for future

inter-Korean broad-scale economic cooperation.

President Kim Dae Jung believes that North Korean leaders “have maintained their political system, while gradually opening up economically. This is what we, and all our friends and allies want from North Korea and we are prepared to help them.”⁷ Indeed, for Pyongyang the only alternative to the beginning of the reforms is a continued growth in dependence on food and humanitarian aid delivered by the ROK, the US, and international organizations. That is why it seems that the North will begin to implement market-oriented instruments in the near future. Thus, North Korea has a chance to cooperate with other countries fruitfully.

But there is the danger that if the domestic economic situation improves even slightly it would give Pyongyang a chance to save its old inefficient domestic economic institutions and to postpone economic reforms until the next crisis. In any case Pyongyang is being very cautious while moderating domestic and foreign policy and North Korean leaders will use the old economic mechanism as long as it will be possible. So the process of “opening” the country will be very slow and it will take a rather long time to begin market reforms on a large scale. Under these conditions there are doubts that Pyongyang is ready to accept Kim Dae-jung’s proposal, which elaborates and requires signature to essential institutional arrangements, including an Investment Protection Agreement and others.

As for President Kim’s proposal to take part in revamping the structure of North Korean agriculture, it is necessary to stress the following: There are two aspects to this proposal. It seems that North Korea is ready to receive pure technical assistance. For example, 160,000 tons of fertilizer from South Korea increased the productivity of North Korean agriculture in 1999. But technical modernization of North Korean agriculture will prolong the existence of a centralized agricultural system

7 H. French. Suddenly, a less reclusive North Korean reaches out of the world. *International Herald Tribune*, March 18-19, 2000, p. 5.

only, without finding fundamental solutions to the problem of food shortages. On the other hand, Pyongyang isn't ready to accept South Korea's assistance in radical transformation of its agricultural system.

One of the main obstacles toward direct inter-Korean cooperation is the lack of mutual confidence. Other countries, including Russia, could support inter-Korean economic exchanges, however, only when the two Koreas reach stage of mutual trust. But Russia's mediator role will depend on the involvement of Russian business in inter-Korean cooperation.

Yeltsin's era is finished and Russia is in a new stage of development now. In this case it is necessary to note that Russian foreign policy will follow a more pragmatic course. Consequently, pragmatism will play a more important role in Russian foreign policy towards the Korean peninsula in the near future. At the same time President Kim's proposals may be characterized as very pragmatic in the sense that they are devoted to improving basic infrastructure such as railways, electricity, etc. Russia is interested in developing North Korea's infrastructure and has a real opportunity to participate in these international projects.

Objectively North Korea must be interested in improving the basic infrastructure. Nevertheless, the realization of this proposal is not only the technical process. It also means that simultaneously it will be necessary to prepare and adopt an adequate legal base, including an Investment Protection Agreement, an Avoidance of Double Taxation Agreement, and an Agreement for Communication, Travel and Trade. But it may be easier for North Korea to accept this proposal if some other countries will participate in these international projects. It means that the internationalization of the reconstruction of North Korea's basic infrastructure is a positive process. It can improve the political climate and provide impetus to the normalization of bilateral North-South Korean relations.

Moscow is interested in the transitioning of inter-Korean cooperation towards a South-North Korea Economic Community. Politically

this process will stabilize the security on the Korea peninsula. Economically it gives Russia a good chance to participate in the Pacific integration process.

President Kim Dae-jung's proposals are a step towards radical improvement of the legal, political and economic framework of inter-Korean cooperation. But it will take a long time to introduce new mechanisms in North Korea's economy and in inter-Korean economic relations.