

## **The Prospects for Economic Reform in North Korea after Kim Jong-il and the China Factor**

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In recent years, it has become clear that China is the most important external partner for North Korea. Total trade with China represented 32.7 percent of North Korea's trade in 2003, and in four short years grew to 67.1 percent, excluding inter-Korean trade. China during its economic growth has tried to encourage North Korea to undertake a similar path of economic reform. Nearly every time Kim Jong-il has visited China, Chinese government leaders have made statements demonstrating China's support for North Korea's economic reform. Moreover, Chinese officials often try to highlight their economic successes to Kim Jong-il when he visits China. Often, Kim Jong-il made statements suggesting North Korea would reform, especially through Special Economic Zones, following these trips. Yet real economic reform and success has yet to be seen in North Korea. Interestingly, as North Korea's relationship with China has grown closer in recent years, North Korea has also taken steps to build relationships with other partners. Kim Jong-il visited Russia in 2011 to discuss economic projects. But among Pyongyang's top trading partners, Russia only breaks into the top ten on the import side as North Korea's fifth largest import partner in 2010. Overall, North Korea has more trade with Egypt and Brazil than Russia, and almost as much with Mexico. North Korea also did around \$50 million in trade with Germany, from whom it imported machinery to make wine and press fruit, while exporting apparel. Ultimately, only North Korea can determine the direction of its economic development. Provocations against South Korea have hurt inter-Korean trade, limiting this option of economic interaction. North Korea still restrains itself from fully engaging in Chinese-style reforms though the passing of Kim Jong-il may open opportunities for greater economic change. Moreover, despite its outreach to other countries like Russia, Egypt, and Brazil, North Korea still needs more trade and financial engagement with other countries to fully develop in the dynamic global economy.

**Key Words:** Korea, China, economics, trade, investment

While the death of Kim Jong-il in December brings a change of leadership to North Korea and prospects for reform, the most significant change it brings in the near term is increased uncertainty. From the outside, the transition from Kim Jong-il to his youngest son, Kim Jong-un, seems to be going smoothly. At his father's funeral Kim Jong-un mirrored the role of Kim Jong-il at the funeral of Kim Il Sung, and he has publically received the backing of the military while quickly taking on many of the titles of leadership. What may not be known for years is whether Kim Jong-un has truly taken on the absolute authority held by his father and grandfather, or whether the decision-making process in North Korea has changed. What we do know is that China will likely play a key role in the leadership transition.

In recent years it has become clear that China is the most important external partner for North Korea. When it comes to trade, aid, or political assistance, it is Beijing that Pyongyang looks to. With the passing of Kim Jong-il, North Korea will now look to China for support and legitimacy during the leadership transition. China's influence in North Korea is interesting since, despite rhetoric such as Mao Zedong's comment that North Korea and China are as close as lips and teeth, it seems clear that North Korea would prefer to diversify its partnership if possible. Interestingly, as North Korea's relationship with China has grown closer in recent years, it has also taken steps to build relationships with other partners. Only a few years ago, it reached out to Orascom to build a cellular network, and in recent months it has sought increased economic ties with Russia. In addition, when one looks closer at North Korea's economic ties, there may be other opportunities for economic engagement with nations outside of Northeast Asia. This is the challenge and question that the new regime in Pyongyang faces: does it further increase its ties with China to maintain stability throughout the transition, or does it consider other avenues of political and economic engagement? This paper will largely focus on the latter.

## China's Role in North Korea's Succession

Unlike his father, who had two decades to prepare to assume leadership before Kim Il Sung died in 1994, Kim Jong-un has only had three years to develop the knowledge, skills, and ties he will need to govern North Korea. With little time to develop internal support for his rule, external support could prove critical. As North Korea's chief patron, China will likely have a significant say in the transition process as it seeks to protect its own interests and the new regime works to ensure its own survival. For both parties stability through the transition will be the most important goal.

Despite concerns, China has been supportive of Kim Jong-un. In May 2011, rumors abounded that Kim Jong-un traveled with his father to China on an official state visit that many suspect was designed to gain Chinese approval for a third generation of rule by the Kim family.<sup>1</sup> Kim Jong-un was then seen welcoming officials back to North Korea from the China trip. At the time, it was widely believed that China had reluctantly agreed to the plan despite its aversion to dynastic succession in communist regimes, as the continued rule of the Kim family largely aids China's own security and economic development goals.

In the aftermath of Kim Jong-il's death, China moved quickly to express support for Kim Jong-un.<sup>2</sup> While the condolences expressed by China for the passing of Kim Jong-il were strikingly similar to those expressed in 1994 for the passing of Kim Il Sung, it is interesting to note that China was much more firm in showing its support this time, with Hu Jintao and other leading party figures visiting Pyongyang's

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1. Lee Moran, "The Snappiest Dresser in North Korea: Kim Jong-un Eschews Father's Boring Beige for Blue Suit on Visit to China." *The Daily Mail*, May 20, 2011 (January 12, 2012).

2. Sangwon Yoon, "China Expresses Support for Kim Jong-un, Yonhap Says." *Bloomberg News*, December 19, 2011, <http://www.bloomberg.com/news/2011-12-19/china-expresses-support-for-kim-jong-un-yonhap-says.html> (January 14, 2012).

embassy in Beijing to express their condolences.<sup>3</sup> Unlike Kim Il Sung's funeral in 1994, which was a uniquely North Korean affair, this time China's ambassador to North Korea attended the funeral to demonstrate Beijing's solidarity with the regime in Pyongyang.<sup>4</sup> Additionally, editorials in Chinese state-run newspapers stressed the need for a stable transition, while the *Global Times* said that China should be "a powerful and secure backer for a smooth transition of power."<sup>5</sup>

### **North Korea's Economic Dependence on China**

North Korea was not always dependent upon China. Throughout the Cold War North Korea had been economically reliant on the Soviet Union, which served as its patron, and trade ties with Japan. However, with the collapse of the Soviet Union trade between the two began to decline, and North Korea also had a decent trade relationship with Japan, but by the middle of the 2000s trade with Japan would slow to a trickle. Trade with Japan began to decline after North Korea's revelation to Prime Minister Junichiro Koizumi that it had abducted Japanese citizens. Furthermore, Japan has "completely banned both exports to and imports from North Korea since its other nuclear test in 2009."<sup>6</sup>

While North Korea's trade dependence on China was on par with its dependence on Japan up until 2000,<sup>7</sup> that would change for

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3. Sarah K. Yun, "China's Response to Kim's Death: 1994 and 2011." *The Peninsula Blog*, December 21, 2011, <http://blog.keia.org/2011/12/chinas-response-to-kims-death-1994-and-2011/>.

4. Chad O'Carroll, "What to Make of Kim Jong-il's Funeral." *The Peninsula Blog*, December 28, 2011, <http://blog.keia.org/2011/12/what-to-make-of-kim-jong-ils-funeral/>.

5. Michael Forsythe, "Hu Jintao Visits North Korean Embassy as China Backs Kim Jong-un." *Bloomberg Businessweek*, December 21, 2011 (January 14, 2012).

6. Jinhwan Oh and Jiyong Ryu, "The Effectiveness of Economic Sanctions on North Korea: China's Vital Role," *The Korean Journal of Defense Analysis*, Vol. 23, No. 1, March 2011, p. 121.

7. Byung-Kwang Park, "China-North Korea Economic Relations during the

reasons beyond Japan's disengagement. China's own economy was changing and undergoing one of the most significant periods of economic growth in modern economic history. As China consumed more of the world's commodities for its own economic development, North Korea began to export an increasing amount of its own mineral fuels and ores to fire China's economy. As North Korea's traditional economic partners went into decline or cut off trade from sanctions over North Korea's nuclear actions, an increasingly prosperous China became an attractive new patron.

Since then, North Korea's dependence on China has only grown, especially as North Korean provocations have limited the growth of its economic ties with South Korea, which had introduced a policy of engagement under previous liberal governments that provided North Korea with an additional avenue for economic exchange.<sup>8</sup> Total trade with China represented 32.7 percent of North Korea's trade in 2003, and in four short years grew to 67.1 percent, excluding inter-Korean trade.<sup>9</sup> By 2010, China accounted for 72.4 percent of North Korea's imports and 64.2 percent of its exports. Pyongyang was dependent on China for imports of fish, basic cereals, animal fats, and fertilizer. The same was true of mineral fuels, machinery, and electrical equipment. The only exception to this was imports of ores and slag (see Table 1).

On the export side the picture is fairly similar. Exports of fuels, ore, iron and steel, as well as apparel, predominately go to China. The one exception to this is electrical equipment, where Mexico is

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Hu Jintao Era," *International Journal of Korean Unification Studies*, Vol. 19, No. 2, 2010, cited footnote in article on page 138; "In 2000, North Korea's trade volume with China was 488.03 million USD, and its trade volume with Japan was 463.65 million USD," *North Korea's Trade Trends 1999-2000*, Korea Trade-Investment Promotion Agency (Seoul: KOTRA, 2001), pp. 73, 91.

8. Jinhwan Oh and Jiyong Ryu, "The Effectiveness of Economic Sanctions on North Korea: China's Vital Role," *The Korean Journal of Defense Analysis*, Vol. 23, No. 1, March 2011, p. 123.

9. Byung-Kwang Park, "China-North Korea Economic Relations during the Hu Jintao Era," *International Journal of Korean Unification Studies*, Vol. 19, No. 2, 2010, p. 138. Parenthetical note is on page 135.

Table 1. North Korea's Top 5 Imports and Percentage from China

(Unit: Thousands of U.S. Dollars)

Product	Total Imports	Imports from China	Percentage from China
Mineral fuels, oils, distillation products, etc.	800,787	478,779	59.8
Machinery, nuclear reactors, boilers, etc.	261,436	245,498	93.9
Ores, slag, ash	250,388	88	0
Electrical, electronic equipment	215,917	190,799	88.4
Vehicles other than railway, tram	166,590	159,826	95.9

Source: WTO Trade Map.

Table 2. North Korea's Top 5 Exports and Comparison with China

(Unit: Thousands of U.S. Dollars)

Product	Total Exports	Total Exports to China	Percent Export to China
Mineral fuels, oils, distillation products, etc.	510,914	397,629	77.8
Ores, slag, ash	251,934	251,571	99.9
Articles of apparel, accessories, not knit or crochet	192,777	160,577	83.3
Iron and steel	164,084	108,547	66.2
Electrical, electronic equipment	120,766	20,924	17.3

Source: WTO Trade Map.

North Korea's largest export market and China only accounts for 17.3 percent of exports (see Table 2).

North Korea's dependence on China is partially a factor of its own policies. A series of missile and nuclear tests have led to increasing international sanctions on Pyongyang, forcing it to look even more to China for aid and economic interaction. Despite China's efforts to restrain North Korea's weapons programs out of concern about stability on the peninsula, North Korea has often found a reluctantly willing partner in China. Less than a year after missile and nuclear tests China and North Korea announced a series of deals related to bilateral aid and economic cooperation during a visit by Chinese Premier Wen Jiabao in October 2009. The package, consisting of \$20 million and deals in tourism, trade, and software,

signaled China's efforts to prevent North Korea from destabilizing due to international pressure and sanctions.<sup>10</sup>

China's supportive signals and economic lifeline to North Korea have raised concerns about the effectiveness of sanctions. Based on the work of researchers in both the United States and South Korea, these concerns appear to be valid, as "North Korea's trade volume and pattern [has] not [been] affected significantly by trade sanctions imposed by several countries. This is because most exported/imported goods are substitutable, and China does not participate in these sanctions."<sup>11</sup> In fact, North Korea's "total trade volume has been increasing for the past two decades."<sup>12</sup>

Marcus Noland makes two interesting caveats for these trade numbers. First, he suggests that North Korean consumer behavior has changed and people in North Korea are demanding more imports of new products, especially from South Korea and China.<sup>13</sup> Second, the main purpose of the sanctions was to target the military and luxury goods; thus, more goods coming into North Korea would not necessarily mean the sanctions were ineffective. Yet, vague definitions of the luxury goods sanctioned by various countries, along with an increased prominence of automobiles and other apparent luxury items in North Korea, suggest the sanctions are not having their desired effect. Moreover, data suggests no matter how one defines luxury goods, China does not appear to be implementing the sanctions resolutions.<sup>14</sup>

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10. Scott Snyder and See-Won Byun, "China-Korea Relations: China Embraces South and North, but Differently," *CSIS Comparative Connections*, January 2010, at [http://csis.org/files/publication/0904qchina\\_korea.pdf](http://csis.org/files/publication/0904qchina_korea.pdf) (November 6, 2011).

11. Jinhwan Oh and Jiyong Ryu, "The Effectiveness of Economic Sanctions on North Korea: China's Vital Role," *The Korean Journal of Defense Analysis*, Vol. 23, No. 1, March 2011, p. 121.

12. *Ibid.*

13. Marcus Noland, "The (Non-) Impact of U.N. Sanctions on North Korea," *Asia Policy*, Number 7, January 2009, p. 72.

14. Stephan Haggard and Jaesung Ryu, "The Lap of Luxury," *North Korea: Witness to Transformation Blog*, October 3, 2011, at <http://www.piie.com>

While trade between North Korea and China is growing, there are some concerns for North Korea about impact of this economic relationship. Most of North Korea's exports to China are minerals and natural resources necessary for China's growth and manufacturing; on the other hand, North Korea seems to be importing just the materials it needs to survive, especially "fuel, machinery, and steel in addition to everyday necessities such as meat products, grains and other products from China."<sup>15</sup> Second, North Korea has a huge trade deficit with China that it will be unable to balance out from trade with other countries in the near future. Third, Chinese investments in North Korea are still comparably smaller relative to trade volume.<sup>16</sup> Moreover, Chinese investments to the rest of its neighbors are much larger than those to North Korea.<sup>17</sup>

Another important issue is whether North Korea will emulate Chinese-style economic reforms. Over the past decade, China has emphasized its economic transition and pathway to reform when interacting with North Korea. Chinese government officials offer their assistance when visiting North Korea and often attempt to demonstrate their economic successes when Kim Jong-il visits China. Wen Jiabao told Kim Jong-il during his trip to China in May 2010 that "China will, as always, support North Korea for developing the economy and improving people's livelihood and is willing to introduce to North Korea the experience of China's reform and opening-up and construction."<sup>18</sup> Then in August 2010, Chinese President Hu

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/blogs/nk?p=3004 (November 6, 2011).

15. Byung-Kwang Park, "China-North Korea Economic Relations during the Hu Jintao Era," *International Journal of Korean Unification Studies*, Vol. 19, No. 2, 2010, p. 139.

16. *Ibid*, p. 137.

17. Drew Thompson, "Silent Partners: Chinese Joint Ventures in North Korea," *U.S.-Korea Institute at SAIS*, February 2011, at [http://uskoreainstitute.org/wp-content/uploads/2011/02/USKI\\_Report\\_SilentPartners\\_DrewThompson\\_020311.pdf](http://uskoreainstitute.org/wp-content/uploads/2011/02/USKI_Report_SilentPartners_DrewThompson_020311.pdf) (November 6, 2011).

18. "Kim Jong-il Earns Economic, Diplomatic Assistance from China Trip," North Korea Newsletter No. 106, May 13, 2010, at <http://english.yonhapnews>



Jintao further encouraged Kim Jong-il to consider economic reforms, saying "Economic development should be self-reliant and also cannot be separated from opening up and cooperation," referencing the *juche* ideology promoted in North Korea.<sup>19</sup>

Many of Kim Jong-il's visits to China have included stops or tours that highlight China's economic reforms. Important officials for North Korean economic policy accompany Kim Jong-il on these trips or pay visits to China shortly after his departure. His 2006 visit seemed very similar to Deng Xiaoping's 1992 southern tour promoting his economic reforms.<sup>20</sup> Moreover, Kim Jong-il's brother-in-law, Jang Song-taek, followed up the trip with another large North Korean delegation.

After almost all of Kim Jong-il's trips to China, including his most recent visits, speculation arises that North Korea may really try to implement reforms similar to China's. Quotes from Kim Jong-il about reform, new economic goals, and new projects, especially work in special economic zones, usually ensue after his visits to China. Special economic zones were important to China's early development; moreover, the Chinese hope that special economic zones in North Korea can help with China's goals of increasing the economic prosperity of its northeast provinces and providing stability to North Korea.

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.co.kr/northkorea/2010/05/12/20/0401000000AEN20100512004000325F.HTML (November 6, 2011).

19. Chris Buckley, "North Korea's 'family firm' sidles up to China," *Reuters*, August 31, 2010, at <http://www.reuters.com/article/2010/08/31/us-korea-north-china-analysis-idUSTRE67U11U20100831> (November 29, 2011).

20. Mika Marumoto, "North Korea and the China Model: The Switch from Hostility to Acquiescence," *On Korea*, Vol. 1, 2008, Korea Economic Institute, p. 109.

## SEZs and Border Projects with China

### *Rajin-Songbong Special Economic Zone*

Kim Il Sung visited China in October 1991, and an aftereffect of the visit was the establishment of the Rajin-Sonbong economic and trade zone in December 1991. The Rajin-Sonbong Special Economic Zone (SEZ) is located near the border of China and Russia and was a first tentative step by North Korea in experimenting in Chinese-style economic reforms. However, the zone remained largely undeveloped for nearly two decades. Slow inflows of foreign investment into the area, poor infrastructure, no real linkages between the SEZ and the rest of the North Korean economy, and ambivalence on the part of the North Korean regime towards capitalism have prevented the flourishing of real commercial prosperity in the Rajin-Sonbong SEZ, now the special city of Rason.<sup>21</sup>

However, this attitude towards the Rason SEZ began to change in the first half of 2011. The new commitment comes as North Korea approaches the 100<sup>th</sup> anniversary of Kim Il Sung's birth and its date for becoming a "powerful and prosperous nation." From its experience with the Kaesong Industrial Complex, North Korea has learned that projects of this nature can be an important source of hard currency at a time when sanctions have largely blocked North Korea's earning potential abroad.

North Korea is taking a number of steps to make the Rason SEZ attractive to investors. The monthly minimum wage for the zone has been set at \$80, which is less than the \$167 wage workers in China receive, but above the \$63.81 workers are paid at the Kaesong Industrial Complex. A series of tax benefits have been established as well. The corporate tax rate is set between 10 to 14 percent, while

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21. Chico Harlan, "In a North Korean port city, foreign investment starts to flow," *Washington Post*, September 26, 2011, [http://www.washingtonpost.com/world/asia-pacific/in-a-north-korean-port-city-foreign-investment-starts-to-flow/2011/09/24/gIQAM4R8yK\\_story.html](http://www.washingtonpost.com/world/asia-pacific/in-a-north-korean-port-city-foreign-investment-starts-to-flow/2011/09/24/gIQAM4R8yK_story.html).

companies that invest in excess of 30 million euros will be exempt from corporate income taxes for four years after they make a profit, and will also receive a 50 percent deduction for the next three years.<sup>22</sup> The corporate tax structure is fairly similar to that of the Kaesong Industrial Complex, where the rates are the same, but taxes are waived for the first five years after making a profit rather than four. Both receive a 50 percent reduction for the next three years.<sup>23</sup> Investors who purchase their buildings will receive a five year property tax exemption and sales taxes have been set between 0.6 to 5 percent.

Much as South Korea oversees the Kaesong Industrial Complex, China is overseeing the development of Rason. The project at Rason is part of China's economic development plan for its northeastern provinces. China is looking to develop an integrated economic region between Jilin and Liaoning Provinces and North Korea's border region. This includes overseeing the development of an all-season road between China and the all-weather port at Rason to provide China's northeastern provinces access to a warm water port for exports. Additionally, in 2002 North Korea established the Sinuiju Special Administrative Region (SAR) across the Yalu River border near the Chinese city of Dandong. This area could potentially serve as an industrial park along the lines of the Kaesong Industrial Complex on two islands situated between Dandong in China and Sinuiju in North Korea.<sup>24</sup> China and North Korea are working on joint development projects on Hwanggumpyong Island. Jang Song-taek, Kim Jong-il's brother-in-law and seemingly the official in charge of most major state-run economic projects, especially those connected with China, was at the groundbreaking ceremony with the Chinese on

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22. "Rajin-Sonbong Minimum Wage Set at 80 Dollars," NK Briefs, Institute for Far Eastern Studies, September 21, 2011, [http://ifes.kyungnam.ac.kr/eng/FRM/FRM\\_0101V.aspx?code=FRM110921\\_0001](http://ifes.kyungnam.ac.kr/eng/FRM/FRM_0101V.aspx?code=FRM110921_0001).

23. Mark Manyin and William Cooper, "The Kaesong North-South Korean Industrial Complex," Congressional Research Service, April 18, 2011.

24. Dick K. Nanto, "Increasing Dependency: North Korea's Economic Relations with China," *Korea's Economy*, Korea Economic Institute, 2011, pp. 75–83.

Hwanggumpyong Island.

While it will take years to see if the Rason SEZ will develop along the lines of the Kaesong Industrial Complex, such a development model would likely be a significant revenue earner for North Korea. Current estimates indicate that North Korea earns \$20 million a year from the Kaesong Industrial Complex.<sup>25</sup> However, given the uncertainty with which North Korea has handled the Kaesong Industrial Complex, China may choose not to develop a robust industrial complex. Rather, once the road and rail links to the port of Rason are complete, there will be an incentive for China to utilize those for the development of their own regions rather than additional development in North Korea, which the North itself may not want. The Chinese government may also try to use its economic leverage to maintain stability on the peninsula; however, for North Korea, China is its best option for political and economic support at the moment.

### ***Alternatives to China?***<sup>26</sup>

Under North Korea's military-first policy the economy has stagnated and its dependence on China has grown over the last decade. One consequence of North Korea's pursuit of nuclear weapons is that it has curtailed North Korea's trade in Northeast Asia which was significantly more balanced, in terms of partners, only a decade ago. This is one of the key challenges the new regime in Pyongyang will have to address.

In 2001, North Korea did roughly \$1.3 billion in trade with Japan, in contrast to \$740 million with China. Trade with Japan fell progressively throughout the decade for a series of reasons, falling to just below \$200 million by 2005. Then, in response to North Korea's nuclear test in 2006 and United Nation sanctions, trade became virtually non-existent by 2007. While North Korean trade

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25. *Ibid.*

26. All trade data in this section was compiled from the World Trade Organization International Trade Center Trade Map.

with Russia expanded in the middle part of the decade, it has decreased in recent years as well.

In addition to sanctions from North Korea's nuclear tests impacting trade with Japan, its provocations in 2010 directed at South Korea have impacted its trade with South Korea. In the first half of 2011, inter-Korean trade was down 16.2 percent from 2010 due to sanctions eliminating inter-Korean trade aside from the Kaesong Industrial Complex.<sup>27</sup> Prohibitions on expansion within the complex and on previously stalled construction projects have only recently been lifted.<sup>28</sup> However, the complex itself faces challenges from the reluctance of the United States and the European Union to accept products made there, along with additional U.S. sanctions which prohibit even the indirect importation of products produced in North Korea.

One option for North Korea to reduce its dependence on China would be to resolve the concerns over its nuclear program. This would open the door to normalized relations with many of its neighbors and an increased prospect of trade and investment. Given the unlikelihood that North Korea will give up its nuclear program in the near future, it may need to pursue a process of strengthening ties with countries that it has more traditional interaction with, as well as countries outside of Northeast Asia.

### **Will the New Regime Consider Economic Reform?**

For years the Chinese and others have tried to no avail to encourage North Korea to engage in economic reforms. Some have speculated that because of his education in Switzerland, Kim Jong-un understands

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27. Nam-sub Sim, "Comparison between the Trends of Inter-Korean Trade and North Korea-China Trade in 2011," Korea International Trade Association, September 8, 2011, <http://www.kita.org/>.

28. Gwang-lip Moon, "Seoul Says it will Resume Construction in Kaesong," *Korea JoongAng Daily*, October 12, 2011, <http://koreajoongangdaily.joinsmsn.com/news/article/html/674/2942674.html>.

the necessities of reforming North Korea's economy. Additionally, Jang Song-taek, who is expected to serve as some type of regent for Kim Jong-un, is also thought to be open to greater economic activity.

If the new regime is to engage in greater economic opening, it would be unrealistic to expect any major announcements or initiatives while the regime is still consolidating its hold on power. Thus it is unsurprising that North Korea has warned not to expect change in its policies,<sup>29</sup> that foreign currency has been banned,<sup>30</sup> and that there was little emphasis on economic reform in the Joint New Years Editorial. Much like an American politician seeking his party's nomination, the new regime in Pyongyang must rhetorically say what is needed to ensure support until its hold on power is firm.

This means that if the new regime does intend to pursue economic reform, which we cannot be sure of, we will likely know only after the fact. It may come from small projects or increased openings to specific countries. This raises the question: if North Korea did seek to diversify its economic engagement, which countries might it turn to?

## Russia

Of the potential options North Korea might have to lessen its dependence on China, Russia would seem to be a natural choice. Russia and Korea have ties going back to the 19<sup>th</sup> century, and the Soviet Union was responsible for the creation of the North Korean state, financially supporting it throughout the Cold War. Throughout the Cold War, Russia served as North Korea's main trading partner and built ninety-three factories that served as the backbone of the country's heavy

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29. Chico Harlan, "North Korea condemns South Korea, vows no policy changes." *Washington Post*, December 30, 2011, [http://www.washingtonpost.com/world/asia\\_pacific/north-korea-blasts-south-korea-vows-no-policy-changes/2011/12/30/gIQAnB2FQP\\_story.html](http://www.washingtonpost.com/world/asia_pacific/north-korea-blasts-south-korea-vows-no-policy-changes/2011/12/30/gIQAnB2FQP_story.html) (January 12, 2012).

30. Choi Cheong Ho and Cho Jong Ik, "Authorities Move to Block Currency Usage," *Daily NK*, January 2, 2012, <http://www.dailynk.com/english/read.php?cataId=nk01500&num=8631> (January 12, 2012).

industry, while educating hundreds of thousands of North Koreans.<sup>31</sup> Even with occasional political conflicts, the relationship was a strong one during the Soviet era.

However, despite Soviet support for North Korea during the Cold War, the relationship began to change as the Soviet Union began undertaking reforms towards the end of the Cold War. In the late 1980s, Mikhail Gorbachev decided to convert trade with the states of the communist bloc to commercial terms and demand payment in hard currency. This precipitated a decline in production across the communist bloc and saw trade between Russia and North Korea fall from \$2.4 billion in 1990 to a mere \$65 million in 1998.<sup>32</sup> Politically, the relationship changed as well. As the Soviet Union ended and its successor state, the Russian Federation, began to reorient its foreign policy towards the West, views in Moscow began to change towards the Korean peninsula as well. Moscow began to reorient its policy on the peninsula towards Seoul and the economically vibrant, democratic half of the peninsula. At the same time it downgraded its ties with North Korea, suspending aid and arms sales, and revising the prior Cold War treaty with North Korea to remove provisions for mutual defense.<sup>33</sup>

Having realized that by downgrading its ties with North Korea it had lost influence on the Korean peninsula and East Asia, Russia has sought to bring more balance to its relations with both states under Vladimir Putin's leadership, based on economic and regional cooperation.<sup>34</sup> More recently, Russia's interests on the peninsula have focused on preventing a nuclear North Korea, while retaining

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31. Alexander Voronstov, "Current Russia – North Korea Relations: Challenges and Achievements," *The Brookings Institution*, February 2007.

32. International Crisis Group, "North Korea-Russia Relations: A Strained Friendship," *Asia Briefing* No. 71, 4, December 2007.

33. Alexander Lukin, "Russia's Korea Policy in the 21<sup>st</sup> Century," *International Journal of Korean Unifications Studies*, Vol. 18, No. 2, 2009, pp. 30–63.

34. Seung Ham Yang, Woosang Kim, and Yongho Kim. "Russo-North Korean Relations in the 2000s: Moscow's Continuing Search for Regional Influence," *Asian Survey*, Vol. 44, No. 6 (November/December 2004), pp. 794–814.

influence on the peninsula and in the Asia-Pacific region.<sup>35</sup> At the same time, Moscow has sought to deepen its ties with East Asia as part of its efforts to modernize and integrate the Russian Far East into the Asia-Pacific region.<sup>36</sup>

As China's influence has grown, Pyongyang has looked to Moscow to provide a counter weight, and both sides have expressed a mutual interest in expanding economic cooperation, although two-way trade in 2010 fell below \$65 million according to statistics from the World Trade Organization. North Korea has expressed interest in gaining Russian aid to revive production at 38 factories built with Soviet help, and Russia maintains an interest in linking the Trans-Siberian Railroad to the Trans-Korea Railroad to connect South Korea to Europe. Russia would also like to construct a pipeline through North Korea to provide natural gas from Siberia to South Korea. However, while these potential projects would deepen economic ties between the two countries, progress has been hindered by North Korea's debt to Russia from the Soviet era, as well as its inability to pay for future transactions and provide a viable investment environment.<sup>37</sup>

However, Moscow and Pyongyang have recently made progress on resolving these issues, perhaps paving the way for the pipeline and rail projects to move forward. At a September 2011 summit between Russian President Dmitry Medvedev and Kim Jong-il, it was announced that Russia and North Korea had reached a tentative deal for Moscow to write off 90 percent of North Korea's debt and to reinvest the remaining 10 percent into projects in North Korea.<sup>38</sup>

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35. Leszek Busynski, "Russia and North Korea: Dilemmas and Interests," *Asian Survey*, Vol. 49, No. 5 (September/October 2009), pp. 809–830.

36. Richard Weitz, "Moscow Ponders Korea Unification," *International Journal of Korean Unification Studies*, Vol. 20, No. 1, 2011, pp. 123–154.

37. Alexander Lukin, *Ibid.*

38. Sergei Blogov, "Moscow Considers North Korean Debt Write-Off," *Eurasia Daily Monitor*, Vol. 8, Issue 181, October 3, 2011, at [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=38485&tx\\_ttnews%5BbackPid%5D=7&cHash=50a1fa3e2cc5243d67e3df75f6a35065](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=38485&tx_ttnews%5BbackPid%5D=7&cHash=50a1fa3e2cc5243d67e3df75f6a35065) (November 29, 2011).



At the same summit meeting, North Korea gave its initial approval for the construction of a pipeline through its territory to provide Russian natural gas to South Korea. The project is expected to provide North Korea \$100 million annually in transit fees, which is more than five times the hard currency revenue that it receives from wages at the Kaesong Industrial Complex.<sup>39</sup>

Russia also has interest in the projects at the Rason SEZ. It is building a rail line at the port to link Rason with the Trans-Siberian Railway and has leased one of the three piers in the port.<sup>40</sup> By leasing part of the port and setting up rail access, Russia would also gain a year-round Pacific port for its Far East territories and easier access to lucrative markets in both Japan and South Korea. Better transportation links would aid Russia in its efforts to integrate its Far East into the Pacific economy and spur development.

While the pipeline project and efforts in Rason, if successfully concluded, would provide North Korea with needed hard currency and a constant revenue stream, Russia is unlikely to provide a long-term solution to North Korea's economic dependence on China without significant reforms. North Korea has only two commodities to supply the international market with mineral resources and cheap labor. Russia is already well-endowed with mineral resources and it has limited interest in cheap North Korean labor. Ultimately, from the Russian perspective, economic projects with North Korea are not so much about developing the North Korean economy as they are about providing better access to the more lucrative South Korean market.<sup>41</sup>

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39. Troy Stangarone, "Five Considerations for a Gas Pipeline Through North Korea," *The Peninsula Blog*, September 29, 2011, <http://blog.keia.org/2011/09/five-considerations-for-a-gas-pipeline-through-north-korea/>.

40. "Rason Economic Trade Zone with Bright Prospect of Development," *North Korea Economy Watch*, August 25, 2011, <http://www.nkeconwatch.com/category/economic-reform/special-administrative-regions/rajin-sonbong/> (November 6, 2011).

41. Andrei Lankov, "Russia-North Korea Trade," *East Asia Forum*, October 6, 2011, <http://www.eastasiaforum.org/2011/10/06/russia-north-korea-trade/>.

## Options Outside of Northeast Asia

Despite North Korea's heavy dependence on China, the perception that China and South Korea are Pyongyang's only two trading options may not be the case. Among North Korea's top ten import partners, imports from the other nine (excluding inter-Korean trade) account for 41.5 percent of North Korea's imports from China. On the export side the figure is 39.9 percent. If North Korea was able to expand its trading relationship with these nations, it could lessen its dependence on China.

Looking deeper at North Korea's trade shows some potentially interesting trends (see Tables 3 and 4). Among Pyongyang's top trading partners, Russia only breaks into the top ten on the import side as North Korea's fifth largest import partner in 2010. Overall, North Korea has more trade with Egypt and Brazil than Russia, and almost as much with Mexico. Trade with Egypt topped \$335 million in 2010, with North Korea exporting steel and steel pipes while importing mineral fuels. In the case of Brazil, North Korea has almost a \$100 million surplus from exporting computer and office machine parts, as well as flat-rolled steel, while importing iron ore and tobacco products. In the case of Brazil, North Korea also trades in a wide

Table 3. North Korea's Top 10 Export Markets in 2010

(Unit: Thousands U.S. Dollars)

Total	1,852,406
China	1,189,728
Brazil	121,419
Netherlands	94,866
Egypt	66,225
Mexico	45,879
Sri Lanka	35,952
Venezuela	35,091
Germany	33,942
Thailand	21,367

Source: WTO's Trade Map.

Table 4. North Korea's Top 10 Import Partners in 2010

(Unit: Thousands U.S. Dollars)

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Total	3,146,112
China	2,277,611
Egypt	269,876
South Africa	216,376
Singapore	47,761
Russian Federation	45,935
Italy	43,562
Thailand	29,685
Dominican Republic	29,563
Germany	24,477
Brazil	21,466

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Source: WTO's Trade Map.

range of other products. North Korea also has a trade surplus with Mexico, with whom it imports zinc and exports electronics. Interestingly, North Korea did around \$50 million in trade with Germany, from whom it imported machinery to make wine and press fruit, while exporting apparel.

When discussing trade with North Korea, countries like Brazil, Mexico, and Germany are not often mentioned as trading partners. However, it is interesting to note that much of the trade between these countries consist of products produced in each country, unlike prior examples of trade partners, such as India, where North Korea's imports primarily consisted of mineral fuels, as is currently the case with Egypt. If North Korea could expand its trade with countries it has not traditionally had strong trading relationships with, it could lessen its dependence on China. Additionally, trade with a growing power, such as Brazil, that is not as invested as others in the nuclear issue could be a promising alternative to China.

## Conclusion

One of the great changes in the last decade has been the role of China in international trade. Just a decade ago, China's trade with South Korea was only \$31.5 billion, or \$22 billion less than South Korea's trade with the United States; moreover, China's trade interaction with South Korea was also \$12 billion less than its trade with Japan. A decade later, China's trade with South Korea dwarfs the United States, Japan and the European Union at some \$118 billion. That represents twice the United States' current trade with South Korea, and more than that of the United States and Japan combined.<sup>42</sup>

Given the trends in China's trade with South Korea, perhaps we should not be surprised at how important a trading partner China has become for North Korea. As the Chinese economy continues to expand at nearly 10 percent per annum and to draw in an ever increasing amount of natural resources, trade with North Korea was bound to rise given the complementary nature of their economies and close proximity.

While China's trade with North Korea will continue to grow, especially if an industrial complex is developed in the Rason SEZ, North Korea may not be destined to become dependent on China. If North Korea were to refrain from provocations and resolve concerns over its nuclear program, trade with South Korea and Japan would likely increase, and there would be a better prospect of foreign investment from other countries. Concurrently, North Korea may be able to develop mutually beneficial relationships with emerging economies such as Brazil, with which it already has growing trade relations.

At the same time, North Korea's growing economic dependence on China has not measurably increased China's political influence over the regime. North Korea has yet to engage in Chinese-style economic reforms despite years of encouragement to do so, and it undertook its second nuclear test despite clear signals from China

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42. Trade data from the Korea International Trade Association.

that it should refrain from doing so. More recently, despite China's concern about the idea of a third generation Kim ruling North Korea, China ultimately gave its consent to the transition to Kim Jong-un. Of course, that influence may not grow with the new regime.

However, if China's economic gains in North Korea continue to be curtailed by limited political influence, policy in South Korea could focus on how better to manage increasing Chinese economic interests in North Korea rather than concerns that it will lead to increasing political control. At the same time, South Korea could choose to encourage North Korean engagement with countries such as Brazil and Mexico that North Korea may not feel as ideologically threatened by as it feels about its neighbors. This could allow South Korea to help to diversify North Korea's economy away from China and slowly introduce it to more market based economies.

Ultimately, however, only North Korea can determine the direction of its economic development. While the Kaesong Industrial Complex offered one prospective model of industrialization and economic liberalization and the potential for greater opening to the wider world, North Korea has instead chosen a course that has limited its options. As long as it continues on that path, China will be an increasingly important economic partner for its development. This ultimately is the conundrum that Kim Jong-un and the new regime face.

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