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THE FUTURE OF NORTH KOREA: *Economic Viability and Regional Stability*

The following is a summary of a workshop on North Korea that took place in December 1998 at the James A. Baker III Institute for Public Policy. The workshop was organized by Suchan Chae of Rice's Department of Economics. It was jointly sponsored by the Asia Research Fund, the President's Office at Rice University, and the Baker Institute. The full report of the workshop, containing all the papers summarized below, will be available through the Baker Institute.

Introduction

The purpose of the conference was to assess the future of the Democratic People's Republic of Korea (hereinafter referred to as North Korea) and to discuss steps that could be taken to promote both economic viability and strategic stability. The participants of the workshop recognized the need to shift the focus of policies regarding North Korea from strategic issues and relief efforts to development programs. In this spirit, there was a proposal to form a network of governments, international organizations, research institutes, universities, and private funding organizations to coordinate efforts to assist North Koreans in learning about and transitioning toward a market economy. The presentations were divided into five sessions.

Transition from a Socialist Economy

The first session described the experiences of former socialist economies that, to one degree or another, are transitioning to a market economy, with the intent of drawing implications for a possible similar transition for the economy of North Korea. The session was led off by Ronald Soligo and Peter Mieszkowski, who examined the success of the economic reform policies in the Czech Republic, Hungary, Poland, Russia, China, and Vietnam. Although they did not find a single universal method of successful transition, they did

find some common characteristics among those countries that have brought forth effective reform. In particular, they noted that having a strong state that is committed to reform is important and that familiarity with market institutions and practices greatly enhances the probability of success. The speed of successful reform varies; some East European countries flourished under quick reforms, while China has been able to maintain an effective gradual approach.

Their conclusion for the prospect of effective reform in North Korea was not positive. North Korea exhibits none of the initial conditions exhibited by the successful East European countries, nor does the current regime indicate any desire to implement gradual reforms along the lines of China or Vietnam, despite the continued deterioration in economic conditions.

The next paper, presented by Sim Yee Lau and Kap-Young Jeong, outlined lessons learned from the experience of the Sasakawa Peace Foundation's Central Asia Project that may be applied to North Korea. The Sasakawa Peace Foundation is a private Japanese foundation that funded a project to expose the Central Asian intellectual community to methods of creating and maintaining a growing economy that have been successful in the development of East Asian economies. Based on this experience and the contrasting evidence from reform in China and Vietnam (compared with that in the former Soviet Union), the authors made three recommendations for helping North Korea's transition to a market economy. First, reforms should be gradual because sudden price reforms would lead to widespread disruption in North Korea's highly distorted economic system. Second, it is important for North Korean researchers, government policy makers, and bureaucrats to be educated about the details of developing market-based economic systems. Finally, in contrast to what the authors call the "Washington consensus," with its emphasis on macroeconomic stabilization and structural adjustment policies, Lau and Jeong favor policies that focus on long-term targets for developing the real sector (i.e., the sav-

ings rate, industrial restructuring, export-led growth, the exchange rate, etc.).

The final paper in the first session, by Fred von der Mehden and Steven Lewis, examined the reform experience in China and Vietnam in more detail. Their paper took a problem-solution approach; they introduced a particular problem faced by China or Vietnam in reforming their socialistic system and presented possible solutions that might be used by North Korea if similar problems arise. They examined two political and five economic system problems. If there is a problem with a lack of foreign investment due to corruption bottlenecks, for example, they proposed that investment approval be decentralized, which should promote competition among local governments and help create fiscal autonomy for localities.

Status of the North Korean Economy

The next session focused on the current status of the North Korean economy. Given the constraint of the lack of reliable published data, the paper by Myung Chul Cho and Hyoungsoo Zang did an admirable job in describing and analyzing the situation. The perspective of Mr. Cho, who emigrated from North Korea several years ago, was all the more valuable because of the paucity of data. What data are available, even official data from the North Korean government, all point to an economic system that has imploded and is on the verge of complete collapse. Production in agriculture, manufacturing, and construction sectors is estimated to have declined on the order of 20 percent per year during the mid-1990s. The risk of mass starvation has been of particular concern and has forced the North Korean government to ask for international assistance in feeding its populace. The authors noted that North Korea has not been self-sufficient in agricultural production during recent history; it has had to rely on trade with Soviet allies to make up for the lack of domestic production. But with the collapse of the Soviet Union, this trade has dwindled, quickly leaving North Korea with an annual food shortage estimated to be around 2 million tons.

However, it is the very near collapse of the centrally run system that has led to the development of private production of food and distribution through farmers' markets. While these activities are officially illegal, the government has largely ignored them. It is estimated that 80 percent of working North Koreans now purchase some of their goods in these illegal markets and that 50 percent of the population are daily customers.

William Brown agreed that the North Korean economic system has come to the point of almost complete collapse, which he defined as a situation where there is no longer the division of labor, the specialization, and the economies of scale that any modern economy must provide. He used the government's inability to make good on its food ration coupons (used to pay coal mine workers) as an illustration of a sys-

tem in collapse. The lack of payment by the government creates a vicious cycle, forcing miners to spend time foraging for food, thereby lowering coal production, which in turn hurts production in every other sector, including the agricultural. This situation does not leave any attractive options for the current regime, since reforms that would help the economic system would likely reduce the chances of the current regime maintaining power. In terms of outside influence on the situation, Brown stressed the importance of giving aid that is "market friendly"; that is, aid that helps to further the development of markets rather than to supplant them.

The final paper of the second session, by Chang-Ho Yoon, focused on the infrastructure needs of North Korea, in particular telecommunications and transportation. He noted that horizontal telephone communications are still very much in the control of the North Korean government. Only about 10 percent of telephone lines are owned by individuals, and no telephone directory exists. However, in the midst of the economic crises during this decade, North Korea has invested heavily in telecommunications by installing fiber-optic cables between major cities even though personal use is still limited. Further investment will require foreign capital and technology, which will come only if North Korea provides an environment that is friendly to foreign investors.

In regard to transportation, Yoon likened the current situation in North Korea with that of South Korea around 1975. Because of the mountainous terrain, rail is the dominant form of transportation, accounting for 80 to 90 percent of transport demand. North Korea is in a strategically important position to link rail traffic between China, Russia, and the Koreans. However, 98 percent of the rail network still consists of single-track lines, which are much more limited than double-track lines. Yoon noted that the dilemma facing North Korea is that it needs foreign capital to improve its infrastructure, but to reduce the investor's risk, institutional reforms need to be carried out. These reforms would have to allow for more private ownership and competition, but that would have the likely consequence of eroding the very foundation of the current regime.

Economic Cooperation Between the Koreans

The papers in the third session focused on South Korea's recent initiatives for economic cooperation with North Korea. Kyu-Ryoon Kim presented an overview of the South Korean perspective of the extent of economic cooperation between North and South Korea. He noted that the first governmental step in this direction came in 1988 in what has been known as The July 7 Declaration. Now, there is a legal framework that encourages contacts among individuals and trade in commodities. South Koreans who want to trade with the North must receive permission from the Minister of Unification. This trade is called intra-Korean trade, not inter-Korean trade; tariffs and

defense taxes are not imposed. This trade has grown from \$18 million in 1989 to \$300 million in 1997, although it experienced a decline in 1998 because of economic difficulties in South Korea. These policies are being expanded under the Kim Dae Jung administration; there is even more of an emphasis placed on economic cooperation with North Korea, and South Korean governmental controls are being loosened.

Gordon Flake made the other presentation of the session. He examined the strategic relations that affect economic cooperation with North Korea. First, he noted that China is currently serving as the lifeline for the North Korean economy and is the primary foreign influence on the North Korean economy. China is acting out of its self-interest because it does not want a refugee problem on its border and it has other reasons for seeing the regime survive. Second, Flake noted that ties with Japan have been fairly stable and that North Koreans living in Japan continue to send money back to North Korea, but the amount has declined considerably in the past decade. Third, he pointed out that South Korea is North Korea's third largest trading partner and the largest supplier of foreign currency. Flake emphasized that Kim Dae Jung's "sunshine policy" is a serious policy, one that attempts to open up the North Korean economy. Finally, Flake stressed that for the U.S., economic cooperation and security issues cannot be separated; otherwise, problems will arise.

Transformation of the North Korean Economy: The Educational Process

The fourth session moved into discussions about feasible steps that could be taken to increase North Korea's ability to transform its economy. The session began with Soo-Bin Park describing the exchange program between Carleton University in Canada and the University of Havana in Cuba. One part of this exchange program provided funding for Cuban economists to go to Canada and perform research. However, the central part of the exchange program was a master's degree in economics, taught mostly by economics professors from Carleton, that was available to students through coursework in Havana. Certain parallels can be drawn between Cuba and North Korea. Both have tried to maintain socialist economic systems after the breakup of the Soviet Union, and both suffered real declines in output as they lost trade with and support from the Soviet Union. Park pointed out that for a similar exchange program to occur in North Korea, permission must first be given by the government. Then it is a matter of finding a suitable partner university in North Korea, designing an educational program and establishing funding. Park was confident that this opportunity will come soon.

In the second paper, Bradley Babson also saw signs that North Korea was beginning to change from a policy of strict self-reliance to greater openness and willingness to interact with the international community. He pointed out three areas that he felt were worth pursuing by the international community to help further North Korea in continuing in this direction. The first was to shift the focus of economic research from identifying the causes and depth of the economic collapse to assessing the potential for economic recovery. To this end, the World Bank has offered to produce an economic report. However, before this work can begin, a written request by the North Korean government is needed. Second, there is a great need for training North Korean officials on the workings of modern market economies. This training has already begun through cooperation with the United Nations Development Program, but there is much room for expansion. The third and final recommendation was that a third prong be added to the framework for engagement with North Korea. The first two prongs consist of political processes and humanitarian processes; the third would consist of addressing economic recovery issues. Mr. Babson added that to be effective the three prongs will need to be connected in a cohesive strategy.

Suchan Chae ended the session on feasible action plans by outlining how plans for teaching economics to North Koreans could be developed. He suggested that such educational programs should target economic policy makers and educators capable of teaching others. Programs could be in both North Korea and abroad, although care would need to be taken so that defection does not become a problem. He noted that instruction should be in both Korean and English, with an emphasis on Korean, to begin with, to facilitate quicker dissemination of market economics. Teachers should come from universities and international agencies, as well as from governments and businesses, so that North Koreans will become accustomed to every component of the workings of a market economy. Some funding for these projects could come from the private sector, but the bulk of the funds would probably need to come from the public sector. He proposed that governments, international organizations, research institutes, universities, and private funding organizations form a network to coordinate the planning and implementation of educational programs for North Koreans.

U.S. and South Korean Policies Toward North Korea

The final session was an assessment of recent U.S. and South Korean policies toward North Korea. First, Robert Manning critiqued the current U.S. policy approach. His paper gave a brief historical overview of the policies and events that led up to the signing of the Agreed Framework in 1994.

He continued by addressing what he considers to be false assumptions in U.S. government thinking that underlie its approach to the Agreed Framework and its thinking since then. The first false assumption was the expectation that the North Korean regime was collapsing and that steps should be taken to ensure a "soft landing" by promoting openness, economic reform and peaceful reconciliation with South Korea. Manning then illustrated other false assumptions by referring to a comment made by President Clinton in 1996. These false assumptions included the belief that North Korea stopped working on its nuclear program and that North Korea is willing to reconcile differences with South Korea and open its economy. Manning questioned these last two assumptions because of the direct threat they pose to the continuation of the current regime.

As an alternative to this approach, Manning suggested what he calls the "grand bargain," where the U.S. puts something on the bargaining table that promises substantial tangible benefit to the North Koreans. He felt that the North Koreans are willing to negotiate if the U.S. frames its approach appropriately, and he concluded by saying that the great tragedy of U.S. policy is that it has yet to offer a serious bargain to the North Koreans.

The final paper of the conference was presented by Myung Hwan Yu, who gave an overview of the current South Korean governmental policy toward North Korea. Yu began by laying out some operating assumptions about North Korea. First, and in agreement with Manning, he believed that despite their economic distress, the North Korean regime is not going to collapse in the near future. Second, the Agreed Framework

should be kept, as it is the only mechanism at the moment that would keep the current situation from deteriorating.

The goals of the South Korean policy are first, to promote peaceful management of national division and second, to create an environment in which North Korea can consider change without fear. To achieve these goals, South Korea is maintaining a strong defensive posture in cooperation with the U.S., while at the same time seeking to promote exchange and cooperation with North Korea. Yu then explained some details about the types of engagement being pursued under the "sunshine policy" of the current administration, and he mentioned the meeting between Chung Ju-yung, the honorary chairman of Hyundai Group, and Kim Jong-il as evidence of early positive results of this policy. He believed that patiently pursuing this policy would give the best opportunity for promoting peace and stability on the Korean Peninsula.

Conclusion

The conference participants recognized that it is no easy task to assess the future of North Korea and to act to influence its direction in a positive fashion. Despite these difficulties, participants offered a number of insightful and useful observations, suggestions, and recommendations. This conference represented a significant attempt to grapple with an important problem for East Asia and the world: to increase the economic vitality of North Korea, while at the same time ensuring the stability of the region.

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