A NEW INTERNATIONAL ENGAGEMENT FRAMEWORK FOR NORTH KOREA?

Contending Perspectives

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Contents

	Preface and Acknowledgments	vii
	Note on Names	х
1	Introduction and Overview Ahn Choong-yong, Nicholas Eberstadt, and Lee Young-sun	3
Th	e Political Economy of North Korea	
2	The Political Economy of North Korea: Historical Background and Present Situation Marcus Noland	17
3	The Structure of North Korea's Political Economy: Changes and Effects Lee Young-sun and Yoon Deok-ryong	45
4	North Korea's Survival Game: Understanding the Recent Past, Thinking about the Future Nicholas Eberstadt	63
	econditions and Rationale for International Economic pport for North Korea	
5	Managing Collateral Catastrophe: Rationale and Preconditions for International Economic Support for North Korea Moon Chung-in	117
6	Strategic Dimensions of Economic Assistance for North Korea Paul Bracken	147
7	Foreign Aid and International Norms: The Case of North Korea Carol Lancaster	159

8	Prospects and Preconditions for Market Economic Transformation in North Korea Anders Åslund	175
	ssible Forms of International Cooperation and sistance to North Korea	
9	Unlikely Partners: Humanitarian Aid Agencies and North Korea Edward P. Reed	199
10	Designing Public Sector Capital Mobilization Strategies for the DPRK Bradley O. Babson	231
11	Coping with North Korea's Energy Future: KEDO and Beyond Kent E. Calder	257
12	Mobilizing Private Capital for North Korea: Requirements for Attracting Private Investment Malcolm Binks and Carl Adams	275
Pos	ssible Role of South Korea and Other Major Stakeholders	
13	A Proactive Approach to Engaging North Korea: Boldness, Flexibility, and Inclusiveness Choo Yong-shik and Wang Yun-jong	295
14	Payback Time: Japan–North Korea Economic Relations Richard J. Samuels	317
15	China's Role in the Course of North Korea's Transition Liu Ming	335
16	Russian-North Korean Relations and the Prospects for Multilateral Conflict Resolution on the Korean Peninsula Alexandre Y. Mansourov	351
17	Expected Role of South Korea and Major Stakeholders: NGO Contributions to and Roles in North Korea's Rehabilitation Scott Snyder	367

1

Introduction and Overview

Ahn Choong-yong, Nicholas Eberstadt, and Lee Young-sun

Can the economic system of the Democratic People's Republic of Korea (DPRK, or North Korea) be successfully reformed? That is to say: Is it possible for contemporary North Korea, with its autarkic, hypermilitarized, and ostensibly centrally planned economic structure (institutions and arrangements, one must note, whose post–Cold War performance has been so woeful that the nation suffered peacetime famine in the middle and late 1990s), to move toward and eventually embody an economic regimen akin to the ones that have permitted so much material progress in East Asia's two exemplars of "reform socialism"—China and Vietnam—over the past generation?

Could the rulers of the North Korean state maintain control if the economy under their command evolved from the current variant of "socialism with Korean characteristics" into something with a more peaceable, pragmatic, market-friendly, and internationally open orientation? Can North Korea's highest authorities seriously entertain the notion of inculcating a comprehensive, far-reaching refashioning of what they formally and officially extol as "our own way of socialism" [*urisik sahoejuii*]? Do they entertain such notions today?

If North Korean authorities did determine to undertake such a transformation, would they be expected to possess the know-how necessary for such a venture? Are there resources—intellectual, institutional, financial—that outside parties could provide that might improve the odds of success for an incipient North Korean economic reform? And, if so, under what conditions and conditionalities—might those resources most prudently be offered?

This volume attempts to examine these questions in a detailed, rigorous, and systematic manner. The following chapters address the status and outlook for the North Korean political economy; the likelihood of an official DPRK shift toward economic pragmatism, and the practical pitfalls any such move would encounter; the record and lessons of economic liberalization in socialist and post-socialist economies and development assistance initiatives in such locales; the identification and analysis of key sectors of the North Korean economy, whose revitalization might be abetted through outside efforts; the prospects for an international mobilization of private and public capital in the service of North Korean economic reconstruction; and the role that particular external stakeholders might be expected to play in such a venture. Each of the chapters in this book addresses one aspect or another of the North Korea economic reform *problematik*; taken together, they present an indepth perspective on the issues that would have to be faced if the international community were to resolve to support the economic reform process in North Korea through comprehensive—but also selective—commitments and investments.

As readers will quickly see, the specialists we have assembled—all authorities in their respective fields and areas—do not speak with a single voice about the prospects for North Korean economic reform or the odds that such reform could be bolstered through an external framework for international cooperation. On many critical points, our authors take issue with each other; at more than a few points, the reader will encounter powerfully argued but strikingly discrepant judgments about the questions we pose at the outset of our introduction.

We do not believe this well-informed controversy is a bad thing. Quite the contrary: In our view, it is precisely on such an elevated and varying intellectual terrain that the quest to understand the possibilities and pitfalls of encouraging North Korean economic reform may be more fruitfully pursued.

While it may be the case that none of the basic questions we pose about North Korean economic reform can as yet be said to have a clear and definitive answer, it is also clearly the case that attempting to get the answers to each of these questions right—or close to right—is more than an abstract academic exercise. These days, in fact, the actual, real-world answers to those several questions qualify as high-stakes propositions for a great many interested parties, including the people of the Korean peninsula, the neighboring regions of Northeast Asia, and a number of peoples and places more geographically removed from the locus of such inquires but nevertheless still directly affected by the dramas these inquiries reflect. Indeed, the reformability of the North Korean economic system is now an issue absolutely central to the future security and prosperity of Northeast Asia.

Ever since the end of the Cold War, the DPRK has emerged as the central locus of instability and tension within the Northeast Asian region. Whether it was the threats to turn Seoul into a "sea of fire" in 1994, the indications that the DPRK state might collapse in the mid 1990s, or the off-and-on nuclear crisis that started in the early 1990s and now, in 2004, is very much "on", it is North Korea that is generating the most immediate and acute challenges to the security of this increasingly important economic neighborhood. And all

of the solutions to the "North Korean problem" would seem to require a successful economic transition within North Korea itself.

The specter of mass hunger in that unhappy land would be exorcized once and for all through the embrace of sounder economic institutions and implementation of more productive economic policies. With a more economically rational regimen, genuine financial self-reliance—as opposed to the false, foreign-aid-focused, "self-reliance" of *juche* in practice—will be possible for North Korea, and the threat of state collapse will be to that degree correspondingly mitigated. No less important, if the North Korean government develops its commercial exports through a more open economic orientation, it would be in a position—unlike its situation today—in which international military extortion would no longer *have to* figure centrally in the state's finances. And, needless to say, economic reform and reform-based development in the North would greatly ease the ultimate burdens that would have to be shouldered by an eventual peaceful and voluntary reunification of the two halves of a too-long-divided Korean peninsula.

We should remind some readers of what others are already well aware: namely, that the notion of promoting and reinforcing from outside those tendencies for economic reform that exist within North Korea itself addressed and evaluated by every chapter in this volume—is no mere blackboard exercise nowadays. Rather, with whatever measure of success, this objective has been enshrined as a top priority of government in the Republic of Korea under two successive governments, the administration of President Kim Dae-jung (1998–2003) and President Roh Moo-hyun (in office as this is written). Although the name for the policy has undergone changes—Sunshine, Engagement, Peace and Prosperity—the constant mission defining it has been the conviction that Pyongyang can be enticed, through external incentives and commitments, to change gradually but also deliberately into a more economically open and less militarily menacing polity.

In greater or lesser measure, additional governments and international institutions have revealed themselves to be sometime adherents to variations of the same theory. In the United States, for example, the Clinton administration subscribed to a similar viewpoint with its "Perry process" of engagement during 1999–2000, but the George W. Bush administration has adopted a decidedly more skeptical posture toward the potentialities of this theory. Other sometime adherents have included the governments of Japan, China, and Russia (albeit sotto voce in these cases), parts of the European Union, organizations within the United Nations family, and many nongovernmental organizations around the globe. With this background, a "new international engagement framework for North Korea" for promoting and reinforcing economic reform in the DPRK—the concept bruited in the title of our volume would entail not so much a breaking of new ground as a revitalizing and intensifying of preexisting interests and activities. Proponents of existing or expanded engagement frameworks for North Korea argue that genuine economic reform is already under way in the DPRK. The evidence they adduce includes the package of new economic measures promulgated by Pyongyang in July 2002, the attempted (but aborted) opening of a special autonomous region around the city of Sinuiju in September 2002, and the ongoing preparations (conjointly with South Korean firms) for a massive Kaesong industrial complex just north of the demilitarized zone, the gradual opening of private markets throughout the country, the advent of heretofore unthinkable private advertising and billboards, and other signs of market-consistent change.¹ Skeptics, of course, interpret differently such evidence of incipient stirrings of economic reform in North Korea and question the practicability of manipulating any reform tendencies from a long distance and through the blunt and limited instruments at the disposal of the international community.

Proponents of continuing and intensifying engagement with Pyongyang believe theirs is the compelling and, ultimately, the overwhelmingly persuasive case. For many of the unconvinced, however, the case for a new international engagement framework for North Korea sounds strangely ahistorical. Despite its ambitious objectives, they counter, there is scant evidence that such engagement has ever before been successful elsewhere.²

It is interesting that most of the "engagement optimists" in our volume happen to be Korean; the non-Korean authors tend generally to be decidedly more pessimistic about the difficulties that a new international engagement framework would confront and the probability that these difficulties would be surmounted. We suspect this cleavage is more than purely coincidental.

Nationalistic pride still runs deep on the Korean peninsula; the conviction that Koreans are an extraordinary people, not bound by ordinary rules or constraints of history, can be readily identified on both sides of the demilitarized zone today. Such attitudes may have been reinforced by South Korea's remarkable economic accomplishments over the past two generations, for Korean policy circles tend to be not only acutely aware that the outside world is deeply impressed by the progress they have managed to achieve but also

¹ For a guardedly optimistic compilation and assessment of these tendencies, consult Ahn Choongyong, ed., North Korea Development Report 2003/2004 (Seoul: KIEP, forthcoming).

² Perhaps the closest recent historical analogy to the international engagement framework currently considered for promoting North Korean reform would be the "Grand Bargain" proposals for Soviet economic reform advanced at the end of the Cold War era. Grand Bargain theorists hoped to entice the policymakers of glasnost into committing to a faster and deeper program of reform through a promise of, inter alia, an additional \$15–\$20 billion a year in Western foreign aid, although the Soviet Union collapsed before these proposals could be brought into application [cf. Graham T. Allison and Robert D. Blackwill, "America's Stake in the Soviet Future," *Foreign Affairs* 70, no. 3 (Summer 1991); Graham Allison and Grigory Yavlinsky, eds., *Window of Opportunity: The Grand Bargain for Democracy in the Soviet Union* (New York: Pantheon Books, 1991)]. With the USSR's collapse, the move toward an open political system and market economy in the former Soviet Union therefore took place much faster—and with considerably less foreign aid—than the Grand Bargain had originally suggested, making it an ever grander bargain than the one theorists had envisioned.

entirely unforgetting of the fact that foreign voices doubted the viability of the Republic of Korea's path to national affluence at almost every critical step of that long ascent.

Might that same Korean confidence come into positive play through a new international engagement framework for North Korean economic reform, making such a venture workable despite its daunting and manifold challenges? This is another question that as yet cannot be answered. It is our sincere hope, however, that readers will find in our volume some grounding for responding to it—and for dealing more capably with other profound and as yet still obscure aspects of the future of reform and international cooperation for North Korea.

Summaries of Subsequent Chapters

The Political Economy of North Korea

Political Economy of North Korea: Historical Background and Present Situation by Marcus Noland

The current reforms in North Korea-marketization and the dysfunctional dual-price strategy—may generate unmanageable social changes, including greater social differentiation and inequality. This problem is exacerbated by the regime's emphasis on the military, which in effect diverts wealth away from society. A similar logic applies to foreign aid: aid acts as regime-sustaining walking-around money, facilitating poor governance while supporting patronage. Anecdotal evidence of growing social differentiation in the DPRK, in part caused by the misappropriation of aid for private and military purposes, is consistent with this view. An early collapse of North Korea is unlikely under current conditions. A prerequisite for the successful application of multilateral coercive diplomacy will be convincing the South Korean government and public of the correctness of this strategy. No coercive plan can succeed without South Korean support. To eliminate the North Korean nuclear program through negotiation or to establish the diplomatic precursors to eliminate it through other means requires the reengagement of the six-party talks as a first step.

The Structure of North Korea's Political Economy: Changes and Effects by Lee Young-sun and Yoon Deok-ryong

This study finds that, since the early 1990s, North Korea's official economy has shrunk because of the collapse of state-owned enterprises, and the private economy has grown as a result of the people's effort to survive amid economic difficulties. Meanwhile, the military economy has maintained its relative fitness despite a small contraction in military spending, demonstrating the military's important role in maintaining domestic stability and external security. Gradually, and often under state-initiated reforms (for example, the reform measures introduced in July 2002), the private sector in North Korea has expanded at the expense of the official economy, thereby transforming the North into a market economy. International engagement toward a peaceful resolution with North Korea should begin with efforts to support growth in the private sector.

North Korea's Survival Game: Understanding the Recent Past, Thinking about the Future by Nicholas Eberstadt

This paper argues that North Korea was set on a trajectory for an imminent economic collapse in the middle and late 1990s. Such a collapse was averted, however, as the regime experienced an upsurge in imports. This widening of the trade deficit has been financed through a variety of clandestine and illicit channels such as international counterfeiting and drug trafficking. A major source of funding also came in the form of international payments and aid. As South Korea embarked on its Sunshine Policy and other countries began to engage rather than isolate the North, funds were transferred to Pyongyang, which helped the regime pay for its imports and, on the whole, sustain its economy. At the strategic level, the current policy of the DPRK is to finance state survival by exporting insecurity-either through the sale of weapons and weapons technology or through military extortion. Since the regime's survival is contingent and sustained development is unlikely, this strategy is inherently unstable and only defers the question of economic collapse. The current attempt at reform does not address the crux of the problem unless North Korea pursues three policies: economic opening to foreigners, military demobilization, and normalization of relations with South Korea.

Preconditions and Rationale for International Economic Support for North Korea

Managing Collateral Catastrophe: Rationale and Preconditions for International Economic Support for North Korea by Moon Chung-in

The dynamics of system change in North Korea are by and large a function of internal and external constraints; ideological stance, institutional arrangements, and power structure serve merely as intervening variables in influencing the leadership's choice. In light of this, North Korea can choose among three possible paths. Neither the status quo nor a sudden collapse of the regime is beneficial to all concerned parties, especially South Korea. The most desirable scenario is a gradual transformation through opening and reforms. However, the North cannot achieve a successful transition without obtaining considerable international economic support. To win international support, North Korea must satisfy several preconditions: the alleviation of international security concerns; a more proactive pursuit of ideational, behavioral, and institutional changes in the economic domain; improvement of human

rights conditions; and the demonstration of a more credible international behavior.

Strategic Dimensions of Economic Assistance for North Korea by Paul Bracken

Dealing with North Korea should be viewed as a problem of crisis management. As countries began to engage rather than isolate the DPRK during the 1990s, there was a surprising degree of convergence on the engagement framework, accompanied by the appearance of important thresholds. First, it has been consensual that North Korea should not be allowed to acquire any substantial number of atomic weapons. Second, the various countries involved have assumed various roles in the process. Third, norms, formal procedures, and standards have been institutionalized over time. Two approaches have emerged: the strategic approach that stipulates the clear goal of disarmament in exchange for economic assistance and security guarantees, and the multilateral approach that emphasizes international norms. In a crisis, miscommunication and counterintuitive behavior are common, and development becomes more unpredictable as economic assistance becomes a larger issue and as more countries and groups become involved. Therefore, crisis management cannot be reduced to formal plans drawn up in advance. Instead, a flexible and pragmatic framework that incorporates both the strategic approach and the multilateral approach should be drawn up. Furthermore, sound management assumes the ability to command and control a slowmotion crisis that cascades into a fast-breaking one as well as the ability to distinguish among declaratory, programmed, and actual policies.

Foreign Aid and International Norms: The Case of North Korea by Carol Lancaster

This paper discusses the underlying norms in the provision of international aid and applies them to the case of North Korea. These norms include the needs, human rights record, and aid effectiveness of the recipient country; the recipient's participation; aid ownership and parity vis-à-vis the donor; and accountability of the donor to its constituency. In turn, aid effectiveness is determined by factors such as the quantity of infrastructure, the level of education and health, the strength of institutions, the degree of governance, the rule of law, the spread of corruption, market freedom, the ability to monitor aid implementation, and, most important, development expenditures compared with military expenditures. North Korea fails by most, if not all, of these indicators. It also barely meets the norms for humanitarian relief and aid in exchange for security cooperation because, in the past, foreign aid was diverted for military purposes and the regime frequently reneged on its international commitments.

Prospects and Preconditions for Market Economic Transformation in North Korea

by Anders Åslund

North Korea is likely to go through a great crisis when its socialist economic system crumbles, and the process of swift economic disruption is already under way. Strong indicators are the decentralization of economic reforms, the empowerment of state-enterprise managers, the emergence of substantial private markets, huge price and wage increases, and massive devaluations. It is not obvious that these indicators will lead to early Korean unification. South Korea could be seriously destabilized by a collapsing North Korean economy, and the North Korean elite would not look favorably upon their own dispossession. Both the North Korean preconditions and the precedents of other postcommunist countries suggest that the country needs to undertake radical market reforms. Three keys are thorough deregulation, radical financial stabilization, and a swift privatization. Foreign assistance will be vital for the success of these reforms. It is essential that foreign assistance is early and is brought in to support market reform rather than to support the rent-seeking interests of the old establishment. The amounts required are likely to be much smaller than usually considered because the absorption capacity of the North Korean economy is likely to be limited.

Possible Forms of International Cooperation and Assistance to North Korea

Unlikely Partners: Humanitarian Aid Agencies and North Korea by Edward P. Reed

Since 1996, some members of the humanitarian aid community have attempted to respond to the call by the North Korean government for assistance in the face of severe food shortages and related human suffering. Inside North Korea, however, these aid agencies have encountered the unique emergency situation of a garrison state—in total control of its population, information, and distribution systems—confronting a hostile international environment. Delivering emergency aid with accountability under these conditions has been difficult, while assisting affected populations in efforts to regain food security and addressing underlying problems have been almost impossible. The widely held consensus is that fundamental changes in the North Korean system are essential for attaining humanitarian goals, yet systemic change depends on internal and external political factors beyond the control of aid agencies. The creativity of a number of humanitarian agencies has demonstrated that this conundrum actually opens the space for aid agencies to play a critical, if limited, role in saving lives, introducing new ideas, encouraging risk-taking behavior, and building standby capacity for more rapid change when the situation allows.

Designing Public Sector Capital Mobilization Strategies for the DPRK by Bradley O. Babson

This paper explores issues that will need to be addressed during efforts to mobilize public capital for the DPRK. In general, experience illustrates the tension between political interests of donors and the DPRK leadership on the one hand, and the humanitarian and developmental needs of the DPRK society on the other. Any future efforts to mobilize public capital will need to take into account a number of factors: initial conditions in the DPRK, strategy for reform and institution building, macroeconomic stability, DPRK creditworthiness, multilateral assistance, bilateral interests and political constraints, and aid coordination and management mechanisms. Furthermore, the DPRK needs to address a number of issues while it builds a new fiscal capability: reform of state-owned enterprises, tax system restructuring, domestic debt strategy, role for contractual savings, and the allocative efficiency of public expenditures. Several options are available for international cooperation with the DPRK: arrangements that are led by the two Koreas, the World Bank/IMF, or the six core countries; a KEDO-based framework; a greater role for trust funds; and the creation of a Northeast Asia development bank.

Coping with North Korea's Energy Future: KEDO and Beyond by Kent E. Calder

Integrating economic and political considerations, this paper outlines elements of a post-Korean Peninsula Energy Development Organization (KEDO) approach to North Korean energy. Given KEDO's original imperfections (the result in significant part of the crisis during which it originated), the irrelevance of its original time frame, and its loss of legitimacy caused by persistent violations of its provisions, the KEDO framework should be rethought and revised. North Korea's energy problems can be resolved through the modernization of its electric power grid and the development of a transnational network of gas-fired power plants that allows both North and South Korean access to Russia's natural gas reserves. Not only can such an approach avoid controversy over nuclear power, it also provides a solution to the fundamental energy need of Northeast Asia, namely, the region's overdependence on imported oil. Nevertheless, the indispensable condition for any form of continued cooperation with North Korea must be a verifiable nonproliferation agreement. If such an agreement is forthcoming, the nuclear dimension of the energy-support program should be scaled down.

Mobilizing Private Capital for North Korea: Requirements for Attracting Private Investment by Malcolm Binks and Carl Adams

Pyongyang needs to find some way to diffuse the issue of nuclear materials deployment and make a conscious effort to become a reasonable and opportunistic destination of choice for private foreign capital. To facilitate funds inflow and provide the private sector with sufficient information to improve risk predictability, it must establish a capital infrastructure that complies with a list of 12 financial codes and standards that can be categorized into three broad areas: macroeconomic policy and data transparency, institutional and market infrastructure, and financial regulation and supervision. Certain institutions should be introduced: an economic czar, a ministry of finance, a ministry for economic reconstruction and development, a central bank, and a functioning commercial banking system. Further steps can be undertaken to improve the investment environment; they include investor education and professional country presentations, identification of key industries and projects, regular provision of economic data and information, permission for foreign control of North Korean businesses, creation of mechanisms for foreign currency transfer and settlement of disputes, and the introduction of tax holidays.

Possible Role of South Korea and Other Major Stakeholders

A Proactive Approach to Engaging North Korea: Boldness, Flexibility, and Inclusiveness by Choo Young-shik and Wang Yun-jong

Despite the significant drawbacks of the Sunshine Policy as a peace plan for the Korean peninsula and the limitations of engagement as a policy strategy for curbing North Korea's nuclear development program, engagement is still the alternative with the fewest number of drawbacks for peaceful resolution of the North Korean crisis. Although engagement remains the preferred strategy, it must undergo a major overhaul. Modified engagement would embody a proactive strategy comprising four major elements: (1) a bold diplomatic initiative to counter North Korea's alarming capability for nuclear weapons, (2) a disciplined means of engagement to counter Pyongyang's bluffing, (3) a comprehensive political, economic, and military engagement policy, and (4) a focus on the regime's long-term self-sustainability and the question of Korean reunification. South Korea should play a key role in the new proactive strategy; to accomplish this, its duties and responsibilities would include, but would not be limited to, persuading other nations that the ultimate goal for North Korea would be regime change through reforms, maintaining solid bilateral relations with the United States, and coordinating international cooperation for resolving the crisis.

Payback Time: Japan–North Korean Economic Relations by Richard J. Samuels

Strong anti-DPRK public sentiment has been nurtured, and then captured, by the Japan's Liberal Democratic Party for electoral gain. Japan-DPRK economic relations, idled by Japanese government policy, have little sustained business or popular support. The Japanese government insists that normalization cannot proceed without resolution of the abduction issue and cessation of nuclear and missile threats, but the abduction issue is the deal breaker that will block massive infusion of Japanese capital. A multilateral grand bargain on the military threat may be accompanied by token payments from Japan reminiscent of the Korean Peninsula Energy Development Organization or in the form of tied aid earmarked for repayment of long-standing debt. In either event, Japanese firms will follow cautiously with projects for infrastructural development and with investments likely to be tied to those negotiated by South Korean firms.

China's Role in the Course of North Korea's Transition by Liu Ming

As North Korea's traditional patron, China can take advantage of their close relationship to influence the outcome of the North Korean crisis. This relationship, however, is challenged by several trends. First, there has been a lack of consultation and coordination on important issues. Second, Pyongyang has dubious feelings toward Beijing's influence, given Beijing's collaboration with South Korea and the United States. Third, in China's view, North Korea's erratic foreign policy and unilateralism have failed to adapt to the international situation and have threatened Chinese interests. Fourth, Pyongyang doubts China's credibility as a partner and protector in times of crisis. Last, economic cooperation has been unbalanced and backward. In a plan that involves all major countries, China should act as monitor of North Korea's fulfillment of international agreements on the one hand and as guarantor for North Korean security and U.S. commitment on the other, show understanding toward North Korea's sense of vulnerability and insecurity, push forward inter-Korean reconciliation and soften the stances of Washington and Tokyo, deal with North Korea in a multilateral rather than a bilateral setting, assist North Korea in joining several key international financial organizations, continue with interpersonal exchanges, and advise on North Korea on its economic situation.

Russian–North Korean Relations and the Prospects for Multilateral Conflict Resolution on the Korean Peninsula by Alexandre Y. Mansourov

This paper provides an overview of the Russia-North Korea rapprochement during the early years of the 2000s. In particular, it attempts to explain the motivations of the two parties throughout this process. For North Korea, the establishment of ties provides several benefits. First, during Kim Jong-il's meetings with Vladimir Putin, Kim outlined a framework for a possible deal between Pyongyang and Washington. Second, the DPRK signified to Chinese leaders that China is not the DPRK's only sponsor (in other words, it tried to play Russia against China). Last, North Korea has learned from the Russian experience of reform and opening, which some Russian analysts believe stimulated Kim's decision to introduce reform policies in July 2002. Russia has several objectives. To ensure a good relationship with a foreseeable unified Korea and a unification process that suits its interests, Russia has striven to influence North Korea and obtain information about developments there, to maintain a proper balance in its relations with Seoul and Pyongyang, to mediate inter-Korean differences, and, finally, to restrain the bargaining position of the United States and thereby reduce the U.S. military presence on the peninsula.

Expected Role of South Korea and Major Stakeholders: NGO Contributions to and Roles in North Korea's Rehabilitation by Scott Snyder

This paper outlines the origin and history of activities of nongovernmental organizations (NGOs) in North Korea and their implications for the country's rehabilitation and integration with the outside world. The rise of South Korean NGOs has influenced the development of inter-Korean relations and is likely to play an even more important and complex role in the fields of advocacy and of grassroots exchange and service delivery that are vital to North Korea's rehabilitation. This prospect, however, depends on the continued support from Seoul and the DPRK's admittance of NGO activities. U.S. and European NGOs have been less active than South Korea in the DPRK (a function of their respective governments' policies). European NGOs have been more successful than their U.S. counterparts in establishing a sustained program in the DPRK., in part owing to differences in the requirements that accompany governmental funding of European NGO work in North Korea and the relatively depoliticized European response to DPRK needs.

