

# Korea's Economy 2009

Korea's Near-Term Economic Prospects and Challenges

Global Financial Crisis and the Korean Economy: Issues and Perspectives

The Impact of U.S. Financial and Economic Distress on South Korea

The Wall Street Panic and the Korean Economy

Economic Policy Reforms in the Lee Myung-bak Administration

Tax Reform in Korea

U.S.-Korea Economic Relations: View from Seoul

U.S.-Korea Economic Relations: A Washington Perspective

Engagement on the Margins: Capacity Building in North Korea

North Korea and International Financial Organizations: Political and Economic Barriers to Cooperation

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## CONTENTS

### **Part I: Overview and Macroeconomic Issues**

#### **Korea's Near-Term Economic Prospects and Challenges**

*Subir Lall and Leif Lybecker Eskesen* . . . . . 1

#### **Global Financial Crisis and the Korean Economy: Issues and Perspectives**

*Pyo Hak-kil* . . . . . 8

### **Part II: Financial Institutions and Markets**

#### **The Impact of U.S. Financial and Economic Distress on South Korea**

*Thomas Cargill* . . . . . 15

#### **The Wall Street Panic and the Korean Economy**

*Kim Dong-hwan* . . . . . 25

### **Part III: Structural Reform**

#### **Economic Policy Reforms in the Lee Myung-bak Administration**

*Tony Mitchell* . . . . . 33

#### **Tax Reform in Korea**

*Randall Jones* . . . . . 45

### **Part IV: External Issues**

#### **U.S.-Korea Economic Relations:**

##### **View from Seoul**

*Han Dongman* . . . . . 55

##### **A Washington Perspective**

*Jordan Heiber and*

*Jennifer Schuch-Page* . . . . . 64

### **Part V: North Korea's Economic Development and External Relations**

#### **Engagement on the Margins: Capacity Building in North Korea**

*Bernhard Seliger* . . . . . 67

#### **North Korea and International Financial Organizations: Political and Economic Barriers to Cooperation**

*Lee Sang-hyun* . . . . . 76

# NORTH KOREA AND INTERNATIONAL FINANCIAL ORGANIZATIONS: POLITICAL AND ECONOMIC BARRIERS TO COOPERATION

*By Lee Sang-hyun*

## Introduction

North Korea's economy has been on the verge of collapse since the beginning of the second nuclear crisis in 2002 because of the international community's growing sanctions and pressure. The future of North Korea, with its tightly controlled authoritarian regime, seems even bleaker owing to the breakdown of its central planning system, persistent food shortages, and continuing nuclear crisis.

The mounting economic hardship eventually rendered the North Korean regime's centrally planned economy and controlling mechanism incompetent and led to the promotion of elements of a market economy in 2002, known as the July 1 Economic Management Improvement Plan. Many North Korea watchers expected some sort of economic reform in North Korea after that; however, North Korea's current policy is focused on strict self-containment from the influence of outside world. This reluctant reform is often called "mosquito-net style," that is, let the benefits come in but keep out the bad capitalist effects.

There is no doubt that, for North Korea, one of the most effective ways to guarantee a successful economic reform is to get outside assistance. Self-reliance—an autarkic planning system—cannot solve the problem. North Korea needs financial aid from the international community, which has a long history of providing developmental aid to transitional economies. For North Korea to be eligible for such assistance, several political and economic conditions must be met. The bottom line is that such aid will become possible only after a successful resolution of the nuclear crisis and after some degree of normalization of the relationship between North Korea and the rest of the international community. In that circumstance, the international community would likely begin to help the North Korean government pursue its economic transition in a way similar to China's and Vietnam's.

This paper explores the major political and economic barriers for North Korea in its desire to receive financial assistance from international financial organizations. First is a review of the recent situation in and around North Korea.

## North Korea's Political and Economic Situation

### *Worsening Inter-Korean Relations*

Recent North Korea–South Korea relations are now worse than in recent years, particularly since the inauguration of a new conservative administration in the South. South-North relations began to sour even before the South Korean president, Lee Myung-bak, took office in February 2008. During the presidential election campaign in 2008, Lee vowed that the expansion of Korean peninsula projects would only follow North Korea's nuclear disarmament. Following Lee's inauguration, the once reconciliatory mood between the two Koreas vanished almost completely. The tense situation escalated after a North Korean soldier shot and killed a South Korean tourist near the Mt. Kumgang resort in July 2008. Kim Jong-il, leader of North Korea, is known to be infuriated that Lee's administration will not discuss honoring inter-Korean agreements signed when Kim met with the then South Korean presidents Kim Dae-jung and Roh Moo-hyun, in 2000 and 2007, respectively.

Kim Jong-il's bluster falls on deaf ears in South Korea and, worse still, in the United States. So far, Kim's threats against South Korea and his counterpart, Lee Myung-bak, have made little impression. Since his inauguration last year, Lee has made it clear that he will engage properly with the North only when it really begins to dismantle its nuclear capability. This stance has infuriated Kim. For months he has abused the South Korean government. He has threatened the South with "all-out confrontation." In December 2008 North Korea expelled most

South Korean officials from the Kaesong industrial complex (KIC), a symbol of economic cooperation between the two Koreas.

KIC is one of the major joint economic projects between South and North Korea. Since it was launched in August 2000, the project has made steady progress. By the end of June 2008, 72 factories were operating with about 30,000 North Korean workers and 1,000 South Korean staff working side by side. The aggregate output of the complex between December 2004 and May 2008 was \$370 million. KIC's annual production was only \$14.9 million in 2005, but output soared to \$73.7 million in 2006 and to \$184.7 million in 2007. As of May 2008, exports totaled \$80 million, or 21 percent of aggregate production.<sup>1</sup> Since inter-Korean relations deteriorated, however, its future has become quite uncertain.

In late January 2009 the North repudiated a 1991 agreement on reconciliation, nonaggression, and cooperation—the Basic Agreement—between the Koreas. The North says it will no longer honor the western maritime boundary between the two countries, known as the Northern Limit Line, which is long disputed by the North. North Korea's verbal threats to South Korea are not new. Ordinary South Koreans seem equally impassive although South Korea's navy takes seriously the possibility of another deadly clash in the Yellow Sea—the most recent one was in 2002.

Kim Jong-il's bluster is probably intended more for a U.S. audience than a South Korean one—as well as for his own people. Through brinkmanship, North Korea is reminding the United States of its existence and, it thinks, putting pressure on the United States to change its supposedly hostile policy. North Korea regularly seeks to show a smiling face to China and the United States while it keeps a stern one for South Korea. North Korean behavior holds few surprises: even Kim Dae-jung and Roh Moo-hyun, known for

their proengagement stance, were targets of abuse at the start of their five-year terms.

President Lee may yet have such a summit, too, with North Korea's "Dear Leader." For now, however, time is on Lee's side. Recently he named Hyun In-taek, the architect of his tougher strategy toward North Korea, to run the Ministry of National Unification, which traditionally conciliates the North. The president promised massive aid and investment, with the aim of raising North Korean income per head to \$3,000 a year within a decade, if only the North gives up its nuclear program.<sup>2</sup>

Behind the troubled relationship between the two Koreas lies North Korea's deeper political uncertainty—Kim Jong-il's ill health. Kim is believed to have suffered a stroke in August 2008, and he has been out of the public eye since then. His conspicuous absence from a parade marking the socialist country's 60th founding anniversary on 9 September 2008 and from the Korean harvest festival called Chuseok on 14 September 2008 fueled further speculation about his illness. In addition, North Korea quietly celebrated the 63rd founding anniversary of his ruling Korean Workers' Party (KWP) on 10 October 2008 without Kim's presence. Seoul officials believe Kim underwent brain surgery in August last year but has recovered well enough to perform his leadership and daily duties. But rumors about his ongoing health problem persist.<sup>3</sup>

A more fundamental uncertainty for the future of North Korea is its failing economy. The collapse of the North Korean economy is evident in that the government is unable to allocate the budget in the planned sectors because the money of the central government has already dried up. The growing shortage of funds in the DPRK government is due to economic hardship and has made it difficult for the government to assign necessary materials and adequate budgets to local factories. **Table 1** shows

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1. "Gaesong Industrial Complex," Ministry of Unification, Seoul, [www.unikorea.go.kr/eng/default.jsp?pgname=AFFexchanges\\_gaeseong](http://www.unikorea.go.kr/eng/default.jsp?pgname=AFFexchanges_gaeseong).

2. "In the court of King Kim," *The Economist*, 5 February 2009, 29.

3. *Vantage Point* (Yonhap News Agency) 31, no. 12 (December 2008): 28–29.

North Korea's economy in negative growth since 2006.<sup>4</sup>

A particularly serious problem, from both a humanitarian and an economic perspective, is the chronic food shortage in North Korea. According to one study,<sup>5</sup> during the 1990s, 600,000 to 1 million North Koreans, or about 3 to 5 percent of the precrisis population, perished in one of the worst famines of the twentieth century. After a decade, North Korea is once again poised on the brink of disastrous famine.

The current cycle of distress can be traced back to late 2005. On the back of improving harvests and generous outside aid, the government attempted to ban the private trade in grain; in doing so, it criminalized the primary mechanism through which most North Korean families obtained food. The regime also sought to revive the state-run public distribution system of quantity rationing, in part by confiscating grain in rural areas. The government also threatened to expel the World Food Program, incapacitating the outside world's early warning system.

High politics has also played an important role in recent shortages. More than two-thirds of the grain consumed in North Korea is produced locally. Domestic production is highly dependent on fertilizer, much of which has been donated by South Korea in recent years. Following the North's missile and nuclear tests in 2006, South Korea suspended fertilizer shipments; predictably, North Korean grain production fell. Food aid also dried up, and, with global food prices rising, the regime's capacity to import grain on commercial terms also withered. These policy-derived shocks were certainly exacerbated by adverse weather in 2006 and 2007, as the country experienced flooding concentrated in grain-growing regions of the southwest. However, exogenous shocks in the form of both weather and rising world prices must be seen in the context of a wider political economy that involves both foreign and domestic policy choices.<sup>6</sup>

The North Korean media have reiterated until recently that resolving the nation's chronic food shortage is the most pressing task in rebuilding its moribund economy. The North recently revived a

**Table 1: Comparison of South and North Korea with Selected Economic Indicators, 1998–2007**

Indicator		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
GDP growth rates (%)	SK	−6.9	9.5	8.5	3.8	7.0	3.1	4.6	4.2	5.1	5.0
	NK	−1.1	6.2	1.3	3.7	1.2	1.8	2.2	3.8	−1.1	−2.3
Nominal GNI (dollars, billions)	SK	340.4	440.0	509.6	481.1	547.5	608.6	682.4	790.1	888.7	971.3
	NK	12.6	15.8	16.8	15.7	17.0	18.4	20.8	24.2	25.6	26.7
Per capita GNI (dollars)	SK	7,355	9,438	10,841	10,159	11,497	12,717	14,206	16,413	18,401	20,045
	NK	573	714	757	706	762	818	914	1,056	1,108	1,152

Source: "Tables and Charts," Ministry of Unification, Seoul, [www.unikorea.go.kr/eng/default.jsp?pgname=NORtables](http://www.unikorea.go.kr/eng/default.jsp?pgname=NORtables).

Note: SK = South Korea; NK = North Korea; GNI = gross national income.

4. For details about North Korea's economic troubles, see Yang Un-chul, "Structural Change of Market and Political Slack in North Korea," in *North Korea in Distress: Confronting Domestic and External Challenges*, ed. Paik Haksoon and Cheong Seong-chang (Sungnam: Sejong Institute, 2008), 61–70.

5. Stephan Haggard and Marcus Noland, "Famine in North Korea Redux?" Working Paper Series, no. WP08-9 (Washington, D.C.: Peterson Institute for International Economics, October 2008), 2, [www.petersoninstitute.org/publications/wp/wp08-9.pdf](http://www.petersoninstitute.org/publications/wp/wp08-9.pdf).

6. Ibid., 2–3.

postwar industrial campaign, known as the Chollima Movement, to mobilize its citizens. Named after a mythical winged horse, the campaign was first launched in 1956 following late leader Kim Il-sung's visit to a steel complex in the western port city of Nampo. Its chief aim was to rebuild the country from the ashes of the 1950–53 Korean War. Kim Jong-il visited the same facility on 24 December 2008 and urged workers to step up efforts toward constructing a thriving nation by 2012. The year will mark the centennial of the birth of the senior Kim, who died in 1994.<sup>7</sup>

Most recently, South Korea's press reported that the North Korea seemed to be making preparations to test-fire its Taepo-dong 2 missile, whose theoretical range of 6,700 kilometers would reach part of Alaska. If North Korea test-fires its missile, this will certainly further complicate the already strained inter-Korean relations.

### ***U.S.-DPRK Relations***

In U.S.–North Korea relations, there have been several ups and downs in relation to nuclear negotiations. Since 1995, the United States has provided North Korea with more than \$1.2 billion in assistance, about 60 percent of which has paid for food aid and about 40 percent for energy assistance. U.S. aid fell significantly in the mid-2000s, bottoming out at zero in 2006. The Bush administration resumed energy aid in the fall of 2007, after progress was made in the six-party talks over North Korea's nuclear program. The United States and other countries began providing heavy fuel oil (HFO) in return for Pyongyang's freezing and disabling its plutonium-based nuclear facilities in Yongbyon. By the second week of December 2008, the United States had provided all of the 200,000 metric tons of HFO it had promised under phase two of the six-party talks process. The talks themselves came to a standstill in December over disagreement on verification procedures. The other countries that agreed to provide

HFO are continuing their shipments, as they appear to be calibrating their assistance to North Korea's progress in disabling Yongbyon, which continued to take place as of mid-December 2008.<sup>8</sup>

U.S.–DPRK relations marked another milestone in 2008 when the Bush administration announced that the DPRK would be removed from the list of state sponsors of international terrorism. This announcement was part of the measures the Bush administration took on 26 June 2008 to implement a nuclear agreement that it negotiated with North Korea in September 2007 and details of which were finalized during a U.S.–North Korea meeting in Singapore in April 2008. The president also announced that he was immediately lifting sanctions that had been imposed on North Korea under the U.S. Trading with the Enemy Act. North Korea's obligations under this nuclear agreement are to allow the disabling of its plutonium facility at Yongbyon and present to the United States and other governments in the six-party talks a declaration of its nuclear programs.

North Korea submitted its declaration on 26 June 2008. In July 2008, however, the Bush administration proposed a system of intrusive international inspections of North Korean nuclear facilities or suspected nuclear facilities. North Korea rejected the proposal, suspended the disablement of Yongbyon, and threatened to resume operations of its nuclear facilities. In October 2008, the U.S. administration negotiated a more limited verification-inspection system with North Korea. On 11 October 2008, the administration removed North Korea from the list of state sponsors of terrorism.<sup>9</sup> According to the 11 October agreement on verification, U.S. and North Korean negotiators agreed on a number of important verification measures, including agreements that:

- Experts from all six parties may participate in verification activities, including experts from nonnuclear states;

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7. *Vantage Point* (Yonhap News Agency) 32, no. 2 (February 2009): 34–35.

8. Mark E. Manyin and Mary Beth Nikitin, "Assistance to North Korea," document no. R40095 (Washington, D.C.: Congressional Research Service, 24 December 2008).

9. Larry A. Niksch, "North Korea: Terrorism List Removal?" Report no. RL30613 (Washington, D.C.: Congressional Research Service, 2 February 2009).



- The International Atomic Energy Agency (IAEA) will have an important consultative and support role in verification;
- Experts will have access to all declared facilities and, based on mutual consent, to undeclared sites;
- Scientific procedures would be used, including sampling and forensic activities; and
- All measures contained in the verification protocol will apply to the plutonium-based program and any uranium enrichment and proliferation activities; in addition, the monitoring mechanism already agreed by the six parties to monitor compliance with six-party documents applies to proliferation and uranium enrichment activities.<sup>10</sup>

The removal of North Korea from the terrorism list did not result in an early conclusion of the February 2007 six-party nuclear agreement, contrary to the expectations of the Bush administration. The North Korean government and the Bush administration soon disagreed over the content of the October 2008 agreement on verification, particularly about whether it allowed inspectors to take samples of nuclear materials from the Yongbyon installations.

North Korea had been added to the “official” list of countries supporting terrorism because of its implication in the bombing of a South Korean airliner on 29 November 1987, which killed 115 persons. According to the State Department’s *Country Report 2006*, North Korea has not been conclusively linked to any terrorist acts since 1987. North Korea has neither acknowledged nor apologized for the bombing.

Despite its removal from the terrorism list, North Korea is currently under a variety of international sanctions owing to its past illegal behavior.

First, North Korea is subject to sanctions on account of its proliferation activities. In the United States, for example, the Iran, North Korea, and Syria

Nonproliferation Act of 2000 requires reporting to Congress certain proliferation-related transfers to or from North Korea and allows for a procurement ban, an assistance ban, a prohibition against certain arms-related sales under the Arms Export Control Act (AECA), and denial of licenses for export of certain dual-use items. Depending on the nature of the transfer, U.S. missile sanction laws require the president to deny export licenses for missile equipment or technology controlled under the AECA and the Export Administration Act, or, in certain cases, all items on the U.S. Munitions List (USML), and potentially a ban on all licenses for imports into the United States of all products produced by the foreign person or entity. Executive Order 13382 allows for the blocking of the assets of designated proliferators. Section 129 of the Atomic Energy Act of 1954, as amended, imposes a mandatory ban on significant nuclear cooperation with any non-nuclear-weapon state that has engaged in specified activities of significance from a nuclear nonproliferation standpoint, including detonating a nuclear device or materially violating an IAEA safeguards agreement.

Second, there are sanctions on North Korea because of human rights violations. Section 116(a) of the Foreign Assistance Act prohibits development assistance to the government of any country that engages in a consistent pattern of gross violations of internationally recognized human rights. Section 110 of the Trafficking Victims Protection Act of 2000 sanctions countries placed on tier three on the annual Trafficking in Persons Report. The DPRK has been placed on tier three since 2003. The DPRK has also been designated a “country of particular concern” under the International Religious Freedom Act of 1998.

Third, more recently, North Korea’s nuclear detonation in 2006 resulted in several sanctions. UN Security Council Resolution 1718 imposes a multilateral ban on exports to and procurement from the DPRK of specified weapons of mass destruction and missile-related items, heavy conventional arms, and luxury goods, invoking Chapter VII of the UN Charter. The United States implements this

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10. “U.S.-North Korea Understandings on Verification,” Fact Sheet, Office of the Spokesman, Washington, D.C., 11 October 2008, [http://seoul.usembassy.gov/nk\\_101108a.html](http://seoul.usembassy.gov/nk_101108a.html).

obligation by requiring licenses for virtually all exports of U.S.-origin goods to the DPRK. The Glenn Amendment prohibits any foreign assistance (except humanitarian, food, and other agricultural products), sales to North Korea by the U.S. government of defense articles and services, licenses for exports of items on the USML, foreign military financing, credit guarantees, or other financial assistance. It also requires U.S. opposition to assistance from international financial institutions and restricts certain U.S. dual-use exports.

In addition to these sanctions, North Korea is still subject to variety of sanctions for its status as a communist state, by presidential executive orders, and sanctions not tied to specific activities (see *Table 2*).

Removing North Korea from the list of state sponsors of terrorism will open the way for a phase three of nuclear negotiations beyond the February 2007 six-party nuclear agreement. More important, given North Korea's long track record of seeking financial subsidies from other governments in nuclear and other negotiations, one of Pyongyang's phase three demands could be for the United States to follow the removal of North Korea from the list of state sponsors of terrorism with an "affirmative" act of proposing that the International Monetary Fund (IMF) and the World Bank extend financial aid to North Korea. Removal from the terrorism support list ends the legislative requirement that the U.S. president oppose proposals of aid to North Korea from international financial agencies.<sup>11</sup>

**Table 2: Sanctions Related to North Korea, 2009**

Reason	Brief description
For proliferation activities	<ul style="list-style-type: none"> <li>— Iran, North Korea, and Syria Nonproliferation Act of 2000</li> <li>— Missile sanctions</li> <li>— Executive Orders 12938 and 13382</li> <li>— Section 530(b) of the Foreign Relations Authorization Act, fiscal years 1994 and 1995</li> <li>— Section 129 of Atomic Energy Act of 1954, as amended</li> <li>— Section 101 of AECA ("Symington Amendment")</li> </ul>
For human rights violations	<ul style="list-style-type: none"> <li>— Gross violations of internationally recognized human rights</li> <li>— Tier three status in trafficking in persons report</li> <li>— International Religious Freedom Act Country of Particular Concern</li> </ul>
For status as a communist state	<ul style="list-style-type: none"> <li>— Section 620(f) of the Foreign Assistance Act</li> <li>— Export-Import Bank Act of 1945</li> <li>— Gramm Amendment</li> </ul>
For the DPRK's 9 October nuclear detonation	<ul style="list-style-type: none"> <li>— UN Security Council Resolution 1718</li> <li>— "Glenn Amendment" sanctions</li> </ul>
Sanctions by recent executive orders	<ul style="list-style-type: none"> <li>— DPRK-related assets that were frozen under the Trading with the Enemy Act (TWEA) as of 26 June 2008 remain frozen.</li> <li>— U.S. persons are prohibited from engaging in transactions involving vessels registered in or flagged by North Korea.</li> </ul>
Other sanctions not tied to specific activities	<ul style="list-style-type: none"> <li>— Section 607 of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2008</li> <li>— International Traffic in Arms Regulations (ITAR)</li> <li>— Section 307 of the Foreign Assistance Act</li> </ul>

Source: For a brief explanation of each existing sanction, see "U.S.-North Korea: Existing Sanctions and Reporting Provisions Related to North Korea," Fact Sheet, Office of the Spokesman, Washington, D.C., 11 October 2008, [http://seoul.usembassy.gov/nk\\_101108b.html](http://seoul.usembassy.gov/nk_101108b.html).

11. Niksch, "North Korea: Terrorism List Removal?" 27.



## International Financial Organizations and the DPRK: Political and Economic Barriers

### *Role of International Financial Institutions in Economic Transition*

For North Korea to revive its crumbling economy, it is essential for it to get financial assistance from international financial organizations. North Korea, however, is not a member of any international financial organizations such as the World Bank or IMF. Because it is not a member, it cannot take advantage of the services of the World Bank, such as loans, grants, technical assistance, policy advice, and donor coordination. The key question therefore, is how outside actors today can play a meaningful role in finding solutions to the DPRK's economic problems.

The international community now has a unique opportunity to influence the DPRK's economic policy selection and implementation process. The long history of developed nations' aid to developing nations suggests that aid can be futile, even counterproductive, in the absence of complementary reforms.<sup>12</sup> Therefore, economic assistance to the DPRK, which would be part of the package for the solution of the nuclear problem, should be aimed at assisting system transformation, not at conservation of the autarkic regime by uncritically satisfying North Korean demands.

The intervention of international financial institutions has been essential for economic development in many former socialist countries such as China, Vietnam, and East European nations. In 1978 Deng Xiaoping launched China on a new road toward a substantially market-driven economy. In 1986 Vietnam initiated its own economic reform program, called *doi moi* (meaning renovation), setting in motion that country's economic transition. In 1989 and 1990, as the Soviet empire collapsed, all of the formerly socialist countries of Central and Eastern Europe and the countries that emerged from the Soviet Union began similar journeys toward

market-oriented economies. Throughout most of this period, multilateral and bilateral aid agencies have been engaged in supporting these processes of economic transition. The international development community has provided development assistance to the transition economies in the form of advice, technical assistance, and a good deal of money.

The effect of international developmental assistance is well proven in China's case. China's economic reform model can be defined as encompassing aspects of simultaneous external opening and internal reform, accompanied by conscious efforts to create linkage between the two types of reform. China's economic transition model is a gradual one and is predicated on the maintenance of authoritarian rule and reliance on the Chinese state's considerable capacity for coherent policy implementation.<sup>13</sup> In other words, in China's case, the willingness and capacity of the government to push through with the reform process was a very important factor. This experience can similarly be applied to North Korea as long as it is willing to accept the international community's intervention.

Legally, based on the Articles of Agreement of the World Bank, in order to become a member of the World Bank, a country must first become a member of the IMF. In practice the processes of obtaining membership in the IMF and in the World Bank have usually been done in parallel. So, as the DPRK thinks about a possible membership in the World Bank, it also needs to plan for membership in the IMF. The IMF's Articles of Agreement effectively require that an applicant for new membership receives 85 percent support of the voting power of the shareholder governments. Voting power is roughly proportionate to the size of each country's economy and hence its quota in the IMF.

The United States now holds 16.77 percent of the voting power and therefore could effectively block the application of a new member. The rest of the voting power is widely dispersed among many

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12. Stephan Haggard and Marcus Noland, "Economic Implications of Summit Agreement," Policy Forum Online 07-082A, Nautilus Institute, 30 October 2007, [www.nautilus.org/fora/security/07082HaggardNoland.html](http://www.nautilus.org/fora/security/07082HaggardNoland.html).

13. Mika Marumoto, "North Korea and the China Model: The Switch from Hostility to Acquiescence," *Academic Paper Series on Korea* (Korea Economic Institute) 1 (2008): 99.

countries. Japan holds 6.13 percent of the votes, and Germany has 5.99 percent. The eight next-largest shareholders each have between 2 and 5 percent of the votes. Any group of countries holding more than 15 percent of the voting shares could block a new applicant. Therefore, in order to achieve an 85 percent majority, it would be necessary to gain the support from not only the United States but also most of the other large nations of the world.<sup>14</sup>

Hence, it can be argued that the key is the attitude of the DPRK regime toward economic reform and the outside world. Many people think about development assistance and aid primarily in terms of financial assistance—loans or grants to pay for projects and to support policy reforms. But, in fact, development assistance is usually a bundle of money and ideas. The money is often very useful. But the money from aid agencies is usually only a fraction of the total public and private investment in a country. The ideas and knowledge that are generated and transferred as part of the aid process are often more important than the money because these ideas and knowledge can increase the level and efficiency of total investment of the country, not just the quality of aid-financed projects. The primacy of ideas over money in the aid process is especially true for countries in economic transition, which are struggling to chart a new course, to design new policies, and to transform their institutions. The key to a successful transition is putting in place the right policies and institutions, not getting the largest possible amount of aid money.<sup>15</sup> Unless the government of North Korea holds reform-oriented attitudes and views, no matter what the international community provides, the effect of such aid will be limited.

#### ***Political and Economic Barriers for the DPRK Case***

There are many challenges for the international financial organizations in providing assistance to the DPRK. Special efforts will be needed to ad-

dress the unusual features of the DPRK situation and regional context in designing strategies for future multilateral cooperation and development assistance. The challenges can appear overwhelming at the present time.

In the political area, the DPRK political system itself forms a most difficult barrier. The North's so-called military-first politics (*songun* politics) is nothing but a modified *juche* ideology designed to solidify the political control of the regime over the entire society. North Korea trumpets military-first politics as the ruling formula of the Kim Jong-il regime in order to perpetuate North Korea's power structure; the current major power elites; and the relations among the party, the military, and the government. Toward the outside world, *songun* is fundamentally antagonistic because the *juche* ideology emphasizes independence and self-reliance against imperialist powers of the world.

There is a widespread misunderstanding about the fundamental nature of *songun* politics because of the strange nature and strong image of the term. Some North Korea watchers have argued that Kim Jong-il values the Korean People's Army (KPA) more than the KWP in his rule of the country with military-first politics. The argument that Kim has been under the military's influence since his father's death began to lose its explanatory power, however, when Kim was inaugurated as general secretary of the party in 1997 and when he was retained as chairman of the National Defense Commission (NDC) the following year. Regarding Kim's official position, North Korean media often call him the "general secretary of the KWP, chairman of the NDC of the DPRK, and concurrently supreme commander of the KPA." General secretary is the top post of the party, NDC chairman is that for the state, and supreme commander is that for the KPA. All three offices are important, but the office of general secretary is the most significant.<sup>16</sup> In this sense, party ideologies still

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14. "IMF Members' Quotas and Voting Power," International Monetary Fund, [www.imf.org/](http://www.imf.org/).

15. Daniel Morrow, "Aid to Transition Economies: Lessons of Experience" (proceedings of the first international symposium on North Korean development and international cooperation, Seoul, 6–7 July 2005).

16. Cheong Seong-chang, "Kim Jong Il's Military-First Politics and a Change in the Power Elite," in *North Korea in Distress: Confronting Domestic and External Challenges*, ed. Paik Haksoo and Cheong Seong-chang (Sungnam: Sejong Institute, 2008), 13–22.

overwhelm military considerations in North Korean politics. That is the real meaning of military-first politics.

In addition, *songun* makes the defense industry the core of the economic structure. In fact, the heavy-industry sector is regarded as the most essential and central to the national economy, followed by light industry and agriculture, which are considered coequally secondary. The military industry is the only one that brings in foreign revenue. This, Pyongyang's own policy choice, coupled with international economic sanctions and the North's inaccessibility to external investors render the economy in a state of chronic poverty. In this sense, *songun* may have been necessitated by a number of national imperatives, but it has not served the economy of the nation well.<sup>17</sup>

Besides these political and economic obstacles, multilateral economic cooperation with the DPRK is challenged by the regional context as well. The larger Northeast Asian geopolitical situation provides another challenge to future multilateral economic cooperation. There is a long history of regional conflict and nation-state rivalry that must be taken into account in policy planning. Offsetting this rivalry, though, is the emerging interconnectedness of the vibrant economies of the region. This economic trend suggests that collaboration with and cooperation from the DPRK's neighbors will facilitate more cost-effective and successful reforms and perhaps contribute to building more trusting and peaceful relations among the regional actors. Development organizations will need to know what planning the regional governments have done for the integration of the region and what this means for shaping the future of the North Korean economy. Organizations not based in the region may not realize the strong linkages already existing among the Northeast Asian countries in economics, the sciences, education, and the environment. Understanding these rapidly growing ties will ensure that multilateral and bilateral

assistance is more cooperative and complementary than duplicative or competitive.

Another major challenge for international financial organizations is to understand how to work with the uniquely closed DPRK political system. The experiences of those who have conducted relief, training, or development work in the DPRK suggest that having a cooperative relationship with bureaucratic leaders in the relevant government, party, or military institutions is indispensable for project approval and effective implementation. Important issues include determining which ministries or officials are relevant and appropriate to moving forward with development assistance activities and how to obtain decisions and other commitments that will be needed to advance a larger, more complex development assistance agenda than the DPRK authorities have experienced in the past. Furthermore, international development organizations will not be dealing with a blank slate when engaging in discussions and planning with North Korean counterparts. Thus, finding the right officials or agencies to work with is one part of the challenge, and convincing them to "wade back into the pool again" and cooperate with outside entities is another part.<sup>18</sup>

Finally, the challenge that bedevils both humanitarian aid and development organizations is that the lack of adequate data collection, accessibility, transparency, efficiency, and accountability hampers the design, implementation, and assessment of assistance programs. Getting accurate information necessary to determining economic development needs will be a serious issue should reforms progress. The problem of information collection and management is two-sided, because both development organizations and DPRK government have their own parts to play. On the part of developmental agencies, they will be unable to plan and do what they want to do ultimately unless accurate statistics are available. On the part of North Korea, the information collecting process will demand more transparency and

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17. Han S. Park, "Military-First Politics (*Songun*): Understanding Kim Jong-il's North Korea," *Academic Paper Series on Korea* (Korea Economic Institute) 1 (2008): 127.

18. "Future Multilateral Economic Cooperation with the Democratic People's Republic of Korea," conference report (conference sponsored by the Stanley Foundation and German Council on Foreign Relations (DGAP), 15–17 June 2005, InterContinental Hotel, Berlin, 16–18).

accountability. In fact, there is little point in talking about economic cooperation with the DPRK in the future unless there is some sort of requirement for transparency, efficiency, engagement, sincerity, and accountability.<sup>19</sup>

If North Korea receives assistance from international financial organizations, it is most likely that North Korea could be the recipient of assistance from the International Development Agency, which specializes in financial aid for education, health, infrastructure, and communication for the world's poorest nations. Because the consent of the United States is imperative for North Korea to join these international financial organizations, North Korea must ultimately prove that it can function as a normal member of the international community through economic reforms and open-door policies.

To wrap up, intervention of international financial organizations is essential for any project to help North Korea to get out of current economic trouble. For international financial organizations to be involved in the DPRK project, certain conditions must be fulfilled. First, the DPRK must prove itself ready for such cooperation with the international community. The DPRK's efforts should include preparing self-help development strategies as well as improving relationships with major donor countries such as South Korea, Japan, and the United States. Economic assistance from an individual country—economic aid from South Korea or Japan, for example—falls short of providing sufficient stimulus for the moribund, stagnant, and decaying economy of the DPRK.

### *Future Prospects*

Despite various political and economic barriers to engaging North Korea internationally, the situation seems to be turning positive for two reasons. One is the Lee Myung-bak government's North Korea policy and the other is the inauguration of the Barack Obama administration in Washington.

In the Lee government's North Korea policy, a key initiative is called "Vision 3000: Denuclearization

and Openness." Vision 3000 is the Lee administration's strategic initiative to help North Korea raise its annual per capita income to \$3,000 within 10 years. The administration plans to accomplish this by implementing joint projects in five key areas—economic development, education, finance, industrial infrastructure, and the quality of life—in cooperation with the international community as North Korea's denuclearization makes progress. North Korea has to develop into an economy with an average per capita income of \$3,000 in order to build a foundation for peaceful unification that can absorb the social shock and financial costs of unification. Vision 3000 will also provide a new growth stimulus to the South Korean economy. The economies of the two Koreas will assume a mutually complementary form and lead to the establishment of a concrete foundation for peaceful unification.

Vision 3000 will proceed in three steps. First, once North Korea completes disablement of its nuclear facilities, the ROK government will immediately initiate discussions for the implementation of Vision 3000 and the realization of an inter-Korean economic community, and it will devise legal and institutional mechanisms for economic cooperation between the two Koreas.

Second, if the nuclear dismantlement process makes progress, the ROK government will initiate a number of projects in the areas of education and quality of life in North Korea. In addition, the ROK will continue to promote the complete resolution of the North Korean nuclear issue through close cooperation in the six-party talks.

Third, when North Korea completes nuclear dismantlement, the ROK will launch full-scale projects in five areas: economic development, education, finance, industrial infrastructure, and the quality of life. More important, the ROK government will raise \$40 billion in international cooperation funds to assist North Korea's economic development.

The timing for launching the Vision 3000 initiative is flexible because the pace of economic cooperation with the North is contingent upon how actively

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19. Ibid., 19.

North Korea responds. When this initiative is fully realized, a foundation will be in place for the establishment of an inter-Korean economic community, which will in turn lead to the political unification of Korea.<sup>20</sup>

South Korea sees the presidency of Barack Obama as an opportunity for much-improved relations with the United States. Obama vowed to pursue tough, direct presidential diplomacy without preconditions with all nations, both friends and foes, including Iran and North Korea. Nevertheless, there is no evidence that North Korea has given up its nuclear ambition. North Korea made it clear on 17 January 2009, just before the inauguration of Obama as the new U.S. president, that it may not give up its nuclear weapons even if Washington normalizes its relations with the DPRK. A spokesperson for North Korea's foreign ministry said in a statement that normalization of U.S.-DPRK relations and the nuclear issue are entirely different issues and that Pyongyang will keep its nuclear capability until it feels safe from what it called the ever-present U.S. nuclear threat. The statement said, "We [DPRK] can live without normalized relations with the United States but we can't live without nuclear deterrence. That is the reality of Korea today."<sup>21</sup> The statement confirmed North Korea's current policy of pursuing de facto nuclear power status. As long as North Korea retains its current nuclear stance, the future of the six-party talks is bleak.

North Korea even insists that it has turned its entire plutonium stockpile into weapons and that it is determined to remain a nuclear-armed nation until Washington abandons its "hostile policy." According to a U.S. scholar who recently visited Pyongyang, North Korea has very high hopes for Obama, but it wants to confront him from a position of strength. Kim Jong-il is said to be very interested in the possibility that Obama will move away from the

regime-change policies of the Bush administration and will move toward normalization. North Korean officials claimed to have "weaponized" 68 pounds of plutonium—believed to be enough for five or six bombs—that the government manufactured after 2002, when President Bush turned away from a Clinton-era agreement that had frozen the North's production of plutonium.<sup>22</sup> Despite North Korea's poor record, the Obama administration is willing to engage the North diplomatically, utilizing both bilateral and multilateral negotiations.

Finally, the recent global economic downturn will have a serious impact on the already difficult North Korean economy in 2009. At least three factors could function synergistically to hurt the North Korean economy in 2009. First, the global downturn could significantly reduce North Korea's income from exports. The North Korean economy is now heavily dependent on exports of minerals and raw materials to China. As is widely known, the global downturn has had a negative impact on the Chinese economy and, as a result, the Chinese demand and price for North Korean mineral products.

Second, foreign investment in North Korea would contract. The major part of Chinese investments in North Korea—for mineral reserves and processing—would slow down and be partially withdrawn because of reduced demands and lower prices. Chinese penetration in the distribution network could continue, but it would not be any more profitable than in the past because of economic contraction in North Korea. The new administration in the South has already slowed its investment in North Korea and stopped delivering rice and fertilizer while it has been pointing out the necessity of North Korea's denuclearization. Even though China will continue economic assistance to the DPRK for political reasons, China will never take on the whole burden of resuscitating North Korea's comatose economy.

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20. "Policy of Mutual Benefits and Common Prosperity: The Lee Myung-bak Administration's North Korea Policy," Ministry of National Unification, September 2008, 29–31; also see Park Hyeong-jung, "Economic Relations between South and North Korea: Present Status and Future Scenarios for Development," in *North Korea's External Economic Relations*, ed. Kim Kyuryoon (Seoul: KINU Press, 2008).

21. *Vantage Point* 32, no. 2 (February 2009): 36.

22. Selig N. Harrison, "N. Korea Discordant on Obama Era, Nuclear Arsenal," *Washington Post*, 18 January 2009, sec. A.



Third, the deterioration of North-South relations since early 2008, which preceded the global downturn, will also impact the North Korean economy negatively. The South Korean government has delivered approximately 400,000–500,000 tons of rice and 300,000–350,000 tons of fertilizer to the North Korean regime since 2002. With the blockades in 2006, after North Korea's nuclear experiment, and in 2008, the North Korean regime's food supply must have been in distress. In addition, the North Korean regime will suffer from reduced income from the Mt. Kumgang and Kaesong tourist projects. Profits from inter-Korean trade may also suffer if deteriorating inter-Korean relations and South Korea's economic recession exert a negative influence on imports from North Korea.<sup>23</sup>

Besides these external factors, North Korea's internal politics also cast shadows. North Korea's domestic policies have moved to the hard-liners' side, and a return to a reformist policy in North Korea will be impossible until hard-liners—such as Jang Song-taek—are replaced with a reformist cadre. “Revolutionary surge” was the key word in the New Year joint editorial issued by North Korea's major news media for 2009. This year's New Year editorial eliminates remnants of the reformist vocabulary and calls for the return of the language of control and mobilization into the official language of North Korea. What the editorial signaled to the North Korean people was that the conservative hard-liners will have a firmer grip on North Korea's domestic policy in the near future.<sup>24</sup>

To sum up, the prospects for the DPRK for the year 2009 do not look good. Its ongoing economic troubles coupled with nuclear negotiation and missile diplomacy are making Pyongyang's stance even stiffer than before. Despite the international community's efforts to engage North Korea, the key to opening the future of the DPRK may lie in the mind of Kim Jong-il and his regime.

## Concluding Remarks

Currently North Korea is laboring under three difficulties. In its international relations, particularly relations with major nations including the United States, North Korea is still under a variety of sanctions. Relations between the two Koreas have been the worst in recent years. Political and economic uncertainty for the future of the North Korean regime is another hurdle.

One of the best and surest ways for North Korea to get over these difficulties is to adopt economic reform and open-door policies as China and Vietnam did. When the North Korean government shows the world that it is ready to take such stance, the international community will have a variety of ways to engage North Korea. South Korea provided the North considerable assistance after the Kim Dae-jung government's Sunshine Policy began. Such aid was surely helpful for sustaining North Korea's crumbling economy, but it was never enough. To help North Korea escape its current troubles, intervention by international financial organizations would be a much more effective tool.

If North Korea wants to negotiate over nuclear weapons and missiles, it must first show its willingness to do so wholeheartedly. Preparing for another launch of Taepo-dong 2 will never help ease North Korea's difficulties. Ideally, North Korea must first come to the negotiation table to discuss the nuclear issue and must adopt more reformist domestic policies. Then South Korea and the international community can begin to mobilize international efforts to help North Korea. At this stage, international financial institutions could take a greater role.

Right now North Korea seems to be depending once again on “bypass the South, dialogue with America” (*tong-mi, bong-nam*) tactics, which brought some rewards to the North during the 1994 Geneva Agreed Framework. Now, however, the

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23. Park Hyeong-jung, “The Global Economic Downturn and North Korea in 2009,” *KINU Insight*, no. 10 (January 2009): 5–6.

24. Park Hyeong-jung, “Prospects for North Korea's Domestic Policy in 2009,” *Vantage Point* (Yonhap News Agency) 32, no. 3 (March 2009): 16–19.



situation has changed, and North Korea's policy of bypassing South Korea will have little chance of succeeding as long as ROK-U.S. relations remain solid and stable.

Although the prospects are not good in the short term, the Lee Myung-bak government should do its best to break through current difficulties in South-North relations. If current tensions are prolonged, inter-Korean relations will deteriorate further, and both South and North will be losers. The situation in the North and worsening inter-Korean relations have ignited a heated debate in the South about whether the Lee Myung-bak government should adjust its tough stance toward the North.

Most of all, the involvement of multilateral organizations and the international community, as well as a concerted effort and willingness by the DPRK to cooperate, will be crucial to the ultimate success of economic engagement with and development of North Korea.

North Korea hopes to push Obama into a direct bilateral dialogue and eventually normalize DPRK-U.S. relations. If, however, the DPRK continues to gamble with its nuclear program and long-range missiles, the Obama administration will have no choice but to take an even tougher stance toward the DPRK. As a result, North Korea will be even more isolated, weak, and insecure than it is now. Kim Jong-il must aware that neither military-first politics nor Taepo-dong 2 rockets nor nuclear bombs will save him and his people from their current difficulties.

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