

A NEW INTERNATIONAL ENGAGEMENT FRAMEWORK FOR NORTH KOREA?

Contending Perspectives

Editors: Ahn Choong-yong, Nicholas Eberstadt, Lee Young-sun



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Designing Public Sector Capital Mobilization Strategies for the DPRK

Bradley O. Babson

Estimates of the financial requirements for reconstruction and future growth of the economy of the Democratic People's Republic of Korea (DPRK, or North Korea) vary greatly, as do estimates for meeting the educational, health, and social security needs of its people. Private investment will be critical in this process, but efforts to stimulate private capital, both domestic and foreign, will need to go hand in hand with mobilizing public investment to remove infrastructure bottlenecks and provide essential social services. An early priority will be to launch investigations in order to take stock of the DPRK's needs and improve the basis for estimating financial resource requirements for the short and medium term. There is broad consensus that the needs will be huge.

Major challenges facing the DPRK leadership and international community in any new international engagement framework will include how to mobilize both domestic and foreign public savings to meet capital investment and recurrent expenditure requirements, how to link public resource mobilization with a comprehensive economic reform strategy and viable macroeconomic framework, how to achieve synergy from public and private investment, how to develop absorptive capacity of the DPRK to use funds efficiently and with transparent accountability to minimize what will be great temptations for corruption, and how best to support a new political economy in the DPRK so that it will share the benefits of growth widely among the population and attend to the needs of vulnerable groups.

Aid Lessons from the DPRK's Past

The international community's experience with mobilizing public, international resources for the DPRK during the 1990s highlights a critical tension between political interests of donors and the DPRK leadership on the one

hand, and the humanitarian and economic development needs of the DPRK society on the other. The tendency to politicize provision of foreign aid is very high, which reduces the impact of aid on the lives of the DPRK population and distorts incentives for reforms by the authorities.

Subsidized Socialism

It is worth remembering that the DPRK built a socialist economic system in which all domestic resources were public, and subsidies from the Soviet Union and China were major sources of international assistance for many years. The DPRK's long-standing misallocation of resources and aid from Communist states contributed greatly to the breakdown of the North Korean economy in the 1990s and the humanitarian crisis that ensued. While espousing the *juche* philosophy of self-reliance, the DPRK actually built a system that institutionalized economic dependence on foreign public financial assistance, even though this was largely disguised in the form of "friendship prices" and countertrade practices that provided large subsidies, especially for energy. This dependence, plus the distorting effects of prices that did not reflect economic cost, led to energy-intensive investments in industry, transport, and agriculture that were inefficient and ultimately unsustainable. The DPRK's military-first policies and favoritism of the elite amplified these failures, which were not challenged by the suppliers of the DPRK's economic aid during this period.

The experience with aid from Communist states underscores the simple fact that the economic policy context is critical for foreign aid to be effective in promoting economic development, and that aid provided primarily for political purposes—in this case to ensure regime survival—does not necessarily lead to economic viability and can foster aid dependence that acts as an inhibitor of needed economic reform.

Korean Peninsula Energy Development Organization

The international response to both the DPRK's nuclear brinkmanship of the early 1990s and the food crisis of the mid-1990s essentially resulted in mobilization of new forms of international public financial assistance for the DPRK. The establishment of the Korean Peninsula Energy Development Organization (KEDO) under the Agreed Framework, negotiated in 1994 between the United States and the DPRK, created a mechanism through which public resources from KEDO members (primarily the United States, Japan, the Republic of Korea [ROK, or South Korea] and the European Union [EU]) were managed to provide both 500,000 metric tons of heavy fuel oil annually to the DPRK and construction of two light-water reactor (LWR) nuclear power plants.

Although this agreement broke down following disclosure in October 2002 of a secret uranium enrichment program, with suspension of oil shipments

in December 2002 and suspension of the LWR project in November 2003, the resources provided by KEDO to the DPRK between 1995 and 2003 did accomplish some positive results. On the political side, the KEDO program did contain the DPRK's plutonium nuclear program and allowed for direct contacts and negotiations between KEDO member states and the DPRK during a period of extreme difficulties for the DPRK, involving both leadership change following the death of Kim Il-sung and the economic and food crises. These stabilizing factors were important for maintaining peace and fostering an environment in which the DPRK could build trust with new foreign partners in cooperative activities. On the economic side, the fuel oil helped offset the trade shock that accompanied the collapse of the Soviet Union in 1992, and the LWR project provided a means to develop practical working modalities for foreigners with the DPRK authorities.

The LWR project itself, however, was never seen by either side as a genuinely economic undertaking for overcoming the DPRK's shortages of electric power. Many issues were left unattended as the project developed, including such elementary questions as how to finance transmission lines to connect the plants to the national electricity grid and how to stabilize the grid itself to absorb power from the LWRs. With the suspension and likely cancellation of the LWR project now a reality, there is a growing realization (especially in the ROK) that significant resources have been deployed without formation of any tangible economic asset.

A lesson emphasized by the KEDO experience is that when public resources are mobilized primarily to achieve political goals—in this case the containment of the DPRK's nuclear program—but are provided as economic assistance that does not meet a test of economic or commercial rationality, the political achievement may be unsustainable and the resources essentially wasted. Although the demise of the KEDO LWR project may have been triggered by the discovery of the secret uranium enrichment program, KEDO was destined in any case to face a crisis at the point when its fundamental lack of economic justification and provision of needed complementary investments could no longer be ignored.

A second lesson is that KEDO did demonstrate the value of multilateralism, both in mobilizing significant public resources from donors with very different interests and in coordinating policies relating to management of these resources and operational relations with the DPRK authorities. For this reason, it may well be desirable to consider a future role for a KEDO-like entity in mobilizing resources for the DPRK under a new international engagement framework if it is provided with a new mandate and is better able to integrate its economic and political functions.

Humanitarian Aid

The international response to the DPRK famine of the mid-1990s also holds valuable lessons for the future. The mobilization of significant humanitarian assistance was accomplished in an orderly way under the leadership of the United Nations (UN). The annual UN appeal is based on detailed crop production and food availability assessments by the World Food Program (WFP) and Food and Agriculture Organization (FAO), with health and educational humanitarian needs defined by the World Health Organization (WHO) and the United Nations Children's Fund (UNICEF). These objectively defined appeals have been supported by donors through contributions to UN-managed delivery programs, bilateral transfers, and support for NGOs active in the DPRK. The willingness of donors, particularly the United States, the ROK, Japan, and the EU, to provide humanitarian assistance while challenging the DPRK on its weapons programs contributed importantly to a growing perception that it is possible to engage the DPRK on multiple fronts concurrently, and that delinking humanitarian assistance from other issues could create an atmosphere conducive to addressing other concerns of the international community.

The fact that the DPRK was willing to ask for international assistance and set up administrative mechanisms to cooperate with foreign partners has contributed to the beginning of a more businesslike way of interacting. While there have been concerns about monitoring delivery of food aid to intended beneficiaries, access to different areas of the country, and restrictions imposed by the government on foreigners working in the DPRK, there have also been improvements over the years, owing in part to mutual trust building and in part to learning from experiences.

There are important limitations, however, on the humanitarian resource mobilization experience of recent years. First is aid fatigue. After seven years of appeals for food aid, the willingness of the international community to continue to meet the food deficit in the DPRK is dwindling. This reflects both frustration that the more fundamental obstacles to improving food security in the DPRK have not been overcome as well as the emergence of new claimants—in Africa, Afghanistan, and Iraq—on resources for humanitarian assistance that compete with the DPRK. A second limitation is the unwillingness of most donors to shift from humanitarian assistance to development assistance, pending resolution of major political security issues. A third limitation is the recent willingness of some donor governments to link humanitarian assistance to other political objectives. Since the reemergence of a nuclear crisis in late 2002, neither the United States nor Japan has made significant efforts to respond to the shortfall in the UN appeal for 2003 and expected for 2004, although official policy is still to maintain a separation of humanitarian aid from other issues.

The overall lesson from the humanitarian experience of recent years is that mobilization of significant public resources for the DPRK depends critically on political will, and this will cannot be assumed to be stable, even for basic humanitarian needs.

Korean Reconciliation

Political will to mobilize resources for the DPRK has been significantly affected by the appeal of inter-Korean reconciliation. The Sunshine Policy adopted by President Kim Dae-jung in the ROK led to significant use of public funds to finance inter-Korean projects, including subsidies to private companies such as Hyundai Assan for its Mount Kumgang tourism project. The ROK Ministry of Unification reported that the Inter-Korean Economic Cooperation Fund, which it administered, grew from 40 billion *won* in 1998 to 1,037 billion *won* in 2002. The Yonhap News Service reported on 10 December 2003 that during the first 11 months of 2003, following the revelation of the DPRK's highly enriched uranium (HEU) nuclear program in late 2002, the ROK provided \$125 million in direct economic and humanitarian aid to the DPRK while it continued efforts to resolve the DPRK's nuclear program peacefully through dialogue.

Revelation of under-the-table payments to secure agreement for the June 2000 summit meeting between Kim Jong-il and Kim Dae-jung underscores the risk, however, that public funds can be used in nontransparent ways that ultimately undermine the objectives of reconciliation and distort incentives for the DPRK to adopt businesslike practices in its dealing with foreigners. The lesson is that corruption is an issue that can infect the donor as well as the recipient; and the risk of corruption's playing a major role in use of public resources mobilized for the DPRK is high. Strong efforts will be needed to introduce transparency and safeguards in the mechanisms for decision making about both the granting of funds and the use of funds.

Recent Chinese Aid

The experience of Chinese economic support for the DPRK in the 1990s also contains important lessons. Since the collapse of the Soviet Union, China has been the DPRK's biggest trading partner and largest supplier of concessional assistance, through both subsidized trade and direct transfers. Chinese agricultural and energy assistance have been vital to the DPRK's ability to avoid internal instability that could threaten survival of the regime. China has chosen not to channel resources through the UN appeal mechanism; it has relied on bilateral channels instead. This permits China to use its assistance to pursue its own political goals independently. It is widely believed, for example, that Chinese food aid is channeled to the military, which allows the WFP food aid to be targeted at the general population

without risk that the military-first policy or regime stability would be undermined by foreign aid policies of other countries.

Cash versus In-Kind Payments

It is noteworthy that most publicly provided humanitarian aid to the DPRK, inter-Korean economic assistance (for example cross-border road and rail links), subsidized trade with China and the former Soviet Union, and KEDO provision of oil and LWR construction have not been in cash but as in-kind payments. Cash payments have been made openly by the private sector but not openly by the public sector, except in the case of protocols negotiated by KEDO under the LWR project for wage payments for North Korean labor, for example.¹ This preference for in-kind payments over cash illustrates the lack of trust by external providers of publicly funded assistance; they suspect that the DPRK authorities would not use the funds for purposes intended, but would divert them to either the military or the elite for their consumption. Any future effort to address the DPRK's large-scale infrastructure investment needs must involve very different modalities for channeling funds for contracts for civil works, equipment, and technical services. Protocols for procurement of goods and services will need to be negotiated, and the use of funds will need to be supervised during future program of development assistance. These will be major issues for both multilateral and bilateral donors. The KEDO experience will be a valuable starting point in these discussions.

Transition to Market Economy

The failures of the DPRK economic system combined with the limitations of foreign assistance in this environment are the backdrop for the emergence of the informal market economy in the DPRK today. Ordinary people in the DPRK are seeking new means to meet basic needs, and they have responded to incentives to fend for themselves and not depend on the state. Economic reforms introduced by the government since mid-2002 have accepted that market mechanisms are now playing an important role in the DPRK economy and social system and that market incentives are needed to increase both agricultural and industrial production. Lack of resources to finance needed infrastructure and intermediate inputs has constrained a supply response to those reforms. Thus, mobilization of public resources, both domestically and internationally, is critically needed to reinforce the reform process and stimulate economic recovery.

The dilemma for the international community is how to facilitate mobilization of resources for the DPRK without undermining the positive features of the emerging market economy. Just when incentives are beginning to stimu-

1 Secret cash payments by the Kim Dae-jung government, recently revealed, are considered a scandal.

late entrepreneurship and when the appetite for freedom in the DPRK population, the risk exists that foreign aid will be used to suit the political needs of donors and the DPRK authorities and to undercut the transformative processes now under way in the DPRK. The challenge is to design policies and mechanisms that put publicly mobilized resources to best use for accelerating economic system change and putting the country on a path to prosperity for its citizens.

Designing a Public Capital Mobilization Strategy

Any future efforts to mobilize public capital under a new international engagement framework will need to take into account the initial conditions of the DPRK economic situation, proposed strategy for economic reform and institution building, requirements of macroeconomic stability, the DPRK's creditworthiness, requirements for multilateral assistance (including membership in international financial institutions [IFIs]), bilateral interests and political constraints, and aid coordination and management mechanisms. These factors will influence how much public capital will need to be mobilized; the purposes to which it will be applied; the balance of contributions from domestic, multilateral, and bilateral sources; modalities that will be used; and the conditionalities that will accompany commitments of funds.

Initial Conditions

The first questions to be asked by potential suppliers of public capital are what the funds will be used for and how much will be needed in specific time frames. Although general agreement exists that the DPRK public infrastructure in power and transport requires a large investment, there is neither a known inventory of the current state of these assets nor an available assessment of the balance that should be struck between rehabilitation and new investment. Nor are there comprehensive assessments of the condition of urban infrastructure, especially water supply, sanitation, and housing. Because of investigations by UN agencies and the ROK, more is known about the conditions of agriculture, but a comprehensive assessment of irrigation rehabilitation and flood control investment requirements is needed. Similarly, it is generally known that educational and health services in the DPRK require both capital investment and large-scale financing for recurrent costs, particularly for supplies and salaries.

Early priorities in a new international engagement framework will be a detailed needs assessment and preparation of a public investment program in collaboration with the DPRK authorities. How such an assessment will be conducted and who will take the lead should be questions addressed up front. It will set a precedent for future aid mobilization modalities and aid coordination mechanisms no matter which option is chosen for conducting the assessment:

- An inter-Korean team could carry out the assessment, which would then be presented to the international community;
- The DPRK could ask international agencies to conduct the assessment; this could be a collaborative exercise similar to the assessment that was conducted by the World Bank and United Nations Development Program (UNDP) for a donors meeting on Iraq in October 2003, or the assessment could be led by one of these agencies;² or
- A core group of countries could commission an assessment; this could provide the political context for the new engagement framework and link the assessment to political conditions associated with earlier agreements on security issues. Such an assessment could be carried out either by a team representing the core group composition or by an inter-Korean team or international organization team working under terms of reference supplied by the core group and reporting to it.

Another initial question will be the absorptive capacity of the DPRK government for funds provided to a public investment program. How would resources actually flow? Although experiences of UN agencies, nongovernmental organizations (NGOs), inter-Korean projects, and KEDO will be useful, the DPRK's actual mechanisms for controlling the flow of funds and managing public works will have to be carefully evaluated. Thus, an institutional assessment will be needed to complement the needs assessment for public investment. This institutional assessment will determine the types of conditions and monitoring requirements that donors will attach to any future funding. Concern about possible diversion of resources to military use and corruption can be expected to be major issues for the international community, and a practical framework for dealing with these concerns will need to be worked out with the DPRK authorities. Multilateral development banks and the UNDP should be given lead responsibility to avoid different standards being demanded by different suppliers of funds.

External technical and financial assistance will have to meet the standards of efficiency and accountability that the international community will require. Use of public capital ultimately requires accountability to the public, in both the DPRK and the countries that supply the DPRK with foreign aid. Attention to this issue by international civil society watchdog groups should be expected.

Strategy for Economic Reform and Institution Building

Money alone will not be the answer to the DPRK's economic troubles. It will be necessary to design a public capital mobilization plan that fits a com-

² Because the DPRK is not a member of any of the IFIs but does host an in-country mission of UNDP, it would be logical for UNDP to play a coordinating role during planning discussions with the DPRK authorities to provide in-country logistical assistance for such an assessment exercise.

monly accepted economic reform strategy and institution-building requirements in a realistic way. The DPRK initially will rely on foreign capital to kick-start its economy recovery, but from the very beginning it is important that efforts be made to put in place policies and capacities to mobilize public resources domestically to support the economic reform and development program. Technical assistance and training funded by foreign aid will be essential for building the capacity to mobilize public capital domestically.

To begin, a workable consensus between DPRK authorities and foreign partners on the economic reform strategy and development agenda must be established. This will require analysis of options available to the DPRK on the basis of its own conditions and history and an assessment of the lessons of experience of other countries undertaking the transition from socialist to market-based economic systems. What should be expected is a debate between advocates of the big-bang reform policy and advocates of paced reform. The implications of these different approaches for both political and financial dimensions of the management of change and the role of different foreign partners would vary greatly.

Institutional limitations in the DPRK are likely to be a major factor affecting the ultimate choice. Thus, it will be critically important that the political context for the economic reform strategy be firmly established before significant public capital is mobilized. The opportunity costs of capital are significant in the DPRK context, and the risks of wasting resources and undermining domestic and foreign political support for the economic strategy should be minimized through decision making that creates a broad consensus of the best way to proceed and a willingness to provide the level of financial support to make the strategy successful.

Engaging the DPRK in policy dialogue must occur from the very start; that dialogue will have a large effect on the ways public capital will be mobilized and the atmosphere of cooperation between the DPRK and foreign partners. Mobilization efforts will be enhanced by building a culture of openness and dialogue, with the DPRK willing to listen to the advice of foreigners but ultimately making its own decisions in ways that promote self-confidence and the political will to follow through on implementation. To achieve this openness and frank exchange of views, the DPRK will need to be willing to be much more transparent in sharing information and cooperative about investigations than it has been in the past.

Macroeconomic Framework

Currently the DPRK economy is not guided by a macroeconomic policy; nor does it have the institutions and tools in place to exercise macroeconomic management. Price reforms introduced in 2002 have resulted in inflationary pressures that the DPRK is ill equipped to constrain. Early in a new engagement framework, it will be necessary to assist the DPRK in developing new

capacities in this area through training and technical assistance. In parallel with work assessing public investment needs and determining the best economic reform and development strategy discussed above, it will be important to work with the DPRK to construct a macroeconomic policy and financing plan that is compatible with these exercises.

The feasibility of any framework will depend critically on the ability to mobilize the resources needed to fulfill the financing plan. Thus, the public capital mobilization process will need to be carefully coordinated with the policy-planning process. This will require a close working relationship between the DPRK authorities and advisers who are in close touch with major potential doors to the program. In many countries, the International Monetary Fund (IMF) and World Bank are called on to perform this coordinating role, but the DPRK does not yet have relations with these institutions. The ROK has the macroeconomic expertise to provide the DPRK with such advice, and, to the extent that the two Koreas are seeking to deepen integration of their two economies, it will be important for the ROK to be closely involved in the macroeconomic policy dialogue with the DPRK because this will also have a direct bearing on macroeconomic policy and management in the ROK itself. Thus, an issue that will need to be addressed is how to balance and coordinate the roles of the IFIs and the ROK in macroeconomic surveillance, policy advice, and technical assistance to the DPRK.

Creditworthiness

Another issue that will need to be addressed is how to factor DPRK creditworthiness into public capital mobilization for the DPRK. The World Bank assesses country creditworthiness on the basis of a number of factors, including gross domestic product (GDP) per capita and public debt–servicing capacity. While the detailed information needed to establish creditworthiness for the DPRK has not yet been made available, the DPRK's low level of economic production and external trade deficits can be expected to constrain its ability to borrow on anything but highly concessional terms.

The DPRK does not have a good reputation as a borrower, and this perception will need to be overcome for public as well as private lenders to the DPRK government in the future. Domestic borrowing is a new phenomenon in the DPRK, but the public bond program introduced in 2003 demonstrated a fundamental lack of appreciation for the role of bonds in public finance, with elements of gambling in the design of the program. Similarly, the ROK Ministry of Unification and the Bank of Korea report that the DPRK has a substantial outstanding external debt, estimated to be as large as \$12.5 billion, on which it is paying neither interest nor principal. Of this, a large portion is debt to Russia.

Implications of this situation are that the DPRK is going to have to rely primarily on building a new tax system as the primary means of mobilizing

resources domestically. It will also need to restructure its existing foreign debt, and build credibility as a borrower by creating new debt reporting and management capacities. As part of the overall strategy for public resource mobilization, the international community will also likely seek conditions for future financial assistance to the DPRK for economic reconstruction that will lead to improvements in creditworthiness over time. To the extent that DPRK will require grants and concessional loans from donors, it will be expected to comply with standards that have been established globally for access to development assistance. These were reconfirmed in 2002 at the International Conference on Financing for Development in Monterrey, Mexico.

One issue that may arise if the ROK and the DPRK pursue a gradual economic integration policy is that the ROK may be asked to guarantee loans made by other parties to the DPRK government. This would help overcome creditworthiness constraints in mobilizing resources for the DPRK, but it would also place a contingent liability on the ROK. Providing such guarantees would be one way for the ROK to avoid the shock of premature German-style integration while it accepts a burden that is larger than would normally be expected of a donor to another country.

Membership in the International Financial Institutions

The DPRK is not a member of any of the IFIs, although it has had informal contacts on several occasions. Mobilization of public capital for the DPRK will be greatly facilitated by IFI membership, which would allow the DPRK to gain access to financial resources mobilized through well-established multilateral mechanisms, to obtain access to knowledge resources and technical assistance from these agencies, and also to leverage bilateral assistance through assurances that would be provided by the multilateral relationships. To obtain membership, the DPRK will need to apply and to meet technical and legal conditions for membership, and existing member governments will need to vote in favor of the DPRK becoming a member. Thus, both technical and political requirements for membership will need to be satisfied. It is possible, however, for the DPRK to obtain services from the IFIs before formal membership if existing members adopt a resolution calling for such assistance in their own interest.

Regional Economic Cooperation

Another factor that will influence the mobilization of public capital for the DPRK is the evolving agenda of regional economic cooperation in Northeast Asia. The DPRK is a member of the Consultative Commission for the Tumen River Development Area and Northeast Asia (Tumen Commission) and has participated in the Tumen River Area Development Program (TRADP) sponsored by the UNDP. This program has languished in recent years, but a new

engagement framework with renewed interest by China, Russia, and Mongolia in expanding cross-border trade and access to the DPRK port of Rajin might well reinvigorate the TRADP framework. Because the Tumen Commission is the only formal intergovernmental body that currently exists to guide regional economic cooperation in this area, it is likely to be used to mobilize support for cooperative projects among local governments.

Regional energy and transport links are also topics of much discussion in Northeast Asia, as a new engagement framework with the DPRK could also be expected to lead to deepening discussions about how to finance a rail link from the ROK through the DPRK to Russia and China and how to trade power supplies and proceed with gas pipeline projects that include the DPRK. While such projects will most likely require private funding, public capital mobilization will also be required; and any regional projects will need to be linked to the public investment program discussed earlier for the DPRK. Any such projects will also require multicountry political and legal agreements in addition to financing. For this agenda to go forward it will be necessary to develop modalities to address all the issues among the concerned states.

Core Group and Second Circle

The six-party-talks framework³ that has emerged as the mechanism for political engagement with the DPRK might well evolve to become an ongoing security dialogue forum. To the extent that a new engagement framework will link such ongoing political and security arrangements with economic assistance, mobilization of foreign aid to support economic reform and development in the DPRK may well be conditioned by the decisions of this core group. KEDO also represents a core group that has been centrally involved in engagement with the DPRK since 1995.

The configuration of these two groups differs. If public capital mobilization in the future is going to be conducted within a framework of policies set by a core group, a question that will need to be addressed is adjustments to the memberships of these two groups. The six-party talks presently exclude the EU, although the EU is an active member and contributor to KEDO. Because a future program to mobilize public capital for the DPRK is likely to be broadly supported by European countries, the issue of EU participation in a core group can be expected to be an important one from their point of view. Similarly, if KEDO is going to play a role in the future under a new mandate, reconfiguring the membership is also an issue that would arise. Neither Russia nor China is a present member, but both should participate in any future core group coordination effort that KEDO might be asked to undertake.

3 Participants in the six-party talks are China, Japan, North Korea, Russia, South Korea, and the United States.

Apart from questions about whether a core group will guide economic cooperation policies and resource mobilization efforts with the DPRK, it will be necessary to consider how best to involve a second circle of countries that do not have a seat at the table for security negotiations but will be important sources of future public capital mobilization and support for economic reforms and institution building in the DPRK. Two Pacific Rim countries already active are Australia and Canada, and others such as Vietnam can provide valuable advice to the DPRK, both on the basis of their own experiences during transition to a market economy and in working with multilateral institutions and bilateral donors in aid mobilization and management. Individual European countries—including Switzerland, Sweden, Italy, Germany, and the United Kingdom—also will want to be involved bilaterally, not only through EU and IFI channels. Finding ways to give second-circle countries a voice in the new engagement framework will be important to the overall effort to help the DPRK integrate with the international community and gain broad financial support for economic transition and development.

Inter-Korean Economic Cooperation

Encouraging inter-Korean reconciliation is a strong motivator for the international community to provide public capital to the DPRK. Thus, it is likely that donor countries will be more forthcoming with resources if the two Koreas are pursuing a policy of deepening inter-Korean economic cooperation in parallel with improving social and political relations within a broadly supported security framework.

Because unification is understood to be a long-term process requiring reduction in the large gap in the two economies and gradual harmonization of infrastructure, financial systems, legal systems, product markets, and labor markets, the inter-Korean economic agenda can be expected to evolve and will need to be calibrated to progress in economic reforms and capabilities in the DPRK. For this reason, mechanisms will be needed to ensure proper coordination between the financing of the DPRK's economic development program and the inter-Korean program. The ROK will probably be expected to contribute a large share of the public capital needed for the DPRK to fulfill its side of the inter-Korean economic cooperation program, but it will face limitations consistent with its own macroeconomic stability and economic growth needs. Thus, the international community will need to support the two Koreas in their process and supplement ROK resources with resources mobilized from other donors and will need to contribute knowledge and expertise from global experience that will bring value added to what the two Koreas can do by themselves.

Normalization of Relations with Japan

When Japan normalized relations with the ROK in 1965, it provided a financial package of \$800 million (Manyin 2003, appendix). This included a grant of \$300 million to be disbursed over a 10-year period, a concessional loan of \$200 million to be disbursed over a 10-year period and repaid over 20 years with interest of 3.5 percent, and \$300 million in private credits over 10 years from Japanese banks and financial institutions. When Japan normalizes relations with the DPRK, it is widely expected that the DPRK will receive a financial package similar in composition to that received by the ROK, but it will be significantly larger in value in order to take into account the intervening time period. Estimates are in the range of \$5–10 billion. Even at the low end, Japan can be expected to be a major supplier of public capital to the DPRK. Thus, the mobilization of public capital for the DPRK will be heavily influenced by Japanese policy with regard to the timing of normalization of relations, the size and composition of the financing package, modalities for transferring resources to the DPRK, and conditionalities that may be applied by the Japanese government.

The Japanese voice will carry significant weight with both the DPRK and other donors, whose own policies toward provision of capital to the DPRK will need to be coordinated with Japanese priorities. Because of concerns about the risk of diversion of funds to the DPRK military, Japan will not want to commit large sums in advance of a more general political agreement with the DPRK on both the multilateral security issues and bilateral issues of concern. Japan will also not want to be the only major player in provision of public capital, and, after normalization of relations, most likely will want close cooperation with the IFIs to multilateralize the risks of extending large-scale capital support to the DPRK.

China's Future Role

After playing a critical facilitator role during the six-party talks, China will be expected to continue to be proactive and collaborative in a new engagement framework. Thus, China's economic assistance policy to the DPRK in the future will need to be more transparent and more coordinated with the policies of other donors than in the past. This would be a significant departure from China's past economic relationship with the DPRK, and would also be widely interpreted as a natural evolution of China's emergence as a regional power following on its success in expanding regional economic cooperation with Central Asia and the Association of Southeast Asian Nations (ASEAN). It should be expected that China's willingness to develop more open and coordinated economic assistance relations with the DPRK will also be reflected in future activism in Northeast Asia regional economic cooperation.

China's future role will also have an impact on economic assistance policies of other countries. If China expands participation in multilateral co-

operation both through active collaboration with IFI activities in the DPRK and in regional economic cooperation mechanisms such as TRADP and KEDO, there will be incentives for other donors to support these initiatives and provide complementary funding.

Human Rights and Environmental Protection

A new engagement framework with the DPRK will be shaped not only by political agreements on security and needs for economic reform and reconstruction, but also by human rights and environmental concerns. The policies of the DPRK authorities in these areas will affect the mobilization of capital from donor countries, especially those democracies where public funds for foreign aid are authorized through national legislatures. It can be expected that the United States and Europe will link their assistance programs to progress on human rights issues. Both the World Bank and the Asian Development Bank (ADB) have detailed guidelines for ensuring both social and environmental safeguards in projects that they finance, and the DPRK would be expected to abide by these standards the same as any other borrower from these institutions. Most bilateral development assistance also requires conditionalities to ensure mitigation of adverse social and environmental impacts. Mobilizing public capital for the DPRK will be much easier if the authorities engage in dialogue with foreign partners on these issues and develop policies and action plans that can be supported by the donors.

Strategies for Mobilizing Domestic Public Capital

The DPRK will require a large infusion of foreign capital to stimulate policy reforms and economic growth. It will also need a strategy to foster significant growth in domestic public savings in the medium term, which will be required for public investments that sustain growth as well as maintain macroeconomic stability and meet expanding requirements for social expenditures, operations, and maintenance of economic infrastructure. Along with other socialist economies undergoing the transition to market mechanisms, the DPRK does not have in place the financial and legal institutions that will be needed to achieve this goal. Thus, a high priority initially will be to design an institutional development plan and fiscal policy that is synchronized with the overall economic reform strategy.

A big-bang approach would be somewhat different from a gradual approach. With a big bang, the priority for fiscal policy would be to secure macroeconomic stability and supply public goods that the private sector cannot provide. More gradually, fiscal reform would be a major driver of growth during transition, and the government could both use fiscal stimulus and intervene to give new economic actors incentives to generate growth (Lee 2003).

In both cases, it will eventually be necessary to address a number of fundamental issues in building new fiscal capability in the DPRK. These include reform of state-owned enterprises (SOEs) and incentives for profitability and growth, restructuring of the tax system, strategy for domestic debt, the role of contractual savings, and improvements in allocative efficiency of public expenditures. These issues are complex problems, and building the necessary institutional underpinnings to make significant progress will take time. Foreign aid, both in knowledge services and financial resources, should be calibrated to support the DPRK's process of building these domestic capabilities so that the need for external public savings can diminish over a reasonable time period. The experience of Vietnam under its *doi moi* program would be a useful reference for the DPRK and future donors in addressing this agenda.

Reform of State-Owned Enterprises

Historically the state budget in the DPRK has been financed principally by turnover tax and profits-remittance tax on SOEs and agricultural cooperatives. The industrial sector also accounts for 70–80 percent of state revenue (excluding military). Thus, the sharp contraction of the DPRK economy in the 1990s is reflected in the drop in central government revenues from 37.1 billion *won* in 1991 to 20.3 billion *won* in 1996 (Koh 1999). This drop largely reflects the decline of revenue from SOEs resulting from a breakdown of production. SOE performance was affected by a number of factors, including depletion of capital stock, outdated technologies, failures of central planning, great distortions in prices, lack of access to finance and intermediate inputs, the trade shock induced by the collapse of the Soviet Union, interference of the Workers' Party in enterprise management, rigidity of the labor market, and absence of entrepreneurship. The revitalization of SOEs thus will be essential for any future domestic effort to mobilize public resources.

Beginning with amendments to its constitution in 1998, the DPRK has begun to accept the idea of profit motive to encourage increased industrial production. In the economic reforms introduced in 2002, the country took a number of initiatives to promote enterprise reform, including permitting firms to obtain inputs from market-determined suppliers, reducing the influence of Workers' Party representatives on management decisions at the firm level, placing a hard budget constraint on SOEs, and allowing more flexibility in labor management. The emergence of the informal market economy is also a factor. In a new engagement framework, a major priority will be to support growth of the market economy in a way that promotes leveling the playing field with SOEs, at the same time improving the ability of SOEs to be autonomous and competitive business enterprises (Park 1995). Tax revenues must be increased through buoyancy based on growth and profitability of the enterprise sector.

Restructuring the Tax System

Another major future priority will be to restructure the tax system of the DPRK in order to capture transactions in the market economy as well as the state sector and to create incentives for enterprise investment and entrepreneurship. Turnover and profits-remittance taxes should be replaced by income taxes for enterprises and individuals and a value-added tax on imports and domestic transactions (Park 1995). The design and implementation of tax reform will need to parallel reform of the financial sector and development of a commercial banking system. The legal and administrative framework to support policy shifts will also need to be put in place, and that will take time. Thus, a phased approach will be needed and technical assistance provided to the DPRK to support the transformation of the public finance system. Resistance to tax reforms can be expected at both the enterprise level and the individual level, so tax administration and anticorruption measures will need to be addressed as part of the agenda.

A related issue is the restructuring of the roles of central and local government in mobilization of public revenues. Already some limited and uneven steps have been taken to give local governments more authority to collect fees and local taxes, and some observers advocate rapid decentralization of the fiscal system following the Chinese experience to promote the private economy (Lee 2003). However, over-rapid fiscal decentralization comes with risk because of the needs for capacity building at the local level, an accountability framework, and good coordination of local fiscal management with macroeconomic stabilization.⁴

Domestic Public Debt

In May 2003, the DPRK introduced a bond scheme intended to mobilize private savings for government use. This scheme was designed as a lottery, after which only a few bondholders would eventually receive interest on their investment. Not surprisingly, few takers have been reported. Eventually, however, domestic debt must play a role in public finance in the DPRK, as a way to mobilize resources for public investment and as a tool of macroeconomic management. While this will require, first, growth in enterprise and private savings as well as legalization of property rights for various classes of assets, a new engagement framework should include assistance in developing public debt policies and management capacity consistent with international standards. The DPRK does not have a good reputation as a public borrower, so investor confidence will need to be developed in the domestic population as well as among foreign investors and donors who supply official development assistance (ODA) loans.

4 For a good discussion of these issues, see Dabla-Norris and Wade (2002).

Contractual Savings

Similarly, the DPRK will need to develop new mechanisms to finance health care and social security as they undergo transition. The existing social security system, for example, has become essentially irrelevant to households participating in the informal market economy, where prices far exceed social welfare payments. A new engagement framework should include a review of contractual savings schemes adopted by other socialist countries in transition and assistance to the DPRK in developing new policies and programs to meet these essential human needs.

Allocative Efficiency

How well the DPRK performs in reforming public expenditures will also have an impact on mobilization of resources from domestic as well as foreign sources. If public investment is diverted to unproductive expenditures or wasted through mismanagement and corruption, it will not have the buoyant impact on economic growth and state revenues that will be needed. Reduction in military expenditures and redeployment of military assets and personnel to productive activities will require major attention and assistance in a new engagement framework. Price liberalization is also needed to foster more efficient allocation of resources throughout the economy, but the DPRK will need support in managing price reforms in ways that will induce supply responses and contain inflationary pressures. Economic efficiency should also be given primary consideration in public investment planning, especially for infrastructure and in the selection and prioritization of projects for both domestic and foreign funding. The DPRK will need training and technical assistance as well as political discipline in order to make good public investment decisions.

Modalities for Mobilizing Foreign Public Capital

Several basic options are available for arranging international cooperation with the DPRK aimed at mobilizing ODA. They differ in two major respects. One is leadership—in other words, who convenes and chairs the meetings of donors. The other is the extent to which political considerations in addition to economic considerations are explicitly addressed in the mandates and processes of these decision-making mechanisms. The choices that are made in establishing institutional arrangements for mobilizing ODA for the DPRK will have lasting impact not only on the DPRK but also on the conduct of relations among the countries of Northeast Asia and relations between Northeast Asia and the United States and Europe.

These choices should be made with a full understanding of their implications. This section of the paper examines three approaches: Korea-led approaches, World Bank/IMF-led approaches, and core country group-led approaches. The strengths and limitations of each approach are discussed,

along with some variations. This is followed by examination of issues relating to future options for KEDO, the potential role for trust funds, and the proposal for a Northeast Asia development bank.

Two Koreas in the Lead

If eventual reunification of the two Koreas is the ultimate goal of both countries and is supported by the international community, a joint sponsorship framework is one option to consider. In this case, the agenda and process for coordinating the mobilization of ODA resources for the DPRK would be guided by the two Koreas together and would reinforce the objectives of reducing the gap between the two economies, deepening inter-Korean economic cooperation, and gradually integrating the two economic systems. This approach has the advantage of keeping the reunification goal at center stage and providing a political incentive for the international community to mobilize resources and provide support for the reunification process for an extended period. The IFIs, the EU, and bilateral development assistance agencies could be commissioned through this framework to work with both Koreas on the program; they could provide advice and technical assistance to both countries and financial support to the DPRK to meet its public investment program requirements. In policy dialogue with the international donors, the two Koreas could describe what each was doing individually, as well as together, to advance the overall economic agenda on the Korean peninsula. Each could also explain where assistance from the international community would be most helpful.

An institutional framework has already been set in place for an inter-Korean economic dialogue and the management of cooperation activities that operate in parallel with frameworks on social-cultural and security matters. It would be relatively easy to build on this existing inter-Korean economic cooperation framework, both to convene meetings with the international donor community and to monitor and supervise implementation of reforms and projects in the DPRK. Capacities that have already been built up in the ROK—in the Ministry of Unification, Ministry of Economy and Finance, Bank of Korea, Korea Institute for International Economic Policy, and Korea Development Institute—could be mobilized rapidly to support the international engagement framework while ROK institutions work with counterpart organs in the DPRK to help the North Korean institutions build their capacity to engage effectively.

One disadvantage of the Korean-led approach is that it could place major powers and other donors in an awkward position of supporting a joint Korean economic agenda that they may find objectionable for one reason or another. If the two Koreas together proceed with an agenda that is inimical to the interests of one or more major donors or that is perceived to be tilted politically, non-Korean donors would have less leverage to influence a change

of course than would be the case in the other approaches discussed below. This potential for preemption could be mitigated if processes were put in place for consultations with donors on major issues on an ongoing basis in both Seoul and Pyongyang. Building a culture of openness and cooperation would be essential for long-term success.

Traditional Consultative Group

The typical model used for other countries around the world is a consultative group chaired by the World Bank in close collaboration with the IMF and UNDP. In the early stages of the ROK's economic development, a consultative group was active there. Although consultative group meetings have normally been held in Paris, either annually or on an occasional basis, in recent years it has been common for these meetings to be held in other centers, such as Tokyo, or in the country concerned. Setting up a consultative group for the DPRK along traditional lines would mean that the DPRK would have to become a member of the IFIs at an early stage and work closely with the IFIs in economic and financial reporting and in preparation of reports used as the basis for the consultative group discussions. Because of the inter-Korean economic agenda and long-term unification goals, any IFI-led consultative group framework would need to be designed to work closely with ROK authorities and institutions to ensure that policy dialogue and financing plans are coordinated with the inter-Korean processes.

The advantages of the traditional consultative group are that it has well-established processes known to the donor community and is an efficient mechanism for coordinating policy dialogue and mobilizing formal commitments to finance a well-reasoned macroeconomic framework for economic development. It also would enable the DPRK to learn rapidly the ways of the international financial system and develop intimate working relations with IFI staff responsible for managing the relationship and consultative group preparations. Because both the IMF and World Bank played central roles in the management of the ROK financial crisis of the late 1990s, and because the IMF maintains a surveillance capability and routinely conducts Article IV consultations with the ROK, the IFIs also would be well positioned to play the lead coordinating role for discussions of the interaction of DPRK economic transition and development with the ROK macroeconomic policy and management.

A disadvantage of the traditional model is that the IFIs are forbidden by their articles of agreement to take political considerations into account in the conduct of their work. For the DPRK, it may be difficult to separate political dialogue from discussions of economic policy and mobilization of resources. Issues such as progress in implementation of security agreements, handling of human rights issues, and domestic political dynamics of change in both Koreas are likely to be discussed as part of the context for extending

ODA. For example, representatives of donor countries participating in consultative group meetings usually come from ministries of finance and development assistance organizations, but political discussions are usually led by representatives of foreign ministries. A variation of the consultative group format that might overcome this liability would be to have the meetings cochaired by the UN and World Bank, which would legitimize the integration of political and economic dialogue at the same meetings.

Core Country Group

If the six-party framework for negotiating security agreements for the DPRK is successful, it might naturally be expanded, with some modifications, to address economic assistance issues as well. The pressure to link economic assistance with progress on political agreements is likely to be strong if a step-by-step, road-map approach is adopted by this group. In this approach, it would be necessary for the core group to either have a rotating chair or elect one country to serve as chair for the economic cooperation meetings. Because donors to the DPRK will include the IFIs, the EU, and second-circle countries such as Australia and Canada, participation in the economic meetings would need to be expanded beyond the six-country framework. Conduct of these meetings would be driven by assessments of progress on political agreements and consideration of the implications of economic assistance. In this framework, the issues of concern to all the core countries would be given high priority, and the mobilization of broader international support for the DPRK would be considered in this context. A variant might make use of KEDO as the forum for economic discussions if KEDO were to be given a new and wider mandate and its membership expanded to include China and Russia (see the next subsection).

The advantage of the core country group's taking the lead on the ODA mobilization discussions is that the linkage to the political framework for international engagement with the DPRK would be clear and explicit. The main disadvantage of this approach is that the DPRK's economic reform process and development would be shaped by the strong political interests of members of the core group and dominance of regional perspectives and, thus, delay the DPRK's full integration in the global community and normal workings of the international financial system. Also, inter-Korean reconciliation would be given a second-row seat to the other interests of the large powers, reinforcing a sense of dependency of both Koreas, with potentially negative effects on public opinion in these countries. Some adjustments in the working modalities of the core group would also be needed to fit the requirements of economic policy dialogue and coordination between foreign policy and economic agency participation.

Future Options for KEDO

A successor to KEDO could be given a role in the mobilization of public capital in a new engagement framework in two ways. Both would require changes in the existing KEDO mandate and membership.

- Use KEDO as the primary mechanism to provide energy assistance to the DPRK, keeping broadly with its present mandate but expanding it to cover conventional (not nuclear) energy supply, rehabilitation of the transmission system, and demand-management activities. The package of such assistance would need to be shaped by an energy-sector study that KEDO would undertake. This could be done in partnership with the World Bank and the Asian Development Bank in order to take advantage of their expertise in studies of this kind. The package of assistance to the energy sector would need to be linked to the overall economic development strategy adopted for the DPRK and the resource mobilization coordinated with the more general ODA mobilization efforts managed through one of the frameworks discussed above.

KEDO would be one important actor in the development assistance to be provided to the DPRK and would need to participate in the general aid coordination processes and have close cooperation with the IFIs, to both ensure consistency in policy dialogue and enlist IFI resources in support of the energy sector program. In addition, KEDO could be the primary mechanism for reaching agreements among the countries of Northeast Asia on cross-border energy trade that involves the DPRK, including potential power trade and gas trade. To undertake this role, both Russia and China would need to become KEDO members, and its activities would become closely linked to the broader discussions of regional energy security. Relatively minor adjustments in the staffing and management of KEDO would be needed for it to be able to undertake this limited expansion in its role.

- The other option would be to give KEDO's successor a much broader mandate to become the "Korea Economic Development Organization" and serve as the primary modality for coordinating all discussions of economic strategy and development assistance for the DPRK. This would operate under the guidance of the KEDO members, who would need to be expanded to include China and Russia, and would thus represent an expanded core country group that would also include the EU. KEDO would become the instrument for linking the political and economic frameworks for engagement, where it would be determined that the political framework would need to tightly guide economic discussions and commitments, not only for the core countries but also for the international community.

The main disadvantage of this approach is that KEDO was never conceived as an economic organization despite its mandate to provide heavy fuel oil and construct two LWRs. As a political organization, KEDO has been managed and staffed primarily by foreign affairs personnel, not by energy experts and economists. For KEDO to assume a broader economic mandate, major adjustments would be needed in its staffing and management as well as in its operating procedures. Another disadvantage is that the inter-Korean economic relationship would be overshadowed by the KEDO organization, potentially causing some inconsistency in the policies adopted by KEDO for economic engagement with the DPRK and the dynamics of inter-Korean cooperation.

Possible Role for Trust Funds

The DPRK requires large-scale public infrastructure investment that will need to be funded by ODA in the short and medium term. Funding for typical projects comes mainly from the multilateral development banks and bilateral development assistance agencies such as the Japan Bank for International Cooperation. Infrastructure funding is usually provided as loans, not grants, even if the loans are at concessional terms for qualifying countries. Large-scale infrastructure projects require much advance preparation:

- A public investment program that is consistent with both an economic development strategy that is widely supported and a prudent macro-economic management framework;
- Feasibility and engineering studies to ensure that both technical designs and costing are prepared properly;
- Environmental and social studies and mitigation plans, including plans and funding for resettlement of households affected by infrastructure projects; and
- International competitive bidding for contracts, required especially by the IFIs; this requires considerable preparation, especially for a country that has not participated in the international system of procurement before.

For these reasons, even though the DPRK's needs for infrastructure investment are high, there will be a period of several years required to undertake the prerequisite studies and preparations to absorb large amounts of ODA. During this time, high priority will have to be given to funding the studies, technical assistance, and training that the DPRK will need to prepare and implement a large program of international assistance.

The idea of a grant trust fund to launch this process has considerable merit. To reduce complications of multiple donor demands on DPRK administrative capacity, it would be efficient to establish a multilaterally funded facility that is administered by a single agency or a limited number of agencies to

take a lead role in organizing a program to use such funds and to supervise their implementation. One option would be to give the UNDP the lead role because it already has a trust fund for the DPRK in place and could ask the IFIs to assist in the execution of specific activities. Another option would be to set up the trust fund in one or more of the IFIs, as has been done for a number of other situations, including East Timor and Bosnia-Herzegovina. If the existing shareholders so desire, such a trust fund could be created quickly, even before the DPRK undergoes the process of obtaining membership in the IFIs. The advantage of establishing IFI-managed trust funds is that it would impel the development of the operational working relations between the IFIs and the DPRK that will be needed for IFIs to play the role they will be expected to play in any of the aid coordination and management scenarios discussed above.

Consideration of the Proposal for a Northeast Asia Development Bank

The idea of establishing a new regional development bank to finance the infrastructure investment envisaged for expanding economic integration in Northeast Asia has been under active discussion in the region for a number of years. If such a new financing institution were to be created, the institution would be expected to be one source of funding for DPRK reconstruction and integration in the regional economy. The case for such an initiative rests on at least two assumptions: (1) that such an institution could mobilize incremental funds to supplement funds that would be mobilized through the World Bank and Asian Development Bank, and (2) that a different governance system would mean the application of standards and conditionalities different from those required by the existing IFIs.⁵ In particular, the argument is made that a Northeast Asia development bank (NEADB) would provide political-risk coverage for countries such as the DPRK.

Like the World Bank and the Asian Development Bank, an NEADB could use a public capital structure to intermediate in the private-capital markets in order to provide financing that the private sector would not undertake on its own. The first-tier, founding-member countries would be China, the DPRK, Japan, Mongolia, the ROK, and Russia; they would be expected to subscribe 40 percent of the bank's capital. Another 20 percent would be subscribed by second-tier Asian countries, and the remaining 40 percent would be subscribed by the United States, Europe, and others. Implicit in the NEADB concept is that this organization would respond to the political will of its first-tier members, which would dominate decision making and also staffing. The institution would become an important instrument for regional

⁵ For a detailed discussion of the case for establishing a Northeast Asia development bank, see Katz (2003).

cooperation among governments that, compared with other regions of the world, do not have a good track record of working collaboratively as a group.

Although these objectives are laudable, there are political, financial, and administrative reasons for skepticism about whether and how quickly an effective institution could be established. The first political question is whether the United States and Europe would choose to participate and support the idea that a third development bank could contribute sufficient value added to the capabilities of the World Bank and Asian Development Bank to be worth the additional costs and administrative overhead a new institution would imply. Alternatives would be to encourage the existing organizations to strengthen their capacity to support Northeast Asia regional development and DPRK economic reconstruction through internal organizational adjustments, including staffing. The question of Russia's membership in the Asian Development Bank would also need to be addressed, but this would be simpler than creating a new organization in order to include Russian participation. A second political question is how an NEADB would relate to the emerging core country group framework that is evolving from the six-party talks. In principle, an NEADB could be designed as an economic instrument of this political framework, but in this case the United States would need to be included as a first-tier member, which is not what the promoters of the NEADB concept had in mind.

Financially, there are significant questions about how capital subscriptions and voting power would be distributed in an NEADB, and there are also questions about who the borrowers would be (other than the DPRK and possibly Mongolia). It is difficult to believe that China and Russia would choose to borrow from an NEADB, if they are major shareholders, when they have their own large domestic capacity to finance infrastructure investments and access to international capital markets as sovereign borrowers.

From an administrative perspective, the question is how quickly a new NEADB could establish the operational policies and procedure, and staffing and management, to function effectively. For all these reasons, the establishment of an NEADB can be expected to be controversial and, in any case, protracted. Efforts to mobilize capital for the DPRK should not be distracted by the larger complications of the debate on creating a new financial institution for the region.

Conclusions

A new engagement framework for the DPRK will need to face up to important realities when it comes to mobilizing public financial resources. One reality is that the linkage of political and economic considerations needs to be handled very carefully in order to avoid problems similar to those with past assistance to the DPRK and to ensure that future assistance is effective in meeting expectations of both the DPRK authorities and the international

community. A second reality is that there are many complex and difficult challenges to be met in transforming the DPRK economy, setting it on a sustainable growth path, and integrating it with the ROK economy, the regional economy, and the international financial system. Open and constructive policy dialogue between the DPRK and the donor community will be essential so that there is common understanding of what will be required to achieve results, especially in conditionalities that will be placed by donors on access to resources and in the supervision of the implementation of donor-financed activities. A third reality is that building new institutional capacities and laying the groundwork of technical preparation for large infrastructure investments will take some time and require good coordination among those providing support to the DPRK. To be successful, mobilizing resources for a new engagement framework for the DPRK will require goodwill and commitment to sustained cooperation between the DPRK and its foreign partners for some time to come.

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Bradley O. Babson is a consultant on Asian affairs with a concentration on Korea and Northeast Asia economic cooperation. He is a retired World Bank official who received his MPA degree from the Woodrow Wilson School of International and Public Affairs at Princeton University in 1974.



Korea Economic Institute
 1201 F Street, N.W., Ste. 910
 Washington, DC 20004
 Phone 202.464.1982
www.keia.org

**Korea Institute for
 International Economic Policy**
 300-4, Yomgok-dong
 Socho-Gu, Seoul 137-747, Korea
 Phone 82.2.3460.1114
www.kiep.go.kr

American Enterprise Institute
 1150 Seventeenth St., N.W.
 Washington, DC 20036
 Phone 202.862.5800
www.aei.org

Chosun-Ilbo
 61, 1-ga, Taepyong-no, Chung-gu
 Seoul, 100-756, Korea
 Phone 82.2.724.5275
www.english.chosun.com