

## GlobalNet 21 Forum No.16

GlobalNet21 Forum

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## North Korea Opens: Recent Economic Developments in the DPRK

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Political control is the core interest of the North Korean regime. It will not respond to any economic incentives that could weaken its control by even the slightest measure. This tough picture of North Korea painted by Stephan Haggard has strong ramifications on any negotiating process with North Korea. Drawing upon the work conducted by Haggard and Marcus Noland (Peterson Institute for International Economics) through interviews with a number of North Korean refugees and surveys of Chinese and South Korean companies operating in North Korea, he focused on North Korea's complex political economy. Haggard emphasized the importance of understanding North Korea's intentions by analyzing this key area. The state of its trade and investment also tells us much about the degree to which North Korea is opening up. All of this of course can be used to give us some indication of the effectiveness and the impact of current policies to North Korea.

### Presentation

#### *The Political Economy of North Korea: Strategic Implications*

The North Korean state was unable to cope with the great famine of the mid-1990s. The inability to deal with a disaster of such great magnitude was reflected by the collapse of the Public Distribution System (PDS). In response to this catastrophic state failure, people in

North Korea forced to fend for themselves, resorted to engaging in market activities to supplement the loss of goods delivered through the PDS. This began the process of "marketization" in North Korea that would change the way people lived their lives. Data on the surveys of North Korean refugees indicates that there is an increase in securing income through private trading following the famine.

In 2002, the government responded to this "marketization" at a grassroots levels by implementing limited reforms. This shows a somewhat lukewarm attitude to the facts on the ground. But from 2005 the picture changes, it began a process of what Haggard calls "reform in reverse." On the back of increasing harvests and rising aid, the government moved in. It banned private trades in grain, conducted seizures in rural areas, and closed off access to remote areas by relief agencies. These efforts were to regain the control that had been lost with the massive famine. Haggard outlined how this was a shift away from reform to an increasingly control-orientated approach to economic policy. This makes it clear that North Korea will not give up anything that would threaten the control of the leadership, regime, and state. For the North Korean regime, the food economy is a key feature for control. A troubling side effect from this "reform in reverse" has been a rise in corruption. The surveys of the refugees reflect this assessment that corruption, inequality, and general dissatisfaction has in-

creased.

Another area that was examined to show North Korea's intentions was those companies that invest in North Korea. Whether South Korean or Chinese, both have shown mixed results of success as reflected in the surveys conducted by Haggard and Noland. Chinese companies, which have been more successful, have shown a kind of "Chinese engagement model." Whether this is a model that could be applied for South Korean companies is debatable especially given North Korea's control-orientated approach to inter-Korean relations. Also, Haggard highlighted that most counterparts in North Korea are state-owned enterprises which raise the question of what impact is this kind of investment really having.

Unlike the Chinese companies, South Korean companies investing in North Korea are based less on commercial activities. Much of the inter-Korean trade is heavily state-subsidized. This non-commercial nature makes it difficult to really transform North Korea in the way that was set out with the Sunshine Policy.

In general, Haggard has argued in favor of analyzing the political economy as a way of understanding North Korea's intentions. He pointed out that the significance of the political economy is rather underappreciated. That at some point North Korea has to deal with its fraying socialist system otherwise there would be an extreme limit to what North Korea could do if it is unable to extract the resources from its society.

## Discussion

### *The Difficulties of South Korea's Engagement*

Having understood the intentions of the North Korean regime, its implications for South Korea's engagement policy are stark. The designated discussion panel agreed with Haggard on the difficulties of South Korea's engagement policy. Its intentions to open up North Korea, promote more commercial activities, and cultural exchange are hampered by the fact that Pyongyang will not yield any loss of control. Haggard explained that North Korea has always made sure that inter-Korean contacts are state-to-state and conducted in isolated areas so that it can manage and control those contacts. Although Haggard conceded that the Sunshine Policy was a gamble and brought about results in some respects, he pointed out that North Korea would never be happy with South Korean businessmen operating in the country. North Korea is always cautious about commercial engagements with the South. Both Haggard and the panel contended that North Korea views such engagements as a challenge to the regime's control on all activities in the country.

Recently the difficulties of South Korea's engagement policies have been very vivid. The Kaesong Industrial Region was again cited by Haggard as an example during the discussion. It was a project that intended to initiate reforms in North Korea but has become something of leverage in reverse. With South Korea's deep investment in the project, North Korea is now using the Kaesong project as part of its negotiations and to manage inter-Korea relations. This is completely the opposite of the expected outcome and intention when the project started.

On the other side, the panel pointed out that there has also been difficulties with the reciprocal policy of South Korea such as Lee Myung-bak's official North Korea policy, Vi-

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sion 3000. Vision 3000 offers North Korea a number of economic incentives and rewards if it is to give up nuclear weapons.

The panel noted three parts that make the goals of Vision 3000 difficult to achieve. The first is that there is a mismatch of parties. Under the plan if North Korea gives up nuclear weapons it will be South Korea that provides North Korea with aid and benefits but North Korea wants to deal with the U.S. in any deal. The second difficulty is that the process has the wrong reward. North Korea wants regime survival not economic development. Lastly the goals of the policy are unrealistic and thus difficult for North Korea to accept. Under the plan were North Korea to give up nuclear weapons the plan promises that they would see their average per capita annual income rise to US\$3,000 within ten years. This assumes that current North Korean income levels are at US\$1,000 when the estimates are of between US\$300 and US\$500.

Although it is important to have such grand visions, Haggard emphasized the point that there is a basic need to get talks started. It is also worth bearing in mind that North Korea will always seek to control inter-Korean relations, making any policy difficult in achieving success.

### ***The Importance of China***

North Korea’s trade with China has been increasing and remains strong. In fact, during the presentation Haggard noted that North Korea is in effect living in a Chinese world with almost forty-five percent of its trade taken up by China. So, in this regard, North Korea’s economy is opening up. But this is not a true opening up of the economy. Trade with Japan and Europe has almost stopped. The

geography now of North Korea’s trade is limited to China and countries in the Middle East who will not be likely to exert pressure or demands on North Korea.

The discussion turned to the issue of the importance of China in any sanctions effort and what could be done. Haggard was keen to point out that this would call for more targeted sanctions efforts like the Banco Delta Asia (BDA) case and counter-proliferation efforts like the Proliferation Security Initiative. The BDA case is a good example of targeted sanctions where the U.S. focused on a major bank in Macau suspected of money laundering for North Korea. In that instance, it worked because the U.S. offered talks to get North Korea back to the negotiating table.

### ***Implications for U.S. Policy***

Taking into account North Korea’s intentions and taking away the picture of a regime that is willing to endure hardships to ensure its survival and political control, the panel wanted to know about what the U.S. could offer to North Korea during any negotiations.

Haggard’s assessment was that so far the Obama administration has not really offered much to North Korea. It appears to be that the Obama administration is going back to policies similar to the Bush administration’s first term. Much of this is because of the concerns of North Korea’s proliferation to the Middle East. Missile sales to Iran affect Israel’s security and thus creating a whole new urgency in dealing with North Korea.

Haggard referred back to the Perry process, the policy of the Clinton administration during its second term, as a format for the U.S. to deal with North Korea. The Perry process offered North Korea two paths but

channeled them in the right direction.

There are limits in what could be offered to North Korea but Haggard felt that diplomatic recognition could be one element. Recognition as a nuclear weapon state poses many difficulties, the least of which is that it would compromise the Non-Proliferation Treaty (NPT). It is not appreciated greatly how much the U.S. values the integrity of the NPT. Therefore, recognizing North Korea as a nuclear weapon state would have wider implications for its non-proliferation efforts, particularly in regard to Iran's nuclear activities.

Haggard did stress that whatever formula is taken, the important part is to get negotiations started. So far there has been no effort to initiate talks. There needs to be a window open for North Korea to talk.

In general, the panel emphasized that North Korea's actions are being influenced from an internal logic due to the current leadership succession. Taking on the panel's assessment, Haggard specified that patience is strongly required in such a case. However, patience is a luxury that Washington is finding harder and harder to indulge in. ■

— Professor Stephan Haggard (UCSD) spoke on the interesting and timely topic about the political economy of North Korea at the EAI's 16th GlobalNet21 Forum. His presentation was from the work he and Marcus Noland (Peterson Institute) conducted which was based on the comprehensive surveys of North Korean refugees and Chinese and South Korean firms operating in North Korea.

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