

## Why now is a good time for economic engagement of North Korea いまこそ北朝鮮と経済面での関係づくりを

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Little more than a year ago, in December 2011, Kim Jong Un was announced as successor to his late father Kim Jong Il. Initial hopes for a change in North Korea's WMD policy faded away after two missile launches in April and December 2012, and the country's third nuclear test in February 2013. Shortly afterwards, wave after wave of threats has been issued by Pyongyang, including the use of nuclear weapons against the United States. Against this background, does it make sense to even think about economic engagement?

I would argue it does. In fact, the chances to achieve progress might be the best in a decade. This seems counterintuitive, so let me list a few points that have led me to this optimistic outlook.

(1) By now it should have become clear, even to the staunchest proponent of isolating North Korea, that passive or active non-engagement including sanctions has not worked. The North Korean nuclear weapons program develops continuously, and the regime shows no signs of destabilization. To add a disclaimer, the East German example warns that such external assessment of domestic stability can be quite

erroneous. But at least so far, the combined leadership of the Kim family, the Korean Worker's Party and the military have survived decades of sanctions to the point that a number of countries find it hard to come up with new measures.

(2) It seems appropriate to again emphasize the humanitarian consequences respectively of sanctions and economic engagement. Gordon (1999) argues that sanctions work like a medieval siege: the weak parts of the population suffer first and most. Hoping that the image of their starving children would make the people rise against their leaders is unethical, and often also unrealistic. On the other hand, improving the economy could mean improving the lives of large numbers of people, although to varying degrees. China is a good example. It has changed from a highly egalitarian to a quite non-egalitarian society in the course of market transition and rapid growth; nevertheless, to quote the Asia Development Bank, "spectacular progress had been made in reducing absolute rural poverty levels to one eighth of what they were in 1978 when the economic reform process commenced – nearly all

people have enough to eat and some clothing” (ADB 2004). China is of course not North Korea. Reforms will proceed differently because the economies, the political systems and the geopolitical environment differ substantially. But in principle, the mechanisms at work in China will generally apply to North Korea, too. We should also not forget that, assuming a more or less stable demand defined by population number multiplied by average calorie consumption, food prices will decrease on the markets if supply rises. Hoarding, speculation and state intervention can slow this process, but at a certain point, people with high incomes will stop buying food if they think they have and will have enough. This will force traders to lower prices. Inflation triggered by an expansionary monetary policy of the North Korean state is a risk factor, as long as food is traded in domestic currency. In any case, typically those who are poor use the largest part of their available income to purchase staple food and would thus benefit the most from lower prices of rice, corn, oil and heating material.

(3) Realists will find many good reasons to oppose the liberal idea of interdependence. Nevertheless, we should not discard the chances that establishing a mutually beneficial economic relationship through trade or investment will increase the North Korean interest in maintaining such cooperation. The catch is to achieve a critical mass in such a relationship. This has not been

done yet, not even by the socialist countries before 1990 or the progressive governments in South Korea 1998-2008. Cancelling economic cooperation or living with its absence was thus relatively easy for the North Korean leadership, as long as its benefits were low. Interdependence has not worked so far with North Korea. But the reason was not too much cooperation, but too little of it.

(4) Another general point that supports economic engagement is related to geopolitical considerations. Is the rest of the world happy with Beijing being the sole “teacher” of North Korea? In particular South Korea should be deeply worried. What used to be the major source of West German power over the East in the German unification process after 1990 is slowly but steadily vanishing in the Korean case. As Thiessen (2009: 10) noted: “Everywhere the West Germans with their naturally superior knowledge of the system played decisive roles and were able to enforce their views”. This “superior knowledge” concerned all aspects of administration at the federal, state and local levels; the legal system; and business (taxation, commercial code, banking, liability, technical norms etc.). This superiority was “natural” because overnight, the economic system of East Germany was replaced by the West German system without prior training. Imagine a sports team, let’s call them the Eastern Socialists, plays soccer and has never played anything else before;

30 minutes into the game, they are told that the name of the game is now American Football, and their opponents are the New York Giants. Neither the players of team Eastern Socialists nor their coaches know the rules and have the right equipment. I leave the rest to your imagination. My point is that the ability of West Germany to determine the German unification process was not only based on economic superiority, but on highly asymmetrical knowledge of the rules of the game. If Korea were to unify today under South Korean auspices, the situation would not be much different. However, things are changing, as any visitor to North Korea can confirm. Chinese businesses, either individually or as parts of joint ventures, have permeated nearly every aspect of North Korea's economy from large mining projects to banks, gas stations, car repair, paper towels and plastic toys. The Chinese are brutal teachers, but they are effective. While many South Koreans understandably worry about the extraction of natural resources and thus a diminishing unification dividend, this should perhaps be their lesser concern. An increasing number of North Koreans are learning the rules of the game (called capitalism) and acquire experience in playing it. The knowledge asymmetry is decreasing, and so is the relative power of South Korea.



**Chinese have invested in North Korea's Musan Mines**

(5) I have already mentioned North Korea's natural resources (including gold, iron ore, magnetite and anthracite). Studies such as Yoon (2011) provide more detail. In combination with the country's cheap and disciplined labor force, the low but growing competence of its administration and economic actors, and the improving legal and business environment, it is not difficult to imagine what this country could achieve. Just take its proximity to the huge Chinese market - few countries in the world have the advantage of a 1,400 km border with this economic giant. To be sure, North Korea is not yet making good use of these opportunities. But this is mainly based on a set of subjective political decisions by the country's leadership, not objective structural restraints. In principle, North Korea has most if not all of what it takes to become a well integrated and prosperous member of the international economic community.

This immediately leads us to more specific, i.e. current and Kim Jong Un-related reasons for economic engagement. Even if North Korea has

the potential, is it willing to take the necessary steps to realize it? Is there any chance of economic reform? Again, I would argue in the affirmative, with an emphasis on “chance”.

(1) Numerous talks I had with North Koreans, including what we could call officials, confirm that economic exchange in the form of trade and in particular investment is wanted - explicitly, and above all else. The reservation “but only under our own conditions” is still there, but it seems to have softened somewhat. I would not yet speak of the same level of desperation that led the East German government to sell its political prisoners to the West, but the North Korean thirst for hard currency and the pressure to acquire it have become stronger. To be sure, the state is not the only source of such worldly desires. Social pressure in an increasingly materialistic society is on the rise; hat-tip to the Chinese.

(2) I have argued before that Kim Jong Un needs economic cooperation with the outside world (Frank 2012). Despite the recent tests and rhetoric, I see no reason to modify this position. Kim Jong Un has reached a critical stage in his buildup of power. One way to interpret the wave of news about domestic developments in 2012 (hiring, firing, reorganizing) would be that he seems to have consolidated his leadership by administrative means. Consumerism in North Korea is now firmly established and since the July 2002 reforms has had about a decade to

shape and transform the minds of people on all levels. Roughly estimated by the number of mobile phones, a middle class of about 2 million people has emerged and looks for ways to maintain and expand its status. Many more hope to join that group. Kim Jong Un is now expected to deliver on his promises to improve the living conditions of his people, as they were made immediately after he assumed power in December 2011 and repeated numerous times including his 2013 New Year’s address. I believe this policy is not only driven by the young leader’s romantic paternalistic feelings, but also by his desire to strengthen the nation as well as by the pragmatic search for a source for his legitimacy. Aid is definitely welcome, be it from China or from North Korea’s enemies. But it is not a sustainable solution, and it comes with strings attached. Improving the economy inevitably means introducing elements of a market economy, because the reasons for the currently low output and quality are mainly systemic in nature. Doing so in the relatively secluded and thus safe agricultural sector, as the Chinese initially did after 1978, will not work in a country that is much more urbanized and industrialized, and which has a much smaller hidden potential in farming. Such an approach was tried in 2002, and it failed. A small rural population benefited from rising prices, while a large urban population had to pay. Inflation was the inevitable and painful result and still remains the major concern of economic policy makers in

North Korea. What is much more suitable is the so-called East Asian model, i.e. export-oriented industrial growth led by a strong developmental state.



**The Rason Economic Zone on the China-Russian Border is one such attempt**

The father of South Korea’s current president showed in the 1960s and 1970s how it works: a strong, militaristic dictatorship, nationalized banks, a few big conglomerates and harsh trade controls. Export-oriented growth, however, cannot be pursued in safe isolation. It needs international markets, finance, and technology and will thus involve a high degree of exposure. It also needs outside political support, which the US rendered to South Korea during the Cold War keeping both eyes shut on grave human rights violations and protectionism. China is likely to take over that role for the North. US financial sanctions do not hurt the current system much, but they would be deadly for a North Korean version of the East Asian model. To improve the

living conditions of his people, Kim Jong Un needs cooperation with the outside - despite the risks involved.

(3) The implosion of the Soviet empire demonstrated these risks impressively. Obviously, the North Korean leadership wants to avoid a similar destiny. This is a complex task including a massive ideological challenge, but the successful tests and the growing power of the nuclear deterrent will at least remove fears of external intervention in the case of potential domestic problems caused by economic reforms. A country that is regarded as erratic, illogical and inscrutable is more likely to be left alone even if circumstances occur that make intervention tempting. It is more likely to receive aid just to keep it from collapsing, especially if the consequences are seen as unclear and potentially dangerous. This strategy is not new; the nuclear issue has been a problem since 1993, and the game has remained more or less the same all the time. The only “progress” we see is North Korea’s growing nuclear capabilities. The more Kim Jong Un can rely on his nuclear deterrent to prevent outside intervention and to increase interest in the stability of his regime, the less risk averse in economic policy he and his leadership will become. Therefore, not only are the benefits of economic reform increasing (see point 2); we could also argue that their political and security costs are diminishing. It remains to be seen, of course, whether the North Korean evaluation of

the balance is positive. But the odds are definitely improving.

(4) One window of opportunity has already been missed. Much has been said about the young age and lack of experience of Kim Jong Un right after his enthronement. Very unfortunately, nobody seems to have made a serious effort to utilize the fact that exactly for those reasons, Kim Jong Un's record was impeccable. He could have been visited, invited and talked to without having to consider a long record of actions and responsibilities. With the three tests of 2012/2013 and in particular the harsh rhetoric and threats of March and April, this chance is gone. We are back to "normal" when Western politicians consider it inappropriate, even unthinkable, to treat the North Korean leader with respect. But there is a slight chance left: he is still relatively new to his job and in the process of forming his general approach to leadership. We should try to make cooperation with us part of it.

(5) Speculating about Kim Jong Un's character comes close to reading tea leaves. But from all we have seen last year, including his public appearances, he does not seem to be afraid of tough decisions. This is pretty bad if it means testing missiles and nuclear warheads or issuing threats of a nuclear attack despite international protests and possible counter reactions. But it could also mean that he has got, in principle, what it takes to make bold decisions about other risky business - such as economic reforms.

Assuming Kim Jong Un is a human being like all of us, he might become more conservative with the years. Therefore, whatever we can do to support economic development and reform: we should try it now and not wait until he has become more static and risk-averse.

(6) Last, but not least: what alternatives exist? The current situation in Korea can at any time develop into a war that nobody wants. Kim Jong Un might feel that he will lose credibility if he resorts only to words; the other side might take the next threat seriously and decide that it is time to preempt a possible attack; or a simple accident at the heavily guarded border can turn into a chain of events that gets out of control.

The two big winners of the current row are North Korea and the USA. North Korea gets a lot of international attention and media coverage; to be sure, it is hated and mocked, but in significant ways, it is taken seriously. The US, much to the dismay of Beijing and Moscow, is deploying anti-ballistic missile defense systems that will not differentiate between shooting down North Korean, Chinese or Russian missiles. This shakes up the balance of power in the region and globally, and North Korea provides the pretext.

There are few alternatives to engagement. Moreover, the North Koreans are interested for a variety of reasons. Time seems to be crucial, as windows of opportunity are closing. The strengthened self-confidence of North Korea as a

nuclear power could reduce the leadership's assessment of the risks of economic reform. The fact that Rodong Sinmun wrote on April 6: "Our country has powerful war deterrence based on nukes. A favorable condition has been created to concentrate funds and labor on economic construction and enhancing the people's living standards." (Put Spurs to Economic Construction ([http://www.rodong.rep.kp/InterEn/index.php?strPageID=SF01\\_02\\_01&newsID=2013-04-06-0031](http://www.rodong.rep.kp/InterEn/index.php?strPageID=SF01_02_01&newsID=2013-04-06-0031)), Rodong Sinmun, 06.04.2013) seems to support my assessment.

The new leader has yet to decide whether he wants to build his legitimacy on economic progress or on military defense. As recent reports on the growing availability of internet and social media (Lee 2013), and on the visit of former NBA player Dennis Rodman (Zinser 2013) show, there is another North Korea beyond the production of nuclear weapons. Neither of them should be ignored.

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