

## Development Strategies for North Korea

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The North Korean regime faces an unstable internal situation both politically and economically. Kim Jung Il's recent health problems raise the possibility of a destabilizing leadership succession, while the dire state of North Korea's economy threatens popular unrest and the prospect of large scale immigration.<sup>1</sup> This instability creates the potential for rapid state collapse.

The rapid collapse of the North Korean regime is not in the best interests of the United States. At worst, it may lead to a costly war on the Korean peninsula. At best, it may result in an expensive rebuilding process for both the U.S. and our regional allies.

Given the dire state of the North Korean regime and economy, the United States should start thinking about plans to encourage North Korean reform and integration into the international system in the event of a positive change in leadership or regime collapse.

History provides two possible models for reintegrating North Korea into the international community: 1) Germany and 2) Vietnam. Like North Korea, both Germany and Vietnam confronted the challenge of reforming struggling communist economies and integrating them into the global economic order. The two models, however, involved significantly different costs and risks.

1.) Germany: Germany followed an instant unification approach in which West Germany quickly absorbed East Germany. Due to the political pressures for instant political and economic unification, East Germany engaged in rapid privatization, monetary union, and the adoption of the Western political system. Rather than reinvigorate the East German economy while keeping the West German economy stable and growing as expected, the 1990 unification further weakened the Eastern economy while burdening the Western economy with expensive monetary transfers to maintain and raise East German standards of living. This approach caused long-term problems for Germany that continue to the present day including 1) expensive monetary transfers from West Germany to East Germany that by 2003 totaled 1.2 trillion Euros with an additional 156 billion Euros budgeted for future transfers<sup>2</sup>, 2) deindustrialization and increased unemployment in East Germany<sup>3</sup>, and 3) the risk of Eastern Germany developing long-term dependency on West Germany.

At first glance, the German model presents a quick solution for the North Korean problem. However, it is not adaptable to the North Korean situation because of: A) high costs, B) South Korea's inability and unwillingness to bear the expenses, C) China's opposition to Korean unification, and D) North Korea's resistance.

A) High Costs: As the German experience illustrates, economic reintegration takes a longer time period and a higher level of financing than previously expected. In North Korea, the cost would be even higher as North Korea is in a poorer economic state than East Germany yet has a larger population. North Korea contains about half of the population of South Korea, while East Germany contained only about a fourth of the population of West Germany. Likewise, North Korea has roughly one tenth of the per capita income enjoyed by South Korea, while East Germany had four tenths of Western per capita income.<sup>4</sup> Ballpark estimates for rebuilding North Korea range from \$330 billion to more than \$3 trillion over five years.<sup>5</sup>

B) South Korean inability and unwillingness to bear costs: South Korea would bear a heavy economic burden following unification. This burden would weaken a key U.S. ally. It also has made South Korea officials apprehensive about reunification. While the South Korean population continues to support the ideal of Korean unification, officials are reticent about the prospect of rapid and full unification.

C) Chinese opposition: China opposes Korean unification, fearing that unification would send waves of North Korean refugees over the shared Korean-Chinese border and shift the balance of power in the area, potentially expanding Korean and American influence at the expense of Chinese power. As the largest power in the region, its opposition severely limits the probability of successful unification.

D) North Korean Resistance: North Korea will resist any move towards unification because that would involve seceding to the South Korean government. Rather, the North Korean regime places survival, as seen by its continual military and belligerent posturing, as a primary goal.

2) Vietnam: Vietnam provides a second development model. Reunited in 1975 under a communist government, Vietnam experienced economic decline in the 1970s and 1980s.<sup>67</sup> The government responded to this economic downturn through gradual reforms, similar to the process in China, starting in the agricultural sector and expanding in 1986 to a full-scale reform policy known as *Doi Moi*. Reforms focused on decentralizing agriculture, opening up the Vietnamese economy to the world economy through increased exports and later the increased attraction of foreign direct investment (FDI)<sup>8</sup>, and macroeconomic stability. This process worked within the existing framework, preserving the party's political power and government control and maintaining the infrastructure

of state enterprises.<sup>9</sup> Unlike Germany, Vietnam has experienced overwhelmingly positive results from its transition with increased GDP growth<sup>10</sup>, increased agriculture production<sup>11</sup>, and decreased inflation rates.<sup>12</sup>

This experience makes the Vietnamese example a more attractive alternative for North Korean development. Benefits include A) increased economic stability and growth, B) ability to diversify funding sources, C) Chinese cooperation, and D) a higher level of North Korean cooperation, albeit limited by a lack of a commitment to reform.

- A) Increased economic stability and growth: Reform would help restart economic growth, eventually resulting in greater regime stability.
- B) Ability to diversity funding sources: Rather than burdening South Korea with the majority of integration costs, a gradual approach will allow diversification of funding sources. The longer time period will allow for alternate development funds to come from Foreign Direct Investment, loans from international financial institutions, and foreign aid.
- C) Chinese cooperation: The Vietnamese model would prevent a wave of North Korean refugees from entering China and would maintain the existing balance of power in the region. This approach would alleviate Chinese fears of U.S. domination and perhaps lead to Chinese assistance, since China has undergone similar gradual style reform.
- D) North Korean cooperation: Since the Vietnamese model assumes that North Korea will retain sovereignty, North Korea will be more willing to engage in this development model. However, one problem of the Vietnam example involves the uncertainty of future reform. No guarantee existed that Vietnam would continue to liberalize. This possibility would prove an even greater issue for North Korea where regime uncertainty and reversals in the realm of nuclear agreements already create problems. Although North Korea engaged in some reforms in 2002, it lacks a commitment to continual reform and has recently erased some of the gains by closing its economy in response to tensions over its nuclear program.

Given the clear benefits of the Vietnamese model, the United States must encourage a gradual development model in North Korea. This approach will require the United States to separate economic issues from the diplomatic issues of nuclear weapons and human rights when dealing with North Korea. Furthermore, any U.S. plan for integrating North Korea into the global economy should involve the following 4 components:

- 1). Encourage Chinese leadership in redeveloping North Korean. China has significant influence over North Korea because of their shared political ideology,

China's status as the North's largest trading partner, and China's status (when including trade flows) as the financier of half of the Korean deficit. Furthermore, China has experience with its own gradual reform and economic opening, experience that helped to form the framework for Vietnamese style reform. That same insight can be applied to North Korea to help guide reform and maintain political momentum by showing that political stability can accompany economic change. Encouraging China's leadership will also help to alleviate Chinese fears about increased US power by proving that the US respects Chinese importance and insight for the region.

2). Encourage the United Nations Development Project (UNDP), the International Monetary Fund (IMF), and the World Bank to offer technical assistance to North Korea despite its lack of full membership. Even though Vietnam did not have membership in these international financial institutions, the IMF helped Vietnam's stabilization process in the late 1980s, while the World Bank gave technical assistance to Vietnam via the UNDP. A similar approach should be applied to North Korea. At first, this assistance should focus primarily on technical advice in the form of leadership training and economic management courses. However, later, the relationship can evolve into full membership including monetary loans to encourage economic growth.

3). Strive to normalize relations with North Korea. This process involves:

A). Easing economic trade barriers towards North Korea. In June 2008, the US made a step in this direction by removing North Korea from the Trading with the Enemy Act. However, North Korean assets remain frozen while goods face higher tariffs to enter the United States. Moreover, the US restricts the export of luxury goods to North Korea as well as US economic assistance to North Korea, not including humanitarian assistance. The United States should work towards reducing these embargoes to encourage the idea of trade and to help open the North Korean economy.

B) Maintaining military force on the Korean peninsula. While this military presence creates tension with North Korea, it is needed to deter North Korea from military attack, especially if economic issues are no longer used in connection to military matters.

4) Encourage South Korea to engage in inter-Korean trade and to return to the Sunshine Policy. Currently, South Korean policy links economic assistance to North Korean cooperation in denuclearization and other matters. This represents a shift from the earlier Sunshine policy, which stressed diplomatic engagement and economic assistance regardless of North Korean posturing. The US should encourage the engagement strategy as a way to prevent North Korean isolation and collapse.

In the end, a prosperous economy will help stabilize North Korea, preventing a costly rapid collapse of the regime and possibly reducing its desire to develop nuclear development or engage in proliferation. The main challenge of the Vietnamese-style reforms will involve securing the North's commitment to reforms.

<sup>1</sup> Externally this has led to increasing trade deficits and debt, while internally this economic trouble has caused severe famine throughout the country.

<sup>2</sup> By 2003, net transfer from West Germany to East Germany amounted to 1,200 billion Euros, an amount almost equal to West Germany's GDP at the time of unification (3G5). These funds supposedly have supposedly slowed down but a new solidarity package promises 156 billion Euros until 2015 to invest further in eastern infrastructure. See Michael Kaser (2007). "East Germany's Economic Transition in Comparative Perspective". *Germany's Economic Performance from Unification to Euroization*. Ed. Jens Holscher. New York: Palgrave Macmillan.

<sup>3</sup> Within the first six months of 1990, industrial output plummeted by 60% as deindustrialization gripped East Germany. See Gerlinde Sinn and Hans Werner Sinn. (1992). *Jumpstart The Economic Unification of Germany*. Cambridge: MIT Press. Due to these declines, unemployment rose from around 0% before unification to 30% by the end of 1991. This unemployment has continued with unemployment rates of 10.1% in West Germany and 19.3% in East Germany as of March 2006. See Stephan Frowen (2007). "The Post Reunification Economy of Germany". *Germany's Economic Performance from Unification to Euroization*. Ed. Jens Holscher. New York: Palgrave Macmillan.

<sup>4</sup> Funke, Michael and Holger Strulik. (2005). "Growth and convergence in a two-region model: The hypothetical case of Korean unification." *Journal of Asian Economics* 16 pp 255 – 279.

<sup>5</sup> Library of Congress Research Division (Jul 2007). *Country Profile North Korea*. <[http://lcweb2.loc.gov/frd/cs/profiles/North\\_Korea.pdf](http://lcweb2.loc.gov/frd/cs/profiles/North_Korea.pdf)>

<sup>6</sup> Annual economic growth averaged only 0.4 percent that when combined with an annual population growth of 2.3 percent equated to an overall per capita economic decline. In fact, in 1979, industrial output fell by 9.6 percent, while in 1980, GDP dropped by 3.7 percent. Meanwhile, typhoons in 1980 wiped out 40 percent of Northern crops and forced Vietnam to import over 3 million tons of rice annually between 1977 and 1980. See DR SarDesai. (1998). *Vietnam Past and Present*. 3<sup>rd</sup> edition. Colorado: Westview Press; Arkadie, Brian Van and Raymond Mallon. (2003). *Vietnam a transition tiger?* Asia Pacific Press; and Kolko, Gabriel. (1997). *Vietnam Anatomy of a Peace*. London: Routledge.

<sup>7</sup> The 1980s saw further economic instability with high inflation and large government deficits. In 1986, inflation even reached 487 percent, making the macro economy severely unstable and preventing economic growth. See SarDesai

<sup>8</sup> At first, Vietnam had low levels of foreign aid due to the collapse of the Council for Mutual Economic Assistance as well as western embargoes. However, later increases in foreign aid and FDI made the Vietnamese economic growth sustainable.

<sup>9</sup> Although reform within these state run industries did occur and private firms did form, the state framework remained and little privatization of existing state enterprises occurred to transform the economy as seen in the German case.

<sup>10</sup> Vietnam avoided the traditional transition recession, and instead enjoyed an increased GDP growth rate up from 4.7 percent in 1989 to 8.1 percent in 1992. See Arkadie. Vietnam maintained this high growth rate throughout the 1990s, only slowing slightly in the Asian Financial Crisis of 1997. Yet, even then, the Vietnamese economy performed well, maintaining economic growth though at a slower pace of 5.8% in 1998, 4.8% in 1999, and returning to 6.8% in 2000. See Paul Gleww, Nisha Agrawal, and David Dollar ed.

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(2004). *Economic Growth, Poverty, and Household Welfare in Vietnam*. Washington DC: The World Bank.

<sup>11</sup> Agriculture output increased, from 1989 to 1999 increasing from 18.3 million tons to 27.5 million tons. This allowed Vietnam to become the third largest exporter of rice and the second largest exporter of coffee. See Nam, Pham Xuan, Be Viet Dang, and Geoffrey B Hainsworth (2000). "Rural Development in Viet Nam: The Search for Sustainable Livelihoods." *Socioeconomic Renovation in Viet Nam The Origin, Evolution, and Impact of Doi Moi*. Ed Peter Boothroyd and Pham Xuan Nam. Ottawa: International Development Research Center

<sup>12</sup>Meanwhile, by 1996 inflation rates decreased to below 5 percent. See Gleww. This was caused by the decrease of budget deficits from 10.3 percent of GDP in 1989 to around 1 percent of GDP in 1996. LeVigne, Marie. (2000). "Transition to the Market in Asia : The Case of Vietnam" *Planning, Shortage, and Transformation Essays in Honor of Janos Kornai*. Ed Eric Maskin and Andras Simonovits. Cambridge: MIT Press