

▶ Chapter 3

Guiding the North Korean Economy Toward Reform and Opening Up

——Inter-Korean Exchange and Northeast Asian Economic Cooperation

[Key Points]

- Estimates suggest that the North Korean economy has been considerably affected by the sanctions imposed by the international community since 2017. The Kim Jong-un regime has pursued a number of improvement measures, such as expanding the economic development zones and giving companies greater autonomy. However, it has recently been advocating self-reliance in order to withstand sanctions, bringing North Korea's economic policy and economic management to a turning point.
- Looking at the prospects for North Korea's future, a scenario involving reform and opening up would subject both North Korea itself and the international community to less political and economic shock than a scenario of transformation following sudden change. The former scenario is therefore more acceptable to both sides.
- As well as enhancing diplomatic activities aimed at denuclearization in North Korea, Japan and the rest of the international community should encourage the reform and opening up of the North Korean economy by mustering their collective wisdom to achieve a phased expansion in inter-Korean exchange and Northeast Asian economic cooperation.



Key Data

Inter-Korean Exchange and Northeast Asian Economic Cooperation

	Inter-Korean Exchange	Northeast Asian Economic Cooperation
Significance	<ul style="list-style-type: none"> • The peaceful denuclearization of the Korean Peninsula will be impossible without achieving stable, long-term coexistence between the two Koreas • Energizing North Korea's literal market economy and promoting reform and opening up of the economy 	<ul style="list-style-type: none"> • Achieving not only economic development, but also détente among the countries concerned, thereby contributing to the peace and stability of the region • Providing a focus in the event that North Korea agrees to denuclearization, to serve as a carrot to encourage change in North Korea
Considerations	<ul style="list-style-type: none"> • Conditions and timing are important, and efforts should be based on the international community's understanding and collaboration 	<ul style="list-style-type: none"> • Unilateral action by individual countries putting their own interests first risks feeding North Korea's dogmatic survival strategy
Examples	<ul style="list-style-type: none"> • Political and military dialogue, cultural exchange, humanitarian support, reunions of families separated by the Korean War • Resumption of economic cooperation, along with cooperation programs such as the Kaesong Industrial Park and tourism at Mount Kumgang 	<ul style="list-style-type: none"> • Infrastructure and energy cooperation • Japanese participation in the Greater Tumen Initiative (GTI)

1. The North Korean Economy at a Turning Point

The North Korean economy has seen a modest recovery and growth since the beginning of the 21st century, but the economic sanctions imposed on North Korea in 2017 by the international community — most notably those imposed by China — are presumed to have had a substantial impact on its economy. According to preliminary figures released by China's General Administration of Customs, the value of trade between China and North Korea in 2017 fell by 10.5% from the previous year to \$5.06 billion. The decline in imports was particularly marked, falling by 33% year-on-year to \$1.72 billion in 2017. China is North Korea's biggest trading partner, accounting for almost 90% of the latter's imports and exports. The Bank of Korea estimated North Korea's 2016 GDP growth rate at 3.9%, but this growth could possibly have been reversed by a substantial decline in 2017.

If North Korea is to achieve fully fledged economic development, turning around the deterioration in international relations resulting from its nuclear and missile development will be essential. Looking solely at the field of economics, North Korea will need to modernize its economy by such means as normalizing production and supply, increasing domestic demand, revitalizing distribution systems (markets), improving systems for providing the market with finance, reforming systems for allocating labor income and wealth (property), reforming state-managed strategic assets, furthering technological development, and reforming the conditions for international trade and investment.

Under the banner of its new strategic line of parallel economic construction and nuclear arms development, the Kim Jong-un regime has embarked on policy shifts in the economic field, such as the Socialist Corporate Responsible Management System, which involves granting companies self-management rights, as well as the expansion of economic and trade zones and economic development zones. The measures to improve economic management that are currently underway in North Korea are not regarded as measures aimed at transitioning to a new market economy, rejecting the previous economic system. However, the current changes in economic policy could be described as a positive process, in that they incorporate elements of a market economy, while maintaining the basic principles of existing economic policy. It would probably be fair to say that this is a North Korean-style process of change that flexibly interprets existing socialist economic principles and tailors them to the actual economic situation.

However, with North Korea becoming increasingly isolated in the international community, the future for such fresh changes is unclear. According to the bulletin of the East Asia Trade Research Board, a private sector group, North Korean economist Professor Ri Gi-song of the Institute of Economics at North Korea's Academy of Social Sciences told a visiting Japanese journalist on

January 18 that international economic sanctions were affecting four fields: (1) trade; (2) finance; (3) investment; and (4) science and technology. He disclosed that, in the realm of trade, fuel-related items in particular had been affected, while in the finance sector, North Korea was no longer able to make international settlements, placing a heavy burden on trade as a whole. The establishment of economic development zones was intended to revitalize the economy through domestic and international inward investment, but Professor Ri stated that investment from outside the country's borders had almost completely dried up.

Amid growing international tension over the nuclear issue, the Kim Jong-un regime is advocating the strengthening of the “self-sufficient national economy.” This means promoting the strategy called *charyok kaengsaeng* (“regeneration through one's own efforts”), which advocates self-reliance, free from dependence on cooperation from other countries. At the second plenary meeting of the 7th Workers' Party of Korea (WPK) Central Committee, which opened in Pyongyang on October 7, 2017, Chairman Kim Jong-un called for efforts to “further strengthen the power of the country under the unfurled banner of independence and self-reliance and thus decisively frustrate the reckless nuclear war provocation and sinister sanctions and pressure of the enemies.”

The change in economic policy will alter the nature of the socioeconomic system and the outcomes of economic management will directly affect the lives of the populace. If North Korea's domestic economic situation were to deteriorate, the resultant risks would not be confined to the economy and one cannot completely rule out the possibility that a contingency could occur. In the next section, let us consider several scenarios for the future of North Korea's economy and domestic governance.

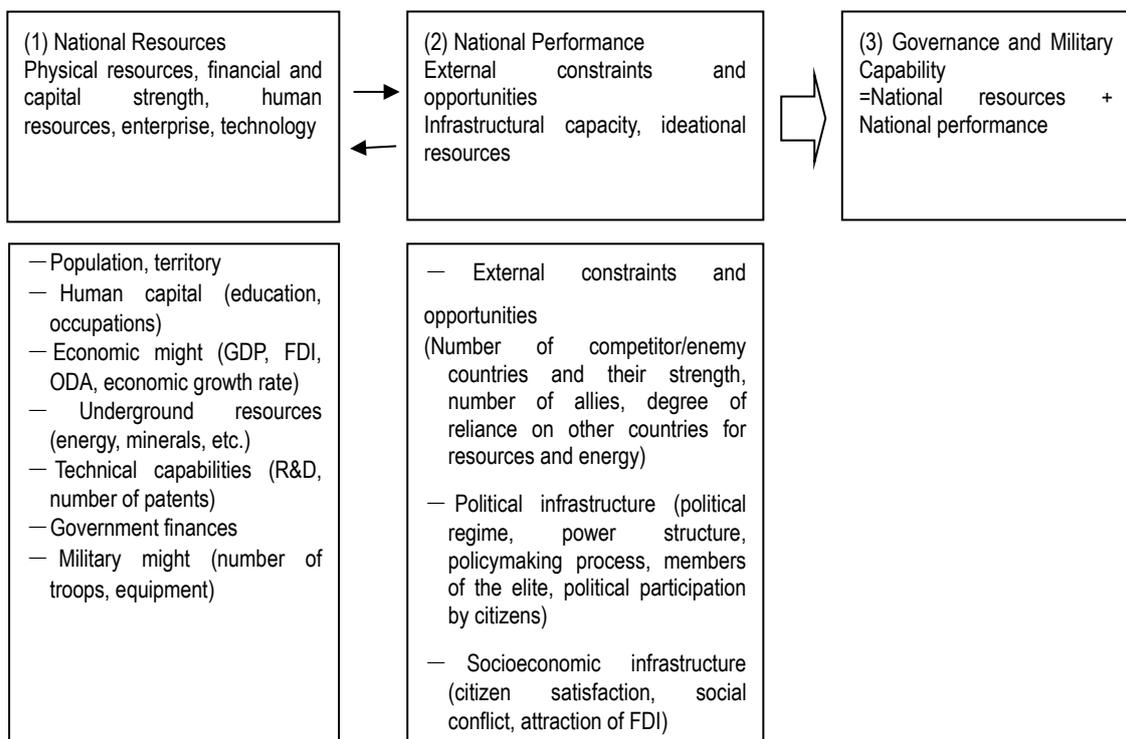
2. Scenarios for the Future of North Korea

2.1 Perspectives and Benchmarks Used in Scenario Analysis

Among the perspectives for forecasting the direction that North Korea could take in the near future are a variety of elements, including domestic governance capacity and external strategic capabilities at the national level, the legitimacy of the ruling group and internal power struggles, unifying and repelling forces acting on the administration at the level of the populace, and conflicts of interest and maintenance of equilibrium among stakeholder countries. Even in theoretical political science, there are various tools for analyzing changes in states and societies, from the theory of realism, which emphasizes state-centered power politics and security, to the theory of liberalism, which stresses international mutual cooperation and economic profit, and the theory of constructivism, which highlights changes in states brought about by the social and international interaction of identities.

This chapter analyzes North Korea’s national power based on the following benchmarks: (1) national resources (physical resources, financial and capital strength, human resources, enterprise, technology, etc.); (2) national performance (ability to turn resources into energy, external constraints, infrastructural capacity, ideational resources, etc.); and governance and military capability (=national resources + national performance). As the development (or lack thereof) of (1) national resources affects (3) military capability, the scenarios for national resources and national performance will be analyzed in combination.

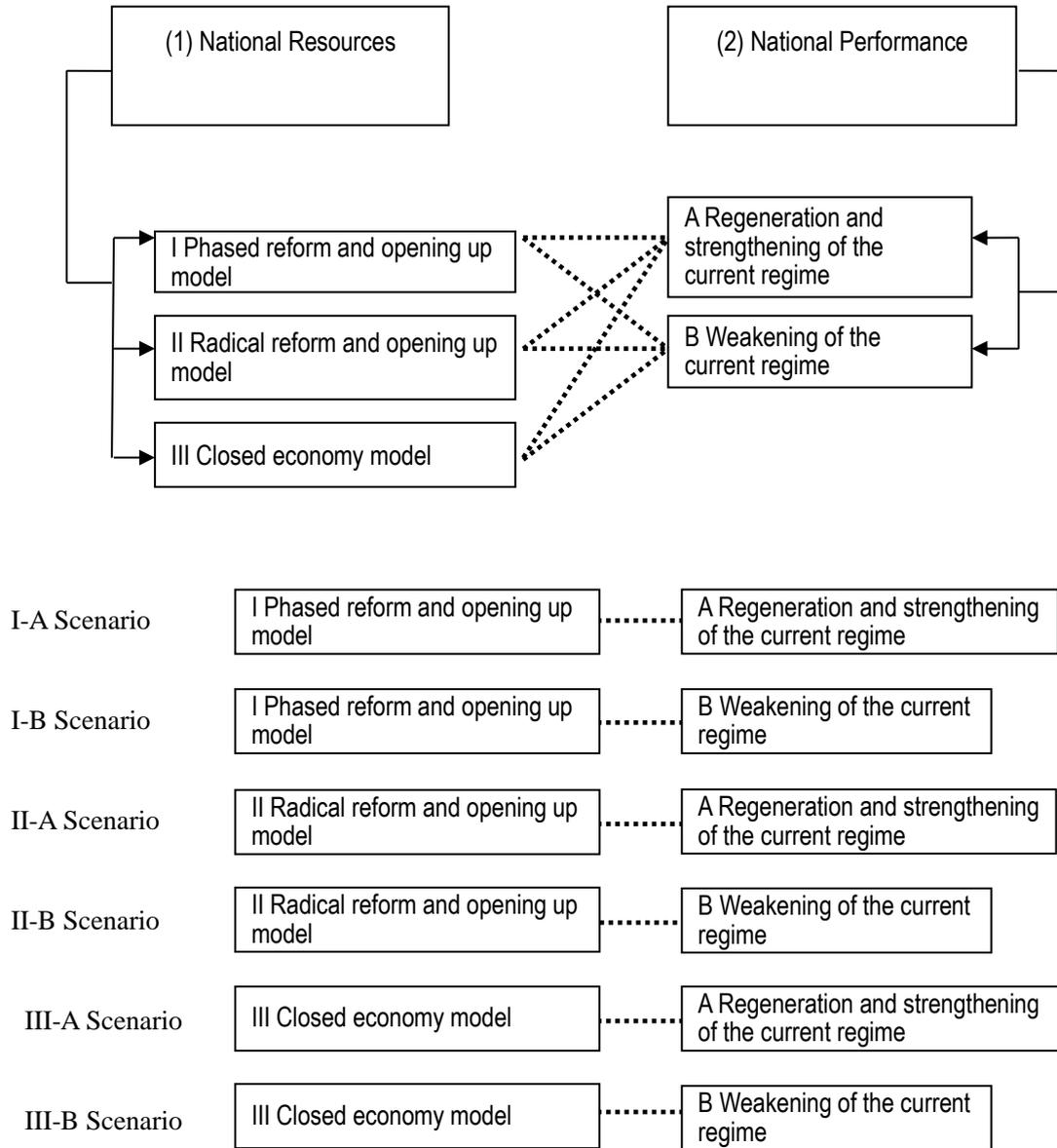
Figure 1 Benchmarks for Analysis of National Power



Source: Modified version of Ashley J. Tellis, et al., *Measuring National Power in the Postindustrial Age: Analyst's Handbook* (Santa Monica: Rand, 2000), p. 45

Combining the benchmarks of national resources and national performance as shown in the top half of Figure 2 gives the six possible scenario types shown in the bottom half.

Figure 2 Conceptual Diagram of Scenario Composition



2.2 Types of Scenario for the Future of North Korea

In the envisaged six types, factors such as North Korea's domestic situation and international relations intertwine to form specific scenarios.

① North Korean Internal Factors

<Economic Factors>

The following provide valuable information as factors determining whether the economy will

recover from its current situation.

N-1 Food supply situation

N-2 Munitions industry as a share of the economy

N-3 Proliferation of markets

N-4 Extent of foreign trade and investment by foreign enterprises

N-5 Operation and output of domestic factories

<Political Factors>

The following provide valuable information as factors determining the nature of the North Korean administration and policy reaction as each scenario unfolds.

N-6 The state of Kim Jong-un's health

N-7 Changes in the administration's core group

N-8 Presence/absence of an organized opposition

N-9 Conflict between policymaking groups

N-10 Changes in the power ranking between the WPK, the Cabinet, and the military

<Social Factors>

Social factors are another set of factors determining the regime's reaction in each scenario; the following provide valuable information.

N-11 Extent of the increase in the number of North Korean defectors

N-12 Changes in citizens' trust in ideational resources

N-13 Influx of information from the outside world

N-14 Level of blocking of external information and presence/absence of friction

N-15 Changes in consciousness among citizens and the elite class

N-16 Formation of civil society and presence/absence of opposition to the administration's leadership

② Status of International Relations

The following provide particularly valuable information from the perspective of the international nature of the Korean Peninsula issue.

S-1 South Korea's economic growth and financial capabilities

S-2 South Korean leadership's desire for unification

S-3 Changes in the US-South Korean alliance and/or Sino-Korean relations

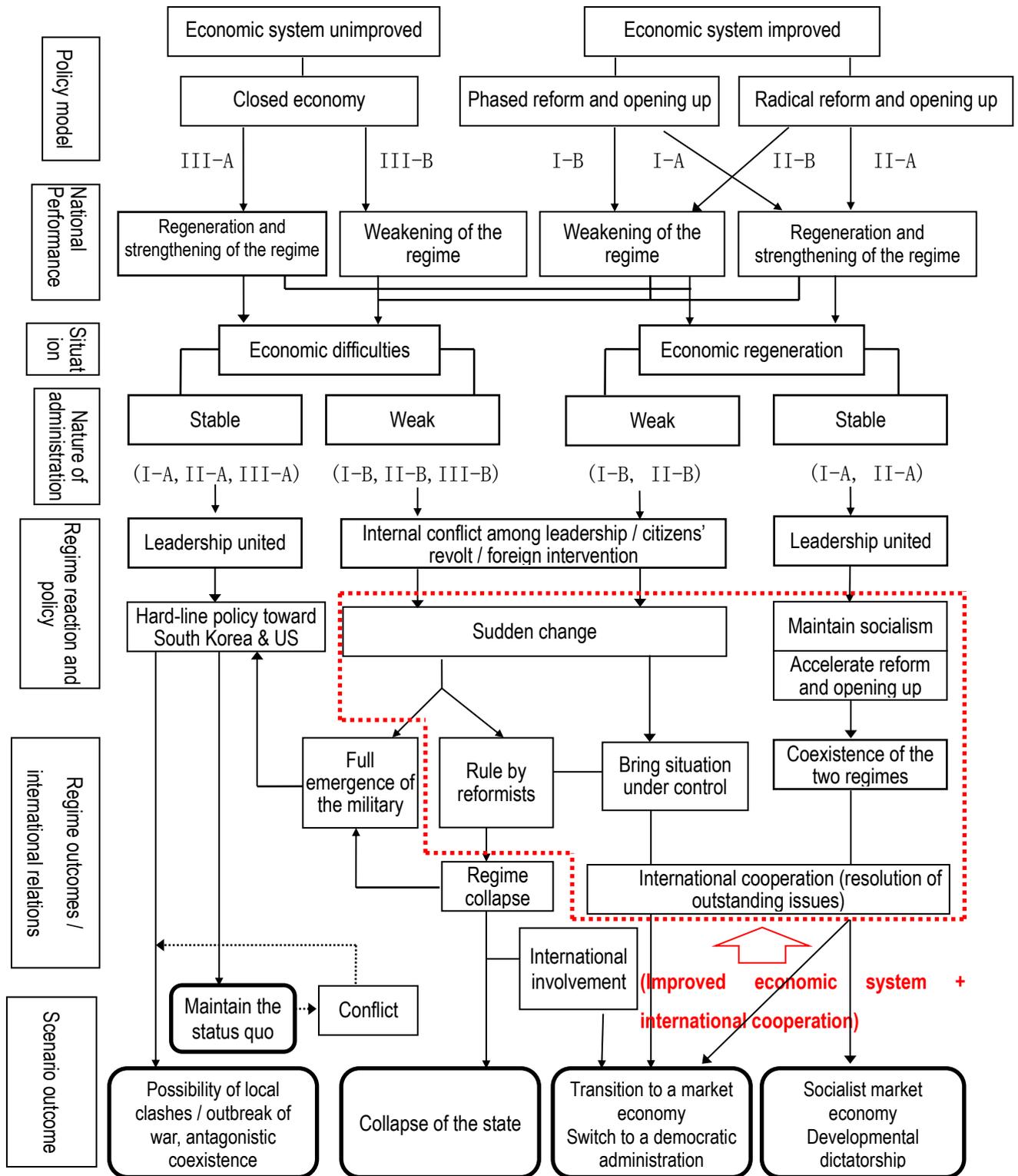
S-4 Support for unification within South Korean society

A-1 US policy on the nonproliferation of nuclear weapons and weapons of mass destruction (WMD)

- A-2 US policy toward China and relations with North Korea
- A-3 Possibility of dialogue between the US and North Korea
- A-4 Presence of US forces in South Korea
- C-1 China's economic support for / sanctions on North Korea
- C-2 China's guidance to North Korea in the areas of economic reform and opening up
- C-3 China's Korean Peninsula Policy (including relations with South Korea)
- J-1 Outstanding issues between Japan and North Korea
- J-2 Strengthening of alliances between Japan, the USA, and South Korea
- R-1 Russia's economic and military cooperation with North Korea
- R-2 Russia's status in Northeast Asia

Figure 3 shows the possibilities that emerge if we take an assessment of the foregoing factors as the central axis and then add in such factors as the nature of the North Korean administration, the unity of the leadership / potential for social disruption, and the presence or absence of reform.

Figure 3 Possible Scenarios for the Future of North Korea



2.3 Pattern Analysis of Scenarios for the Future

(1) Possibilities by scenario

As seen in Figure 3, there are five possible scenarios for the future of North Korea: (1) maintain the status quo; (2) war breaks out; (3) collapse of the state; (4) regime change (switch to a market economy and a democratic administration); and (5) reform and opening up (socialist market economy). Figure 4 shows the likely details of each scenario.

Figure 4 Details of Scenarios for the Future of North Korea

	Scenario Outcome	Details
(1)	Maintain the status quo	(i) Stable administration —Economic difficulties —Hard-line stance toward South Korea & other countries —Continued state of anxiety
(2)	War breaks out	(i) Stable administration —Deepening economic difficulties / failure of economic reforms —Hard-line policy toward South Korea & other countries —Local clashes / outbreak of war (ii) Weakened administration —Deepening economic difficulties / failure of economic reforms —Internal conflict among leadership / creation of refugees / social change —Emergence of reformists and failure of reforms —Full emergence of the military and local clashes / outbreak of war
(3)	Collapse of the state	(i) Weakened administration —Deepening economic difficulties / failure of economic reforms —Internal conflict among leadership / creation of refugees / social change —Emergence of reformists and failure of reforms —Collapse and disappearance of the state
(4)	Regime change (Market economy and democracy)	(i) Stable administration —Success of economic reforms —Change of track by leadership —International cooperation (ii) Weakened administration A. Continued economic difficulties —Internal conflict among leadership —Change in the military —Rule by reformists to bring the situation under control B. Implementation and failure of economic reforms —Social disruption —Change in the military —International cooperation to bring the situation under control C. Forced transformation via international involvement in the wake of sudden change
(5)	Reform and opening up	(i) Stable administration —Economic regeneration through economic reform and opening up —Coexistence of socialism with reform and opening up —Inter-Korean conflict / inter-Korean exchange

		(ii) Weakened administration A. Economic regeneration through economic reform and opening up B. Deepening economic difficulties and internal conflict among leadership —Change in the leadership —Social disruption and emergence of reformists —Peaceful coexistence with South Korea & other countries —Success of reforms and peaceful coexistence with other countries —Military cooperation —Military cooperation
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At present, North Korea has a strong ruling regime (demonstrates national performance) centered on the WPK, so the possibility that economic problems will lead immediately to political disruption (change) and regime change is relatively low and the potential for the collapse of the state is low. The possibility of North Korea itself embarking on an all-out war that would lead to the collapse of the state is even lower. While maintaining its current regime, North Korea is moving forward with partial economic improvement measures (the strategic line of parallel nuclear and economic development). Maintenance of the status quo is also conceivable, but, depending on the way things develop going forward, there is also a possibility of ensuring the safety of the regime, while promoting economic reform and opening up. Consequently, this chapter excludes the first three scenarios — (1) maintain the status quo, (2) outbreak of war, and (3) collapse of the state — and considers first the scenario of transformation after sudden change, and then the scenario of reform and opening up while still maintaining the current regime.

(2) Scenario of transformation after sudden change

The following are cases leading to a scenario of regime change involving a shift to a market economy and democracy in the wake of sudden change.

A. Failure of the current regime’s policy of maintaining the status quo (continued economic difficulties) and weakening of the regime

- As the North Korean administration’s policy of maintaining the status quo fails and economic difficulties deepen, social disruption occurs in the form of a flood of refugees, along with internal conflict among the leadership
- As a result of conflict over the economic regeneration strategy, a reformist faction pursuing the path of reform emerges and establishes a new government (change of administration or partial change)
- The military supports the path of reform

B. Promotion of economic reform by the present regime and weakening of the administration

- The present North Korean regime implements reforms to regenerate the economy

- While economic regeneration is taking place, an upsurge of popular sentiment triggers sudden change, leading to a change of administration
- The military supports the path of reform

C. Regime change and forced transformation via international involvement in the wake of sudden change

- The international community becomes involved when the domestic administration proves unable to bring the situation under control
- The military cooperates in the international involvement

(i) Example of regime change following sudden change

One example of regime change involving a shift to a market economy and democracy following a sudden change can be seen in the case of the countries of Eastern Europe.

Regime change progressed rapidly in Eastern Europe from 1989. Popular resistance to socialist regimes led to regime change. Elections were the means of achieving regime change. In Poland, the Czech Republic, and Hungary, the power of civil society served as the motive force driving regime change. On the other hand, in countries such as Romania, Bulgaria, and Albania, resistance in the form of an exodus of citizens to other countries led to regime change.

Cases in which the first transition away from a socialist regime began with liberalization and a change of leadership through elections attract attention as examples in which a change in the political regime brought about a transformation in the economic system. These transitions progressed along the following two courses.

- Early civil society formed → free general elections held in consultation with the Communist Party → popular movements achieve victory and Communist Party forces excluded (Poland, Czech Republic, Hungary)
- Early civil society formed and free general elections held → Communist Party forces excluded (Romania, Bulgaria, Albania)

While it could be said that Eastern Europe chose a radical approach to regime change, the approaches adopted in transforming economic systems differed from one country to another. Poland and the Czech Republic adopted a radical approach called shock therapy, while Hungary employed a progressive approach.

Figure 5 Eastern European Approaches to Economic Policy

Method	Details	State	Result
Shock therapy	<ul style="list-style-type: none"> – Privatization All assets privatized at once (pursuit of economic efficiency) – Price liberalization Prices liberalized at the same time as privatization 	Poland Czech Republic East Germany	<ul style="list-style-type: none"> – Disruption in the initial stage, including rising exchange rates, falling production, and mass unemployment – Stabilized from 1992-94
Progressive therapy	Reforms introduced progressively over a period of time, to enable the country to get used to a market economy	Hungary (Romania, Bulgaria)	<ul style="list-style-type: none"> – Economy was relatively stable – Economic recovery slowed – Although Romania and Bulgaria adopted progressive measures, their inflation rates were more than 100% between 1990 and 1995

Source: Compiled from various materials.

(ii) Suggestions based on Eastern European cases

The key to regime change in Eastern Europe was the fact that, following the change of administration in each country, the new leadership implemented both economic reform and regime change. Regime change took diverse forms, due in part to the fact that each Eastern European country differed from each other in such areas as their history, civil society formation process, culture, and religion. In Eastern European countries with few national resources, the weakening of national performance led to radical regime change. Central to this process was the formation of civil society. While the regime change scenario is a possibility, in many respects it is unclear whether or not Eastern European cases can be applied unaltered to North Korea, which pursued the path of Stalinist socialism immediately after colonial rule by Japan was brought to an end, building up a three-generation dictatorial regime under Kim Il-sung, Kim Jong-il, and Kim Jong-un.

(3) Scenario of reform and opening up

This is the scenario in which the framework of North Korea’s current systems is maintained, while promoting a policy of radical or progressive reform and opening up, with the present regime remaining stable as it becomes established. This scenario involves the following cases.

- The present North Korean regime transitions to a path to reform and opening up to regenerate the economy
- The policy of reform and opening up involves parallel strategies of maintaining socialism and undertaking economic reform and opening up, while safeguarding the ideational resources of “the revolutionary tradition of President Kim Il-sung”

- Through Chinese-style or more radical economic reforms, industrial production recovers and North Korea proactively promotes a policy of special economic zones
- North Korea's systems undergo partial change, while the existing adversarial relationship between North and South Korea continues and the division system between the two becomes more entrenched
- Inter-Korean relations improve and initiatives focused on reform and opening up accelerate within a state of peaceful coexistence

① Examples of scenarios for reform and opening up

Both China and Vietnam are model examples of this scenario. Here, we will analyze the example of Vietnam.

Around 1980, Vietnam's efforts to build its economy via the path of socialist revolution collapsed. Within the Communist Party, which had adopted a collective leadership system, a conflict over the strategy to be adopted arose between the faction advocating central control and the faction promoting liberalization. Due to regrets about the rapid pace at which socialism was adopted, resulting in such developments as the emergence of an anti-government movement among peasant farmers, agricultural reforms were implemented in 1979, including the introduction of a contract farming system and the dismantling of agricultural production cooperatives. These were accompanied by reforms of the industrial and service sectors. Since the adoption of the *doi moi* (renovation) policy at the 1986 party conference, the Communist Party government has been promoting reform and opening up.

Vietnam's reform measures in the 1980s were similar to those of China, but they attached greater importance to the recovery of the battered economy. In the 1990s, Vietnam implemented measures to encourage the development of a market economy, based on policy advice from the International Monetary Fund (IMF) and the World Bank.

Figure 6 Vietnam's Promotion of Policies to Develop a Market Economy

Reform and opening up for economic regeneration (1980s)	Encouraging the development of a market economy (from the 1990s)
<ul style="list-style-type: none"> – Central government power devolved to the regions and production units – Production units granted autonomy over management and finances – Reform of the egalitarian wage leveling system – Introduction of market principles to the pricing and distribution systems – Shift in emphasis from heavy industry to 	<ul style="list-style-type: none"> – Reform of rural communities – Price liberalization – Currency devaluation – Interest rate reform – Public finance reform – Encouragement of private enterprise – Proactive efforts to attract FDI – Trade reforms (abolition of import and export

agriculture, light industry, and trade – Promotion of a policy of opening up the economy to the outside world → Economic disruption due to such issues as annual inflation of several hundred percent and incompatibility with the legal system; unemployment surged; support from the Soviet Union halted → Full-scale promotion of the transition to a market economy (Debt carried over, meeting of donor countries organized by the World Bank)	controls) – Reinforcement of the safety net (support for the unemployed)
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Source: Compiled from various materials.

Figure 7 Classification of Periods in the First 20 Years of Chinese and Vietnamese Reforms

Category	China		Vietnam	
Stage 1	1978 onward	People’s communes dismantled	1979 onward	Burgeoning efforts to transition to a market economy; contract production by farmers introduced
Stage 2	1984 onward	Autonomy of companies extended; opening up of economy to the outside world gains momentum	1986 onward	Foundations for the transition to a market economy developed; reforms of companies and urban areas
Stage 3	1992 onward	Dramatic advances after Deng Xiaoping’s instruction to accelerate reform and opening up (in the <i>nanxun jianghua</i> (southern tour speech))	1991 onward	Full-scale promotion of the transition to a market economy, achievement of sustainable growth

Source: Teruyuki Tanabe, “Hikaku Kenkyū: Betonamu no Ikō Keizai Jirei Kenkyū” [Comparative study: Case study of Vietnam’s transitional economy], *Keizai kara mita Kitachōsen* [North Korea through an economic lens], Akashi Shoten, 2010, p. 222

The following policy goals were set in Vietnam’s policy of reform and opening up.

The first was the restoration of shattered production capabilities. Measures implemented to restore agricultural production in a country in which 80% of the population lived in rural communities included a system of contract production, the liberalization of distribution, the lifting of the ban on exports, and allowing land usage rights to be on sold or inherited. As a result, Vietnam went from being a country with food shortages to being a rice exporter. The foundations of the market mechanism were laid by deregulating the management of state-owned enterprises and liberalizing prices, as well as by switching to private management of enterprises.

The second goal was the stabilization of the economy. Vietnam carried out fiscal management in accordance with policy advice from the IMF and the World Bank, which alleviated the budget deficit.

The third goal was infrastructure development for the purpose of economic development. Both hard (physical) infrastructure — such as industrial parks to attract foreign capital, as well as roads, gas supply infrastructure, hotels, and residential areas — and soft (legal systems) infrastructure was put in place.

As these policies focused on reform, opening up, and the introduction of a market economy gained momentum, Vietnam's economy experienced ongoing high growth and government debt underwent a sharp reduction from 250% of gross domestic product (GDP) in 1992 to 38% in 2002.

② Pointers based on Vietnam's example

At the outset of the reform process, Vietnam was an agrarian country in which agriculture accounted for the majority of industry, so it had a simple industrial structure in which the economy would function as long as productivity in the agricultural sector was restored. The leadership of the Communist Party of Vietnam remained free from excessive competition among individual leaders and adopted the basic principle of consensus building based on comparatively free discussion, so not a single violent purge took place. Vietnam used foreign aid (grant aid and loans) to fund the development of electric power, roads, and other infrastructure, as well as promoting industrialization through the introduction of private sector funding via foreign direct investment (FDI). A meeting of donor countries convened by the World Bank played a central role in rolling over debt repayments, fiscal stabilization, and the development of a market economy.

From this perspective, Vietnam differs greatly from North Korea in terms of the level of national resources and national performance. Vietnam's example provides pointers concerning a phased approach to economic reform and opening up, as well as the method employed in foreign relations. If North Korea maintains the framework of its current regime, one cannot expect to see major changes from the current situation, in which the country's access to financing is blocked by the international community. The key lies in how to secure funding and goods from friendly countries and how to attract FDI. A scenario involving reform and opening up would subject both North Korea itself and the international community to less political and economic shock than a scenario of transformation following sudden change. The former is therefore more acceptable to both sides.

3. The Future Direction of the Situation on the Korean Peninsula and the Economic Card

3.1 The Effects and Limitations of Economic Sanctions

What is unfolding at present is a struggle over North Korea's nuclear weapons and missiles in which the security of the other countries concerned is at stake. In the short term, there is little scope for economic issues to make it onto the agenda. However, the economy could become a crucial card when looking at a long-term strategy aimed at achieving the denuclearization of North Korea and at the future of Northeast Asia.

Even now, a series of offensive and defensive moves involving the economy is playing out between Japan and the US, among others, on the one hand, and North Korea, on the other. The economic sanctions against North Korea are a prime example of these. Between October 2006, when North Korea conducted its first nuclear test, and the end of 2017, the United Nations Security Council adopted 10 resolutions imposing fresh sanctions on North Korea. Initially, the sanctions were limited to such items as weapons and materials directly related to North Korea's development of weapons of mass destruction, as well as luxury goods, but in recent years, the focus has broadened to encompass the ability to develop weapons of mass destruction, with restrictions imposed on the mineral resources that form North Korea's main exports. Items for civilian use have also been targeted of late, with limits on exports of clothing produced under contract manufacturing, as well as marine produce and even labor. Sanctions have taken on an increasing tinge of containment, spreading the net widely across North Korea's foreign economic activities to curb its ability to develop weapons of mass destruction.

Under the banner of "maximum pressure," the US made clear its intention to embark in earnest on secondary sanctions, imposing autonomous sanctions on companies and financial institutions in third countries that engage in illegal transactions with North Korea. It is because of the existence of brokers in countries such as China that North Korea has, until now, been able to access the international financial system and expand its foreign economic activities despite the imposition of sanctions by the international community. Secondary sanctions target such brokers. It is hoped that this will also have a psychological effect in curbing transactions with North Korea, as banks on which sanctions have been imposed are shunned by other banks.

Sanctions will regulate the extent of North Korea's foreign economic activities and the transaction costs thereof. If the content of sanctions is tightened and the number of countries that comply with them increases, North Korea will find it markedly more difficult to engage in economic transactions with other countries. Attempts to evade sanctions will entail even higher costs than before, from the perspective of developing new markets and methods of doing business. It is only natural to conclude that, if the effort and risk involved in doing business increase, the fees that brokers charge to use their services will also rise. In other words, it will be high risk for high

returns.

Another line of analysis argues that North Korea has actually increased its ability to procure the goods that it needs, because it has already secured highly capable brokers, such as Chinese companies, by paying large sums in fees, despite being subject to sanctions. Countries such as Japan and the USA argue in favor of tightening UN sanctions and urge UN member countries to abide by them, with the objective of pressuring North Korea into a policy change aimed at achieving denuclearization by increasing the cost of North Korea's foreign economic activities to the very limits. North Korea could conceivably move to procure the requisite goods irrespective of cost, if it deems them essential to the completion of its nuclear missile program. However, it is anticipated that there will be a substantial impact on trade in other goods. There is also a possibility that the lifestyle of the populace could take a direct hit as a result of North Korea's economic difficulties, which could affect governance by the Kim Jong-un regime as it pursues its strategic line of parallel economic construction and nuclear arms development.

On the other hand, fundamentally speaking, there are constraints on the effectiveness of economic sanctions, as well as political limitations due to the international situation. Specific issues identified include (1) the existence of countries that do not comply with sanctions or which have difficulty in complying with them; (2) issues with the substitutability of goods; (3) problems relating to the impact on ordinary citizens in sanctioned countries; and (4) the associated destruction of the existing economic order.

The destruction of the existing economic order encompasses the expansion of black market transactions and economic crime; in the case of North Korea, which is undertaking nuclear development, the ace up its sleeve is the possibility of procuring funding via nuclear proliferation. Vessel inspections and naval blockades intended to stamp out black market transactions run the risk of heightening military tensions. One cannot completely discount the possibility that the embattled Kim Jong-un regime might even choose the path of explosion rather than implosion. Even if one wanted to further tighten sanctions or eradicate sanctions-busting, there is the question of what should be done and how far those steps should be taken. It seems likely that the international community will need to make a comprehensive judgment that takes foreign policy and military affairs into account.

3.2 Shifting to a Path of Dialogue and Potential for Trade

As tensions over the North Korean nuclear missile issue rise on the Korean Peninsula, there is a possibility that foreign policy focused on North Korea could itself reach a turning point. Whereas Japan and the US are advocating maximum pressure through economic sanctions and the like,

South Korea has taken the opportunity presented by the Pyeongchang Olympics and Paralympics to devote its energies to inter-Korean dialogue. China and Russia are both seeking a solution via dialogue, with China proposing a “double freezing” initiative under which North Korea would freeze its nuclear and missile activities, while the US and South Korea froze their joint military exercises, along with “dual-track parallel advancement” toward the denuclearization of the Korean Peninsula and the creation of peace mechanisms on the peninsula. The path chosen by the international community going forward is likely to substantially influence the content of sanctions and the approach to economic exchange with North Korea.

Economic assistance has featured in previous deals relating to the North Korean nuclear issue. In the 1994 US-North Korea Agreed Framework, the US and other nations agreed to provide energy assistance in exchange for North Korea freezing its nuclear development program. The US supplied North Korea with heavy fuel oil, while an international consortium centered on South Korea and Japan provided support for the construction of light water reactors. Energy assistance was also incorporated into the 2005 Joint Statement of the Six-Party Talks, which was aimed at North Korean denuclearization.

Now that North Korea has reached the final stage in its development of nuclear missiles, many argue that it should not be allowed to buy time or renege on its end of the deal under which it received support. However, others take the view that some kind of deal will need to be made at some stage. Experts in the field of security and foreign policy are even discussing proposals for a phased deal involving a long-term plan under which North Korea would denuclearize on the basis of the following process: halt tests → mothball nuclear facilities → monitor nuclear material → disable nuclear facilities → dismantle nuclear facilities. In return, the US and other countries would provide support in such areas as joint peaceful use of nuclear energy + joint space development + humanitarian aid → human resource development + technical assistance → basic infrastructure support → advanced infrastructure support. North Korea’s nuclear and missile development will be contained through the joint peaceful use of nuclear energy and joint space exploration. This plan is based on the fact that North Korea regards nuclear power and space exploration as a means not only of ensuring its security, but also of achieving economic development.

What the international community can offer North Korea is the phased relaxation of economic sanctions; humanitarian aid in such fields as health and medical care; approval for inter-Korean economic exchange; gradual escalation of the exchange of people and goods between the US and North Korea, and between Japan and North Korea; development of human resources and of agriculture and rural communities; cultural and educational exchanges; economic assistance in such areas as infrastructure development; and the normalization of diplomatic relations between the US

and North Korea, and between Japan and North Korea.

In the event of a shift to the path of dialogue, there will be the question of whether the central framework will be bilateral (for example, between the US and North Korea, or between North and South Korea) or multilateral. In addition to four-party talks involving the two Koreas, the US, and China, previous experiences of multilateral discussions include the Six-Party Talks, which also involved Japan and Russia. The deal could possibly be executed over the long term in ten-year increments; the country that formulates the most rational and practical plan based on the optimal timing will lead the process.

3.3 Points to Note Concerning Inter-Korean Exchange and Northeast Asian Economic Cooperation

Solidarity among the international community will be essential when embarking on dialogue with North Korea. Previously, a lack of unity among the international community produced gaps that North Korea was able to exploit to continue its nuclear and missile development. Moreover, each country pursued economic activities for its own ends, permitting North Korea to take advantage of the situation and pursue a self-centered survival strategy. To ensure that the failures of the past are not repeated, the international community must work in close partnership in the area of economic activities and address the situation strategically.

The Pyeongchang Olympics were the catalyst for inter-Korean dialogue; discussion of the pros and cons of inter-Korean economic cooperation must go beyond South Korea to encompass the international community. North Korea will at some stage pursue the relaxation of economic sanctions and seek to embark on economic cooperation, and there is concern that international collaboration will collapse if this comes to fruition.

However, the resumption of inter-Korean dialogue, exchange, and cooperation should not be excessively restricted. This is because, as pointed out in Chapter 1, the nuclear and missile issues stem from the division of the Korean Peninsula and the rivalry between the two regimes, so the peaceful denuclearization of the Korean Peninsula will be impossible without achieving stable, long-term coexistence between the two Koreas

If inter-Korean cooperation results in the development of North Korean economic infrastructure, a kind of mutually dependent inter-Korean economic community could emerge in the future. It is hoped that the easing of economic sanctions, along with inter-Korean exchange, will actually energize North Korea's literal market economy and promote economic reform and opening up. The reform and opening up of the economy will lead to the North Korean regime becoming more flexible.

If inter-Korean dialogue advances in due course, specific economic cooperation projects are likely to emerge, in addition to humanitarian support for North Korea and the resumption of reunions of families separated by the Korean War. The first such projects could conceivably be the restart of operations at Kaesong Industrial Park, which was closed as a result of the sanctions against North Korea, and the resumption of the Mount Kumgang tourism project.

These are projects that earn cash for North Korea, but the conditions for implementation and the timing are the problem. Inter-Korean exchange should be based on the international community's understanding and collaboration. The stabilization of the region that would result from improved inter-Korean relations, and indeed, the reform and opening up of the North Korean economy itself would also be desirable for Japan. If the conditions are met, it would be fine for Japan to engage in cooperation appropriate to each phase.

Other countries, too, should emphasize international collaboration in economic activities involving North Korea, refraining from unilateral actions that prioritize their own interests. One of the factors behind North Korea's success in achieving modest economic growth since conducting its first nuclear test in 2006, despite the UN's imposition of sanctions, is the growth of North Korean trade with China. Some have commented that Premier Wen Jiabao's agreement to expand economic cooperation, reached in 2009 during his visit to North Korea after the second nuclear test, was regarded as a seal of approval and acted just like a shot from a starting pistol, with Chinese companies stepping up their business with North Korea — including illegal activities — thereafter.

One line of thinking is likely to focus on multilateral international cooperation projects, to enable the international community to work together and respond strategically, without allowing individual countries to steal a march on others in economic activities involving North Korea. Aside from the North Korean nuclear and energy problems, security and historical issues still remain in Northeast Asia. Multilateral cooperation in such areas as logistics infrastructure development and energy cooperation has advantages not only in an economic sense, but also in terms of contributing to the peace and stability of the region through *détente* among the countries concerned.

For example, there is the Greater Tumen Initiative (GTI), a comprehensive development plan for the Tumen River Area, focused primarily on the region where the borders of North Korea, China, and Russia meet. China, Russia, South Korea, and Mongolia are members of the initiative, which is supported by the United Nations Development Programme (UNDP). Japan did not participate from the outset, while North Korea was previously a member, but subsequently withdrew.

With North Korea having dropped out of the project, now might be the right time for Japan to become involved. If the US also became involved and the participants drew up a vision for international economic development, there would be scope for North Korea to join the framework,

if it agreed to denuclearization. This could be turned into one ingredient that would encourage change in North Korea by setting out a realistic vision for the future of Northeast Asian economic cooperation that includes North Korea.

As seen in the scenario analysis, reform and opening up would involve less political and economic shock than a scenario of transformation following sudden change, and would therefore be more acceptable to stakeholder countries, as well. As the third generation, Kim Jong-un and his regime dislike the term “reform and opening up,” associating it with a rejection of the policies of the previous two generations, but it is vital to substantively guide North Korea in that direction. There are matters that must be considered now, to encourage the reform and opening up of the North Korean economy, as well as addressing the pressing nuclear and missile issue. Japan has various economic cards that it can play, even before embarking on the normalization of diplomatic relations with North Korea, which will be a prerequisite for the resolution of both the abductions issue and the nuclear and missile issues.

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