



Policy Forum 07-082: Economic Implications of Summit Agreement



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By Stephan Haggard and Marcus Noland

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I. Introduction

Stephan Haggard, Director of the Korea-Pacific Program (KPP) at the University of California at San Diego, and Marcus Noland, Senior Fellow at the Peterson Institute, write, "Ultimately the success of the program sketched out in the summit announcement will depend on the intentions of the North Koreans. Pyongyang could use the assistance offered by the Seoul to leverage its own reform program. However, it could take the aid and simply retreat into its shell, avoiding real reform and a verifiable resolution to the nuclear issue. Only time will tell."

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II. Article by Stephan Haggard and Marcus Noland

- "Economic Implications of Summit Agreement"

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The success of economic cooperation projects depends on the intentions of North Koreans.

The Arabs have a proverb: "He who foretells the future lies." The recent summit announcement may make many people liars, not the least its authors. The problem with the summit announcement is that its ultimate impact depends on three major unknowns: the attitude and commitment of the next South Korean president; the willingness of the North Koreans to embrace reforms; and progress-or lack thereof-on resolving the North Korean nuclear issue.

The summit and the nuclear controversy are inextricably linked, even if Roh Moo-hyun and Kim Jong-il may have wished to downplay it, and the summit announcement must be evaluated in the context of the nuclear matter. The nuclear issue provides a great opportunity for North-South reconciliation but also sets limits on how fast progress on other fronts can be made.

On the one hand, aid from Seoul may act as inducement for Kim Jong-il to resolve the nuclear issue; this has long been the claim of proengagement politicians. On the other hand, Seoul will receive little support for its diplomacy from the United States, Japan, and other countries if it moves forward aggressively on economic cooperation before the North Korean regime shows a genuine willingness to abandon its nuclear weapons program.

Indeed, the risk is that aid from the South could reduce economic incentives on the North to cooperate and undercut the negotiations. Pyongyang's celebration of the first anniversary of its nuclear test underscores that achieving this goal could prove an arduous march of its own.

Yet there are signs of hope. The summit document did make a reference, however brief, to resolving the nuclear question and in the context of the six-party talks the North Koreans have-almost simultaneously-agreed to a timetable for the dismantlement of existing nuclear facilities. The summit agreement also contains some important confidence building measures, including most notably a commitment to address conflicts over the disputed boundary in the West Sea that has led to military engagements in the past.

However, all parties have to date studiously avoided mention of what will be done with North Korea's stocks of nuclear weapons and fissile material. And talk of a final peace settlement to replace the armistice puts the cart before the horse; in the absence of a resolution to the nuclear question it would make little sense to negotiate a broader peace agreement.

If these issues can be resolved the next hurdle is North Korea's willingness to embrace economic reform. The summit document lays out a number of economic cooperation projects that could be beneficial to both North and South Korea: reestablishment of trans-Korean transportation links; expansion of the Gaeseong Industrial Complex and its replication in other locations; and cooperation in specific industries such as shipbuilding where complementarities would seem to exist between North and South Korean capabilities. All of these are positives.

Yet the projects, while desirable, will have a limited impact as long as North Korea avoids the challenge of broader opening and reform. North-South discussions appear to have avoided the basic

building blocks of a market economy-operation of markets, enterprise management, agricultural reform-which would allow the North Koreans to make the most of the aid that they will receive. The long history of aid to other developing countries suggests that aid can be futile, even counterproductive, in the absence of complementary reforms.

Moreover, South Korea's engagement-in contrast to China's-remains bottled up in physically and economically delimited projects such as Gaeseong and the Mount Geumgang tourism venture. This situation is regrettable because it is only by broadening contacts with profit-oriented South Korean firms that their North Korean counterparts will learn about the operation of a market economy. Pyongyang continues to resist broader opening, presumably due to concerns that more contact with South Korea could be politically destabilizing.

South Korean analysts are already calculating the costs and benefits of the program outlined in the summit announcement, with one press account describing the costs as "astronomical." Even the high-end estimates, on the order of \$11 billion and more, are a mere drop in the bucket compared to the ultimate costs of rehabilitating the North Korean economy and providing a stable basis for eventual unification. If nothing else, such analyses should stimulate a serious discussion in South Korea of the long-term costs and benefits of different contingencies on the peninsula including the possibility of regime collapse, a discussion that, regrettably, has largely been avoided.

The resolution of outstanding security issues on the peninsula is an important precondition for broader reforms to really work. It is unlikely that foreign investors from the United States, Japan, or Western Europe are going to take a serious interest in the country in the absence of a resolution of the nuclear question. The summit announcement is unlikely to have much of an impact on the passage of the Korea-US free trade agreement (KORUS FTA) in the US Congress. But if North and South Korea push forward with the phase II expansion of the Gaeseong complex in the absence of resolution of the nuclear issue, it would make passage of the KORUS FTA agreement in the US Congress more difficult.

Ultimately, these issues will be laid at the doorstep of the next South Korean president. One contender, Lee Myung-bak, has already expressed reservations about the open-ended nature of South Korean commitments. But whoever enters the Blue House in February 2008, the president-elect will have to make their own decisions on how to approach the North and may not be bound by a document negotiated by an unpopular lame duck president. The 2007 summit announcement may end up like the 1991 North-South Denuclearization Accord, amounting to little more than a statement of good intentions rather than a map for subsequent policy.

The two agreements differ in one significant respect, however. The big budget projects of the summit announcement may create constituencies in South Korea in favor of expanded engagement for purely self-interested reasons. The next South Korean president may confront South Korean corporations lobbying for expansion of contact for the contracts or subsidies they bring regardless of the broader political or diplomatic ramifications.

Ultimately the success of the program sketched out in the summit announcement will depend on the intentions of the North Koreans. Pyongyang could use the assistance offered by the Seoul to leverage its own reform program. However, it could take the aid and simply retreat into its shell, avoiding real reform and a verifiable resolution to the nuclear issue. Only time will tell.

III. Nautilus invites your responses

The Northeast Asia Peace and Security Network invites your responses to this essay. Please send responses to: napsnet-reply@nautilus.org . Responses will be considered for redistribution to the

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