

Transformation and Modernization of North Korea: Implications for Future Engagement Policy

Bradley O. Babson
Independent Consultant

This paper was produced as part of the project “Improving Regional Security and Denuclearizing the Korean Peninsula: U.S. Policy Interests and Options.”

Transformation and Modernization of North Korea: Implications for Future Engagement Policy

A U.S. strategy for pursuing long-term goals in North Korea policy should include as an integral component, American interests in transformations taking place inside the country and in economic as well as security relations with its neighbors and the international community more generally. These transformations are inevitable and in fact are well underway. But the ultimate outcome is uncertain, and the process of change is largely reactive and so far has not been guided or managed coherently by the North Korean authorities. In order to construct policy responses and actions that will advance essential American interests, it is necessary to seek to understand the dynamics of transformative change already taking place and potential courses that future developments could take. The overall objective should be to try to influence the course of transformational change to avoid outcomes that are inimical to long-term U.S interests, and to encourage and support changes that would be compatible with these interests.

In pursuing this objective, the U.S. should take actions that will affect the incentives for desirable change and disincentives for undesirable change. In addition, the U.S. should provide political and financial support for activities that will further U.S. goals both bilaterally through official and non-governmental channels, and through complimentary policies and activities of other countries and organizations in multilateral and bilateral frameworks for engagement.

The scope and modalities for actions that are feasible to consider will be affected by the general environment of U.S.-North Korean relations. Thus it is important to calibrate the strategy, policies and actions to the different situations the U.S. may face in engaging North Korea. For the purpose of this report, two such situations are assessed: North Korean intransigence coupled with escalatory and retrogressive actions, and a fresh start in bilateral and multilateral engagement following the recent nuclear test and breakdown in the Six Party Talks process.

Dynamics of Transformational Changes Already Underway

North Korea’s isolation and secretive practices pose a major challenge for efforts to understand and influence the dynamics of change within the society and system of governance. Nevertheless, it is possible to discern a number of distinct themes that illuminate the nature of the changes that are taking place. Ultimately these dynamics of change could lead North Korea towards becoming a “normal” state; or they could lead to increasing internal fragmentation of interests and political conflicts that could be destabilizing. The former direction would be conducive to pursuing a roadmap for desirable transformations in security and economic relations, while the latter direction would pose new challenges for both the leadership and the international community. Thus it is important to try to understand the nature of these changes and assess the implications for domestic policy for managing change and for international engagement.

Contending With Expanding Market Economic Forces

Since the early 1990's, North Korea has been adjusting to two important economic realities. One is the fact that following the collapse of the former Soviet Union and as a result of Chinese economic reforms, all of North Korea's external economic relations are now with market economies. North Korea has been forced to contend with the gulf between its state-directed non-monetized economic system and a world where money matters and where prices and the decentralized decision-making of markets dominate economic activity. The counterpoints to this increased need to understand and find ways to deal with international markets are aid provided by governments, international organizations and NGOs given for political or humanitarian purposes, and North Korea's state-sponsored efforts to produce counterfeit currency and pursue criminal rather than commercial markets for its illicitly produced goods.

It is not surprising that the North Korean leadership has devoted considerably more effort to seeking aid from foreigners and making money from illicit products and military industry sales to governments in Africa and the Middle East, than earning foreign exchange through an aggressive outward-oriented commercial trade and economic development policy. Becoming a successful player in the international economy will require major not minor changes in the domestic economic and financial system. While some efforts have been made in this direction, notably in the legal system for attracting foreign investment, North Korea remains largely naïve and vulnerable to international market forces and the impact of political and security policies on its economic interests. Nor has North Korea faced up to the policy and institutional changes required to become a competent and reliable player in the international economy. But the pressures to move in this direction are strong, especially if politically motivated and humanitarian aid flows continue to decline and military and criminal sales are curtailed by internationally supported efforts such as the Proliferation Security Initiative (PSI) and cooperation in international anti-money laundering and other sanctioned financial transactions.

The rapidly expanding but somewhat chaotic economic relationship with China is a positive indicator of North Korean acceptance of the necessity of expanding external market-related economic relationships, but also illustrates the lack of coherent policy and management of this process. Cross-border trade is essentially unregulated and most is conducted on a barter basis by individuals or enterprises with little direct involvement on the part of the Chinese government, accompanied by predictable corruption among North Korean security and enforcement personnel in the border areas.

The joint Korean efforts to pursue commercial economic ties through the Kaesong enterprise zone and expanding processing on commission trade are two other models of cross-border economic cooperation that have promise, but as recent events have shown, these are vulnerable to souring political relations between the two Koreas. The damage done by North Korean repudiation of wage, land and transport agreements that have underpinned the commercial viability of the private investments in Kaesong, threatens to set back investor confidence and inter-Korean economic integration aspirations in a major way. In sharp contrast to the economic activities on the China border, inter-Korean

economic activities are infused with government involvement on both sides, with market forces playing a subservient role that have in fact been undermined by South Korean willingness to provide bribes and other cash payments for North Korean concessions that have not always been based on commercial principles. North Korea has a long way to go to learn how to do business the “right way” for success in the international economy where markets and risk assessments of private investors really matter.

The second reality that North Korea is contending with is the growth and diversification of markets inside the country. These markets developed during the famine of the mid-1990’s as a grass-roots response to the breakdown of the Public Distribution System and the inability of the state to provide for the basic needs of the population. Along with the growth and diversification of the markets both in number and the range of goods available, there has been increasing monetization of the markets as they have evolved from barter trade to widespread use of both domestic and foreign currencies. This has complicated monetary management of the economy by the central financial authorities for which they were unprepared, and financial system reforms have not kept up with the evolution of market-based transactions and household and enterprise savings and investment activities.

The Constitutional changes adopted in 1998 that legalized the concept of profit making, and the economic reforms of 2002 and 2003 that monetized the economy by raising official prices to market-determined levels at that time, legalized the markets, and allowed state enterprises to engage in market transactions, should be understood as backward not forward looking measures. The reforms should not be seen as a policy-led economic transformation process, but rather as a reactive response to what defacto had become a practical reality that the leadership had to accept and legitimize. This reveals an important insight into the dynamics of change in North Korea, which is that it is not being guided by a knowledgeable policy process but by knee-jerk responses to perceptions of the implications of dynamics that have been unleashed by a changing environment for governance and the fact that other-than-elite households now depend on markets and not the state for their survival. Since 2005, the central authorities have pursued a number of initiatives to reign in the domestic markets and subject them to more disciplined state control. But the continued resilience of the markets and patchy compliance by local authorities with directives from the center are testaments to the limitations of state power in the present realities of North Korea. This applies both to the behavior of households and enterprises pursuing their own interests, and the behavior of local government officials who have to balance local political and economic realities with the imperatives of the governing elite in Pyongyang.

Changes in the Social Contract

From the beginning, the social contract of North Korea was an exchange of loyalty to the leadership for cradle to grave sustenance from the state. This contract started fraying at the seams in the 1980’s and was seriously eroded by the famine of the 1990’s. Despite the enormous investment in political education of the population from a very early age, the failure of the state to sustain the basic needs of the people led to both an economic

and psychological distancing that has fundamentally altered the domestic equation in North Korea.¹

The expansion of markets has contributed in a critical way to this process. By participating in markets, ordinary North Koreans experience the freedoms that come with consumer choice and returns to their own initiatives. Self-reliance in North Korea now is more in keeping with the Ralph Waldo Emerson version of self reliance of the individual than the *Juche* version that conceives of self reliance of the state. While the state is still powerful in its ability to control the population through fear and coercive means through the state security apparatus, it has been losing control over the psychology of the people and the economic relationship of the state to the household and enterprise.

The economic reforms of 2002 and 2003 reinforced the restructuring of the social contract by not only monetizing the economy but also requiring payments for services such as electricity supply and housing that signaled a reduction in government subsidies for basic household needs. Changes in enterprise management regulation to expand discretionary decision-making and linkage to markets were also important developments. The reshaping of the financial relationship between the state and the household and between the state and economic enterprises is a fundamental change in North Korea, but the policy, technical capacity and institutional arrangements for managing this shift are not in place and represent major challenges for the government in re-tooling itself for a society and economy where market forces play an increasingly important role. The legitimacy and financial viability of the state are now critically tied to how well it manages this transition in the social contract with the general population and enterprises. The retrogressive measures attempted since 2005 to reassert central distribution mechanisms and control over undesirable developments in society are reminiscent of sporadic and unsuccessful attempts by Communist Party bureaucrats to enforce old ideas in China and Vietnam. Essentially they are bound to fail because old mechanisms of social control have been overtaken by the changes in the social contract and the mentality of the people that are already well underway in North Korean society.

Impact of Increasing Knowledge of the Rest of the World Among the Population

Wariness about the implications of widespread knowledge in the general population of how the conditions of their lives relate to the realities of the rest of the world has reinforced tendencies of the leadership to limit access to such knowledge and place tight controls over North Koreans allowed to engage with foreigners. This impulse to contain the contagion of knowledge reflects regime insecurity and is being eroded by inevitable contacts between North Korean people and the outside world that have evolved since the mid-1990's when North Korea appealed to the international community for humanitarian assistance when faced with a severe economic contraction and famine.

¹ See “Viewpoints on North Korea’s Economy,” BBC News, August 26, 2008, especially Curtis Melvin: “In terms of the cultural implications of marketisation, I guess the main one is a complete breakdown in the social contract. North Koreans know they are poorer now than they used to be. They were taught their whole lives that the state would provide for them. There's been a lot of want and a lot of suffering. Today everyone knows they have to take care of themselves.” Also, Haggard and Noland (2009).

In the knowledge area, North Korea faces a fundamental dilemma. While the state is limiting and controlling contacts with foreigners in some areas, such as reducing in-country UN and NGO presence, it is also being compelled to pursue greater interactions with foreigners to access their knowledge as well as financial resources, in order to cope with domestic problems that it has not been able to manage on its own and pursue modernization that it recognizes is necessary to be a strong and independent nation in today’s world. As a result, actions taken by the regime can appear at times to be contradictory and not guided by an overarching policy and strategy for how best to manage the knowledge gap that still defines North Korea’s isolation from the international community.²

Despite recent retrenchment efforts, the combined impact is both significant and irreversible, as over 10 years of humanitarian engagement; expansion and diversification of inter-Korean relations under the “Sunshine” policy; protracted engagement with the U.S. and other concerned countries on North Korea’s security issues and WMD programs; efforts by European countries, Australia and China to provide educational opportunities abroad for North Koreans in technical, economic and financial areas; sporadic forays into cultural cooperation, such as sports events and the symphony episode; and the significantly expanded cross-border interactions with China. With essentially unregulated markets providing more access to televisions, videos, radio and cell phones to those that can afford them, information from outside will continue to erode the isolation of the North Korean people despite retrenchment efforts by the state and will pose an increasingly challenging domestic environment for the regime.

Generational Change and Focus on the Future Rather than the Past

Beginning with significant government reorganization in 1998, North Korea has been developing a new generation of more technocratic civil servants in order to pursue modernization of the economy and public administration. There have been several waves of appointments to key middle management and senior policy making positions of younger people, some of whom who have been abroad for education or work, as the government has tried to upgrade the performance of the cabinet. As a result, the present staffing of many government agencies has the potential for effective working relationships and capacity building for managing improvements in economic management if political conditions were to be evolve in ways that would make international economic development cooperation desirable and possible.

Similarly Kim Jong Il has carefully managed the promotion of younger members of the military elite to ensure their loyalty and support, and to pursue the regime’s ambitions for technically viable missile and nuclear programs. The path and implications of inter-generational transfer of military leadership is nevertheless unclear and adds uncertainty to the direction of future military policy and capabilities.

² See Stanley Foundation (2007) for a good discussion of issues relating to knowledge engagement with the DPRK.

As a result of the expanding role of markets, younger people -- especially among the elite -- have more access to consumer luxury goods than in the past and make choices to satisfy their personal preferences, including fashionable clothing. This reinforces the expectation of improvements in living standards and the stake young consumers have in a future that delivers on aspirations rather than following blindly the directives of the state.

Even in the dilemma of leadership succession, the implications of handing over power to the younger generation are a major factor contributing to uncertainty how the transition will be managed and affect future regime stability and policies. All of Kim Jong Il’s children have received education abroad, and their world views are well informed of these realities.

A constraining factor is the generation of famine-affected youth who are significantly stunted and have less physical and mental capacity to contribute to economic productivity than earlier generations.

None of the inter-generational dynamics point towards a future wedded to an increasingly distant past of unfettered loyalty to the world view and policies of Kim Il Sung and Kim Jung Il.

The Weakening of Central Authority at the Local Level

An important dynamic of change in North Korea is the increasing difficulties that the central authorities are having in obtaining support from local authorities for measures dictated from Pyongyang that militate against local realities and interests. This is particularly the case in the areas far from Pyongyang along the border with China.³ Some significant decentralization of authority was granted in the economic reforms of 2002 and 2003, which like the price reforms and legalization of markets, was essentially acquiescence to a reality that was already well established. The inability of the center to provide financial resources to local authorities severely handicaps its control and influence over the periphery, although the coercive power of the state is still extensive through its security services and food procurement apparatus. For this reason, administrative dictates, for example on clamping down on markets, seem to have limited impact.

The power of Pyongyang, however, to extract rents from local production units, especially in the nearby southern areas, remains strong. The cross-subsidization of the Pyongyang-based elite class by the other parts of the country continues to be a significant part of the political economy.

It should be noted that any significant internationally supported economic development effort in the future is likely to strengthen the fiscal and administrative power of the center

³ For a good discussion of recent developments in the DPRK-China economic relationship, see Haggard and Noland (2009). Also, Smith (2009) provides interesting insights on differences in regional food production and nutrition that reflect internal dynamics within the DPRK.

over the local level at least initially, as official development assistance and foreign investment typically are contracted and directed through central authorities.

Leadership Succession and the Challenge of Competition for Power and Resources Among the Military, Party and Cabinet

Much attention has recently been given to the issues surrounding leadership succession. While selection of one of Kim Jong Il’s sons as designated successor and emergence of brother-in-law Chang Song Taek as a potential regent dominate this attention, of equal importance are the institutional interests in the jockeying for power. This applies mainly to the relationship of the military and the party, but also the way guidance is given to the cabinet as a subordinate but critical institutional player.

A particularly important question is whether the long-standing stove-piping of the military economy, court economy and people’s economy might be changing in ways that could have significant impact on the balance of power and potential economic efficiency gains through more rational allocation and management of resources available to the country. For example, reports that supervision of the financial arm of the party has been given to the number two official of the National Defense Commission, if true, and the expansion of members of NDC to include Chang Song Taek and other non-military persons, suggest a potential broadening of the role of NDC to take on integrating and policy guidance functions that in other Communist states have typically been the purview of the Politburo.⁴ While speculative at this stage, such developments could foreshadow not only the resolution of the succession question but the beginnings of the emergence of a more collective leadership system that holds the seeds of sustainable systemic guidance of reforms of various kinds and control over factionalism and political rivalries. Developments in this area, however it evolves, will have great impact on the future of North Korea and its ability to manage both domestic and international challenges and achieve regime stability and sustainability.

Implications for Future Scenarios and Challenges for the North Korean Leadership

Taken together, these dynamics of changes that are already underway in North Korea pose dilemmas for the leadership that require choices that could lead to significantly different futures. These dilemmas are rooted in trade offs between isolation and openness, maintaining social control and permitting growing freedom, sustaining ignorance and expanding access to knowledge, prioritizing regime survival and meeting the requirements for household survival, and adherence to the past and adjustment to the future. A younger generation that seeks a higher quality of life and connectivity to the outside world through market mechanisms and more opportunities for acquiring knowledge and pursuing business activities is not compatible with a military-first politics that requires high maintenance mobilization of national will and resources against constant danger and enemies. Whether the leadership seeks to maintain legitimacy of rule through isolation and mass appeal for nationalistic fervor and sacrifice or delivery of

⁴ See “North Korea military in control of state spy body,” AFP, May 10, 2009.

a better life and prosperity to the people through opening up and modernization is a fundamental choice with high consequence.

The risk of the former response is growing disenfranchisement between the general population and the leadership. This could lead towards more popular open dissent and civil disobedience and/or to increasing numbers of North Koreans seeking new lives across the borders, mainly in China. Either case would require that more focus and resources be devoted to maintaining domestic order and control. Efforts to maintain power and social cooperation through appeals to nationalism, ideological purity and coercive measures would be both costly and not encouraged or supported by the international community. While China has an understandable interest in domestic stability inside North Korea, it is unlikely to be able to stem by itself a significant acceleration of domestic dissent over time. In this environment, incentives for fragmentation within the military and party elite would grow if opportunities for gaining advantages or popular support are perceived as possible. Devoting energy to maintaining loyalties and relations among the inner circle would have to be given high priority to mitigate the risk of growing competition and diverse interests undermining the leadership status quo. This domestic distraction would certainly limit the leadership’s ability to pursue a progressive policy of building relations with the international community.

While there are numerous scenarios for how growing social and political divisions would be managed and play out if the leadership opts for continuing isolation and focus on external enemies for its legitimacy and social contract, this path to the future is bound to be uncertain and unstable. Whether a total system breakdown occurs is hard to predict, but contingency planning for this is prudent on the part of the international community. More likely is a protracted period of confused and contradictory policies and actions that consume political energy and embody a competition for economic resources across major institutional lines and between the state and households and enterprises. In this environment it is possible that significantly changed configurations of leadership might come to power, although sustainability would be uncertain. If hard-line leadership prevails there is a risk that it would be willing to instigate military conflict rather than face internal breakdown.

On the other hand, it is also possible that either the present leadership or a new configuration that emerges from internal political processes would be willing to pursue a path of reform and modernization that could be supported by the international community and lead to a stable and “normal” state that is increasingly integrated into the international community.

U.S. Interests in Transformation and Modernization and Policy Implications for Engagement

Peaceful Evolution. It would be preferable and less costly for the U.S if transformative change in North Korea is peaceful and evolves towards a normal state as political will, capacity to manage change effectively, and access to knowledge and financial resources permit. Two policy imperatives are to find ways to keep the process peaceful and ways

to nudge the evolutionary process in desirable directions and discourage evolution in undesirable directions.

Stable long-term political solution for national viability and inter-Korean relations.

Whether or not the North Korean leadership’s present aim is to be recognized as a nuclear weapons state, the U.S. ultimately has an interest in arriving at a political solution that is compatible with long-term stability in North Korea and the Northeast Asia region as a whole. Such a political solution could take a number of different forms, ranging from unification of the two Koreans on mutually agreed terms or by capitulation of North Korea to South Korean superiority, to North Korea aligning itself more firmly to China and adopting a communist political system that successfully manages opening up to the rest of the world and pursuing a socialist market economy, similar to Vietnam. (In this case, unification would not be a viable long-term ambition, but friendly inter-Korean relations and some degree of confederation might be possible.)

In either case, the key to a long-term stable political outcome is the removal of the perceived requirement to have enemies for regime survival and replacement of military-first politics with civilian centered politics where the “first-family,” party, and civil administration work out a new form for collective governance. This realignment of domestic politics is fundamental for long-term stability. U.S. strategy should be focussed on this goal and seek to convince the North Korean leadership that they cannot pursue twin goals of being “strong and prosperous” with a military-first politics, because we with the support of other countries will maintain an overwhelming military superiority and have the ability to constrain their economy. If the leadership can neither ensure the protection or survival of the population on an ongoing basis, it will be a failed state and risks internal turmoil. We should be prepared for this and take actions that will both reinforce the breakdown of the social contract to increase pressure on the need for internal adjustments, and keep open lifelines for survival at the household level that provide incentives for containing the risk of domestic dynamics spilling over the borders. The counterpart to this coercive posture is to put on the table a vision of an alternative future that is viable and a road map of concrete steps that can be taken to make that vision a reality. Central to this vision and process would be removing the need for enemies as a requirement for regime survival and legitimacy and the alteration of domestic politics to accommodate this new foundation.

More openness and transparency coupled with more predictable and rational behavior in conformity with international norms. North Korean secrecy and rent seeking are not consistent with any long-term stable solution for national viability. Discouraging bribes-for-concessions agreements and encouraging humanitarian and commercial practices in keeping with international norms should be policy principles for U.S. engagement. Support should be given for activities of NGOs, international agencies and other governments that seek principled engagement, promote knowledge-based rather than politically-based decision-making and resource allocation, and demonstrate acceptable practices in the international community.

North Korean population becoming more knowledgeable about the outside world and able to interact with it freely. The more North Koreans who have access to knowledge about the outside world and the way others see the country and conduct their affairs, the more beneficial for the transformative processes inside the country. The U.S. should significantly expand knowledge engagement with North Korea in a variety of areas not tied to its military interests or capabilities. This should focus not just on the policy-making level, but also on middle level officials who have to carry the bulk of heavy lifting in managing changes, and the younger generation who have more of a stake in the future than the past. Some degree of knowledge engagement is warranted even if political relations are difficult and confrontational, although greater reliance on other countries and international organizations on this agenda may be needed in this circumstance. Even so, some level of direct U.S. engagement in knowledge activities would be desirable both to keep open informal channels of information and relationships and to foster trust building that might help in managing the relationship towards more productive directions and to plant seeds for longer-term developments that we would like to nurture.

North Korean economic system that provides welfare improvements for the whole of the society, is integrated in the regional economy and international financial system, and is able to manage effectively vulnerabilities to illicit activities and corruption. While economic system change is underway inside North Korea, there is no well-defined policy or management process for guiding this change, as discussed earlier. This is partly due to lack of understanding of market economics among the senior leadership and partly to resistance to the political economic implications of economic changes in North Korea with the consequences this has for political balancing between the interests of the inner elite, military, party and civilian administration. U.S. policy should be to nurture economic system change in ways that will put it on a sustainable long-term footing with the large majority of ordinary North Koreans benefiting, and an outward-oriented economic growth strategy that integrates the North Korean economy better in the dynamic regional economy in Northeast Asia and the international financial system more generally. As part of this process, the U.S. should encourage North Korea to adopt policies and institutional capacities that will permit a strengthening of ability to manage its financial affairs in keeping with international norms for transparency and rules-based practices. This could involve a continuation of the technical dialogue that emerged in parallel to the Six Party Talks process, and also support for efforts by other countries and international organizations to help North Korea move in this direction. In a situation where relations between the U.S. and North Korea are on a positive track of step-by-step improvement, concrete measures that support economic system changes that will produce major benefits for the North Korean people and long-term viability should be an integral part of the road map. In a situation where relations are confrontational, direct U.S. assistance for this economic track will need to be restrained, but the costs of not being able to make a robust economic transformation should be emphasized both in bilateral communications and reinforced in communications that the North Koreans have with other countries and organizations. Coordinating the messaging will be important in this circumstance.

Reduction in military tensions and capabilities that allows for redeployment of resources for sustained economic growth and a new security framework based on common interests and inter-dependencies in the Northeast Asia region. Progress in resolving both the WMD and conventional weapons threats that North Korea poses to its neighbors and the international community should be coordinated with exploiting opportunities to convert military resources to peaceful use and more economically beneficial outcomes for the North Korean people. This will both provide incentives to support the implementation of measures to reduce military tensions and also provide an underpinning for expanding cross-border economic and environmental protection activities that serve mutual interests of North Korea and its neighbors, contributing to regional security. While this policy cannot be pursued in a period of confrontational relations, it should be an integral part of an alternative vision of the future that is put on the table.

Objectives for Transformative Engagement

In constructing specific actions for integrating policies that will influence the course of transformation of North Korea into an overall strategy of engagement, overall objectives should include:

- *Encouraging expansion of markets and decentralized decision-making by enterprises, collective farms, households and local governments.*
- *Supporting adoption of appropriate regulation and social safety nets, while resisting regressive efforts to stifle markets and reassert the dominance of the Public Distribution System.*
- *Promoting more transparency, openness, accountability and systemic integration, while resisting secrecy and stove-piping that protect inefficient and unacceptable practices.*
- *Supporting development of a rules-based financial system and credible legal enforcement system, while pursuing anti-money laundering and illicit transactions interventions.*
- *Encouraging development of a business culture based on internationally accepted commercial practices, such as honoring contracts, while resisting corruption and cash-for-concessions dealings.*
- *Supporting expansion of opportunities for knowledge sharing for modernization, mutual learning, and trust building.*
- *Supporting younger generation gaining access to knowledge and relationships that reinforce their confidence in building a better future.*
- *Ensuring that any aid given that is linked to political objectives has a meaningful economic rationality compatible with the transformative agenda, so that the aid*

will reinforce and not undermine the sustainability of the political achievements and vice versa.

In addition to these general objectives, linkages of actions designed to influence the course of transformations of the North Korean socio-economic system to actions designed to achieve specific objectives in the political and military security areas, should be carefully considered. Where such linkages can reinforce the incentives environment for accomplishing U.S. goals in these areas, they should be considered. Where maintaining independent tracks would better serve the objectives, this should be pursued.

Strategies and Actions for Deliverables under Two Scenarios of U.S.- North Korean Relations

A. North Korean Intransigence

Strategy

Convince the leadership that North Korea can become neither strong nor prosperous by their pursuing the present confrontational course. We together with the support of the international community can enforce sufficient political and economic isolation to deny North Korea its stated goals for 2012. In parallel, support activities that convey to the North Korean people our concern for their welfare, encourage them to take responsibility for improving their own lives, and demonstrate possibilities for an alternative future.

Actions

- Exploit vulnerabilities for coercive diplomacy targeting military and elites, particularly trading companies and sector banks aligned with the military, party and first-family interests.
- Encourage China to maintain small-scale barter trade to keep markets functioning for the general population, but cut back on enterprise to enterprise trade and investment with firms linked to military and party, and keep transactions on barter basis not cash within UNSC non-sanctioned commodities.
- Support ROK policy of requiring transparency and reciprocity in aid and economic relations and encourage ROK to link future aid and continuation of Kaesong enterprise project to acceptance of international norm practices and principles. Be supportive of North Korean employees in whatever transitions take place. Encourage ROK NGOs to provide humanitarian aid in kind and not in cash.
- Maintain limited U.S. NGO humanitarian activities and relationships to obtain information maintain trust, and signal to general population U.S. support for their basic needs.

- Support limited academic exchanges and track 2 dialogue of issues related to improving relations, developing a market economy that conforms to international norms, and technical improvements in food security, health, and energy, especially technologies for alternative energy and efficiency.
- Encourage Europe, Australia and Canada as well as UN agencies to maintain a modest level of humanitarian engagement and knowledge engagement, geared to promoting understanding of market economics and international finance requirements, small-scale and local level health, food, micro-enterprise, and energy projects, and foreign language training. Target mid and lower level officials and younger generation (under 45).
- Step up efforts to communicate directly with the North Korean people about how the rest of the world views the leadership’s policies and actions, and support continuation of cross-border trade in radios, televisions, and cell phones.
- Articulate and put on the table an alternative futures vision and the political prerequisites for the U.S. to proceed down a concrete road map to achieve that vision. This would need to contain both bilateral and multilateral elements.

B. A Fresh Start

Strategy

Articulate an alternative futures vision and roadmap towards denuclearization, a peace accord, and normalized relations. The road map should not be a matter for negotiation, but the timing and modalities for implementation should be open for discussion. The roadmap should include activities related to the transformative change processes that compliment and reinforce the actions required to achieve the political and security goals. The objective should be to provide incentives for North Korea to follow the road map in its own best interest, and at the same time to influence the course of internal change dynamics inside North Korea in directions that are compatible with its becoming a normal state. Building trust and achieving deliverables are critical for a successful process. Providing access to knowledge and resources that are needed to achieve these goals are the principle areas for action. Linkage and sequencing of actions with steps taken in the military and political areas are important both for providing incentives to move the process forward and for pragmatic reasons to ensure preconditions are in place to make subsequent activities possible or meaningful.

Three possible phases of a potential roadmap are: confidence building, pre-IFI membership, and post-IFI membership. Triggers of achievements on the security and political agenda would need to be defined as the basis for moving through these three phases. It is not recommended that specific linkages to security or political measures be determined for specific socio-economic activities, but rather to pursue an approach of

bundling these activities so that they are discrete within each phase, logically sequenced, and prerequisites to subsequent activities in succeeding phases.

Confidence Building

Priorities of a confidence building phase should be to: (i) build understanding and willingness to pursue policies and methods needed for a collaborative transformation and modernization process; (ii) develop relationships and trust needed for mutual learning and partnerships; (iii) provide assistance to meet immediate humanitarian needs and demonstrate concern for vulnerable people; and (iv) provide knowledge and assistance to achieve practical results at a small scale that demonstrate benefits of development collaboration and provide foundations for expanded activities in subsequent phases.

Actions

- Track 2 and 1.5 meetings to exchange ideas with officials, experts, and academics on the benefits and issues involved in pursuing economic modernization efforts in cooperation with the international community.
- Educational and cultural exchange visits to promote mutual learning, targeting younger officials and experts. Also, encouragement of educational activities of other countries and UN agencies.
- English language training inside North Korea by American NGOs and also other countries such as the UK, Canada, and Australia, both in universities and for targeted government officials at mid and lower levels.
- Support for USAID, NGO and UN humanitarian assistance and social programs that are targeted for delivery to specific groups with appropriate monitoring.
- Support for small-scale and diversified projects by USAID, NGOs and other countries to demonstrate best practice development cooperation in such fields as energy conservation, agriculture, environmental protection micro credit, and small and medium-size enterprise development.
- MIA cooperation projects.

Pre-IFI Membership

Priorities in the pre-IFI membership phase should be to: (i) expand knowledge opportunities for North Koreans, linked to a deepening collaborative economic development and modernization process; (ii) put in place the main elements of a development assistance program based on best practice principles at a modest scale, including policy dialogue, technical assistance for capacity building, joint research, pre-investment studies, and demonstration projects; and (iii) improve the environment for expanding trade and foreign investment.

Actions

- Removal of selected economic sanctions both under the UNSC resolutions and bilateral sanctions.
- Expanded track 2 and track 1.5 meetings among midlevel officials and experts, and joint research in topics related to economics, finance, business, energy, agriculture, environmental protection, transport, health, and education. These can be both bilateral and multilateral. Policy dialogue should include Vice Minister level in a range of ministries.
- Well-prepared track 1 meetings to pursue bilateral and multilateral dialogue on economic system reform and modernization issues.
- Expanded education opportunities for short and long-term programs in the U.S. including funding and visas for North Koreans to study in the US at the graduate level, as well as encouragement of such programs offered by other countries, UN and EU. IFI participation in these educational activities sponsored by others should be allowed to build relations and draw upon their expertise.
- Technical assistance for capacity building in economic management and policy analysis, including economic and social statistics, external debt management, financial system, legal system, etc. This can be provided by the USAID, UN development agencies, EU, other countries.
- Provide technical assistance for financial system reform and Anti-Money Laundering capacity building.
- Support restructuring and expansion of ROK-North Korea economic cooperation projects, including Kaesong enterprise zone, Mt. Kumgong, and others. Emphasize commercial principles in future inter-Korean economic activities.
- Support establishment of special trust funds for capacity building, research, and pre-investment studies, for the IMF, World Bank and Asian Development Bank. (This would require a special resolution of their Boards of Directors).
- Support external debt dialogue with IFI’s and creditors.
- Support UNDP and UN country team programs for capacity building, demonstration projects, social assessments, and development of aid coordination mechanisms.
- Support IFI pre-membership preparations.

Post-IFI Membership

Priorities in the post-IFI membership phase should be to: (i) implement a full-scale development assistance program calibrated to absorptive capacity and North Korean economic institution building progress; (ii) integrate North Korea in regional and global international economic cooperation mechanisms and organizations, including accession to the World Trade Organization; and (iii) encourage expansion of trade and foreign investment through an outward-oriented economic development policy.

- Endorse lifting of remaining UNSC and US economic sanctions.
- Support establishment of normal IFI programs for North Korea, guided by a Poverty Reduction Strategy Policy (PSRP) process.
- Support establishment of Consultative Group for North Korean economic development.
- Provide energy aid, focusing on energy efficiency, alternative energy projects, hydropower rehabilitation, selective new power generation projects, and transmission system upgrade.
- Provide development assistance and technical assistance in priority areas such as agriculture, transport, urban infrastructure, and social sectors with a focus on poverty alleviation and economic efficiency improvements.
- Support expansion of ROK and Chinese trade in investment in North Korea, and encourage Japanese and US private sector trade and investment.
- Endorse re-invigoration of the Tumen Area Development program, with both Japanese and US participation in addition to existing members.
- Support regional initiatives in energy and transport cooperation, such as power trade, oil and gas pipelines, and railways that include North Korean participation.
- Support for WTO accession process in coordination with development of programs of IFIs and European Commission.

Implementation Considerations

There are a number of important considerations that need to be taken into account in implementing a phased approach to a road map that provides tangible economic benefits to North Korea. One is ensuring that foundations for a successful process are well established. These include motivation to move ahead with an economic restructuring and development process that will have domestic political economy consequences as well as attracting support from the international community. These also include willingness to move towards transparent and rules-based management of

finances, which is essential for any development assistance program and expanded role for private investment in North Korea. Another important consideration is absorptive capacity. North Korea must be able to use knowledge and assistance as well as meet political requirements to gain access to them. Capacity building is thus a critical aspect of the engagement process and necessary to remove technical and administrative obstacles to successful development cooperation. This includes coordination capacity both internally within the North Korean government and externally with donor countries and multilateral organizations. Sequencing is also an important consideration. Larger and more complex activities and investment should be preceded by building blocks that enable a progression that is logical and where capacity created in first phase activities can be expanded and build up in later ones. Cost and questions about allocation of financing responsibilities are additional considerations. As the process moves from confidence building through to a full scale development assistance program, the costs can be expected to rise sharply and the participants in the process will become more diverse. This will need to include mobilization and management of domestic resources for development as well as international development assistance and foreign investment. Altogether, implementation of any road map will be highly demanding both of the North Koreans and partners in the international community who participate. For this reason it is very important that a high level policy and management coordinating mechanism be established to guide the progress and overcome implementation obstacles.

BIBLIOGRAPHY

Babson, Bradley, "Economic Security in the DPRK," Hazel Smith Ed., Reconstituting Korean Security: A Policy Primer, United Nations University Press, New York, 2007, pgs. 65-81.

Babson, Bradley, "Economic Perspectives on Future Engagement with the DPRK in a Post-Test World," Policy Analysis Brief, The Stanley Foundation, December 2006.

Babson, Bradley, "Realistic Expectation of the Future Role of the IFI's on the Korean Peninsula," Korea's Economy 2008, Korea Economic Institute, Washington DC, 2008, pgs. 106-113.

Babson, Bradley, "Constructing a Roadmap for the DPRK: Critical Issues on the Economic Side of the Equation," Korea's Economy 2006, Korea Economic Institute, Washington DC., 2008, pgs. 55-61.

Chul, Chung Young, "Society in Disarray: Crime, Corruption and Deepening Cognitive Dissonance in North Korea," Global Asia Volume 4, Number 2, Summer 2009, pgs. 26-32.

Frank, Ruediger, "Classical Socialism in North Korea and its Transformation: The Role and the Future of Agriculture," Harvard Asia Quarterly, Vol. X, No. 2, 2006.

Haggard, Stephan and Noland, Marcus, "Political Economy of North Korea: Implications for Denuclearization and Proliferation," East West Center Working Papers, Economic Series, No. 104, Honolulu, 2009.

Lee, Young-Sun and Yoon, Deok Ryong, The Structure of North Korea's Political Economy: Changes and Effects, Discussion Paper 04-03, Korea Institute for International Economic Policy, 2004.

Moon, Chung-in Ed., Understanding Regime Dynamics in North Korea, Yonsei University Press, Seoul, 1998.

Seliger, Bernhard, "Engagement on the Margins: Capacity Building in North Korea," Korea's Economy 2009, Korea Economic Institute, Washington DC., 2009, pgs.67-75.

Seok, Kay, "North Korea's Transformation: Famine, Aid and Markets," Human Rights Watch, April 14, 2008.

Smith, Hazel, Hungry for Peace: International Security, Humanitarian Assistance and Social Change in North Korea, U.S. Institute of Peace Press, Washington D.C, 2005.

This paper was produced as part of the project “Improving Regional Security and Denuclearizing the Korean Peninsula: U.S. Policy Interests and Options.”

Smith, Hazel, “North Korea: Market Opportunity, Poverty and the Provinces,” New Political Economy, Volume 14, Issue 2, June 2009, pgs.231-256.

The Stanley Foundation, Prospects for International Cooperation in Economic Development Knowledge Sharing with the DPRK, conference report sponsored by the Korea Institute for International Economic Policy and the Stanley Foundation in collaboration with the National Committee on North Korea, Seoul, 2007.