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Economic Perspectives on Future Directions for Engagement With the DPRK in a Post-Test World

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Introduction

The decisions by the DPRK leadership to conduct a missile test on July 5, 2006, and a nuclear test on October 9, together with Resolutions 1695 and 1718 adopted by the UN Security Council in response to these actions, have fundamentally altered the context for engagement by the international community with the DPRK. Governments, multilateral organizations, private companies, and NGOs who have been pursuing engagement activities of various kinds need to reassess the rationale, strategies, and modalities for continuing engagement activities in the future. These adjustments will have to take into account how increased sanctions imposed on the DPRK following the adoption of the Security Council resolutions are implemented, changing perceptions of the benefits and risks of engagement, and growing isolationist tendencies within the DPRK. The choices made by governments and other stakeholders in the coming months will have profound consequences for the possible pathways for the future and the ultimate resolution of the security dilemmas on the Korean peninsula. Much also depends on the responses of the

DPRK leadership to the actions taken by others, and on the responses by stakeholders in North Korean society, especially households, enterprises, the military, and the Workers Party. At the present time, despite the decision of the DPRK to return to the six-party talks process, there is much uncertainty about how the dynamics that have been set in motion will unfold, and the longer-term consequences of the choices that will be made.

This paper reviews recent developments in the North Korean economy and its external and internal vulnerabilities, explores perspectives on the economic implications of possible future paths in a post-test world, and evaluates alternative scenarios from the point of view of the implications of choices made on sanctions and engagement policies by major stakeholders. By illuminating critical trade-offs and potential impacts of these choices, the paper aims to contribute to discussions of how best to achieve a peaceful resolution of the multidimensional challenges posed by the situation that now exists on the Korean peninsula.

Recent Developments in the North Korean Economy and Challenges Ahead

In 2005 and early 2006 it appeared that the DPRK economy was showing some signs of improvement and that the leadership was gearing up for a new phase of economic reform efforts. Positive developments included a good agricultural harvest, growing trade with South Korea and China, improvements in organizational and legal arrangements for economic management under the leadership of the Cabinet, formation of a national economic cooperation

committee, reorganization of the legal and administrative apparatus for inter-Korean economic cooperation, and widely publicized trips to China by Chairman Kim Jong Il and the economic leadership team in January and February 2006, with expressions of admiration for Chinese economic achievements. In April there were also reports¹ that the DPRK was on the brink of moving ahead with land reforms that would include long-term leases of land to individuals, leasing plots of collective farms to individuals, imposing taxes on land used by factories and businesses, making grants to build and operate roads to businesses and individuals, and recognizing ownership of apartment buildings built by businesses or individuals. In addition, labor reforms were being considered for introduction later in the year, including moving from a system of monthly wages to daily or weekly wages.

Concerns about experiences with earlier reforms and humanitarian assistance led to stocktaking and assertions of some new policy directions in this period. One was the decision to reinstate mandatory use of the Public Distribution System for grains, especially rice, which was intended to reduce inflationary pressures and demonstrate renewed capacities of the state for managing food security. Another was the decision to reduce the presence of foreign humanitarian aid workers in the country, press for a shift from humanitarian aid to development assistance from the international community, and negotiate a reduced level of support from the World Food Programme. These moves signaled a change of course that reflects both political motivations to tighten control and a desire to find solutions to negative effects of the earlier reforms and pursue a home-grown economic reform agenda that can be managed. Since the missile test in mid-2006, it appears that economic reform efforts have taken a backseat to the military initiatives, including curtailment of planned activities such as foreign-supported economics training programs.

The willingness of the DPRK to sign the September 19, 2005, Joint Statement in the six-party talks bred optimism that the DPRK leadership was prepared to proceed down the path of a negotiated resolution of not only its nuclear and missile programs but also a general improvement of its international relations and cooperation in its future economic development. However, the consequences of the September 2005 US Treasury decision to issue a notification that the Banco Delta Asia in Macau was a “primary money laundering concern” overtook this optimism. The notification was based on information that transactions involving accounts held by

North Korean companies and individuals had involved counterfeit US dollars and monies received through illegal activities. This led to intervention by the Central Bank of Macau, impounding all North Korean accounts pending a full investigation of the allegations. The North Korean reaction to these actions was to suspend participation in the six-party talks process and demand a change in the “hostile policy” of the United States, and specifically a relaxation of the “financial sanctions.” While there is uncertainty about the sincerity of the DPRK’s commitment to the six-party talks process and the Joint Statement that it signed, there is no doubt that the financial sanctions issue has played a critical role in the politics of confrontation and escalation over the past year. The economic meaning, however, of the financial sanctions and related efforts by the United States to discourage banks in other countries from opening new accounts for North Korean companies and individuals needs to be put in perspective.

North Korean External Economic Vulnerabilities

The North Korean economy is not (and never has been) self-sufficient, despite the aspirations of Kim Il Sung’s *Juche* political philosophy. It is particularly vulnerable to shortages of food, energy, and foreign exchange. The DPRK has a very low ratio of arable land to population, which means that it cannot achieve food security through its own domestic production and must import food and fertilizer. While the DPRK has significant coal supplies and some hydroelectric capacity, it is completely dependent on imported petroleum products required for both military and civilian use. The DPRK is also not integrated into the world economy and financial system, so its ability to earn foreign exchange and engage in normal trade finance is severely circumscribed. It is not surprising, therefore, that the politics of engagement with the DPRK since the early 1990s have focused on these three variables for both carrots and sticks.

Following the collapse of the Soviet Union in 1991, China has bargained oil, food, and trade for political and social stability in the DPRK, first during the economic crisis of the mid-1990s and more recently during the nuclear crisis that has unfolded since 2002. The Agreed Framework negotiated between the United States and the DPRK in 1994 bargained energy (heavy fuel oil and construction of two light water reactors) for a freeze in the North Korean plutonium nuclear program. This lasted until 2002 when, after the revelation of North Korea’s secret uranium nuclear program, the carrots turned to sticks as first fuel oil ship-

¹ “DPRK to Announce Real Estate Reforms,” *Donga Ilbo*, April 13, 2006.

ments were suspended and then the light water reactor project cancelled and KEDO disbanded as a cooperation framework. The Sunshine Policy pursued by South Korea after the election of President Kim Dae-jung bargained inter-Korean reconciliation for food aid, trade, and publicly subsidized investment. This included large cash payments in foreign exchange as gifts to secure concessions from the DPRK leadership, including the alleged secret payment of \$500 million for the meeting of the two leaders in June 2000. A current debate in the South Korean National Assembly is what amount of South Korean aid has in fact been provided to the DPRK in cash or commodities that could have been diverted to military use. Japanese food aid and trade expansion in the wake of the economic and humanitarian crisis of the mid-1990s shifted to increasingly stringent sanctions affecting food aid, trade, and remittances after 2002, reflecting public frustration over the abductees issue and the escalation of confrontation over the DPRK's nuclear and missile programs.

Japan, in fact, was the first country to link denial of humanitarian food aid to the deteriorating security situation and its unhappiness with progress on the abductees issue. This was followed by the decision of the United States not to contribute to World Food Programme appeals unless there was improved monitoring of food distributions and a de facto alignment with Japanese policy, despite the longstanding US policy of not linking humanitarian assistance to security issues. Most recently, the South Korean decision following the July 2006 missile tests to withhold its annual provision of 500,000 tons of rice pending the DPRK's return to the six-party talks represents a significant departure from past policies. It is also noteworthy that the World Food Programme appeal for 2006 had only met 10 percent of its target of \$102 million for commitments by October, with only Australia and Ireland contributing.² The European Union likewise has cut back on food aid and is continuing with a humanitarian aid program of about 10 million euros mainly for health and water sanitation. Thus the present situation leaves China as the primary provider of food assistance to the DPRK, although there is speculation that South Korea may soften its position if the 2006 harvest results in a 2007 food deficit that conjures prospects of renewed starvation for parts of North Korean society. South Korea can be expected to at least partially lift the ban once the six-party talks are under way again.

While trade and aid from South Korea and China have supported their national policies of pursuing relaxation of

tensions and advancing inter-Korean reconciliation for South Korea and maintaining stability in the DPRK while encouraging it to adopt more market economy mechanisms for China, these pro-engagement economic policies have not deterred the DPRK leadership from pursuing its nuclear ambitions and continuing missile development programs. Taken together, the policies have provided the North Korean regime with a safety net that has allowed the leadership to avoid making any major change in the status quo security standoff. With food and energy vulnerabilities effectively controlled by South Korean and Chinese national policies, Japan and the United States turned to the DPRK's foreign exchange vulnerability in seeking to pressure the leadership to change course in its weapons development programs and illicit moneymaking activities. Both the sanctions on specific firms involved in weapons business and illegal activities and the actions targeting North Korean accounts in foreign-owned banks have been aimed at stifling access to foreign exchange for money laundering and military procurement and sales.

While cross-border trade with South Korea and China and the growing market economy inside the DPRK have not been significantly affected by US and Japanese efforts to deny DPRK access to foreign exchange (at least up until the adoption of Security Council Resolution 1718), the DPRK leadership needs hard foreign currency both to sustain its weapons programs and to provide the elites in North Korean society with the luxury goods they have come to expect. Thus the impoundment of accounts at Banco Delta Asia, although amounting only to about \$24 million, can be understood to have hit at the heart of the DPRK leadership's needs for access to hard foreign exchange for these purposes. When coupled with the intensified efforts being made to curtail the DPRK's ability to open new foreign exchange accounts in other countries by the US Treasury and Japan's restrictions on trade and remittances, it is not surprising that the DPRK leadership interprets the present intentions of the United States and Japan as hostile with the aim of undermining the regime itself. From the US perspective, the effectiveness of this initiative is reflected both in the North Korean leadership reactions and in the fact that denial of access to foreign bank accounts has not significantly hurt the North Korean people as a whole, but only the elite and military. This unusually effective targeting of sanctions has been possible because the core of the North Korean "people's economy" depends more on the food and energy imports from China and South Korea and cross-border barter trade and cash transactions than it does

² "North Korea Weapons Tests Reduce Food Aid, UN Says," Reuters, October 23, 2006.

on hard currency foreign exchange transactions involving banks. However, it is important to note that some of the accounts impounded at the Banco Delta Asia were held by legitimate businesses, and there are ongoing efforts to deny any North Korean entity from opening overseas bank accounts. This means that legitimate businesses involved in trade and investment with other countries that require banking services will be affected by the financial sanctions initiatives, and this will have a distorting effect on the future pattern of trade and investment in the people's economy, not just curtailing access to foreign exchange by the military and elite economic subsystems in the DPRK. From this perspective, the DPRK's insistence that the "financial sanctions" issue be taken up as part of the six-party talks agenda is understandable, and it is a positive development that the United States has agreed that a working group be set up in the six-party talks framework to address this issue.

North Korean Internal Economic Vulnerabilities

Choices made by the DPRK leadership as well as foreign governments, multilateral organizations, private investors, and NGOs engaging with the DPRK are influenced as well by perceptions of internal forces of change within the DPRK and the vulnerabilities of the regime in managing these forces. These forces were set in motion by the severe economic contraction and famine of the 1990s, the penetration of information about the outside world that came with allowing foreign organizations to provide humanitarian assistance and educational opportunities inside and outside the DPRK, the effort to expand diplomatic relations with many countries during the late 1990s (particularly with Europe), progress in inter-Korean reconciliation that has increased bilateral contacts and cooperation among Koreans, and the economic reforms introduced in July 2002 and subsequently. Critical issues connected to the DPRK's poverty trap include the changing relationship of the state to the people resulting from the growing market economy, a changing political economy with new winners and new losers in the change process, and increasing corruption.

Poverty Trap. There is broad agreement among economists who have studied the North Korean economy that it has for many years been caught in a poverty trap, where economic growth is insufficient to replace deteriorating capital stock or invest in new technologies to increase productivity. Foreign aid and trade deficits have kept the economy afloat, but with very low levels of foreign investment and no capacity to mobilize capital domestically, the country remains in a poverty trap. Furthermore, because of the lack of a supply response to the economic reforms introduced in 2002 and 2003, inflation has become a major new problem

for the economy. Without an infusion of investment, it will be impossible for the DPRK economy to achieve sustained growth and exit the poverty trap. The dilemma that faces the DPRK leadership is that this investment needs to come from outside the country, and this will require an improvement in the external environment to reduce risk perceptions of foreign investors and induce development assistance from governments and multilateral organizations. From this perspective, the decision of the DPRK leadership to go ahead with the missile and nuclear tests, thus creating a worsened external environment, risks consigning the country to continued poverty and with a population even more vulnerable to the impacts of poverty.

Relationship of the State to the People. The growth of markets and consequent entrepreneurship among the North Korean people is fundamentally changing the social contract in the DPRK. At the heart of this socialist contract has been the obligation of the state to provide for all basic human needs, including shelter, food, education, health care, and social welfare. The economic and humanitarian crisis of the mid-1990s was accompanied by a breakdown in the capacity of the state to meet this obligation, with the result that people were forced to fend for themselves or face starvation, as many did. The emergence of the farmers' markets as a grassroots, bottom-up response to the breakdown of the Public Distribution System symbolizes this break in the social contract. The very existence of markets, where people exercise the freedom of consumer choice, has undermined the socialist social contract and altered the psychology of the North Korean people. Government efforts to reassert the contract are only partial and likely to fail, as the markets remain open for most consumer goods and producers have price incentives to circumvent the system. One example of this is the requirement introduced in October 2005 that rice be distributed through the Public Distribution System and not through the markets. In today's DPRK, making money matters, and how the state makes its money through allowing private initiative and then collecting taxes will be an important part of the process of redrawing the social contract for the future. This will require the development of new institutions, especially in banking and public finance. In their absence, the country will remain economically weak and socially vulnerable.

Changing Political Economy. Economic reforms already introduced and the changing character of cross-border economic relationships, especially with South Korea and China, are resulting in new sources of economic power and newly vulnerable groups in North Korean society. The potential for accumulation of economic power by

entrepreneurs, traders, and enterprises with joint ventures with foreign companies will inevitably strain the political balance between the Workers Party, the military, and the interests of the newly economically powerful. It may well be that such strains are already a factor in the internal political dynamics of Pyongyang. Also, there is a significant realignment of power taking place between central and local levels of government in the DPRK, with local communities having more autonomy. While little is known about these internal processes and their impact on the decision making of Kim Jong Il, the status quo separation of the economic subsystems that have supported the elite, military, and general population is not likely to remain stable. In fact, a debate has been taking place internally for some time on how to best allocate resources between the needs of the military and the interests of the people's economy.³ If new forms of economic wealth generation are emerging in the DPRK, then there are likely also pressures to reshape the flow of resources across these subsystems, and the direction and mechanisms used to make those transfers will be an indicator of the emerging realignment of power.

There are also new losers in the economic dynamics now active in the DPRK. People who cannot participate in the market economy, especially the urban unemployed and the disabled and elderly who depend on state support, are at risk. Inflation also is a factor in these dynamics as it robs purchasing power of people on low or fixed incomes and those unable to acquire assets, such as hard currency, that maintain value over time. The effort to reassert the role of the Public Distribution System for rice in 2005 was in part motivated by a desire to address these downside effects of the economic reforms introduced earlier, although the pricing policies that were adopted seem to be more intent on supporting employees of state enterprises than meeting the social welfare needs of the unemployed. The very low level of international funding commitments for the World Food Programme appeal for 2006, the reduction in humanitarian aid for the DPRK as a result of government preferences for development aid, and now the impact of sanctions imposed by the United Nations as punishment for the nuclear and missile tests will undoubtedly lead to further worsening of the plight of the internally vulnerable groups in the period ahead.

Corruption. China, Vietnam, and Russia have all experienced high levels of corruption in the transition from socialist- to market-oriented economic systems, and the DPRK can be

expected to face the same problems for the same reasons. But corruption in the DPRK is likely to be exceptionally problematic. The DPRK is already perceived as a corrupt system—with a history of state-sponsored criminal activities seeking payoffs for political concessions and renegeing on agreements, as has been amply demonstrated in inter-Korean relations and experiences of foreign investors. This complicity of the state also enables a culture of tolerance for corrupt acts of individuals. Since the economic crisis of the 1990s there has been a growth in the practices of asset stripping and bribery linked to the emergence of markets, cross-border smuggling, and refugee traffic. Thus corruption in the DPRK is likely to become increasingly widespread and endemic and therefore a challenge to the political order. Any future strategy of engagement will need to take the corruption factor into account, which will need to be addressed as a systemic issue and not just a moral one.

The Fundamental Challenges in North Korean Economic Transformation

The DPRK leadership faces very difficult dilemmas and trade-off choices in pursuing its primary aim of regime survival while reforming its economy and pursuing economic development. Kim Jong Il's fundamental challenge is to find a way to move forward with a transformative process on three fronts at the same time. The first is to achieve an improved external environment that both meets the DPRK's security needs and expands opportunities for trade, investment, and development assistance. Second, is to design and implement economic reforms that work; i.e., result in sustained economic growth, a more efficient economy, and a broadly based improved standard of living for the North Korean people. And third is to manage the domestic social and political consequences of economic reform and opening up. All of the external and internal vulnerabilities discussed above are issues that will need to be addressed in finding a workable path forward. The multidimensional nature and complexity of the task is formidable.

At the present time there does not seem to be any consensus on the formula that would succeed in permitting these three transformations to take place in a coherent way. There is neither consensus internally in the DPRK nor externally among the governments participating in the six-party talks process. In the absence of this consensus, the six-party talks are not likely to make headway in reaching agreements on practical measures, even if they recommence in a serious way. Viewed from this perspective, the decision by the

³ For a full discussion of the internal debates, see Carlin and Wit, *North Korean Reform: Politics Economics and Security*, International Institute for Strategic Studies, Adelphi Paper 382 (Routledge, July 2006).

DPRK leadership to put its military ambitions ahead of its economic aspirations seems to represent a major gamble. Can the DPRK retain a nuclear threat capability and develop an economy that can sustain the welfare of the North Korean people and long-term political stability? The choices made by governments and other stakeholders in the coming weeks and months will determine the ultimate answer to this question.

Economic Perspectives on Implementation of UN Security Council Resolutions 1695 and 1718

Taken together, Resolutions 1695 and 1718 require all member states of the United Nations to deny the DPRK access to resources that could be applied to both its WMD programs and its conventional military forces. The pertinent provisions are:

Resolution 1695:

3. *Requires* all Member States, in accordance with their national legal authorities and legislation and consistent with international law, to exercise vigilance and prevent missile and missile-related items, materials, goods and technology being transferred to DPRK's missile or WMD programmes;
4. *Requires* all Member States, in accordance with their national legal authorities and legislation and consistent with international law, to exercise vigilance and prevent the procurement of missiles or missile-related items, materials, goods and technology from the DPRK, and the transfer of any financial resources in relation to DPRK's missile or WMD programmes;

Resolution 1718:

8. *Decides* that:

- (a) all Member States shall prevent the direct or indirect supply, sale or transfer to the DPRK, through their territories or by their nationals, or using their flag vessels or aircraft, and whether or not originating in their territories, of:
 - (i) any battle tanks, armoured combat vehicles, large calibre artillery systems, combat aircraft, attack helicopters, warships, missiles or missile systems as defined for the purpose of the United Nations Register on Conventional Arms, or related materiel including spare parts, or items as determined by the Security Council or the Committee established by paragraph 12 below (the Committee);

- (ii) all items, materials, equipment, goods and technology as set out in the lists in documents S/2006/814 and S/2006/815, unless within 14 days of adoption of this resolution the Committee has amended or completed their provisions also taking into account the list in document S/2006/816, as well as other items, materials, equipment, goods and technology, determined by the Security Council or the Committee, which could contribute to DPRK's nuclear-related, ballistic missile-related or other weapons of mass destruction-related programmes;

- (iii) luxury goods;

- (b) the DPRK shall cease the export of all items covered in subparagraphs (a) (i) and (a) (ii) above and that all Member States shall prohibit the procurement of such items from the DPRK by their nationals, or using their flagged vessels or aircraft, and whether or not originating in the territory of the DPRK;
- (c) all Member States shall prevent any transfers to the DPRK by their nationals or from their territories, or from the DPRK by its nationals or from its territory, of technical training, advice, services or assistance related to the provision, manufacture, maintenance or use of the items in subparagraphs (a) (i) and (a) (ii) above;
- (d) all Member States shall, in accordance with their respective legal processes, freeze immediately the funds, other financial assets and economic resources which are on their territories at the date of the adoption of this resolution or at any time thereafter, that are owned or controlled, directly or indirectly, by the persons or entities designated by the Committee or by the Security Council as being engaged in or providing support for, including through other illicit means, DPRK's nuclear-related, other weapons of mass destruction-related and ballistic missile-related programmes, or by persons or entities acting on their behalf or at their direction, and ensure that any funds, financial assets or economic resources are prevented from being made available by their nationals or by any persons or entities within their territories, to or for the benefit of such persons or entities;

- (e) all Member States shall take the necessary steps to prevent the entry into or transit through their territories of the persons designated by the Committee or by the Security Council as being responsible for, including through supporting or promoting, DPRK policies in relation to the DPRK's nuclear-related, ballistic missile-related and other weapons of mass destruction-related programmes, together with their family members, provided that nothing in this paragraph shall oblige a state to refuse its own nationals entry into its territory;
- (f) in order to ensure compliance with the requirements of this paragraph, and thereby preventing illicit trafficking in nuclear, chemical or biological weapons, their means of delivery and related materials, all Member States are called upon to take, in accordance with their national authorities and legislation, and consistent with international law, cooperative action including through inspection of cargo to and from the DPRK, as necessary;

Other provisions of the resolutions encourage “all States concerned to intensify diplomatic efforts, to refrain from any actions that might aggravate tension and to facilitate the early resumption of the six-party talks, with a view to the expeditious implementation of the Joint Statement issued on 19 September 2005...,” and call upon the DPRK to return to the six-party talks without precondition.

The interpretation and implementation of these provisions will form the context for actions and diplomacy over the coming months, with the Security Council actively engaged through the ongoing activities of the committee that are also outlined in Resolution 1782. This will put the United Nations squarely at center stage of engagement with the DPRK just as the new Secretary-General Ban Ki-moon begins his term. There will be many issues to be addressed, and also the question of how a new special envoy will relate to the Security Council and the six-party talks process. Understanding of the underlying economic issues and the trade-off choices that have yet to be made will be important for any process for a negotiated peaceful solution to be successful and sustainable.

The scope of the sanctions imposed on the DPRK is broad, covering physical, financial, and knowledge resources that directly or indirectly could be used to support the DPRK's nuclear, missile, or other WMD programs. Denial of access to these resources and to military-related exports and other

illegal exports will require a variety of mechanisms and extensive coordination efforts among and within member states to obtain compliance in the implementation of the Security Council resolutions. There is a high potential for leakage, both because countries may adopt different interpretations and practices of implementation and because of inadvertent lapses due to the complexity and scope of sanctions-related activities, inadequate coordination, and gaps in information flow required for full compliance.

It is also important to note that the sanctions do not apply directly to legitimate trade and investment activities with the DPRK, nor to humanitarian assistance. On the face, this implies that both the South Korean and Chinese bilateral commercial and humanitarian activities would not necessarily be curtailed, although increased intensification of inspections would be needed. However, there are a number of issues of the “devil in the detail” variety that can be expected to surface early in the formulation of specific implementation policies.

Dual Use. Resolution 1782 refers to specific lists of prohibited items that will be reviewed and if necessary amended by the committee. It can be expected that a significant subset of these items would be considered dual use, with potential for application in nonmilitary industrial or commercial activities as well as military ones. The inclusion of such dual-use items will have a distorting affect on the investment and trade regime in the civilian sector. Experience with the Kaesong Industrial Complex has already encountered and successfully dealt with this issue in the small pilot-scale program that presently exists, and it could be argued that the planned expansion of the program could be handled in such a way as to avoid the dual-use problem. Even if this were the case, it would likely mean that certain industries, where the DPRK might in fact have an international comparative advantage, would be foreclosed to development under the dual-use restrictions. The information technology-related industries—to which the DPRK leadership has a special attraction—would certainly fall in this category, as would some mining (uranium) and chemical industries that would serve markets outside the DPRK, especially the Chinese market. With the growing scale and diversity of Chinese investment and trade with the DPRK, an important question will be how effectively the dual-use regime will be implemented in that economic relationship.

Even though not explicitly covered by the UN sanctions, oil imports to the DPRK, especially petroleum and diesel fuel, pose another controversial challenge when viewed from a dual-use perspective. These fuels are needed for normal

agricultural, fisheries, and domestic commercial activities, and without oil-based energy the people's economy would run the risk of severe contractions in already low levels of production, and provocation of social instability. But these fuels are also critical for military operations. As oil is supplied from China through a pipeline, it is virtually impossible to control internal allocation decisions. As long as the DPRK pursues a military-first policy, it can be expected that any reduction in oil supply will be largely borne by the civilian sector, as already seems to be the case in the cutback of diesel fuel to the fishing fleet this year, which is also resulting in declining fisheries exports to China. China's control over the supply of oil thus has major consequences for competing stakeholders within the DPRK, and cutbacks to apply political pressure or price increases for oil shipments reflecting the global market trends are certain to affect the internal political dynamics.

Scope of Interpretation. While the Security Council and committee have defined detailed lists of proscribed items for military-related trade, the inclusion of a general proscription on luxury goods leaves broad scope for interpretation. It is likely that there will be different lists adopted by different trading partners that could lead to confusion in the monitoring of the impact of this sanction and realignment of trade to accommodate these differences. To the extent that this results in higher prices even if luxury goods continue to be available, then it could be argued that the general intent of the sanction will be met. On the other hand, trade in luxury goods has been one part of the growing market economy and restrictions that affect goods that are becoming increasingly desired by consumers in North Korean society will dampen the growth of market forces in the economy.

Substitution Effects. The debates over the impact of humanitarian assistance and how government makes use of income earned through legitimate commercial activities are likely to resurface to some extent. If humanitarian aid, even if given in commodity form, allows the government to divert resources from purchases it would have had to make itself to meet the needs of the people, then it can be accused of indirectly supporting DPRK's military-first policy. The same argument applies to national savings that are used for military programs and not for civilian consumption or investment in the people's economy. On the other hand, it has also been argued that targeted humanitarian assistance reaches people who would otherwise not be supported by the government given its priorities, and denial of humanitarian assistance would result in increased human suffering. As different stakeholders both outside and inside the

DPRK will have varying views about the seriousness of the potential substitution effect, this is one area where some controversy in the interpretation and implementation of the sanctions resolutions can be expected.

Already before the missile and nuclear tests, the food aid policies being pursued by South Korea and China were taking very different approaches with different impacts. The South Korean policy of providing rice directly to the government allowed for the possible diversion of food from the most vulnerable to preferred social groups through the Public Distribution System, thereby strengthening the central government's allocation capacity. Most food from China, on the other hand, is coming through relatively small-scale barter trade transactions and is directly supporting the development of the market economy with little direct benefit to the central government, which effectively has been denied the rents that it receives from the South Korean rice aid. Thus there are consequences for the economic system and distributional outcomes not only for decisions about whether and how much humanitarian assistance should be provided but also about the form in which this assistance is given.

Thus there are consequences for the economic system and distributional outcomes not only for decisions about whether and how much humanitarian assistance should be provided but also about the form in which this assistance is given.

Incentives. How the sanctions are implemented will affect the incentives for the DPRK to adopt economic and financial practices that are in line with a desirable path for future accommodation and integration in the international community. Conversely, the incentives could lead to practices that are criminal or incompatible with desirable directions.

For example, the ban on import of luxury items could lead to a more socially equitable pattern of consumption, with basic human needs being met for a larger spectrum of the population and a corresponding drop in consumption of luxury items by the elite. On the other hand, depending on what goods are defined to be luxury, the extent of their availability in the DPRK markets today and the role of profit motives for entrepreneurs, the ban on consumption goods could have negative effects. These effects would fall on the non-elite civilian population engaged in cross-border trade or in pursuit of profits for personal gain in legal commercial activities, thereby undercutting the market economy. Also, if the inspections of cross-border trade with South Korea and China are strictly enforced and the demand for banned luxury goods

is widespread within the DPRK, there will likely be increased smuggling to avoid inspections and increased corruption of officials linked to inspections of cargo and border control.

Similarly, the efforts to curtail opening of foreign bank accounts that might be used for direct or indirect financing of procurement of banned military-related items and money laundering gains from illicit activities could have negative as well as positive consequences. To the extent that legitimate commercial transactions would be caught up in the implementation of the financial sanctions, as appears already to be the case with some of the accounts impounded at the Banco Delta Asia, then the incentives for the DPRK to do business the “right” way, with full financial transparency working through the international banking system, will be undermined. These commercial activities and potential will either be curtailed or driven to use less transparent cash-based payment methods. The questions of separating “clean” accounts from those suspected of being used for money laundering or supporting military programs, and clarifying the conditions under which North Korean entities will be permitted to open new accounts abroad under the UN Resolution 1718 implementation, can be expected to be taken up by the working group to be established on this topic in the six-party talks framework. Disentangling the law enforcement processes from incentives for the DPRK to join the international financial system in a proper way in the context of political negotiations for resolving the military issues will be challenging for both the negotiators as well as the legal and financial authorities responsible for implementation of the financial sanctions mandated by Resolution 1718.

Reallocation of Resources in the Economy. Ironically, implementation of Resolution 1718 could be one of the best ways to help the process of moving toward a more efficient North Korean economy that is more appropriately linked to the international economy. At present, the misallocation of resources in the economy is one of the reasons for its poor performance after decades of giving priority to military programs at the expense of the civilian economy. Other factors linked to poor economic performance include pursuing a closed-door policy while the economies of the DPRK’s neighbors soared, and state-controlled prices sending distorting signals through the system. If the *physical* sanctions mandated by Resolution 1718 are effectively implemented, then a large part of the military economy in the DPRK will be denied the factors of production it needs, and remaining factors such as land, labor, and some portion of capital stock could in fact be forced to be allocated to other nonsanc-

tioned activities in the economy. Examples may include infrastructure rehabilitation, reorientation to industries that can trade with other countries based on market principles and comparative advantage, and expansion of the Kaesong Industrial Complex and other industrial zones as a way to redeploy excess military manpower to economically more productive jobs made available through South Korean and other foreign investment. This would also strengthen the linkage of the North Korean economy to the international economy in desirable ways. A carefully calibrated implementation effort that used the push of the sanctions regime together with a pull of a well-designed incentives policy could facilitate propelling and accelerating a much needed reallocation of resources in the DPRK that could help put it on a path of sustainable growth and a way out of the poverty trap. This is most likely to be a scenario that could unfold if the six-party talks negotiations are proceeding in tandem with the implementation of the sanctions mandated by Resolution 1718, and where an incentives and investment package linked to an economic reform strategy is designed in a way that could be implemented in concert with a denuclearization implementation plan.

Any such major process of resource reallocation would necessarily also require internal political adjustments in the DPRK. The implications of such a shift, if it were supported by the Security Council and the six-party talks negotiations, would be to give more weight to the future of the people’s economy and the leadership it receives from the Cabinet and Workers Party than the priority given to the military that exists at the present time. Acknowledging the sensitivities involved in these internal adjustments, seeking ways to facilitate management of the internal realignment process, and promoting principles of good governance could be areas where the United Nations might be able to play a role. Already the United Nations Development Programme (UNDP) has activities that are beginning to address governance issues in a preliminary way. And the UN humanitarian programs led by the World Food Programme, UNICEF, and World Health Organization (WHO) also have established frameworks that can be built upon. A new special envoy could seek ways to expand the space for engagement on these issues.

Coordination of Sanctions Policies. It is important to remember that the sanctions mandated by Resolutions 1695 and 1718 do not exist in a vacuum. The United States, Japan, and the European Union all have in place preexisting trade restriction policies and other economic sanctions that have evolved over many years and respond to their own concerns, objectives, and methods that are not shared by

other countries involved in the six-party talks, let alone embraced by all member states of the United Nations. Immediately after the adoption of these resolutions, Japan implemented new sanctions policies beyond the scope of the UN resolutions on their own initiative, including banning all imports from North Korea and denying North Korean vessels access to Japanese ports. An important issue in the upcoming period of negotiations with the DPRK is the question of how much coordination of sanctions policies and modalities will be possible under the supervision of the Security Council and committee. Countries acting independently of the collective process run the risk of losing support from other parties and undermining the multilateral diplomacy. This applies equally to the risks of adding pressures to those that have been mandated or undermining the impact of the resolution through softer or weaker implementation of specific provisions than expected by others. There is already apprehensive discussion of these issues as regards future US expectations of the Proliferation Security Initiative and scope of financial sanctions efforts, and the extent of flexibility in South Korean and Chinese policies and practices in actual implementation. Another question will be how well coordinated the agreements that may be reached through the six-party talks process will be in their implementation. Reaching and maintaining consensus on the coherence of policy in relation to the multiple objectives being pursued by major stakeholder countries is a considerable challenge.

Assessing Alternative Futures

There are a number of possible paths for the future of the DPRK economy. The earlier analysis suggests that the choices made by governments and the ways that other stakeholders pursue their interests and respond to a changed environment of opportunities, constraints, incentives, and disincentives will determine the future course of history on the Korean peninsula. This section explores the economic implications of alternative futures based on key choices that will have to be made by major players.

There are three broad paths that could be taken into the future from the perspective of the DPRK leadership. One is *continued escalation and confrontation*. Under this scenario, the DPRK's decision to return to the six-party talks could result in a failure to reach agreements through negotiations and a further process of escalation with the DPRK claiming that the failure was not their fault, and taking further steps to try to convince the international community to accept the present regime remaining a nuclear power indefinitely. A second path is a choice by

the DPRK to *delay and defer*. Under this scenario, the DPRK could use the six-party talks process to engage in extended discussions at the working group level. These discussions could address technical issues involved in reaching agreements on a verification mechanism for dismantling its nuclear weapons programs, on other military programs sanctioned by the United Nations, and on an economic aid package to bridge time to negotiate with a new US administration following the 2008 elections. In this case it can be expected that no substantial progress would be made, but the DPRK could choose to continue to participate in the negotiations process in the hope of eroding the consensus in the Security Council on the sanctions and their implementation, exploiting differences in positions of other parties, and improving the DPRK's bargaining position for more serious negotiations later on. Ambiguity is likely about whether the DPRK's ultimate objective is to secure acceptance as a nuclear state or to secure a better bargain in giving up its nuclear and other military programs; dealing with this ambiguity can be expected to be a major issue for the other parties in this scenario.

The third path is one of *serious negotiations* now toward implementation of the September 19, 2005, Joint Statement and removal of sanctions imposed by the Security Council. Under this scenario, the DPRK leadership would have come to the conclusion that now is the time to strike a bargain for a different future, both because of the pressures being brought to bear under the UN sanctions and the belief that it is possible to obtain security guarantees and economic assistance that will meet the DPRK leadership fundamental requirements for regime recognition and a process of transformation on multiple dimensions that will be politically manageable.

It is also possible to imagine other post-test scenarios that would not be driven by the choices of the DPRK leadership, but by other factors. These include the various scenarios of an internal political breakdown that could be triggered by a coup, social unrest, or unforeseen incapacitation of Kim Jong Il's leadership. They also include the possibility of military conflict that could arise from miscalculations in an escalation of confrontation scenario, or a nuclear accident, or other development that triggers new forms of engagement and actions altogether. These scenarios are not explored in this paper, but need to be recognized as having potentially very significant negative economic consequences for the DPRK as well as transformational political and security consequences.

External Economic Implications

(Trade, Aid, Investment, Access to Financial Services)

An escalation of confrontation choice by the DPRK would mean that international cooperation in implementation of UN Resolutions 1695 and 1782 would remain high over a sustained period, with both China and South Korea supporting tighter rather than looser implementation policies. This would certainly lead to reductions in commercial trade and investment flows, and likely China sharply limiting oil exports to the DPRK (as it appears already willing to do).⁴ Escalation could also lead to another Security Council resolution that adds to the sanctions already mandated, further restricting access to legitimate commercial economic activities, freedom of movement in international waters, and imports of consumer goods from China. A hardening of humanitarian and food aid policies could also be applied in this scenario, which could include specific conditionalities for provision under Security Council supervision. The combined impact of these developments on the North Korean economy would be to reduce sharply the external deficits that have propped up the economy in recent years. The severity of the shock could prove to be highly destabilizing given the current fragility of the economy and its dependence on aid and trade deficits.

A *delay and defer* choice by the DPRK leadership would likely lead to conflicts within the six-party talks countries about policies for economic sanctions and engagement with the DPRK. Both South Korea and China could choose to be sympathetic with this strategy, and work within the framework of a protracted negotiation process to protect their national priorities while still adhering to the objectives and general intent of the Security Council resolutions. Both could also use their influence in the United Nations to contain efforts by the Bush administration to force actions within a timeline dictated by US elections. The DPRK has successfully employed such divisive tactics before, so critical judgments would need to be made on what are feasible objectives in a two-year time frame and what price the DPRK can extract for meeting these more limited objectives. These objectives could include maintaining a moratorium on a second nuclear test, reinstating a moratorium on missile tests, freezing plutonium processing, and allowing IAEA inspections while maintaining existing nuclear program capabilities. The price to be paid would probably include fairly loose controls over cross-border trade with China, and maintenance of close to a status quo with existing inter-Korean economic cooperation activities after adjusting for at least a minimum compliance with the Security Council resolutions.

Under these conditions, it is possible that the United States and Japan would choose to make every effort possible to enforce the implementation of the Security Council resolutions through proactive use of the Proliferation Security Initiative capabilities on North Korean shipping and aggressive pursuit of the financial sanctions agenda. The North Korean economy in this scenario would most likely remain in a fragile low-to-no-growth situation with stability dependent on maintaining trade and aid deficits with China and South Korea. If Chinese banks retain limits recently imposed on North Korean financial transactions, a shift to more barter trade and smuggling can be expected with growing corruption issues on the border. This would contribute to an increasingly confused situation in monitoring compliance with the UN resolutions.

A *serious negotiations now* choice by the DPRK could lead to very significant improvements in the North Korean economy and its integration with the regional economy and international financial system. If managed well, the DPRK economy could receive the large-scale development assistance and private investment that would allow it to get out of the poverty trap and also gain access to the international financial system in ways that would permit adoption of an outward-oriented economic development strategy, which is essential for sustained high growth. To succeed in any such promising path for the DPRK's economic future, any measures taken would need to be guided both by objective economic logic and the ability of the parties to reach political agreements on concrete actions that would address the objectives set forth in the September 19, 2005, Joint Statement and the specific requirements of the Security Council resolutions. The challenge would be to design a road map of coordinated actions between the implementation of the security agreements and the implementation of the economic agreements.

The economic agreements would need to include both phased removal of existing sanctions (both multilateral and bilateral) and the calibrated delivery of economic assistance, which would take the form of cooperation in policy advice and technical assistance, political aid that is linked to the security agreement, and opening the way for official development assistance through normal multilateral and bilateral mechanisms. It is also important that any political aid that is included in the package have a genuine economic value and logic that is related to a reasonable economic rehabilitation and development strategy for the future North Korean economy. Big mistakes could be made if a

⁴ "Wary China may flex energy chokehold on North Korea," *China Post*, November 1, 2006.

political aid package is negotiated that does not meet this requirement, as resources could be wasted or perpetuate major inefficiencies in the economy. This is one lesson from the light water reactor project that was the centerpiece of the 1994 Agreed Framework that should not be repeated.

Thus the potential benefits of a negotiated agreement on the future path for the North Korean economy will largely depend on the quality of the economic thinking that lies behind the actions and decisions taken during the negotiations process. A key part of this is the shaping of the future incentives environment that would influence decisions by the DPRK government, donors, private investors, and NGOs about the priorities and sequencing for development assistance and foreign investment. Another critical factor is to improve the quality of economic thinking inside the DPRK through expanded access to training and dialogue among experts. A good information-sharing and aid and investment coordination mechanism would also be needed to get maximum value for the North Korean economy from these external resources and relationships.

As noted earlier in this paper, a coordinated approach to the application of sanctions against the DPRK's military programs and military-related industry, with planning for future development assistance and foreign investment incentives, could lead to a rapid restructuring of the North Korean economy through redeployment of resources from the military subsystem to the people's economy managed by the Cabinet. If the six-party talks negotiations can supply the necessary security guarantees and openly address this issue—especially the potential redeployment of military assets and manpower, as part of a road map that would be endorsed by the Security Council and widely supported by the international community—it would have very positive impacts on both the realignment of the security framework and the economic development process in the DPRK's future. To be successful, it would also be necessary to find a mechanism to reach consensus on an economic reform and development strategy that can be both managed by the DPRK Cabinet and supported by the international community. To do this would require discussions among economic experts with the aim of defining the strategy and building consensus, linked in some way to the political negotiations process.

Internal Economic Considerations (Growth, Allocation Efficiency, Equity, Reforms, Corruption)

From an internal perspective the consequences of alternative future paths for the North Korean economy would also vary greatly, depending on the choices made by the major stakeholders.

An *escalation of confrontation* choice would most likely lead to another economic crisis with a downturn in agricultural and industrial production linked to deterioration in availability of intermediate inputs, such as fertilizer and energy, which cannot be obtained domestically. This crisis could be more severe than that of the 1990s if there is only a limited humanitarian response from the international community and if the UN sanctions are tightly enforced by South Korea and China. The consequences would most certainly include significant additional strains on the North Korean society; a worsening of poverty conditions; a deepening of the poverty trap; and potentially a new humanitarian crisis with starvation among vulnerable groups, increased refugee flows, and this time maybe social unrest also.

Social and political instability is more imaginable today than in the last crisis because of the changes in the relationship of the state and the people over the past decade, particularly the psychological changes in the underlying social contract. Hoarding and corruption would become widespread, with the risk of increasing tensions among internal stakeholder groups and pitting the interests of the military against those of the Workers Party, the Cabinet, and local authorities. Choices made by these groups to push for their own interests, sacrifice them for the larger good of the country, or give blind allegiance to the choices made by Kim Jong Il will determine the course of internal political developments and stability, largely outside the influence of foreigners. Nevertheless, the risk of such consequences could well influence the choices made by major stakeholder governments if the escalation and confrontation scenario unfolds, adding to conflicting objectives in international engagement with the DPRK. Given the multidimensional character of these problems, they would most likely need to be addressed by the United Nations both in the Security Council and in its humanitarian and human rights activities, and not through the six-party negotiations process. The role of a UN special envoy could become critical in this scenario.

A *delay and defer* scenario could lead to different economic and social results, depending on how the different stakeholders respond to the tactics adopted to pursue this policy. If South Korea and China choose a soft policy of cooperating with this strategy, then the impact on the North Korean economy from the present situation would likely be minimal, although access to foreign exchange for trade finance in the civilian economy would still be a constraining factor that would keep growth at near-zero levels. A key question would be the handling of food aid and energy supplies during the period of protracted negotiations, both on the side of the donors and in the allocation

choices made by the DPRK leadership on balancing the needs of the military with the needs of North Korean society. It should be expected that because of the UN sanctions, there will be some reduction of cross-border trade and investment, and the extent of this would depend as much on the decisions of private actors, especially private businesses, as on the attitudes of the governments involved, and this could affect the availability of rice and consumer goods in the markets. The equity impact would depend on whether the needs of vulnerable groups were being protected through the Public Distribution System, which would be most likely if the UN food aid programs are funded by donors and if the South Korean rice aid is resumed as a government-to-government transfer. The question of internal allocation policy will be a critical one for the future political economy of the DPRK. If the leadership believes that it will eventually strike a negotiated agreement through the six-party talks, then restraint on military allocations and steering resources toward the people's economy would better position the country to move forward on that path for the future.

If the objective is to retain a nuclear capability in a changed international environment down the road, then protecting the military allocations even at the cost of deeper social stress could be the choice made by the leadership. In any case, these allocation decisions will provide signals of policy intent during the negotiations phase, however long it lasts. Any prolonged negotiation period is likely to also mean that the DPRK will not move ahead with any major set of economic reforms until some eventual political agreement is reached. While there may be some innovations in labor policy, land use, and continuing efforts to dampen inflationary pressures, the DPRK is not likely to be able to achieve macroeconomic stability nor any significant productivity improvements in this environment. Nor will banking reforms be able to proceed in a situation where access to the international financial system is being denied.

If the choice is for *serious negotiations now*, then it will be important for the impact on the North Korean economy that an economic reform and development strategy be worked out cooperatively with the DPRK early in the process and that the negotiated economic package support the implementation of this strategy in a phased and logical manner. This will require a different type of international cooperation and partnership than was developed either under the Agreed Framework with the Korean Peninsula Energy Development Organization (KEDO) or under the humanitarian assistance programs that were put in place in the 1990s. It will help this process if the organizations that

are expected to play lead roles during the implementation phase are consulted and become actively involved in the negotiations phase. It would also be particularly important in this scenario that effective aid coordination and monitoring arrangements be put in place to minimize the risks of corruption and inefficient implementation. If carefully constructed, the economic road map could lead to a restructuring of the North Korean economic system in a way that is not only compatible with the future security framework but allows the economy to be put on a sustainable growth path that delivers welfare improvements to households widely in North Korean society, and contributes to social improvements that would also help improve the human rights situation in the country. Internally, this means that the Cabinet, not the military, will need to be given a major say in the negotiations process and in shaping the agreements that will affect the future economic development of the country. This implies that senior economic officials, not just the Foreign Ministry and senior military officials, will be involved.

The internal policy coordination challenges within the DPRK governance system to accomplish this should not be underestimated, as it raises sensitive issues about the balance of power between the military, the Cabinet, and the Workers Party. A serious negotiations process would bring these internal political issues to the surface sooner rather than later, and the international stakeholders would need to choose whether to remain aloof or to try to influence these internal dynamics of transformational change. Remaining aloof runs the risk of the DPRK not accepting international norms for good governance that are ingrained now in the policies and practices of the donors that provide official development assistance. Attempting to influence the internal course of events could also run the risk of meeting resistance from the DPRK stakeholders and impede the negotiations process. A balance would have to be struck and understandings reached about rationales and intentions. This could only be done through creating a culture of openness in discussing sensitive issues within the negotiations environment.

Regardless of which scenario unfolds, there will be a need to deal with the challenges posed by DPRK's isolation and low level of knowledge about the outside world and the way it works. This is especially critical for any meaningful discussions on economic perspectives on future choices and their implications. While learning opportunities grew significantly since the late 1990s through overseas educational and training activities—and some internal workshops, training, and contacts with foreigners working inside the

country—the overall scale remains very limited. An important question is how to sustain this knowledge-building process in a post-test environment.

Implications for Policy

The alternative paths to the future in a post-test world present new complexities and challenges that affect calculations of the benefits and risks of engagement with the DPRK.

One general implication for engagement strategy is that the three paths forward are not equally desirable; the one that holds the most promise for positive outcomes for all stakeholders is the *serious negotiations now* option and the one that is most threatening is the *escalation and confrontation* option. Thus governments, NGOs, and private groups should consider ways to mitigate the factors that would cause the DPRK leadership to choose the escalation route and stay within the negotiations framework, and consider the role of “limited engagement” policies as an interim measure, with the promise of “scaled-up engagement” at a future time that would be linked to the progress of the negotiations. The *delay and defer* scenario poses the most challenging of engagement strategies, as different stakeholders may choose to pursue their own interests within the framework of an extended negotiations process. Ambiguity about the DPRK’s ultimate intentions could allow multiple interpretations leading to potentially conflicting policies among the major stakeholder countries, and between humanitarian groups and profit-seeking enterprises and advocates of maintaining tight isolation policies.

While different stakeholders may have different ideas about what *limited engagement* would mean in practice, there are some common elements. First, any engagement would need to take into account the impact of the UN resolutions on both the environment for cooperative engagement and how any specific activities would affect the achievement of the objectives of the resolutions. Second, limited engagement should help illuminate the costs to the DPRK of the strategies that they are pursuing and the potential benefits of moving to a less costly strategy. Third, limited engagement should keep communication channels open that can be used to provide information that might positively influence the internal processes of discussion and decision making within the DPRK. And fourth, limited engagement should maintain relationships and goodwill that can be the foundation for scaling-up later if political developments permit moving in this direction. This incentive factor is an important part of the strategy to encourage the DPRK to move toward more desirable paths for the future from each stakeholder’s perspective.

Limited engagement would also need to take into account the processes and progress being made through the six-party talks as well as responses to the UN resolutions. If working groups are established to work on technical aspects of areas where agreements are to be reached, it may be possible that Track 2 activities designed to support the content of the work of these groups might have value. In particular, bringing experts together from inside and outside the DPRK in a nonthreatening setting to explore ways to address and resolve practical issues and to build consensus on ways forward, could be an avenue of engagement that could make positive contributions to the formal negotiations process.

Another implication for future engagement strategies is the need to reconsider the modalities of engagement. Managing financial aspects will be affected by the pressures to constrain North Korean access to accounts in foreign banks. If this leads to more cash-based transactions with NGOs, business partners, and humanitarian donors, there will be a higher risk of abuse and corruption. Some shift from financial transfers to commodities is likely to be considered to minimize these risks and to keep in line with UN sanctions. Future engagement will also be subject to scrutiny by skeptics and the press. This means that engagement will therefore need to be disciplined, with transparent accountability for being in line with acceptable practices under the UN resolutions, and include clearly understood conditionalities that are respected by the North Korean partners for monitoring and reporting on the use of any resources that are transferred.

Given the complexity of the issues now at play, information-sharing and coordination among groups that are pursuing limited engagement policies will be even more important in the future. Mechanisms to improve such sharing and coordination need to be put in place. Informal as well as formal ways to do this should be explored, including electronic options as is already being put in place by the National Committee for North Korea in the United States.

Conclusion

For both the DPRK and the international community, the stakes are high in the post-test world. Depending on the choices made by stakeholders both inside and outside the DPRK, the future path could be highly destabilizing or highly transformational with positive outcomes for regional security and economic prosperity for the North Korean people. Viewed from an economic perspective, the implementation of UN Resolutions 1695 and 1718 will be both difficult and problematic. But the potential impact on the North

Korean economy of a well-managed sanctions regime on military programs and military industries, combined with a well-designed economic development strategy and support packages for reforms and investment, could be huge. Such a transformational security and economic process would require political dexterity among the major stakeholder countries and understanding of the difficulties that the DPRK would face in making internal adjustments required.

Facilitation and support will thus be needed both in the realignment of the external environment and the management of domestic change. While the six-party talks framework is an important tool in this process, the active involvement of the Security Council is also now a factor. Because the challenges involve interests at the global, regional, and national levels, balanced and thoughtful statesmanship will be needed in the period ahead. The advent of a new secretary-general at the United Nations provides an opportunity to reshape the future role of the United Nations in providing a neutral facilitating contribution to the diplomacy that will be needed in the coming months and years. Engagement strategies will need to be coordinated and linked in meaningful ways to the diplomacy.

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