

**ECONOMIC TRANSITION OF NORTH KOREA AND INTERNATIONAL
ASSISTANCE: IMPLICATIONS OF JAPAN-DPRK NORMALIZATION**

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EXECUTIVE SUMMARY

This paper analyzes strategies for economic transition toward a market economy in North Korea and assesses conditions for international assistance with this economic transition.

Main Argument

To break out of its long-term economic stagnation, North Korea must pursue fundamental structural reforms, including transition to a market economy, demilitarization, and an external opening for foreign trade and investment. A “gradualist” approach to this economic and structural transition—similar to those pursued by China and Vietnam—would be the most effective way of bringing about economic growth and development.

North Korea’s economic transition requires a cooperative solution and mutual trust between North Korea and the international community. This is only possible if Pyongyang:

- abandons its nuclear development programs and promotes a peaceful stance in Northeast Asia
- resolves the Japanese abduction issue
- initiates market-oriented economic reforms

North Korea’s economic transition also requires the international community to:

- provide assurances for the existing political regime
- support peaceful reunification of the two Koreas
- provide economic assistance for North Korea’s economic reconstruction, development, and growth.

Policy Implications

- Mutual cooperation and trust building between North Korea and the international community are the only ways to secure peace, stability, and prosperity in Northeast Asia.
- North Korea could preclude the threat of its complete collapse through the pursuit of gradual economic and structural transition, similar to those carried out by China or Vietnam.
- The East Asian economies can encourage Pyongyang to integrate North Korea with the regional and global economies by joining the International Monetary Fund, the World Bank, and the Asian Development bank and pursuing fundamental structural reforms.

Introduction

Nuclear arms development by North Korea is posing a potential threat to the peace, stability and prosperity of Northeast Asia. In order to secure permanently peace, stability and prosperity in the region, one needs to see the abolition of nuclear weapons, sustained economic development and growth in North Korea and mutual trusting building between the international community (particularly the United States and Japan) and North Korea.

North Korea has experienced economic stagnation over the last fifteen years because of its deep structural problems. Unless North Korea addresses these problems, one may expect a total economic collapse and the associated political and social crises, which is not desirable for neighboring countries like South Korea, China, Russia and Japan. It is vital for North Korea to rectify the current problems in a fundamental way and transform its economy so as to begin reconstruction, development and growth. Toward this end, North Korea needs to embark on substantial economic reforms to initiate transition from a centrally planned economy to a decentralized, open market economy, and the international community needs to provide large-scale economic assistance to support the economic transition process. North Korea and the international community must break away from the looming distrust of each other and establish a cooperative relationship.

The organization of the paper is as follows. Section 2 assesses the causes of North Korea's long-term economic stagnation and the recent efforts to reform its economy. Section 3 lay outs strategies for economic transition and emphasizes that a gradualist approach a la China and Vietnam may be a useful model. Section 4 attempts to find conditions for a cooperative solution between North Korea and the international community so that the country can initiate its economic reconstruction, development and growth. Section 5 provides concluding remarks.

North Korea's Economic Stagnation and Structural Problems

North Korea in Economic Crisis

North Korea has experienced long-term economic stagnation since the beginning of the 1990s (Figure 1). From the mid- to late-1990s, the country encountered severe

floods, food shortages, energy crisis, foreign exchange shortages and financial difficulties. Looking at statistics, North Korea's economic stagnation does not appear to have been as serious as that of severely hit transition countries in Central and Eastern Europe or in the former Soviet Union—such as Georgia, Moldova, Ukraine, and Tajikistan (Figure 2). However, the fact that North Korea's level of economic activity was low initially, its infrastructure provision was grossly inadequate in preventing serious floods, and a large number of people suffered from malnutrition and even died of hunger, the country's economic crisis was much more serious than the level of economic activity indicated.¹

The economic stagnation and crisis in North Korea were structural and attributed to several factors. First, external trade and aid flows declined sharply due to the economic and political breakdown of the former Soviet block, which was a major trading partner and aid donor. Imports of crude oil, other intermediate inputs and capital goods plunged because of the shortage of foreign exchange after trade settlements were required to be done in hard currencies. As a result, capacity utilization in the overall economy declined. The negative aspects of over-reliance on the former Soviet Union and its allies became exposed. Second, the inefficiency of a centralized planned, closed economic system was exposed, due to the lack of competition and economic incentives. For example, in almost all sectors—such as manufacturing and agriculture—production and economic activities plummeted. In particular, agricultural production declined throughout the 1990s, after having reached its peak in 1991, falling to 55 percent of the peak in 1996-97. Trade and capital transactions with outside market economies were tightly controlled even after the breakdown of the socialist system of international division of labor, making it all the more difficult to import foods and energy through exports of its products and inflows of foreign capital. Third, lack of investment in industrial infrastructure and human capital severely limited the economic potential of the country.

Together with the overall economic stagnation, North Korea has seen deterioration in human development (see Table 1). Average life expectancy is short at 62 years and the rate of infant mortality is high at 42 per 1,000. Moreover, one third of the population is suffering from severe malnutrition. Spending on health is a mere 2.5

¹ Needless to say, mass death by hunger is an unprecedented event in a modern, civilized state.

percent of GDP, significantly lower than other East Asian transition and developing countries.

Table 1. Economic and social indicators of North Korea (2002)

	National Income	Population	Health Spending	Average Life Expectancy	Infant Mortality Rate	Child Mortality Rate	Malnutrition
	US\$ Billion	Million	% of GDP	Years	Per 1,000	Per 1,000	Population
North Korea	17	22	2.5	62	42	55	34
South Korea	473	48	6.0	74	5	5	3
China	1,234	1,280	5.5	71	30	38	11
Vietnam	35	80	5.1	70	20	26	19
Japan	4,324	127	8.0	82	3	5	--

Source: World Bank.

Economic Reform of July 2002

North Korea embarked on an economic reform called “Economic Improvement and Management Measures” on July 1, 2002. The 7.1 economic reform program included the following measures:

- Increases of official prices of consumer goods and currency devaluation
- Official acceptance of farmers’ markets and freer transactions of consumer goods
- Expansion of business autonomy of state owned enterprises

The government attempted to arrest the expansion of underground markets by raising official prices and narrowing the gap between official and black market prices. Farmers’ markets which had been in place for a long time were officially accepted as a reality, and markets for manufactured consumer goods in addition to agricultural products were also approved in March 2003. Price reform and the expansion of freer exchanges of consumer goods have no doubt had a positive impact on the economy by stimulating market activities. However, these measures did not cover the key part of the economy because the government maintained price controls on intra-enterprise transactions of intermediate inputs and capital goods despite the greater business autonomy granted to state-owned enterprises. As such, the 7.1 reform program has not liberalized key economic activities and, hence, has not altered the centrally planned nature of the economic system. Essentially it introduced a market economy for the allocation of consumer goods outside of the planned economic system while maintaining the key economic activities—such as production and investment—intact under state control. An expansion of markets for consumer goods is clearly a step forward to a market economy, but in order to induce a strong supply-side response, a

full-fledged economic reform must be initiated.

North Korea had launched economic reforms since the beginning of the 1990s. In December 1991, for example, it made Rajin-Sunbon a “free economic and trade zone” and in October 1992, it implemented several laws such as the “Foreign Investment Law” and “Foreign Corporate Law.” However, not many foreign corporations were attracted due to the inadequate industrial infrastructure, the inflexible control system, the rigid labor management and employment practice and, more generally, the lack of a promising investment climate. As a result, the North Korean government established a “special economic zone” in Shineui in October and an “industrial zone” in Kaesung in November 2001 in an attempt to vitalize economic activities. In order to make these “special economic zones” a success, there is a need to remove various impediments.

Weak Industrial and Social Infrastructure

One of the biggest impediments to the development and growth of the North Korean economy lies in the grossly inadequate industrial and social infrastructure. In particular, its capacity to provide energy and electricity, reliable transport facilities (such as railway, roads and ports) and telecommunication systems are very limited (Table 2).

Table 2. North Korea’s Industrial Infrastructure and Energy Demand & Supply, With International, Comparative Perspectives (2002)

	Roads		Railroad	Telephone Lines	Energy			Power Output
	Total Distance	Pavement Ratio			Production	Consumption	Per Cap. Cons.	
	1,000 km	%			1,000 km	Per 1,000	Million Tons	
N. Korea	31	6	5.2	21	19	20	914	20
S. Korea	87	75	3.1	489	34	195	4,114	282
China	1,698	91	70.1	167	1,139	1,139	896	1,472
Vietnam	93	25	3.1	48	50	39	495	31
Japan	1,166	77	23.2	558	104	521	4,099	1,033

Note: Unit of energy production and consumption is oil of million metric tons

Source: World Bank. See also Appendix 2

Although the road network in North Korea appears adequate, its pavement ratio remains low at around 6 percent, which is far from the international norm. As for railways, while the total distance constructed far exceeds that of South Korea, the maintenance and repair are insufficient and traffic delays are common. One of the many reasons for this lies in the serious lack of foreign exchange which prevents imports of gasoline and diesel required for road transportation. Moreover, cargo-related facilities

have become obsolete and maintenance insufficient. Information and telecommunications infrastructure is also generally weak and the telephone line network is equally underdeveloped.

Per capita energy consumption in North Korea is not too low in comparison to other East Asian developing countries in transition, but its level is below one fourth that of South Korea. The seriousness of North Korea's energy crisis is starkly shown in the dramatic decline in energy production and consumption during the 1990s. For example, annual energy production, which recorded 29 million metric tons (in oil) in 1990, dropped to 19 million metric tons in 2001, and annual energy consumption dropped from 33 million metric tons recorded in 1990 to 20 million metric tons in 2001. These were sharp declines. As a result, the volume of per capita annual energy consumption declined from 1,647 kg in 1990 to 914 kg in 2001 (a drop of 45 percent). Power production similarly declined. North Korea relies heavily on hydroelectric power and thermal power (coal) generation, and not on oil and gas, for its power supply because of the country's inability to import oil and gas due to the lack of foreign exchange. As both the supply of heavy oil and the light water reactor plant project under the Korean Peninsula Energy Development Organization (KEDO) were suspended as a result of North Korea's nuclear arms development program, the country has suffered from extreme shortage of energy and a large number of factories appear under pressure to reduce capacity utilization or unable to operate any more.

Strategies for Economic Transition in North Korea

Economic Reform: Toward a Market Economy, External Opening and Demilitarization.

North Korea's agricultural sector was not competitive even in the pre-World War II period,² but it had abundant underground mineral resources (iron ore, gold, silver and copper) and succeeded in industrialization supported by hydroelectric power generation. Essentially, North Korea had a comparative advantage, relative to the southern counterpart, in natural resources and manufacturing. North Korea's strategy to reconstruct and develop its economy should take this factor into account.

² It can be said that the southern part of the Korean Peninsula had a comparative advantage in agriculture.

For North Korea to achieve sustainable economic development and growth, a priority should be placed on a market-oriented reform of its domestic economic system accompanied by the liberalization of foreign trade and investment through external economic opening. In so doing so, it is critical to strengthen export competitiveness by inviting foreign firms and developing the light manufacturing and mineral resource-based sectors. By expanding exports, North Korea can import foods, energy, intermediary inputs and capital goods, and initiate economic reform programs. North Korea must consider joining the World Trade Organization (WTO) eventually by pursuing significant trade and investment liberalization.

There is also a need to improve productivity by introducing market principles into many sectors of the economy, particularly the agricultural sector. Food production has gradually recovered from the flood and famine in the mid-1990s, but food supply is far from sufficient to meet North Korea's demand and, as a result, the country must rely on assistance from the international community to fill in the gap. North Korea's labor force distribution in the agricultural sector is about 33, which is higher than those in the Central and Eastern European countries and the former Soviet Union states. Given the low level of productivity in the agricultural sector, there is a benefit in promoting migration of labor from agriculture to manufacturing and services. In addition, new incentive systems need to be introduced for higher productivity growth.

Moreover, the North Korean economy is highly militarized, as seen in the ratio of military personnel accounting for 9 percent of total work force and military spending accounting for 23 percent of GDP.³ Such a highly militarized state can be seen only in two or three countries throughout the world. A major challenge is how to demilitarize the economy, nurture civilian economic activity and increase productivity of the economy at large.

In conclusion, North Korea should implement an economic reform program with a focus on the following tasks:

- Decentralization and market orientation of the whole economic system, including reforms of state-owned enterprises—for raising efficiency of resource allocation and strengthening production incentives—and expansion of private ownership and private sector activities
- Promotion of export-oriented light manufacturing sectors and mineral resource-based industries through the liberalization of foreign trade, investment, technology imports,

³ GDP ratio to military spending differs in accordance with the source of the data. According to Geography IQ, it is high at 33.9%.

- with the aim of joining the WTO
- Improvement of agricultural productivity through greater migration of agricultural labor force and market-based incentive systems
- Demilitarization of the economic system through conversion of military industries into civilian ones and retraining of military personnel for private-sector activities.

Better Investment Climate

In order to achieve external economic opening and encourage foreign trade and foreign direct investment, North Korea must strengthen the country's general economic environment and investment climate. Its investment climate is one of the worst in the world (Appendix 2). First, there is a need to improve and upgrade the country's industrial and social infrastructure—railways, roads, ports, electricity, and telecommunications, etc.—for private-sector activities, such as production, investment, export and import. Second, while laws on investment by foreigners and foreign companies have already been introduced, these must be altered fundamentally to embrace and encourage foreign firms' market activities. In addition, the country must establish soft infrastructure (legal, regulatory and supervisory institutions and mechanisms) supporting the country's overall market-based economic activities. The “rule of law” which is the foundation of any market economy—including a strong legal system, the protection of private ownership (and intellectual property rights), enforcement of contracts (such as claims and debts), regulatory transparency and predictability—must be put in place.⁴ Third, labor management and employment practices should become much more flexible so as to allow private firms, including foreign firms, to employ high-quality labor and human resources. Such efforts would encourage private firms' domestic activities.

In conclusion, an improved investment climate would require the following:

- Improved industrial and social infrastructure, particularly railways, road, ports, electricity, and telecommunications
- Rule of law including the protection of private ownership, enforcement of contracts, a strong legal system, regulatory transparency and predictability
- Flexible labor management and employment practices.

Gradualist Reform

One of the most serious potential threats of North Korea to neighboring

⁴ As far as the North Korean business relationship with foreign firms is concerned, the author has been indicated by several international business people that the concept of “contract enforcement” is fairly well shared in North Korea, which is a good sign for foreign firms' operations.

countries (particularly to China, South Korea, Russia and Japan) is the collapse of its economic, social and political order and the associated exodus of a massive number of people out of the country. To reduce this potential threat, North Korea should maintain stable economic, social and political conditions. While transition to democracy is clearly desirable, it is not a prerequisite for effective economic reform and external economic opening.

Although the Korean peninsula will be reunified eventually, the mode and speed of reunification matter. First, super big bang-type reunification a la West and East Germany will be extremely costly. Per capita GNI of North Korea is currently only about 6 percent that of South Korea's, while per capita income of East Germany before reunification was 28 percent that of West Germany. The population of North Korea is nearly half (47 percent) that of South Korea, while East Germany's population was one fourth (27 percent) that of West Germany (see Table 3). Essentially, North Korea has a much larger population of poor people relative to South Korea, which will entail much higher cost for reunification than in the case of German reunification. Hence, it is more rational for North Korea to grow on its own, narrow the income gap vis-à-vis South Korea, and achieve greater convergence before reunification. North Korea must establish new institutions and market infrastructure to support market activities, which is a time consuming process.⁵ In the transition period, it is highly desirable for North Korea to maintain political stability—i.e., govern the country in a stable manner—and undertake efforts to pursue market-oriented reforms and begin economic reconstruction and development.

Table 3. Population and Income of North and South Korea, in comparison with Pre-reunification East and West Germany

	North and South Korea (2003)			East and West Germany (1989)		
	N. Korea (A)	S. Korea (B)	A/B	E. Germany (C)	W. Germany (D)	C/D
Population (MilL.)	22.7	48.1	47%	16.31	61.17	27%
GNI (USD Billion)	20.8	681.0	3%	200	2,650	8%
Per capital GNI	914	14,162	6%	12,048	43,300	28%
Area (1,000 Km2)	120.5	98.5	122%	108.3	248.6	44%

Note: German GNI is GDP expressed in West German deutschemark.

Considering North Korea's economic transition from an international, comparative perspective, the best model appears to be that of China or Vietnam. In most

⁵ See McKinnon (1991). See also Rana and Hamid (1995) for the reform strategies of East Asian transition economies, including China, Vietnam and others.

of Central and Eastern Europe and in Russia, political transition to democracy and economic transition to a market were undertaken rapidly and more or less simultaneously. However, in China and Vietnam, economic transition to a market has been pursued gradually without political transition. For North Korea to initiate economic reform while at the same preserving social and political stability, the Chinese or Vietnamese model appears most suitable and appropriate. The economic development model based on export-oriented industrialization a la South Korea under Park Chung-Hee, will also be of some relevance to North Korea (Table 4). As the industrial foundation in South Korea was weak to start with, its successful industrialization can provide a good example. Although the share of agricultural workforce in North Korea is lower than in China and Vietnam, there is still room for reduction of agriculture and expansion of manufacturing and services.

Table 4. Models of Political and Economic Transition

Model	Political Transition	Economic Transition
Super Big-Bang: East Germany Big-Bang: Russia	Instantaneous political transition to West Germany's democracy Rapid political transition to democracy after political crises Rapid political transition to democracy	Instantaneous economic transition to West Germany's market system Rapid economic transition to a market with economic dislocations Relatively orderly economic transition to a market
Quasi Big-Bang: Central and Eastern Europe Gradualist Approach: China or Vietnam Development Dictatorship: South Korea	One party (communist) political regime Authoritarian dictatorship	Gradual economic transition to a market Export-oriented industrialization with heavy government intervention

One point to be noted is that an important international factor led China under Deng Xiaoping to take a step toward a "reform and open door" policy: It was the reduction of military threat resulting from diplomatic normalization with the United States and Japan in the 1970s. In the case of North Korea, it will be similarly important to reduce military tension in the region and achieve diplomatic normalization with the United States and Japan so that North Korea will no longer feel pressed by external military threats.

Finding a Cooperative Solution

Overcoming the Prisoners' Dilemma

The present relationship between North Korea and the international community,

particularly the United States, can be described as a “prisoner’s dilemma” situation. Table 5 summarizes this in a simple game form. North Korea has two strategies, namely, cooperation (abandoning nuclear arms) and non-cooperation (maintaining nuclear arms). The United States also has two strategies, namely, cooperation (guaranteeing North Korea’s political regime) and non-cooperation (exercising hostility toward North Korea). U.S. cooperation here means that the United States will not attempt to overthrow the present political regime by force like in the case of Iraq, and U.S. non-cooperation means that the United States will take a hostile policy including the overthrowing of the present political regime by force or covert operations. In case both sides take a cooperative strategy their payoffs are both large. If one side takes a cooperative strategy and the other a non-cooperative strategy, the former gains the most in this simple game and the latter loses. In case both sides take a non-cooperative strategy, their payoffs are both small but still higher than in the case of one-sided cooperation. In such a simple game, for both North Korea and the United States, the non-cooperative strategy will become the dominant strategy and thus North Korea will maintain nuclear arms and the United States maintains hostility toward North Korea as an equilibrium of the game.

Table 5. Prisoner’s Dilemma in a Game between North Korea and the United States

		United States	
		Cooperation (Guaranteeing regime)	Non-cooperation (Exercising hostility)
N. Korea	Cooperation (Abandoning nuclear arms)	a, a	0, 10
	Non-cooperation (Maintaining nuclear arms)	10, 0	b, b

Note: Payoffs are indicated in each cell in the order of North Korea and the United States. $0 < b < a < 10$.

Such a non-cooperative equilibrium is not a Pareto optimum situation.⁶ Instead, each could gain a higher payoff by adopting a cooperative behavior. A non-cooperative result emerges because North Korea and the United States do not trust each other, and both think that they would suffer from damage by showing trust and good will, which would be countered by the other side’s distrustful behavior. For both parties to take a cooperative behavior, there is a need to establish a trusting relationship and

⁶ Pareto optimality means that either player’s payoff cannot be increased without decreasing the other player’s payoff. As both sides can obtain higher payoffs by moving from a non-cooperative to a cooperative strategy, the combination of non-cooperative strategies is not a Pareto optimum situation. In contrast, the combination of cooperative strategies leads to a Pareto optimum outcome.

institutionalize cooperation in a binding form. Specifically, building an international framework in which both North Korea and the United States can commit to cooperation. Perhaps the Six-Party Talk is proving to be an excellent vehicle for such a purpose.

Conditions for International Cooperation

To help North Korea and the United States establish a cooperative relationship, the members of the Six-Party Talk can make various commitments including the normalization of diplomatic relations if not having done so.

First, North Korea should:

- Abandon nuclear arms irreversibly and in a verifiable manner, respect the Non-Proliferation Treaty (NPT) and make a commitment to maintaining peace and stability in Northeast Asia
- Resolve the Japanese abduction issue completely
- Initiate economic reform programs for transition to a market and external opening to trade and investment and, for this purpose, apply for membership with the International Monetary Fund (IMF), the World Bank, and the Asian Development Bank (ADB).

Second, the international community centering on five countries—Japan, the United States, China, South Korea and Russia—should pledge the following:

- Guarantee the security of the existing political regime, regardless of who is the political leader of North Korea
- Support peaceful reunification of the Korean Peninsula
- Provide external assistance to North Korea in its efforts for economic reform, including economic transition to a market and external opening by extending financial and technical assistance and securing stable energy supply.

North Korea must meet the first three conditions because the international community will take these actions as evidence of North Korea's commitment to cooperation. The first condition may require international teams led by the International Atomic Energy Agency (IAEA) to continuously monitor all the nuclear facilities. The third condition enables North Korea to integrate itself with the global and regional economies, without which large-scale external assistance is ineffective in helping North Korea to pursue market-oriented economic transition. The international community led by Japan and the United States must meet the last three conditions in order to provide North Korea with incentives to cooperate. The international community should extend large-scale economic assistance to North Korea so that the country can accelerate

various economic reforms, including stable supply of energy. While peaceful use of nuclear energy is not permitted for the time being, the international community will supply the required energy such as heavy oil. Once North Korea establishes that it has abandoned nuclear arms completely through IAEA's strict inspections, that it strongly adheres to the three commitments, and that it has the will and ability to fully manage nuclear power plants for peaceful purposes, its right to secure a stable and long-run supply of energy through peaceful use of nuclear facilities may be respected.

Box. Requirements for Asian Development Bank Membership

A critical requirement for any regional country to become an ADB member is that it must be a member of the United Nations Economic and Social Commission for Asia and the Pacific (UN ESCAP). For any non-regional country to be an ADB member, it must be a member of the United Nations. The country does not have to be an IMF member, unlike in the case of World Bank membership. Then the ADB requires two steps for a country to become its member. The first step is the establishment of an informal general consensus among member countries. The second step is the formal agreement between the country and the ADB on the terms and conditions of membership, followed by the country's formal application for membership, the official approval of the Board of Directors, and finally the approval by the Board of Governors. North Korea is a member of ESCAP and, hence, is eligible for membership, but has not cleared the first step above as it has not obtained the requisite support needed to proceed further.

Note: See Article 3 (Membership) of "Agreement Establishing the Asian Development Bank."

Target of International Economic Assistance

Under appropriate conditions, international economic assistance may be extended to North Korea from two perspectives, namely, from a short-term and a medium- to long-term perspective. From a short-term perspective, humanitarian assistance addressing the immediate needs of the socially vulnerable—such as foods, cloths, medicines and health services—is essential. From a medium- to long-term perspective, economic assistance that contributes to the sustainable economic reconstruction, development and growth—such as investment in life-supporting infrastructure, industrial infrastructure, agriculture and human resource development—would be critical.

Such international economic assistance should be provided under a close coordination of the international community, involving the United Nations Development Program (UNDP), the World Bank, the Asian Development Bank (ADB) and the International Monetary Fund (IMF). These international institutions—including even the two Bretton Woods institutions (IMF and World Bank)—do no longer consider a big

bang-type of economic transition as the most effective approach, as has been observed in the recent experiences of China, Vietnam and Cambodia. In these economies, assistance programs have focused on domestic reforms of institutions and capacity from a long-term perspective. International institutions and potential bilateral donors such as Japan and South Korea should respect North Korea's ownership of its economic reform program and at the same time coordinate their assistance efforts.

International economic assistance to North Korea should be extended in the following priority order:

- Humanitarian assistance addressing the immediate needs of the socially vulnerable—such as foods, cloths, medicines and health services (largely led by UN institutions)
- Strengthening life-supporting infrastructure—such as gas, water supply and sewerage, public transportation, health and sanitation
- Substantial improvement of industrial infrastructure—railways, roads, ports, electric power, telecommunications, telephone networks—to contribute to the development of export-oriented industries (light manufacturing sectors and mineral resource-based sectors) and to attract foreign investment
- Increasing agricultural productivity through rural developments
- Strengthening human resources through education, training and other human resource development programs.

Role for Members of the Six-Party

North Korea and the United States must play the most important role in ensuring effective international cooperation. The other Six-Party Talk members will also have their roles to play.

First, Japan will likely extend a massive bilateral assistance including postwar reparations to North Korea and, in so doing, should take the initiative to help design North Korea's reform program for reconstruction, development and growth by coordinating with other bilateral donors and international institutions. In particular, its comparative advantage over other donors will be to focus on financial and technical assistance for improving industrial infrastructure and helping trade and investment expansion. Second, China is in the position to convince North Korea that it can achieve economic development and growth by "reform and open door" policies even under the present political system, given its remarkable success in economic transition. China can provide useful lessons on the virtue of liberalization of foreign trade, foreign direct investment and finance as well as domestic structural reforms. Third, South Korea may

provide economic assistance from the standpoint of eventually unifying the Korean Peninsula, based on its successful experience of export-led industrialization growth. Fourth, Russia has a capability to provide its abundant crude oil to North Korea through an oil pipeline project covering Northeast Asia including North Korea.

The East Asian economies as a whole can also encourage North Korea to integrate itself with the regional and global economy by joining the IMF, the World Bank and the ADB and pursuing fundamental structural reform for economic transition and market opening. Toward that end, the leaders of East Asia led by Japan, China, South Korea and ASEAN should encourage North Korea to participate in the ASEAN+3 process.

Concluding Remarks

Peace and stability of Northeast Asia requires a cooperative solution and mutual trust between North Korea and the international community. A cooperative solution is possible if North Korea abandons nuclear development programs and makes commitments to peace and stability in Northeast Asia, resolves the Japanese abduction issue and initiates market-oriented economic reforms by joining international financial institutions (IMF, WB and ADB) and if the international community provides assurance of the existing political regime, supports peaceful reunification of the two Koreas and provides external economic assistance for North Korea's economic reconstruction, development and growth.

For North Korea's economic construction, development and growth, the country needs to pursue fundamental structural reforms—including transition to a market economy, demilitarization, and external opening in foreign trade and direct investment—and the international community needs to provide external economic assistance to support North Korea's reform efforts. North Korea must recognize that achieving economic transition, rather than maintaining a centrally planned economy, is the only way out toward economic reconstruction and sustained development and growth. External economic assistance may focus on the provision of social and industrial infrastructure—health, gas, railways, roads, power and telecommunication—to strengthen cross-border connectivity, on the productivity growth in agriculture and on human resource development. A “gradualist” approach to

economic transition, a la China and Vietnam, would be more effective and realistic than a “big bang” approach because of the need to establish new institutions and market infrastructure to support private sector- led activities. New institution building is a time consuming process.

Mutual cooperation and trust building between North Korea and the international community—led by the United States and Japan—and North Korea’s integration with the regional and global economy are the only way to secure permanently peace, stability and prosperity in Northeast Asia.

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