

**REGIONAL ECONOMIC IMPLICATIONS OF DPRK SECURITY BEHAVIOR:
THE “BOLD SWITCHOVER CONCEPT”**

**International Conference Held in Beijing, January 18-19, 2006
Final Conference Report**

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EXECUTIVE SUMMARY

This report summarizes the findings of an NBR project on the regional economic implications of North Korea's security behavior. It also analyzes the potential economic consequences of a "bold switchover" from "military-first politics" to "defense sufficiency" by the Democratic People's Republic of Korea (DPRK).

Main Argument

The economic costs of North Korean military policies and international security behavior cannot be measured by foreign aid budgets—or defense budgets—alone; all of North Korea's neighbors have suffered broader economic costs, and lost economic opportunities, as a direct consequence of Pyongyang's security policies and practices. Likewise, all of North Korea's neighbors stand to benefit economically from an emendation of North Korea's security behavior.

Policy Implications

- Bringing the discipline of economics to bear on the North Korean security problem will help empower decision makers by presenting with alternative ways of conceptualizing solutions to the North Korea security problem. It might also encourage a shift from the zero-sum thinking of a securities studies paradigm to the win-win thinking of an economic paradigm.
- Policymakers would profit from taking into account the far-reaching economic costs of DPRK security behavior, and the potential economic opportunities to be had from a DPRK posture change; the economic neighborhood should prepare to take advantage of opportunities a "Bold Switchover" would generate.
- The DPRK should be encouraged to realize that, even if it maintains its socialist-style central economic planning, it stands to make significant gains if Pyongyang undertakes a "Bold Switchover." Much greater benefits could be had, however, if a « switchover » were accompanied or followed by far-reaching economic reforms.
- The DPRK's current international posture adversely affects economic development, economic reform, and poverty alleviation in China, particularly in the northeast provinces.
- South Korea, Japan, and China may be vulnerable to 'business panics' precipitated by North Korean brinkmanship; China, especially, has much to lose if Pyongyang induces broad international economic sanctions and if Beijing sides with them.
- Economic reconstruction of the North after a "Bold Switchover" would be a major financial undertaking that could generate economic returns. Political and policy decisions made now, however, will determine the scale and distribution of these potential costs and economic returns.
- While international financial institutions (IFIs) may eventually prove a source of concessionary capital to fund DPRK reconstruction, Pyongyang's membership in IFIs may be difficult to negotiate unless it is prepared to bear the tradeoff costs of overhauling policies, practices, and (possibly) losing control.
- The DPRK would benefit from normalizing relations with Japan, but the terms of normalization and the economic perks that might accompany it are still unclear.

Background

This report presents a summary recapitulation of highlights from a project that culminated in an international conference on “Regional Economic Implications of DPRK Security Behavior: The ‘Bold Switchover’ Concept” in Beijing, China, January 18–19, 2006. The conference was convened by The National Bureau of Asian Research (NBR) and was lead by Dr. Nicholas Eberstadt of the American Enterprise Institute (Senior Advisor to NBR’s Northeast Asia Studies Program).

The frank, illuminating, and wide-ranging discussions and deliberations in these sessions are worth remembering for the record—and part of what made them noteworthy was the representation of specialists and policymakers concentrated around the conference table. It is possible that no such collection of persons had ever before been assembled for such a discussion of the North Korea question on Chinese soil.

The conference brought together researchers of five nationalities (USA, ROK, Japan, Russia and China), and officers from two international financial institutions (World Bank, Asian Development Bank). From within China itself, specialists and experts associated with ten separate universities, research organizations, and advisory bodies—groups charged with informing the Chinese governmental decision-making apparatus through a range of important nexus-points within both Party and State—brought voices to the table.

The dialogue at this conference about the economic effects of DPRK security behavior accrued an additional measure of consequence due to events entirely beyond the conference organizers’ plans: For in the event, the opening session of this Beijing-based conference on the external economic repercussions of DPRK security behavior happened to coincide with a visit by DPRK “Dear Leader” Kim Jong Il to China. Though putatively “unofficial”, this visit was heavily freighted with symbolism—and suggestive portent. With an entourage rumored to number as many as 300 persons, Kim Jong Il reportedly embarked on an eight-day journey that included a retracing of Deng Xiaoping’s famous 1992 “Southern Tour” (now celebrated by Chinese leadership for having re-energized China’s then-stalling economic reform efforts). Upon his own tour’s completion, Kim

was received in Beijing by the entire nine-member roster of the Chinese Politburo's Standing Committee.¹

While outsiders may still know all too little about the precise agenda and outcome of this China-DPRK summit, we can be fairly sure that the coincidence in timing of that summit with this conference augured well for the quality of conversation *at the conference*.

Why This Conference? Why This Theme?

Why should we study the economic implications of Pyongyang's military policies and international security behavior? At least five reasons come immediately to mind.

First, and most obviously: because almost no research has been undertaken in this area.

Although the fact may seem surprising upon reflection, it is nevertheless the case that, at least up to now, virtually no internationally-accessible academic research or policy research seems to have been devoted to this question. A quick literature review confirms this broad assertion. For example: *EconLit*, the electronic database cataloguing peer-reviewed contributions to the economics literature from the year 1969 onwards, apparently catalogues only a handful of entries bearing even indirectly on this subject.² Similarly: *PAIS*, the electronic database for peer-reviewed public policy and foreign policy literature from 1972 to the present, recovers hundreds of contributions bearing on international security or defense policy and North Korea, and a few entries that touch

¹ For the official Chinese and DPRK accounts of Kim Jong Il's « unofficial » January 2006 visit to China, see *Xinhua*, January 18, 2006, reprinted as “Xinhua reports on China-DPRK summit in Beijing”, *BBC Worldwide Monitoring*, January 18, 2006; and *Pyongyang Central Broadcasting System*, January 18, 2006, translated as “North Korean radio reports Kim Jong-il's visit to China”, *BBC Worldwide Monitoring*, January 19, 2006.

A roll-out of the entire CCP Political Bureau Standing Committee for a foreign visitor, we should note, has become a relatively rare political occurrence, usually limited to meeting visiting Communist Party chiefs from fraternal countries. Such meetings signify international discussions, agreements, or pending decisions that have been accorded the highest priority by the Chinese state.

² For the period since 1969, *ECONOLIT* several items bearing upon the inter-Korean arms race, and a few others on the economics of a Korean unification (in which military conversion in the Northern part of the peninsula is presumed to proceed)—but virtually nothing else directly discussing the impact on North Korea or the neighboring economies of DPRK military policies and security behavior.

upon economic aspects of the DPRK security behavior issue (e.g. costs of the inter-Korean arms race, prospects of coercive economic diplomacy for affecting the DPRK's nuclear posture)—but almost nothing that examines systematically the economic costs imposed by DPRK security behavior, or the economic opportunities that might be presented by amending that behavior.³

Second, because the economic impact of Pyongyang's external behavior may be of genuine consequence—not only for North Korean economic performance, but also for the performance of neighboring economies.

For the DPRK itself, the government's extraordinary allocation of national resources to the defense sector, and its perennially high level of military mobilization, is self-evidently an issue with ramifications for economic development and welfare as well as national security.

Yet it is also plausible to expect that North Korea's neighbors—China, the Republic of Korea [ROK, or South Korea], Japan, Russia, and even the United States—are affected economically by patterns of DPRK security behavior. When one enumerates some of the particulars that are commonly said to characterize Pyongyang's current external posture, namely:

- Nuclear Weapons Development
- Potential Nuclear Proliferation
- Ballistic Missile Program
- Potential Ballistic Missile Proliferation
- Chemical Weapons Program
- Biological Weapons Program
- Enormous Conventional Military Force
- Formal State of War with ROK
- Abduction of Overseas Nationals
- Shrill Bellicosity As Routine Diplomacy
- State Role in Drug Trade, Counterfeiting, etc

³ Although a PAIS search cross-referenced several dozen « hits » since 1972 for search terms « North Korea or DPRK », « economic », and « security or military or defense », most of these were general assessments of the security situation in the region. There were several in-depth articles examining the interplay between economics and DPRK military or security behavior, but all of these were focused on the potentialities of coercive economic diplomacy for altering Pyongyang's posture on specific issues (such nuclear weapons development).

it would seem entirely reasonable to imagine there could be economic costs imposed on surrounding populations by the existing North Korean *modus operandi* (much less an intensified version thereof), and that conversely an emendation of current North Korean security practices could conduce to international economic benefits and opportunities.

Third, because the topic is eminently researchable. That is to say: many aspects of the issue look amenable to empirical economic investigation, to pursuit through “rigorous economic speculation”⁴, or to analysis within a political economy framework.

The research agenda suggested by a focus on the regional economic implications of DPRK security behavior could include, but would not be limited to, the following questions:

- Economic cost and benefits of DPRK military conversion;
- Regional impact on trade on investment from a sudden new DPRK “security shock”;
- Risk, transaction costs, and the international economy in the Northeast Asian region: implications of a shift to a new North Korean security paradigm;
- Macroeconomic and distributional consequences for ROK of an end to inter-Korean hostilities;
- Economic development and poverty reduction in Northeast China: impact of the DPRK security behavior;
- Opportunities for international infrastructure development in Northeast Asia in the context of a less menacing Korean peninsula security environment;
- DPRK-Japan diplomatic normalization: preconditions and prospective financial terms
- US-DPRK economic relations: any trade impact from resolution of outstanding security issues?

These themes, and allied inquiries, outline a field of practical research that could yield publishable results meeting peer-review standards.

Fourth, because the induction of the discipline of economics into the study of the North Korean security conundrum may help stimulate creative new thinking about this thorny problem.

⁴ Cf. Marcus Noland et al. «Rigorous speculation: the collapse and revival of the North Korean economy », *Institute for International Economic Working Papers*, No. 99-1 (1999).

The hope for productive new thinking does not totally center on the potentially salutary effect of training additional new talent on old and difficult dilemmas. Fresh and potentially productive ways of thinking about North Korean security behavior may derive from the application of economic reasoning to the problem purely from the introduction of that disciplinary perspective. To oversimplify: the template for security studies tends to be “zero-sum”, whereas modern economic training, with its doctrine of “Pareto optimality” and its focus upon the welfare-enhancing effects of resource reallocation, is alert to “win-win” solutions. This cast of mind may be especially desirable in reconsidering problems that have seemingly taken on a fixed and frozen permanence.

Fifth, because the topic has policy relevance.

Better understanding the range and nature of the costs that DPRK military policy and security posture imposes upon their societies would stand to be useful information for all of the governments in North Korea’s neighborhood. So, too, assessments of the economic opportunities that might present themselves with alternative patterns of DPRK external behavior. Making available previously inaccessible policy-relevant information should *ceteris paribus* conduce to more informed decision-making for the governments that interact with the DPRK most regularly. Moreover, so long as the international community is locked in a set of seemingly intractable security disputes with Pyongyang, the timetable for whose resolution remains altogether unpredictable, studies on this theme may serve a sort of “policy planning” function, preparing governments to move more agilely once opportunities appear thanks to advance thought and strategizing.

Improving the scope and quality of the information available to decision-makers in the governments most directly obliged to deal with the DPRK’s security behavior need not, we must emphasize, presage a harmonization of their policies toward North Korea: those policies will be presumably charted against with their own perceived national interests, irrespective of their neighbors’ preferences. To the extent that research on the regional economic implications of North Korea’s external posture points to common and overlapping costs and potential benefits for North Korea neighbors, such research might also conduce to enhanced coordination in North Korea policy among the country’s neighbors.

These five arguments weighed strongly in favor not only for a conference on this topic, but for an international conference involving researchers from all of the five countries most intensively involved in the process of “engagement” with the DPRK [e.g., China, ROK, USA, Japan and RF]. Convinced as we were of the policy-relevance of the topic, it seemed to us worthwhile and indeed highly desirable to keep policy circles in those five governments informed of any conference results.⁵

To stimulate and sharpen discussion of the regional economic implications of DPRK security behavior at our envisioned conference, we devised a heuristic device: a hypothetical construct we termed “The ‘Bold Switchover’ Concept”. (The phrase was a play on words, deliberately chosen: an inversion on Pyongyang’s eponymous call for a fundamental transformation of Washington’s approach to its relations with the DPRK). The “Bold Switchover” Concept hypothesized an “alternative future” for the DPRK in which the following conditions were postulated to obtain:

- 1) DPRK Maintains Sovereignty over Northern Korea;
- 2) DPRK Remains Socialist System (Planned Economy);
- 3) DPRK Satisfies Neighbors’ Various Security Concerns; and
- 4) DPRK Achieves Successful Transition From “Military First Politics” To “Defense Sufficiency”.

By way of historical analogy, this imaginary DPRK system might be likened to early Tito-era Yugoslavia: to a polity, in other words, characterized by many of the appurtenances of “ordinary Stalinism”⁶, but unburdened of revisionist impulses about or menacing behavior toward neighboring states.

⁵ Readers may note that representatives of the government at the very center of this conference’s research agenda—i.e., the DPRK—were neither mentioned as invitees in the preceding paragraph, nor in the event invited to the actual conference. This lacuna was entirely by design. The Americans among the conference organizers maintained an open mind initially on the question of DPRK participation. However, other potential participants counseled against inviting DPRK researchers or spokespersons to the conference, warning that North Korean representatives would have a “chilling effect” on frank and open discussions even under the best of circumstances. The issue proved moot, however, when the conference organizers determined that they could not identify a roster of suitable DPRK conferees: that is to say, potential North Korean participants sufficiently conversant in modern Western economic thinking as to be able to participate comfortably in the envisioned intellectual dialogue.

⁶ Cf. Ronald Tiersky, *Ordinary Stalinism : "democratic centralism" and the question of communist political development*, (Boston : George Allen and Unwin, 1985).

Some readers may immediately object that a “Bold Switchover” in DPRK security behavior is an utterly unrealistic prospect for the real existing North Korean state under current conditions. (This was a reservation tendered at the conference itself by more than one participant.) We offer no brief for the likelihood of such a transition for Kim Jong Il’s transition. Rather, the “Bold Switchover” Concept was offered as a notional alternative to assist in clarifying thinking about the economic implications of DPRK *security behavior* (in contradistinction to the existence of a Stalin-style state on the Korean peninsula, or to the DPRK style of governance, or to the DPRK’s conduct of its economic policy). This imagined alternative DPRK was introduced to help discipline discussion at the conference: by providing a sort of benchmark against which the economic ramifications of various DPRK security postures could be assessed.

The “Bold Switchover” device was useful not only for the manner in which it helped to focus discussions, but also with respect to the sorts of conversations it helped us to *avoid* at our conference. Whenever international experts gather to discuss North Korean affairs, no matter what the ostensible assigned topic, there is inevitably a strong temptation for specialists to digress: for conversations to devolve into “Kremlinologizing”, speculation about the latest arcane, and speechifying about preferred or imagined solutions to the particular “North Korea problem” of the moment. Establishing the “Bold Switchover” Concept as the focus (or foil) for our conference’s central conversation helped us discourage such pleasant but unproductive side-tracking, precisely because the “Bold Switchover” hypothesis—i.e., the vision of a DPRK that had already embraced a new and radically different approach to international security policy—was so very distant from the day’s actual headlines and news reports about North Korea.

Key Points from the Beijing Conference Proceedings: January 18–19, 2006

Our conference was comprised of nine sessions, each of them anchored with a presenter’s paper, and all but the first of them including one or more designated discussants.

*Conference Atmospherics: The Sociology of the Conversation*⁷

Summary minutes of our two-day dialogue may not adequately convey the outcome of the conference's deliberations without some additional description of the temperature and tenor of the interactions and the bearing of the participants. Some general observations about conference dynamics are in order here, as well as a few words about the mien of contributions by nationality.

All in all, the conference atmosphere might fairly be described as one of open, engaged, and even enthusiastic discussion. Although the discussions grew heated at times, good humor and mutual respect generally prevailed; there were jokes and laughter in almost every session. Although interjections tended to be disciplined and focused, the ambience was "relaxed" in the sense that the stiffness sometimes attending analysis of sensitive policy issues was almost entirely absent. There was little—under the circumstances, perhaps surprisingly little—in the way of "debating", or "scoring points" against other participants during these two days of talks.

Despite the obviously contra-factual nature of our "Bold Switchover" Concept, conference participants were by and large willing to suspend disbelief and enter into the "thought experiment" of exploring the regional economic implications of such a change in North Korean security behavior; this was the case even among participants highly skeptical of the practicability of any such shift for the current Pyongyang regime. The stimulating nature of the ongoing conversation, and the degree to which the unfolding discussion captured the group as a whole, was indirectly indicated by the fact that almost every session ran over the allotted time, despite the conference chairs' best efforts to keep to schedule—and at the end nearly every session, there were excited participants still waiting to make their points.

To offer some comments on the contributions of the conferees by nationality: the *American* participants were perhaps most predictably true to expected national form. Outspoken, cheerful, confident of their own knowledge, happy to disagree, often unnervingly Cartesian, and sometimes blunt to the point of inadvertent rudeness, the

⁷ We do not neglect the conference's single representative of the Russian Federation in the following reportage willfully—only out of statistically-based humility about the representativeness of a single stochastic observation.

ambience of the US participants was similar to that of many other contemporary academic and scholarly gatherings.

Chinese participants at the conference proved surprisingly comfortable expressing a range of views—and in disagreeing with one another—still unusual at international gatherings on potentially sensitive topics. The forthcoming disposition of the Chinese conferees encouraged revealing and informative interjections from the body of the whole.

Japanese specialists are often extremely cautious in discussing their country's North Korea policies or their government's concerns with Pyongyang's external behavior; before Chinese or South Korean audiences, this cautiousness sometimes seems to approach practically Delphic proportions. Ambiguity of expression and defensiveness of tone, however, were not at all in evidence in an official Japanese explication of Tokyo's policy toward Pyongyang at our conference. Pressed for clarification of Japan's position on normalization with the DPRK by a South Korean conferee, an observer from the government of Japan obliged by responding with a point of information so precise and unapologetic that left the room momentarily speechless. Although this would count as ordinary diplomatic give-and-take for representatives of almost any other country, postwar Japanese diplomatic etiquette has had no room for such exchanges—at least, until very recently. Evidently, such terms of engagement are still sufficiently novel as to retain the capacity to startle other Asian interlocutors.

Within recent memory, *South Korean* experts and researchers were with predictable regularity the very most trenchant critics of North Korean policies and practices at any given international gathering. Times and mores, however, have changed. Today ROK specialists often seem to be among the more tolerant, or let us say understanding, of international discussants when it comes to DPRK patterns of external behavior. This turn has a generational aspect to it, but it has also coincided with the top-level change in Seoul's official policy toward the DPRK (the promotion of an inter-Korean reconciliation having been heavily and steadily emphasized since the late 1990s).

With so much engagement, unleashed energy, and unexpected role-playing among the participants in our conference, the often cascading flow of the conversation had a way of breaking down barriers of reserve and formality (in both manners and talking points) that can characterize international exchanges on disputatious topics. All this is worth

reporting so as to give the reader a better feel for the context of the following thematic highlights from the conference.

Ten Themes Emerging from the Two-Day Conversation

From this summary record, a number of points or recurrent themes seem worthy of mention. We will note ten of these below.

- 1) *The economic costs of DPRK security behavior—and the potential economic opportunities from a less revisionist and menacing North Korean international posture—are by and large quantities that have not as yet been taken into account by policymakers in the governments most immediately exposed to risk from Pyongyang’s external practices.*

In a sense, a multi-national, multi-lateral consensus here was implicitly signified before the start of the conference by the very attendance of the many parties who gathered around the table to explore the conference’s proposed theme.

To be sure: not all participants concurred on the general magnitude, or even the relative international distribution, of those extant costs and unseen potential benefits. But the wide sense that all of North Korea’s neighbors were paying financial penalties for the DPRK government’s preferred course of action—and the perception that all of North Korea’s neighbors might benefit economically from a changed DPRK security environment—propelled the conversation forward, despite ample opportunity for our conferees to “opt out” through digression into policy minutiae or formal objection to our “Bold Switchover” straw-man.

Our conference was but an initial step in fleshing out the dimensions of the costs of current practices, and the currently un-reaped opportunities from some fundamental changes. Yet there seemed to be general agreement that further investigation of this question was warranted—and that researchers capable of informing relevant decision-making circles should be harnessed for further and more in depth inquiries in this area.

- 2) *A “Bold Switchover” in Pyongyang’s military policies and security behavior would unquestionably generate opportunities and benefits for the Northeast Asian economic neighborhood—but it is hard to imagine the current North Korean government agreeing to such a course.*

There was little disagreement among our participants on this point; the pertinent question, in the view of most discussants, was whether one could ever expect the real existing Kim Jong Il government to embark upon such a policy path.

The argument that the Northeast Asian economic neighborhood would profit from a DPRK “Bold Switchover” was persuasive to our conferees precisely because of the particulars they recognized to be part and parcel of Pyongyang’s articulation of its officially proclaimed *songun chongchi* [“military-first politics”]. In effect, through its massive conventional military force, its attempt to amass a nuclear arsenal, and its confrontational approach to international relations, North Korea is an economic exporter in the Northeast Asian region—but the main product it exports is economic risk. With a less bellicose and more cooperative state at the center of the Northeast Asian geographic space, the environment of risk and uncertainty would be affected positively to some degree, and transaction costs would likewise be reduced in some measure. In addition to these “static” effects, one might also expect “dynamic” effects: among them, infrastructural development projects [transport, communications, and energy linkages, among others] that would lower the costs of commerce and stimulate regional development. In other words, if the DPRK simply ceased manufacturing and exporting tension and insecurity into the region, enhanced regional economic integration would naturally be expected to result—with all the attendant economic benefits that economic integration tends to produce.

For the contemporary DPRK, however, that stands out as a gigantic “if”. Most of our conferees expressed doubts that the Kim Jong Il government would ever agree to such a turnaround in its security behavior. Pessimism about the possibility of a “Bold Switchover” was expressed throughout the conference. In a clinically dispassionate analysis, one participant detailed the interlocked economic, political and security crises that currently beset the DPRK system. Despite the seeming dysfunction of that system, he argued, there is a logic to Pyongyang’s provocative international behavior: it is viewed as the key to regime survival by current leadership. With the option of economic reforms worthy of the name raising specters of uncontrollable domestic change, and no international guarantees of regime security being deemed credible by North Korea’s own

leadership, the Kim Jong Il regime may actually regard its current international military posture as the *least* risky alternative available.

While most conferees indicated their skepticism about the feasibility of a “Bold Switchover” for the real existing DPRK today, a subtle but important difference of opinion on this matter seemed to emerge over the two days of the deliberations. Some participants implied or maintained that the DPRK would be systemically incapable of coping with the aftereffects of a “Bold Switchover”: in other words, they viewed such a recasting of policy as fundamentally destabilizing to “Socialism with Korean characteristics”. Others, however, did not discount the fundamental viability of a “Bold Switchover” for North Korea, but rather held as inconceivable the notion that Kim Jong Il would voluntarily embark upon such a path. Left unexplored in our deliberations was the subsidiary question of whether a post-Kim Jong Il leadership configuration for the DPRK might find a “Bold Switchover” practicable.

- 3) *A “Bold Switchover” would likely result in significant improvements in DPRK economic performance, even if Pyongyang maintained socialist central economic planning and eschewed substantive economic reform.*

One conference paper contended that the DPRK’s deplorable economic performance over the past generation was attributable not so much to the generic inefficiencies of Soviet-style economies as to Pyongyang’s own idiosyncratic and highly militarized adaptation of that structure. It further argued that international patterns of development suggested that the DPRK’s levels of per capita exports and per capita income would be far higher than those achieved today if North Korea could perform as an “ordinary Stalinist economy”. While recognizing the practical challenge of financing a conversion from the existing “military first” economy to a more “normal” pre-reform Soviet-style economy, the author suggested that considerable international sources of security assistance might be available to support some of the transitional expenses if DPRK security reforms were judged to be credible.

While some participants raised specific technical questions about the paper’s econometric methods, the conferees generally seemed to agree with the broad thrust and conclusions of the essay. At the same time, the “alternative future scenario” for the North Korean economy suggested by this paper underscored the distinctive and troubling cost-

benefit calculus to which North Korean policy decisions are currently subject. Even if a shift from “military first politics” to “defense sufficiency” could credibly be predicted to elicit an upsurge in DPRK exports, a corresponding increase in imports, a substantial augmentation of per capita income, and a consequent improvement in economic welfare for the North Korean population, it is by no means clear that North Korea’s present leadership would view these as persuasive arguments for charting a new course in security policy.

4) A “*Bold Switchover*” might not be *bold enough* for the DPRK.

This point was made by a number of Western economists at separate junctures during the conference (to the apparent approval of several Chinese participants). Although the individual renditions of the argument varied somewhat, the general thrust was that far greater economic benefits could be grasped by both the DPRK and the Northeast Asian economic neighborhood if far-reaching economic reforms accompanied, or followed on the heels of, a DPRK “Bold Switchover”. In one formulation, a “bold” economic opening would be necessary to capitalize the infrastructural opportunities a “Bold Switchover” might open: rail-links or energy pipelines across a newly-peaceable DPRK terrain, in this iteration of the argument, might still be a non-starter if a more business-friendly atmosphere did not prevail in North Korea. Other versions of the argument trained upon the economic sclerosis that might entomb the North Korean economy absent reform, implicitly suggesting that a “Bold Switchover” would offer one-time-only productivity stimuli unless reinforced by further continuing policy and institutional changes.

On the other side of the conversation, some participants—primarily Chinese conferees—implied or stated that DPRK might be able to embark upon economic reforms without a major recasting of international security policy beforehand. This was an interesting but also a curious judgment. Attentive as they are to their own recent history and national experience, Chinese speakers would have known that such a trajectory would be completely different from China’s own successful sequencing of international security changes first and economic reforms second in the 1970s and thereafter. How economic reforms might proceed (and international capital might be attracted) in an

environment is still overclouded with unresolved international security problems, moreover, is far from immediately apparent.

- 5) *The DPRK's current international confrontational posture may have direct and immediate implications for economic development, economic reform, and poverty alleviation in China—all of them adverse.*

One economist argued that Pyongyang's security behavior is especially prejudicial to economic prospects for Northeast China. In his explication, both economic performance and economic reform are lagging in Northeast China—in part because the region is “bottled up” for lack of better geographic opportunities for integrating with the regional economy, and the world economy. For Northeast China, a primary impediment to greater integration—and to the reforms such integration would inherently tend to spark—is the existence of a “black hole” in neighboring North Korea, a zone of insecurity that makes ordinary commercial links with the outside world more difficult and expensive.

Interestingly, some of the ROK participants took issue with this analysis. Some of them maintained that South Korean investment and trade with Northeast China *was not* being affected by the current security situation in DPRK: an assertion that implied that there would be little in the way of a “substitution effect” for ROK investment and trade between nearby North Korea and nearby Northeast China. It is also worth noting that some Chinese participants scoffed at this South Korean proposition, noting that it would confound elementary precepts of current Western economic teaching.

- 6) *Intensification of revisionist DPRK security behavior could have far-reaching economic consequences for the Northeast Asian neighborhood—but the magnitude, duration and distribution of those consequences are as yet by no means clear.*

This topic was highlighted in a paper presented by one of the U.S. based economists. It argued that South Korea, Japan, and China were all vulnerable to “contagion effects” triggered by an extension of already-familiar adverse DPRK security behavior, such as a nuclear test or Pyongyang-abetted proliferation of nuclear materials to a terrorist organization.

The author's assessment suggested that South Korea, Japan, and China were vulnerable to 'business panics' precipitated by North Korean brinkmanship and aggression—and in that general ordinal ranking. The paper warned, however, that China's exposure could be much greater if Pyongyang should take some action so egregious as to invite broad international economic sanctions—if Beijing were subsequently to align with the DPRK position.

The author cautioned that a more precise estimate of the hypothetical impact of DPRK "shocks" on ROK, Japanese, and Chinese trade/investment/output/employment would require extensive and deep assessments. Looking at analogous "security shocks" in other global hotspots, however, the author speculated that even a "scary" North Korean gambit might have temporary and manageable economic ramifications for the Northeast Asian economic neighborhood.

The paper invited follow-on research: further exploration would be necessary to quantify—or even to bound—the sort of potential economic effects he described. But his outline also pointed to troubling and immediate policy questions. If the Northeast Asian neighborhood could "live" with a North Korean nuclear test, at least from an economic standpoint, would that not also mean that Pyongyang would not have to factor in the region's economic responses to any ultimate decision to ratchet up the nuclear drama?

7) A curious conceptual ambiguity was revealed in our discussions over the possibility of a "peace dividend" through cessation of hostilities with the DPRK—and that uncertainty seemed greatest in respect to a potential "peace dividend" for the ROK.

This conceptual haziness was explored at some length a presentation whose theme was the economics of an ROK "peace dividend". The paper, written by a commentator from the ROK, defined that dividend as the enhanced wellbeing ROK citizens would enjoy from a more secure existence—peace as a "good"—and then went on to catalogue the various programs initiatives the ROK government was financing to promote peace and reconciliation in inter-Korean relations. Referring back to the German experience with *Ostpolitik* and reunification, the paper argued that South Korea's expenditures on preparing for peace and unification were still in fact relatively modest, and that the

country could afford far higher outlays, both in terms of the size and per capita income level of the contemporary ROK economy and on a “willingness to pay” basis.

The analysis, however, was challenged on first premises by a number of conferees. One of the more probing comments came from a Chinese researcher who noted that modern economics conventionally defines a “dividend” as a direct return from an investment, and one that increases the recipient’s stock of wealth or stream of consumption. The officially-supported South Korean activities encompassed in the “sunshine” or “engagement” policy, by contrast, involved an outflow of resources, reducing the stock of wealth or the potential consumption stream. In analyzing any potential “peace dividend”, the critic concluded, it would be essential at the outset to distinguish the concept of “dividend” from the concept of “debit”. Other participants, both Chinese and non-Chinese, also affirmed the importance of sticking to the economic conception of “dividend” in any discussion of the economics of a DPRK “peace dividend”.

This elementary and highly uncharacteristic lapse by a distinguished ROK economist was perhaps both revealing and significant. It suggested, among other things, a powerful and literally uncritical degree of enthusiasm for and commitment to official ROK policy toward the DPRK. It was also noteworthy that it was Chinese researchers who explicitly pointed to this lapse, and urged that the conference cleave to a more economically orthodox framework for assessing the regional costs and benefits of DPRK security behavior.

- 8) *Economic reconstruction of the North after a “Bold Switchover” would be a major financial undertaking—but it would generate economic returns as well as costs, the scale and distribution of which are still unclear, being highly contingent on political and policy outcomes yet to be determined.*

Appreciation of the uncertainties surrounding this issue was heightened by the conference session featuring a trans-Pacific teleconference presentation by one of the conference paper authors. The presenter concentrated on one possible scenario for economic reconstruction of the North—a German-style Korean unification—to make points that could be applied, with appropriate customization, to other “alternative futures” for North Korea as well.

The presentation noted the tremendous range in the extant estimates of the capital requirements in an economic reconstruction of the North: numbers cited in published studies currently range from the low hundreds of billions of US dollars to several trillion US dollars. He cautioned, however, that much of this work suffered from false precision, and suggested in addition some of the assumptions upon which some of this work was predicated might be unwarranted. The presenter took issue in particular with the notion that per capita income levels in North and South Korea should be presumed to converge toward equality: he held instead that a substantial absolute improvement in North Korean income levels (say, a doubling) might suffice as an objective in an initial phase of reconstruction. The additional capital requirements for achieving a doubling of per capita income in the North, he argued, would depend upon a number of factors, including the institutional and policy climate, the pace of military conversion, and the time-frame for the envisioned doubling. But the presenter argued that the volume of necessary investment funds might be considerably lower than received opinion currently posits—and if those funds were raised from private as well as public sources within the Korean peninsula and the Northeast Asian neighborhood, it would in principle look like an entirely manageable undertaking. (He provided exploratory calculations that illustrated the point.) The presenter emphasized that the reconstruction of the North could be likened to an investment project; that such projects are expected to generate returns; and consequently a successfully pursued economic reconstruction of the North should potentially be capable of generating benefits for all of the investors concerned.

No consensus on the presentation's arguments emerged during the conference. While some participants seemed persuaded by the reasoning, others remained skeptical, with respect to method or conclusion or both. In retrospect, it might seem unreasonable to imagine that consensus could emerge here, since the argument required a journey through such inescapably speculative terrain. Not the least of the difficulties here is the almost utter lack of reliable economic data about current DPRK conditions—and so long as outside observers have no access to the sorts of data that might help to inform researchers about the current performance of the DPRK economy, estimates of the scale of the task entailed in its reconstruction seem likely to be characterized by a wide range (and also perhaps by very large errors).

- 9) *Although international financial institutions (IFIs) may eventually prove to be a source of concessionary capital for the DPRK once it resolves the international community's concerns about its security behavior, membership in the IFIs may prove surprisingly difficult for Pyongyang to negotiate unless the North Korean government is prepared to amend or overhaul many of its non-military policies and practices.*

One of the conference presenters, a former World Bank official, presented a paper that outlined in detail the likely process and requirements that the DPRK would face in a successful application for membership in the World Bank and other IFIs. To date, one may observe, the DPRK government has been interested in international political agreements that provide an immediate, significant, and unrestricted transfer of resources from abroad (e.g., bilateral foreign aid flows, the Kumgang Mountain tourism deal; the “inspection fee” for the 1999 US visit to the suspect Kumchang-ri site, and the like). Preparations to join the IFIs, by contrast, would be obligation-heavy from the DPRK’s vantage point, would entail considerable new obligations for the North Korean government and administration, and would offer little in the way of immediate “payout”. Financial disclosure—not a North Korean strong suit—would be *de rigeur*, as would vastly increased foreign access to DPRK officialdom, some of it for “capacity building”. The North Korean government would be evaluated by foreign officials along criteria hardly familiar to DPRK decision-makers today (among these: quality of the legal system, environmental consequences of policies and projects, and implications for poverty reduction). After membership, IFI lending would likely not commence without careful (and intrusive) project preparation efforts—a process in which lending institutions would insist upon access to relevant DPRK counterparts, and to responsiveness from them. Loan surveillance would be routine—and loans would be monitored to ensure that they were being used only for the purposes expressly contracted.

Although the presenter did not need to say so explicitly, his presentation telegraphed the need for radical changes in DPRK governmental norms and practices in order for Pyongyang to qualify for regular IFI lending. Even then the scale of IFI transfers might not be immense. The author estimated that under current conditions, DPRK might be a candidate for lending from IDA-14 (the World Bank’s most highly

concessionary window) on the order of \$25 million to \$250 million a year. The paper noted, however, that additional funds might be available for the DPRK from other IFIs, and also through such arrangements as the “special trust fund” (in which donors are permitted commit funds dedicated to a special and accepted purpose).

While the paper was well-received, and stimulated extended discussion, some participants suggested he might be painting an excessively “pessimistic” picture of DPRK prospects for funding from the IFIs. Some conferees wondered whether procedures and requirements would be so onerous at other IFIs (for instance, the Asian Development Bank), or whether the IMF and the World Bank really did set financial disclosure as a strict precondition for membership. And with respect to the perhaps “disappointingly” low level of IFI lending that DPRK could presently receive, other participants suggested that the primary benefits of IFI membership might not be resource transfers *per se* but rather the technical assistance such membership might facilitate, and the credibility the IFI “seal of approval” might convey to other international actors (private and public) with much greater resources at their disposal.

10) *The DPRK stands to benefit financially from a normalization of relations with Japan, if this can be achieved—but there remains considerable uncertainty over the actual terms under which Pyongyang-Tokyo diplomatic cross-recognition might be arranged, and no clear indications of the magnitude or structure of the Japanese economic program that might accompany normalization of relations.*

Foreign North Korea watchers are well aware of the potential economic significance for Pyongyang of an eventual Japan-DPRK normalization of relations—not least because of the presumed package of economic benefits that would attend this normalization. Insight into Japanese official thinking about Tokyo-Pyongyang normalization—preconditions for its occurrence, and prospective financial consequences—seem to be remarkably limited, due primarily to a Japanese governmental reluctance to discuss these contingencies outside a very limited circle of trusted persons.

A Japanese representative cast a bit of light on official Japanese thinking. He offered his personal surmise that the Japanese government in all likelihood would not normalize relations with DPRK until it had obtained satisfaction from North Korea on the abduction issue, the nuclear issue, and the missile issue. He further expostulated that it

would not be unreasonable to imagine a Japanese economic package for DPRK following the general formula from the 1965 normalization of relations with South Korea.

The 1965 Seoul-Tokyo normalization package, one may recall, was a yen-denominated ten-year program with a total value (in then-current terms) of \$800 million USD. The package was divided roughly evenly between grants, soft loans, and export credits for purchases from Japan.

Presuming such surmise to be correct, scaling that earlier package to present day conditions—pro-rating for such factors as population size, changes in price levels, and (perhaps) time discount—would appear to involve some normative judgments, and thus would seem to open the process of designating a final total for the Japanese economic normalization package to an element of negotiation.

Concluding Observations

Although there were a number of important questions raised at this conference upon which no general consensus was forthcoming among specialists, participants generally recognized that this was an exploratory gathering—and that a great deal of additional work on this topic could be profitably undertaken, both by country-specific research teams and through international coordination. The old cliché of “having just scratched the surface” seemed indeed to describe accurately this preliminary investigation of DPRK security behavior through the economic lens.

From the policy research perspective, one of the central “take home” findings for all governments concerned with North Korean military policies and external postures was clearly that foreign aid budgets and military budgets alone do *not* provide an accurate measure of the “cost” of North Korean behavior. Those costs, for North Korea’s neighbors, have to be measured in foregone development opportunities as well—and that toll looks to be consequential, perhaps most especially for North Korea’s treaty ally China. By a quirk of fate, a US Treasury Department team happened to visit Beijing to brief the Chinese government on alleged DPRK counterfeiting of US currency just before our conference began. One could easily imagine that the Bank of China’s collateral vulnerability to such illicit DPRK activities might have been high on the list of concerns

for both sides in that set of discussions. For a government that might be otherwise reluctant to consider the broader set of questions associated with the economic costs of a formal ally's security behavior, it is hard to see how the question might be more vividly clarified for top-level decision-makers through daily affairs.

In conventionally framed academic expositions of suboptimal arrangements in political economy or public choice, the portrayed tension is usually between foregone economic opportunities for potential but “unvested” beneficiaries and immediate interests for stakeholders who profit from current inefficiencies. The proceedings at this conference strongly suggested that *none* of North Korea's neighbors were characterized by such dilemmas as far as DPRK security behavior was concerned: to the contrary, all of them suffered immediate costs or lost opportunities for that behavior (albeit of varying and somewhat unspecified magnitudes), and all of them would benefit economically from an emendation of North Korean security behavior.

Whether the current North Korean government might be willing—or could be capable—of taking the economic interests of its neighbors into account is a critical question that could not be comprehensively addressed at our conference. But our conference repeatedly underscored the importance of this question—and not just for researchers.