East Asian Economic Integration and North Korea

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Introduction

• The issue of North Korea is very important in East Asian economic integration

  – Sincere efforts for regional economic integration
    • Various FTAs: three 1+ASEAN, Korea-China, trilateral talks
    • Monetary and financial cooperation: CMI(M), ABMI, AMRO, ABF, currency swaps

  – But if a North Korean issue turns sour, prospect for regional integration becomes uncertain and negative
    • May cause instability, conflict among regional countries
    • Regional efforts may fall into a disarray all of sudden: TAR, PNG

  – Thus, embracement of North Korea is necessary for a closer regional cooperation
Introduction

• Regional economic integration can be helpful to enhancing North Korean transformation and inter-Korean relationship
  – North Korea can take advantage of regional integration
    • to attract capital for development and to expand its export markets
  – A strong economic bond with neighboring countries reduces possible military conflict between regional states
    • and strengthen inter-Korean relations and improves the condition for unification
  – Thus we need to find ideas to combine the issue of regional integration and that of North Korea
    • so that North Korea has incentives to be more involved in regional economic integration process for economic transformation and opening
Perception: Regional integration → North Korea

• What is the role of North Korea in East Asian economic integration process? (East Asian perception on North Korea)
  – Negative vs. positive
  – Usually negative perception, but various positive potentials as well

• Negative
  – The role of North Korea in East Asian economic integration has usually been seen as one of the obstacles to closer integration in Northeast Asia
  – It is a potential threat to regional stability and discourages regional integration, economic or security
Perception: Regional integration → North Korea

• Positive

  – Deepening and expanding regional production network
    • The cross border production and trade networks explain the rapid increase of both trade and FDI flows between East Asian countries
    • This shift from Japan to the NIEs to NEMs to China regarding the FDI flow in East Asia is significant for the regional division of labor
    • There was a change in the flying-geese pattern of development which has characterized to date the industrial location pattern in East Asia with the stagnation of Japan and the rise of NIEs and China
    • North Korea could act as a ‘prolonged workbench’ in the regional production network (as other developing countries did in the past) - i.e. specialize according to its comparative advantage of low-labor cost with good quality: This would further deepen and expand the intra-regional trade and investment
Perception: Regional integration → North Korea

• Positive

– New opportunities for sustainable economic growth
  • Two bottlenecks in economic growth that neighboring developed countries are confronted with: lack of new investment opportunities and lack of supply to meet excessive demand for resources and energies
  • Once it starts economic relations with regional countries, North Korean can provide many new investment opportunities for infra-structure development
  • North Korea is known for rich natural resources and its development can meet the demand for energies and natural resources in the region
  • Thus North Korea can act as a new booster for regional economic growth and integration
Perception:
Regional integration → North Korea

• Positive

– Focal place for regional integration
  • Geographically, North Korea locates at the center of Northeast Asian region
  • Various pilot projects to realize regional integration is possible only through North Korea’s cooperation
  • Example: TSR, TAR, PNG, etc.
  • These ideas could greatly boost regional economic integration: They will increase regional investment to develop infrastructure such as railway or pipeline, and encourage intra-regional trade by reducing transportation and energy costs for regional industries
  • North Korea can act as a bridge between South Korea and Japan on one side, to China, Russia and even the European countries on the other side
Perception: North Korea → Regional integration

• How can East Asian economic integration process affect North Korea? (North Korea’s perception on regional integration)
  – Negative vs. positive
  – Mixed feelings: again, usually negative perception, but various positive potentials as well

• Negative
  – Threat to regime stability
  – Dependence on outside forces in the progress of countries and nations is as dangerous as poison (KNCA, 10.06.2000)
  – International economic exchanges are needed, but not liked and actually feared
Perception:
North Korea → Regional integration

• Positive

– Direct benefit from participation in regional economic integration

  • Pilot projects for regional economic integration will bring direct profit such as transmission fees and can improve infra-structure of North Korea by re-linking railways and by constructing new lines
  • North Korea can earn urgently needed foreign currency and upgrade its production facilities and management qualifications through foreign direct investment
Perception:
North Korea $\rightarrow$ Regional integration

• Positive

– Smoother rapprochement towards reform and opening of North Korea
  • Regional integration process creates more ample opportunity and necessity for opening, simply due to more frequent meetings with neighboring countries with less media attention
  • Also it allows for rapprochement towards reform of the economy within a politically more acceptable framework: If contacts are carried out within a regional framework, less ideological confrontation is probable, since the contacts are less prominent and more routine business
External Economic Relations of North Korea

• Poor record of international economic exchanges

  – Very limited trade and investment
    • And the trend is too much volatile especially in investment

  – Although there are both negative and positive perceptions on external economic relations, mainly negative ones have been realized while positive potentials have often been interrupted
    • Non-economic conditions have been too much influential
External Economic Relations of North Korea

- Despite poor record, trade has continuously increased
  - This shows that North Korea also recognizes necessity of international economic exchanges
  - Trade with China has steadily increased while trade with Japan suddenly dropped to near zero due to very political reason after nuclear test in 2006
International trade of North Korea
## Trading partners

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External Economic Relations of North Korea

• Investment is much more sensitive to non-economic factors than trade

  – Since 2006, investment in North Korea has suddenly reduced

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  – Many development projects have been on and off without beneficial results
    • UNDP: Tumen River Economic Development Area
    • KEDO: Light water (nuclear) power plant
    • Special economic zone: Gaesung, Hwanggumphyong, Chang-Ji-Tu and Rason
    • Inter-continental projects: TSR, TAR, TKR, PNG
External Economic Relations of North Korea

• Implications from the record

  – The record of North Korea reflects the mixed feeling that “International economic exchanges are needed, but not liked and actually feared”

  – Still very much fear of the threat to its regime and only limited contacts with limited countries, in particular China

  – Need to reduce the perception of potential threat so that North Korea expand trade with more countries and development projects can be sustained without interruption
Ideas to Link Two Issues

• Basic principle

– The ideas should be mutually beneficial both to regional economic integration and to North Korea
  • Need to reduce negative perception not only in perspective of regional economic integration process but also in perspective of North Korea
  • In practice, it would be more important to reduce North Korea’s perception of potential threat to its regime to realize the mutual benefit
Ideas to Link Two Issues

• Practical approaches

  – Start with the most feasible project and deepen integration (Neo-functionalism)
    • From economic cooperation to political cooperation
    • Even within the economic area, start with the easiest one

  – Start with an area where neighboring countries have enough experiences of regional cooperation

  – Start with a project for which concerned countries have big demand

  – Start with an area in which North Korea feels less threat and more incentives
Ideas to Link Two Issues

• Outward processing zone
  - Designate, e.g. Gaesung Industrial Complex in North Korea as an outward processing zone
    • South Korean companies' goods made in Gaesung Industrial Complex could be exported to other regional countries with whom South Korea has FTAs
    • China would also want Hwanggumphyong to be regarded as an OPZ for its products
  - OPZ is a good way to reinvigorate economic cooperation between North and South Korea by providing preferential tariffs for products of Gaesung Industrial Complex, and to improve relations between North Korea and regional countries as well
Ideas to Link Two Issues

• FTA between South Korea and North Korea
  – It will increase North Korea’s international economic relations
    • North Korean products can be harmonized with the international HS-code system and exported more to neighboring countries and to the world market
  – The FTA can increase foreign direct investment in North Korea
    • The FTA improves the investment environment such as policy transparency, simplification of administration, and the standardization of law regulation and contributes to increasing FDI not only from South Korea but also from other countries
  – South Korea can circumvent trade conflicts with other countries: issues related with MFN and inter-Korean trade
Ideas to Link Two Issues

• A3Fund and Northeast Asia Development Bank
  
  – A3Fund
    • Emergency liquidity fund based on contributions of foreign reserves among Korea, China and Japan
    • This fund can also be used to finance A3 mega project for regional development and other regional activities that could not have been feasible within national boundaries, allowing for increased supply of public goods for the regional market
  
  – Northeast Asia Development Bank
    • Bank to attract regional investors who search for attractive investment opportunities and to solve mismatch between strong regional saving and fewer investment opportunities
  
  – The A3Fund and NEADB money can be used to finance development of North Korea, or relevant cross-border development projects including North Korea
    • They could also help as a multilateral mechanism to manage North Korea’s integration into the region
Ideas to Link Two Issues

• A3Fund and Northeast Asia Development Bank

  – Examples of regional mega projects
    • Environment: Cross-border pollution (emissions, sea water, etc.)
    • Transport: Joint traffic network
    • Energy/resources: Gas pipelines, power grid
    • Health care: prevention of spreading infectious disease

  – North Korea eagerly needs those projects
    • Less political but more humanitarian
    • More cross-border issues than national
    • Big incentives: collection of fees, improvement of infrastructure