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Economic Integration with North Korea: A New Economic Territory

7.1 Introduction

In the first year of the new millennium the summit meeting between President Kim Dae Jung of South Korea and Chairman Kim Jong Il of North Korea marked an important turning point in inter-Korean relations and offered the possibility of peace, reconciliation and cooperation between the two Koreas in economic and many other areas.

The current state of the North Korean economy is briefly reviewed in Section 2, while Section 3 discusses the prospect of major economic reform and the opening of the North Korean economy. Section 4 considers the current state of inter-Korean relations, and Section 5 discusses how gradual economic integration between the two Koreas could ultimately lead to the unification of the Korean peninsula. Final remarks are made in Section 6.

7.2 Overview of the North Korean economy

Oh and Hassig (2000) note that, under communism, North Korea is as independent as Yugoslavia, as closed as Albania, as harsh a dictatorship as Romania and as loyal to socialism as Cuba. This captures the gist of North Korea, which since 1946 has been a highly centralised and planned command economy. Virtually all natural resources are owned by the state and resource allocation is completely controlled by the central planning board. But the North Korean economy is operated differently from that of the former Soviet Union in that it is based on the ideology of self-reliance or juche, with as little reliance on external sources of capital, investment and technology as possible.

The North Korean economy surpassed that of South Korea until the early 1970s in terms of per capita income. However this was not because of the command economy system and the juche ideology but largely because of substantial assistance from the Soviet Union and China. The first serious economic problems emerged in the late 1960s when the Sino-Soviet
dispute resulted in diminished aid to North Korea. To cope with this challenge North Korea began to borrow capital from the West. However it was unable to pay off its initial loans, largely because of its ineffective economic structure, the oil price increase and the worldwide recession in the 1970s. Furthermore its emphasis on heavy industry and arms production damaged the economy by exacerbating structural bottlenecks and inefficiencies. Subsequent defaults on the foreign loans severely reduced its international credit rating. Consequently the economy had become even further isolated from the West by the end of the 1970s.

In 1984 North Korea promulgated a Joint Venture Law to attract foreign capital and technological investment, but the response from the West was negligible because of North Korea’s poor international financial standing and domestic economic conditions. By 1993 144 foreign joint ventures had been established, but 133 of these were by pro-Pyongyang Koreans living in Japan. Accordingly the economy continued to stagnate in the 1980s.

Furthermore the collapse of the communist bloc from the late 1980s caused a sharp decline in North Korea’s trade volume. The Soviet Union had been a major supplier of strategic resources to North Korea (including petroleum, most intermediate capital goods, and equipment used in the heavy and chemical industries) and trade had been conducted on a barter basis. But the Russian Federation required the North to pay in hard currency at world market prices, and this prompted a sharp reduction in trade. Furthermore public transfers to North Korea from the former Soviet bloc were curtailed from 1989. To make matters worse, North Korea has been subject to major crop failures due to heavy rains and flooding each year since 1995.

As shown in Table 7.1, in the 1990s North Korea had nine consecutive years of negative economic growth. There were shortages of raw materials, energy, food and foreign exchange, and there were numerous reports that the majority of the North Korean people were having to obtain many of their basic necessities from farmers’ markets. Thus the functioning of the central distribution system was debilitated and replaced largely by private markets.

Somewhat surprisingly, however, the economy is reported to have grown by 5.2 per cent in 1999 and 1.3 per cent in 2000 (Bank of Korea, 2000a, 2001b). According to the Bank of Korea (BOK) this growth was partly driven by foreign aid and increased food production in 1999, and by construction and mining projects in 2000. But this assertion was greeted with considerable scepticism by specialists working outside the South Korean government. Eberstadt (2000), for example, argues that the BOK used high-end estimates of North Korean agricultural output to calculate its figures, and if it had used other estimates it would have concluded there had been no economic growth at all in North Korea in 1999.