

## **Chapter 3:**

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# **The Korean Peninsula— Emerging Prospects for Change**



Following a flare-up of North Korea's nuclear issue and the inauguration of Roh Moo-hyun as president of South Korea in 2002, the situation on the Korean Peninsula is going through a period of dynamic change. Roh Moo-hyun, who had come to power on a wave of anti-American sentiment, advocated that South Korea pursue a policy of "self-reliant national defense" so that, in the long run, it will be able to defend itself on its own. Subsequently, however, President Roh felt the necessity to avoid rocking the alliance with the United States until the North Korean nuclear crisis had been solved, and emphasized that self-reliant national defense should be pursued within the framework of the alliance with the United States. Moreover, the severe condition of the South Korean economy made pursuing self-reliant national defense difficult.

The Roh administration's North Korea policy, dubbed "the Policy for Peace and Prosperity," essentially is a continuation of the Engagement Policy (also known as "the Sunshine Policy") of his predecessor President Kim Dae-jung, which placed emphasis on peaceful coexistence and inter-Korean cooperation. President Roh's policy is designed not only to pursue peaceful coexistence and cooperation with North Korea, but also to build up the foundations for South Korea to become a "Northeast Asian economic hub," by coupling the process of solving the North Korean nuclear issue with promotion of North-South co-prosperity and cooperation in Northeast Asia. In this sense, President Roh's policy is an ambitious one that encompasses objectives reaching beyond its northern neighbor.

With a view to restructuring its domestic economy and to restoring the government's control over economic activities, North Korea in July 2002 began to implement measures to improve economic management. They included delegating economic planning authority to lower agencies, introducing material incentives to motivate workers, and raising pay and prices. They are epoch-making in the sense that these reform measures were not confined to special economic zone but were extended to all areas of the country. If North Korea carries out these reforms persistently in conjunction with foreign assistance, it may achieve significant results. However, in order to lure foreign assistance, it is essential for North Korea to solve the nuclear problem first.

## **1. South Korea's Policy of Self-Reliant National Defense**

### **(1) History of Self-Reliant National Defense**

On August 15, 2003, President Roh stated, "I intend to help lay a firm foundation for our armed forces to be fully equipped for self-reliant national defense capabilities within the next ten years." In the past, President Roh had already advocated the necessity of self-reliant national defense, and he used the occasion to make an official declaration, at long last, of his firm resolve to carry it out. A majority of South Koreans expressed sympathy with his policy. According to a poll conducted in August the same year, 58.8 percent of the respondents said they sympathized with the self-reliant national defense policy as one that established a normal security concept, while 34.4 percent said that they did not approve because it did not take into account the nuclear crisis and the financial burden of the arms buildup it entails.

A survey of Korean history shows that the term "self-reliant national defense" itself is not all that new. It was in February 1968 that South Korea set its sights on achieving self-reliant national defense. On the heels of an attack on South Korea's presidential residence by a North Korean commando team, a U.S. intelligence-gathering vessel operating on the Sea of Japan was seized by North Korea in January of the same year. Park Chung-hee, then president of South Korea, took the incident as a prelude to the resumption of North Korea's attempt to unify the two Koreas by force. As the United States showed little reaction to the North Korean commando attack on the presidential residence while expressing serious concern over the seizure of its spy ship, he came to take the view that South Korea cannot indefinitely rely on the United States for its security. At that time, the Park Chung-hee administration created Homeland Reserve Forces, some 2.5 million strong, and attempted to build a defense industry of its own. In response to these efforts, the United States provided \$100 million in military aid and approved the construction of an M-16 automatic rifle plant in South Korea, and Japan cooperated in the construction of a steel mill in Pohang on the east coast.

Come the 1970s, these concerns of South Korea became more real. In 1971, one of the two U.S. divisions stationed in South Korea, the Seventh Infantry Division, was withdrawn. In response, South Korea established a War Planning Committee and formulated the Taegeuk 72 Plan, a war plan of its own that has a scenario of both defensive and counteroffensive operations. In 1974, it

launched a Force Improvement Program that was designed to strengthen its defense capability with emphasis on antitank and air-defense capabilities. In 1975, the unification of Vietnam by force of arms was a development that shocked South Korea. In reaction, South Korea sought to strengthen its self-reliant defense capability by creating a Student Defense Corps and a Civil Defense Corps, and by introducing a defense tax. Around this time, South Korea's defense spending came to exceed North Korea's. When President Jimmy Carter, who had advocated the withdrawal of U.S. forces from South Korea, took office in 1977, South Korean concern over his policy mounted. Finally, however, the issue was concluded with only a partial withdrawal of U.S. forces from the country. Against the backdrop of such a bleak security environment, South Korea sought in the 1970s to develop nuclear weapons and ballistic missiles to strengthen its self-reliant defense capability, but had to give it up under pressure from the United States. As the United States had strengthened its commitment to defend South Korea in the 1980s, talk of building up self-reliant national defense capability virtually disappeared, although it remained nominally as a policy goal.

## **(2) Background of the Reemergence of Self-Reliant National Defense**

Why has the idea of self-reliant national defense been revived? How different is the revived concept from the old one? In this section, we will analyze the factors that have prompted South Korea to pursue the idea anew.

One of the factors that enabled South Korea to take up the theme of self-reliant defense again is the fact that the seriousness of the military threat posed by North Korea has been reduced. According to South Korean defense authorities, the actions that North Korea could conceivably take are infiltration, local provocations, terrorist attacks, and nonmilitary provocations, and they feel that South Korea's present defense posture can effectively deter an armed invasion by North Korea. They are confident that even if North Korea mounted a full invasion, South Korea could ultimately defeat it. In recent years, South Korea's Joint Chiefs of Staff have been formulating a plan for the development of operational concepts and force structure to deal not only with the present threat but also with unspecific future threats. Second, South Korea's economic strength has increased. In 2002, its gross national product (GNP) and defense spending were, respectively, the twelfth and tenth largest in the world. The

military threat posed by North Korea was at its peak in the 1970s, when South Korea was a developing economy. Present moves by South Korea to realize self-reliant national defense are far different from those it undertook in the past.

Why, though, does South Korea feel the need to build self-reliant national defense now? President Roh pointed to three factors. First, South Korea knows from experience that the United States is prone to change its security strategy from time to time. South Korea has been forced to change its own defense policy a number of times as a result. Therefore, it has decided to take the initiative on the assumption that the United States may change its security strategy again.

Second, South Korea as an independent state should, as a matter of principle, defend itself by building its own defense capability. President Roh stated, “Since the Korean War, the military has steadily grown and has substantial power to defend the country. Nevertheless, the military is still not completely equipped with its own independent capability and authority to implement combat operations.” He went on to say that it is not right to leave the country’s national security to the United States Forces Korea (USFK) indefinitely. Some argue that this kind of psychological dependence has bred political and security vulnerability. President Roh stated that the use of the USFK “as a political card by the United States is undesirable,” pointing out that the United States was tipping the diplomatic balance with South Korea in its favor by using its military presence there as a bargaining chip. President Roh also said, “How can a country without independent defense capability claim [wartime] operational control [over its armed forces]?” and added, “it is only when we have an independent defense posture—not before—that we can talk about [taking over wartime] operational control and [revising] the Status of Forces Agreement.” Roh concluded that the establishment of self-reliant national defense was a shortcut to the transfer of wartime operational control from the United States to South Korea.

Third, public opinion is divided over the issue of the USFK. There are people who take the view that even a partial reduction or repositioning of U.S. troops will jeopardize the national security of South Korea, while others call for troop withdrawal, claiming that the presence of U.S. forces encroaches on the national sovereignty of South Korea. The conflict between conservatives and liberals over the presence of U.S. forces has become politicized, dividing the nation into two camps.



The old version of self-reliant national defense and the new version have one aspect in common: both emerged against the backdrop of the possible withdrawal of U.S. forces. However, the rising demand for regaining operational control, the doctrine of independent statehood, and conflicting views over the U.S. military presence did not surface in the 1970s. One big difference between the two versions of self-reliant national defense is that the old version was an inevitable choice for South Korea under the circumstances prevailing then, whereas the new version is an option bordering on “luxury” for South Korea to enhance its position in the new strategic environment.

### **(3) Main Features of Self-Reliant National Defense**

According to materials made public so far, South Korea is aiming to build self-reliant national defense that meets the following three imperatives.

First, it will build military capability strong enough to deter North Korea from attacking the South. In other words, South Korea will build up its own military to the point where the country can on its own act as a strategic deterrent against North Korea. To do this, it is imperative to strengthen those parts of its military that are heavily dependent on the USFK.

Second, South Korea will improve organization and management of its military by carrying out defense reforms. These reforms aim at improving the efficiency of education, human resources management, and force improvement. More specifically, it means cutting redundant personnel, utilizing resources available in the private sector (by making use of outsourcing, for example), improving the efficiency of the decision-making system and making it more transparent, and enhancing joint and combined operational planning capability.

Third, it will push ahead with a program for the improvement of the U.S.-ROK combined command system by drawing upon improvements made through the efforts outlined above. This means a return of wartime operational control to South Korea, that is to say, a breakup of the existing unified command system covering both U.S. and South Korean forces into two commands, similar to the arrangement made under the U.S.-Japan alliance.

The concept underlying the idea of force buildup under the self-reliant national defense policy is, first, to establish deterrence against the threat posed by North Korea and, over the long run, to build up the advanced war-fighting capability at the minimum necessary level, on the basis of a “concept of defense sufficiency.” Among other things, focal points will include: (a) the

strengthening of strategic early warning and command and control capabilities; (b) maneuver/strike capability, which is useful for both deterrence and retaliation; (c) and of nuclear, chemical, and biological protection capability against weapons of mass destruction.

With regard to the procurement of equipment, self-reliant national defense will attach importance to research, development, and production of military equipment in South Korea. In other words, South Korea “must acquire weapon systems by developing and producing them domestically, even if it may take time and require additional appropriations.” In areas that demand accumulating technologies or securing technological capabilities of South Korea’s own over a long period of time, it must tackle these challenges as part of its defense strategy and concentrate its research and development resources on them.

In the area of budgeting, it is necessary to allocate defense budget funds on a steady basis so as to realize self-reliant national defense. In particular, “Force Investment Program (FIP)” to finance procurement of equipment is a core element of the whole project. Although the budget for FIP has increased somewhat in 2002, it decreased continually during the years from 1997 to 2001. According to the estimate by South Korea’s Ministry of National Defense, if it is to build future-oriented military capability, it must appropriate 137 trillion won in the years from 2004 through 2008, and this represents 3.2 percent to 3.5 percent of South Korea’s gross domestic product (GDP). Of this amount, 82 trillion won will be allocated to Operation and Maintenance and 55 trillion won, or 40 percent of the total, will go to FIP. According to the Korea Institute for Defense Analyses, in order to carry out the force improvements envisioned under the self-reliant national defense policy, a total of about 209 trillion won—56 trillion won for the strategic deterrent force, 98 trillion won for the rapid reaction force, and 55 trillion won for the base force—will be needed over the next twenty years.

#### **(4) A Rugged Path to Self-Reliant National Defense**

For all President Roh’s enthusiasm, the path to self-reliant national defense is bound to be rugged. Of particular importance are the financial and economic implications, and the impact on the U.S.-ROK alliance.

One of the reasons cited by President Roh for promoting self-reliant national defense was the prospect of a stronger economy in the years ahead. However, even if the economy were to grow as strongly as hoped, there are limits on the

governmental budget. Earlier, President Roh had stressed the extreme importance of achieving the goal of self-reliant national defense, expressed the optimistic view that financing the program would not be a problem, and said that he would increase the defense expenditure to 3.0 percent of GDP in 2004 and to 3.2 percent by the end of his term. However, late in August 2003 when his administration finally unveiled the program, President Roh said “I learned during a discussion with the Ministry of Planning and Budget that the budget for the next year will be pretty tight, and no matter how hard we may try, we may not be able to do so [to increase defense spending to the above target].” Instead, he set a new goal of increasing the defense budget slightly in 2004 and to 3.0 percent of GDP or more by the end of his tenure. As a result, his government appropriated 18.9412 trillion won for defense in 2004, up 8.1 percent over a year ago, and 42 percent of the increase in the total budget went to defense. However, its share of the GDP remained at 2.8 percent. Moreover, if the expenditure for relocating the USFK—4.2 trillion won to 6 trillion won in 2004 through 2006—to be borne by South Korea is factored into the equation, the rate of increase in the budget for building the self-reliant national defense will be lower still.

On the question of financial constraints, even the Roh administration’s defense report, *Participatory Government Defense Policy 2003*, conceded that “Korean society is divided on the question of increasing the defense budget.” As background, it cites (a) that wishful thinking for there to be “no war among the same people” has spread to certain elements of Korean society, (b) the view that a rise in the defense budget would undermine peace and stability on the peninsula, (c) the idea that portions of the defense budget should be used for economic development and social welfare, and (d) the view that efficient defense management that includes the reduction of troops can help secure resources for force investment. Under such circumstances, it is not easy to expend large sums of money on defense.

Meanwhile, South Korea’s business community fears that the adoption of a policy designed to “achieve a self-reliant national defense over the next ten years” might make “a plan for the withdrawal of U.S. forces from South Korea in ten years” a *fait accompli*, or would help such an idea take hold. They also fear that North Korea’s nuclear issue has already cast a shadow on the international perception of South Korea, and that if an additional disruptive factor emerges, it would scare foreign firms and capital away.

Self-reliant national defense would make it difficult to maintain the U.S.-ROK alliance, at least in its present form. The Blue House stresses that the idea of self-reliant national defense is a cooperative one predicated upon cooperation with the United States, not an exclusive one. However, if remarks made by President Roh are anything to go by, it

**An American soldier (left) shakes hands with a South Korean soldier (right) in front of a U.S. M-1 Abrams tank and a South Korean K-1 tank after a combined exercise in March 2003. (Kyodo Photo)**

is obvious that self-reliant national defense would mean weakening the U.S. position within the U.S.-ROK alliance and that it is intended as a way to restrain the United States' influence on South Korea. As observed in the course of talks that led to the U.S.-Japan Joint Declaration on Security of 1996, close coordination and consultation is essential to reshaping the U.S.-ROK alliance. However, it seems to be unrealistic to put South Korea on a completely equal footing with the world's only superpower. If South Korea makes light of the importance of the U.S.-ROK alliance in its zeal to stick to the principle of self-reliant national defense, it runs the risk of setting the alliance adrift. If the United States withdraws its troops from South Korea in consequence of the latter's intransigence, Japan would become the only country in East Asia that accommodates substantial number of U.S. forces, raising the likelihood of fomenting discontent among the people in Japan about continued stationing of U.S. forces. Thus, such a development in the U.S.-ROK alliance will certainly have significant impact on U.S.-Japan relations.

The pro-independent defense initiative taken by a liberal president, Roh Moo-hyun, can go in two different ways. One possibility is that both conservatives and liberals join forces to push ahead with a policy of self-reliant national defense, and a national consensus might emerge as a result of such coalition. As noted earlier, it was former President Park Chung-hee, a conservative, who advocated self-reliant national defense in the 1960s and the 1970s. Traditionally, liberals had taken a negative attitude toward strengthening self-reliant defense capability. Therefore, the promotion of self-reliant national defense by President Roh might elevate its status to a national agenda

## Factors behind the falling approval rating of President Roh Moo-hyun

By virtue of his endearing way of talking that creates the impression that he is addressing one personally and his man-of-the-people image, President Roh Moo-hyun emerged on the political stage as a new type of leader different from his predecessors. Particularly, voters in their thirties rallied around him as he vigorously pressed ahead with reforms under the slogan of “A Generation Change,” “Shake Off the Old Political Culture,” or “Slough Off the Authoritarianism.”

President Roh came up with various reformist visions from the outset of his term. More specifically, he reshuffled the personnel of the nerve center of the government, (at the Public Prosecutors’ Office, the National Tax Administration, and the State Information Agency, for example), characterized his government as “a participatory government,” and declared that all people can participate in the process of policymaking. Although his policy met with strong criticism from opposition parties and conservatives, he won powerful support from youthful voters.

However, subsequent developments have painted a picture suggesting that even President Roh could not completely cast off the old political culture. Particularly, the fact that aides of presidential candidate Roh have received illicit campaign funds from big businesses came as a shock to the people. Furthermore, members of the ruling Millennium Democratic Party, who supported President Roh, bolted en masse from the party to form a splinter party, and this reminded voters afresh of the age-old political culture. On the diplomatic front, too, his decision to send a contingent of South Korean forces to Iraq has triggered a defection of progressives from President Roh’s faction.

Confronted with such difficulties, President Roh made a remark intimating he might resign from the presidency, and advocated a referendum on his presidency when he had not served a year in office. Such behavior has called his presidential caliber into question. Under such circumstances—he has no power base and is confronted with an opposition majority in the National Assembly, his approval rating dropped from the 80-percent area at the start of his administration to the 30-percent area in less than a year.

(Note : This commentary is based on an analysis of the situation as of the end of 2003)

acceptable to both conservatives and liberals. Acting as glue joining them together are nationalism and the emphasis on independence.

On the other hand, self-reliant national defense as advocated by President Roh may come under fire from both conservatives and liberals and his initiative may be frustrated. At present, the priority of mainstream conservatives is not so much on nationalism as on the maintenance of the U.S.-ROK alliance. They oppose introducing the self-reliant national defense policy at such a critical juncture when North Korea’s nuclear issue has flared up and the U.S.-ROK

relations have become strained, and also the financial burden it would impose on the economy. A commentator from the liberal camp, who had originally supported President Roh, observed, “the military appears to exploit the president’s commitment to self-reliance as an opportunity for an arms buildup, while maintaining a close alliance with the United States and its force structure.” If the conservatives and the liberals criticize the idea of self-reliant national defense for different reasons, and if the issue is thus politicized, the initiative taken by President Roh may fizzle out.

## **2. The Policy for Peace and Prosperity: Expanding the Scope of the North Korea Policy**

### **(1) Two Axes of South Korea’s Policy toward North Korea**

Historically, South Korea’s policy toward North Korea has evolved as a balancing act between competing policy axes: (a) between the status quo-oriented *peaceful coexistence* policy and the revisionist *unification* policy, on the one hand, and (b) between the security-oriented *deterrence* policy and the unification-oriented *engagement* policy, on the other. Where axis (a) is concerned, South Korea’s policy toward the North has fluctuated between peaceful coexistence and unification, shifting from unification to peaceful coexistence, back to unification, and then back to peaceful coexistence again. By contrast, with regard to axis (b), the emphasis has gradually shifted from deterrence to engagement, since South Korea began to pursue an engagement policy toward North Korea in earnest in 1988. Despite the flare-up of the nuclear issue in 2002, South Korea continued its food aid to North Korea and joint economic development projects. This is a proof that the engagement policy of South Korea has gained considerable stability and consistency.

Syngman Rhee, the first president of the Republic of Korea was an advocate of “Unification by the March to the North.” However, after he left South Korea in 1960, succeeding governments abandoned this policy in favor of peaceful coexistence. In 1970, President Park Chung-hee called for “bona fide competition” between the North and the South and announced the Idea for Peaceful Unification, a forerunner of the peaceful coexistence policy. In June 1973, President Park Chung-hee issued the Special Statement on the Foreign Policy for Peace and Unification. With this document, South Korea clearly set forth its peaceful coexistence policy.

In the 1980s, backed by its economic superiority over North Korea, South Korea's policy toward North Korea was invigorated and shifted from emphasizing status quo-oriented coexistence to calling for a revisionist unification-oriented approach. In 1982, President Chun Doo-hwan came up with "the Formula for National Reconciliation and Democratic Unification." The formula proposed a road map for unification that called for the establishment of a unified democratic republic through the adoption of a constitution of a unified Korea and a general election throughout the Korean Peninsula. In 1989, President Roh Tae-woo announced a three-stage "Korean National Community Unification Formula" that called, first, for interaction and cooperation between the North and the South, next, for forming a Korean commonwealth, and lastly, for completing a single unified nation-state. In 1994, President Kim Young-sam also announced a "Three-Stage Unification Formula for Building a Korean National Community" that spelled out a process of promoting reconciliation and cooperation, the formation of a Korean commonwealth, and the creation of a unified nation-state. Toward the end of his term, President Kim Young-sam aggressively pushed ahead with a unification policy that did not shy away from destabilizing the North Korean regime.

It was in 1982 that "the Twenty-Point Action Plan for National Reconciliation," a prototype of South Korea's engagement policy, was announced. At that time, the action plan was impracticable, but it had an epochal significance in that it included projects for a road link between Seoul and Pyongyang, a reunion of separated families, and the opening of Mt. Kumgang to South Korean tourists, all of which are pursued today. It was in 1988, the year when an enthusiasm for peaceful unification grew stronger and the Cold War regime began to waver, that South Korea began to pursue its engagement policy in earnest. In July the same year, President Roh Tae-woo issued a "Special Presidential Declaration for National Self-Esteem, Unification, and Prosperity" (July 7 Declaration). Its essential features included an exchange of visits between the people of North and South Korea, reunion of separated families, trade between the two Koreas, provision of economic assistance to North Korea, and cooperation with North Korea in its efforts to improve relations with the United States and Japan. It was a statement of South Korea's position that it considered North Korea a partner, not an enemy, and that South Korea was willing to encourage exchanges to realize unification between the two Koreas. South Korea followed it up by starting aid shipments of rice to North Korea in 1995.

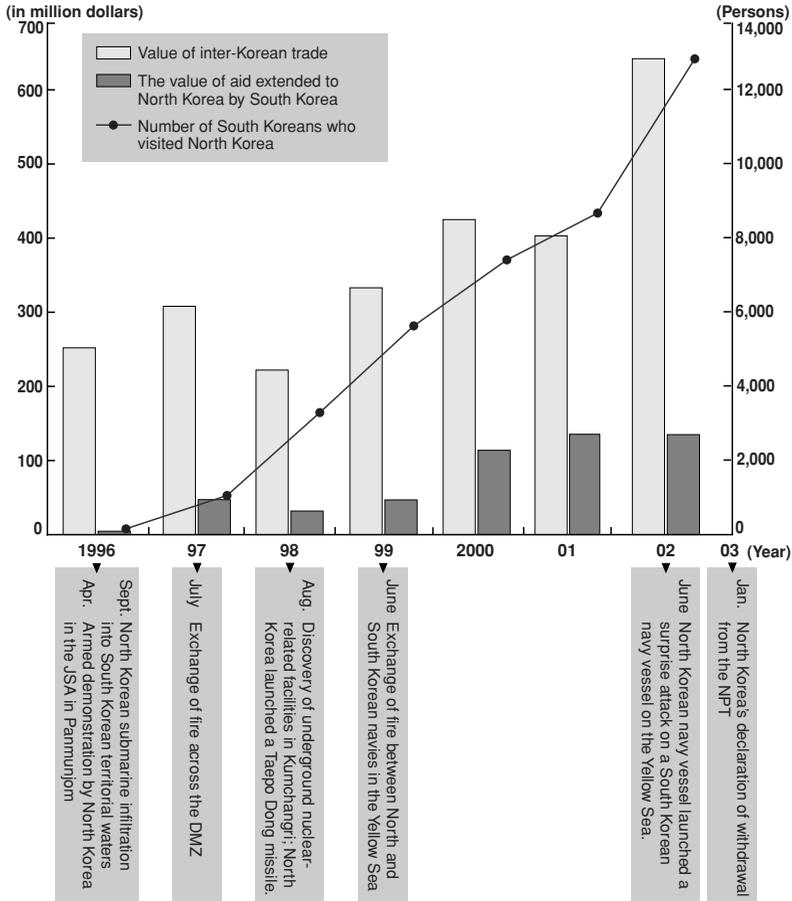
The “Sunshine Policy” pursued by President Kim Dae-jung since 1998 was the most ambitious and unqualified engagement policy ever in that it did not demand reciprocity from North Korea. However, contrary to the impression the general public had, the Sunshine Policy was a status quo-oriented policy that shifted its focus away from unification back to peaceful coexistence. It played down the objective of early unification and made its main thrust institutionalizing a peaceful coexistence. Factors behind the adoption of the Sunshine Policy seem to lie in the fact that (a) the larger-than-expected cost entailed from a hurried unification of East and West Germany dampened South Korean enthusiasm for a unification of the North and the South, (b) the South Korean economy was hit by a financial crisis in 1997–98, and (c) President Kim Dae-jung felt the necessity to assure North Korea that he had no hostile intention in order to make his Sunshine Policy work.

## **(2) Engagement Policy Stays on Track**

South Korea has vacillated between peaceful coexistence and unification on a number of occasions in the course of executing its policy toward North Korea. However, with regard to the balance between *deterrence and engagement*, it has gradually tilted toward the latter, and at present, its engagement policy has become considerably steadfast and consistent. As a result, the dollar value of trade (exports and imports) between the North and the South has soared from \$18.72 million in 1989 to \$641.73 million in 2002, and the number of people who visited North Korea (excluding tourists visiting Mt. Kumgang) jumped from one in 1989 to 13,877 in 2002. The total value of trade during the past five years exceeded \$2 billion. During the past several years, South Korea and North Korea signed an agreement on investment protection, prevention of double taxation, and procedures for resolving commercial disputes and clearing settlements. According to the *2003 Unification White Paper*, the number of South Korean tourists who have visited North Korea for sightseeing at Mt. Kumgang since 1998 has reached half a million; and official and private economic assistance extended to North Korea amounted to \$272.08 million and \$190.72 million, respectively.

Despite many obstacles including problematic acts by North Korea, South Korea pushed ahead with projects for exchanges and cooperation. The ROK Ministry of Unification said, “despite numerous difficulties such as a naval clash in the Yellow Sea, South Korea has consistently promoted exchanges and

**Figure 3.2. Trade and tensions between the North and the South**



Source: Data from the Ministry of Unification of South Korea.

cooperation in wide-ranging areas such as economic cooperation, social and cultural exchange, and sporting events.” This suggests that South Korea is implementing the engagement policy with tremendous patience.

It is true that inter-Korean joint projects have slowed down since the flare-up of the nuclear issue. Investment in North Korea from South Korea has tended to stagnate, and the South Korean government is taking a somewhat cautious attitude. On the other hand, North Korea is taking a more-than-usually active interest in inter-Korean joint projects in part to check the United States and in

part to make up for the decrease in foreign aid. Overall, therefore, the inter-Korean joint projects have been progressing in their own way.

There are several core inter-Korean joint projects carried out by South Korea as part of its engagement policy. They include: the construction of the inter-Korean railways and highways; the construction of an industrial complex in Kaesong; overland tours to Mt. Kumgang; reunion of separated families; and humanitarian food aid.

First, projects for track connection works for the Seoul-Sinuiju Railway in the west and for the East Coast Railway in the east were launched simultaneously in September 2002. Pursuant to subsequent agreements to the 1953 Korean Armistice Agreement authorizing the construction of a road and rail transportation corridor through the Demilitarized Zone (DMZ), a 250-meter zone along the Seoul-Sinuiju Railway and a 100-meter zone along the East Coast Railway, were established within the DMZ. These zones are to be administered by the North and South, and they jointly conducted mine clearing operations in these zones. South Korea decided to provide North Korea with equipment and materials to be used in railway and highway construction in the form of loan, and sent excavators, trucks, and cement to the North. In June 2003, a function celebrating the linking of the Seoul-Sinuiju Railway and the East Coast Railway was held, and in September 2003, the construction of most of the roadbed for the railways and highways was completed, and the work of laying rails is under way.

Second, in Kaesong, a North Korean city about sixty kilometers northwest of Seoul, the first-stage work of a three-stage project to construct an industrial complex started in June 2003. The first-stage will take three years. When completed, about 250 labor-intensive businesses employing 23,000 workers will be invited to locate their plants there, and are expected to export \$2.4 billion worth of goods a year. The second stage of the project will take five years. When completed, 450 light- and heavy-industry firms employing 24,000 workers will be invited to establish their

**Engineering work linking the Seoul-Sinuiju Railway in an area south of the DMZ** (Yonhap Press/Kyodo Photo)

plants. The third stage will take eight years, and 900 cutting-edge industrial firms employing 53,000 workers will be invited to open plants. In November 2002, North Korea enacted a Law on Kaesong Industrial Zone that established rules regarding development and management of the industrial zone, establishment and operation of business enterprises, and procedures for settlement of disputes. By this legislation, North Korea announced that it would run the industrial zone in accordance with market economy principles. In August 2003, a total of 224 managers of small-to-midsize firms in South Korea visited the Kaesong Industrial Zone.

Third, the number of tourists who visited Mt. Kumgang in 2001 sharply decreased to one-fifth of those of a year ago, plunging the Mt. Kumgang tourism project into crisis. Concerned about the future of the project, the South Korean government began to prop up the embattled project by providing subsidies to specific tourists and by improving tourism facilities. As a result, the number of tourists increased about 50 percent in 2002 over the year before. However, as the bulk of that increase was accounted for by school excursions, the increase did not necessarily contribute to an increase in revenue. As 2003 progressed, South Korea promoted overland tours to Mt. Kumgang via a road temporarily set up along the East Coast Railway. After a trial tour in February in which 400 South Koreans participated, overland tours to Mt. Kumgang were resumed in earnest in September the same year.

Fourth, at the seventh round of inter-Korean reunions of separated families held in June 2003, 899 Koreans were briefly reunited with their loved ones. This brought the total number of reunited Koreans to 7,109 since the inter-Korean summit held in June 2000. In November 2003, North Korea agreed to allow South Korea to build a place for the reunion of separated family at a location in Mt. Kumgang.

Lastly, South Korea continues to ship humanitarian aid to North Korea without linking it to political developments. In 2002, South Korea shipped 400,000 tons of food in the form of a loan and 300,000 tons of fertilizer to North Korea. Bags of rice shipped in aid to North Korea in 2002 bore a label indicating in *Hangeul* (the Korean alphabet), not English, that it was from “the Republic of Korea.” In 2003, it shipped 300,000 tons of fertilizer and \$15.63 million worth of corn in aid, and provided 400,000 tons of rice to North Korea in the form of loan. On the question of continuing humanitarian aid to North Korea, the United States and South Korea took the same position. At a summit

meeting held in May 2003, the leaders of the two countries said that they would continue it “without linking it to political developments.”

Overall, projects for Mt. Kumgang tours, reunion of separated families, and food aid have made considerable strides and are making steady progress. Meanwhile, the projects for linking railways and highways between the two Koreas and for the construction of the Kaesong Industrial Zone have just begun to gather momentum. As these projects could become a launching pad for luring North Korea into the international community, attention is being focused on the progress they may make in coming years.

### **(3) A New Dimension of South Korea’s Policy Toward the North**

The government of President Roh Moo-hyun that took office in 2003 came up with a new policy dubbed “the Policy for Peace and Prosperity.” This policy “aims to lay the foundation for the peaceful unification of Korea” and “for the development of Korea as an economic hub in Northeast Asia” through the promotion of peace on the Korean peninsula and mutual prosperity for the two Koreas. The South Korean government characterized it as “a comprehensive concept encompassing policies on unification, national security, and foreign relations.” It differs from Kim Dae-jung’s Sunshine Policy on the following points: (a) It is a policy designed to promote peace and common prosperity not only on the Korean Peninsula but in Northeast Asia as a whole; (b) it is a comprehensive concept encompassing policies on unification, national security, and foreign relations; and (c) it has broadened its scope to include not only reconciliation and cooperation but also peace and prosperity.

Where does this peace and prosperity policy stand relative to the trade-offs in the two axes of “peaceful coexistence and unification” and “deterrence and engagement”? First, the Policy for Peace and Prosperity envisions a “gradual unification,” a euphemism for peaceful coexistence. In this sense, it is a peaceful coexistence policy no different from the Sunshine Policy. Second, it is a policy for engagement not deterrence. The government of President Roh Moo-hyun remains committed to the engagement policy, as noted earlier, although it takes a more guarded stance than before because of a suspected illegal money transfer by the government of former President Kim Dae-jung to North Korea that came to light in recent months. In other words, Roh Moo-hyun’s Policy for Peace and Prosperity is anything but a slightly modified version of the North Korea policy his predecessor had pursued.

The biggest difference between Roh Moo-hyun's Policy for Peace and Prosperity and the previous North Korea policy lies in the fact that he stressed the importance of the role neighboring countries—not only Japan and the United States but also China and Russia—can play in promoting the engagement policy. That is to say, the peace and prosperity policy “has broadened its sight to include Northeast Asia.” The countries that will play an important role in the pursuit of South Korea's engagement policy are Japan (potentially North Korea's largest source of aid), China (a role model for North Korea's economic reforms), and Russia (which aims at revitalizing the economy of its Far Eastern territories through the construction of a railway network called “the iron silk road”).

Of course, the July 7 Declaration of 1988 supported improved relations between North Korea on the one hand and Japan and the United States on the other, and Kim Dae-jung's Sunshine Policy went a step further to spur the normalization of diplomatic relations between North Korea and Japan and the United States. However, the Sunshine Policy had been pursued under the strong leadership of President Kim Dae-jung and Lim Dong-won, former senior secretary to the president for foreign affairs and national security. It centered around promoting inter-Korean relations, and did not explicitly link his North Korea policy to the economic development of all Northeast Asia. Moreover, until the Japan-DPRK summit was held in September 2002, policy objectives envisioned by South Korea were little more than a pipe dream. Also, the active involvement of China and Russia has materialized only recently. In this sense, Roh's Policy for Peace and Prosperity brought to the fore a third axis, “ROK-led engagement vs. the concerted engagement by countries concerned,” in addition to the two mentioned earlier. In response to the new reality, the Policy for Peace and Prosperity is designed to achieve the goal of “concerted engagement.”

Put another way, South Korea's policy toward North Korea has become much more dependent on the assistance and support of other countries than before. South Korea, led by President Kim Dae-jung, together with his senior secretary Lim Dong-won, had stayed on the central stage while paying lip service to the necessity of concerted engagement of countries surrounding the Korean Peninsula. Unlike them, the present administration is not necessarily fixated on playing a leadership role in engaging North Korea. The low-profile presence South Korea has had in the six-party talks symbolizes this.

However, the Policy for Peace and Prosperity has not produced substantial

results in promoting concerted engagement yet. In order to build a full-fledged concerted engagement system, North Korea's nuclear issue must first be solved within the multilateral framework.

### **3. Prospects for North Korea's "Economic Reform"**

#### **(1) Implementing Economic Reform**

On July 1, 2002, North Korea took a series of measures to improve its economic management methods. The main features of these measures are (a) the delegation of authority for formulating economic plans to subordinate agencies, (b) the introduction of material incentives to stimulate the will to work, and (c) a hike in pay and prices and the devaluation of the North Korean won.

First, the authority to set economic planning goals, which had been vested in the State Planning Commission, was delegated to competent organizations and corporations except for goals of national and strategic importance, such as those for the arms industry. Factories are authorized to decide on the price of their products and to plan their production by themselves. The government hoped that this system would help rationalize economic planning, heighten the sense of responsibility, and encourage initiative within each organization.

Second, the government decided to strengthen the cost-accounting system and reward workers with material remuneration commensurate with the volume and quality of their labor. It is said that "this is correct implementation of the socialistic principle of distribution"; that is to say, "the harder you work, the greater is your income."

Third, the base wage of production workers was raised about eighteen-fold, and that of coal miners twenty- to thirty-fold. The price of rice was hiked 550 times and the bus fare twenty times. In addition, rent and utility bills are to be borne by users. At the same time, the system under which the state bought up rice at a higher price and sold at a lower price was abolished. In its place, the government introduced a new system under which the government buys up rice at 40 won per kilogram and sells it at 44 won. Also, it has abolished foreign-currency convertible notes, and devalued the won from about 2.2 won to about 150 won to the dollar. These measures are designed to lower the degree of state intervention in economic activity and to adjust the government-dictated value of the won to its market value.

In addition, on September 12, North Korea designated Sinuiju, a city

bordering on China, as Sinuiju Special Administrative Zone and sought to revitalize economic activity by guaranteeing property ownership of individuals and by creating an investment environment and conditions favorable to business enterprises. North Korea's Supreme People's Assembly also passed the Law on the Kaesong Industrial Zone and the Law on Mt. Kungang Tourist Zone in rapid succession.

In 2003, there was a reshuffle of government officials that showed the government's commitment to promoting economic reforms. At the first session of the Eleventh Supreme People's Assembly held in September, Chemical Industry Minister Pak Pong Ju was elected premier in place of Hong Song Nam. Before he became premier, Pak Pong Ju served as director of a food plant, a chemical complex, the Party Light Industry Department, and the Party Economic Policy Inspection Department, and had served as chemical industry minister since 1998. In 2002, he visited South Korea as a member of an economic mission. In his inaugural address as premier, after having said, "all projects will be carried out in accordance with the army-first policy," he stated a task of utmost importance is to introduce a "fundamental change in the approach to economic projects."

## **(2) Background to Reform**

The basic policy for economic reforms had reportedly been announced as early as October 2001 by Chairman Kim Jong Il of the National Defence Commission. In a directive entitled "To Improve and Strengthen the Socialistic Economic Management in Line with the Requirements for the Construction of a Powerful Nation," Kim stated, "we should manage and operate the economy in such a way as to ensure the largest profitability while firmly adhering to the socialist principles." According to a press report, it was toward the end of 2000 that North Korea started to implement this policy on a nationwide scale. Pursuant to this policy, the role of the Administrative Council as a center for controlling economic policy was strengthened, the authority to formulate economic plans was delegated to competent economic agencies, and projects for rationalizing the organization of plants and business enterprises, and for dividing and specializing production, were implemented. The government began to implement these reform measures in earnest in 2002.

North Korea was prodded to implement these economic reforms by both domestic and foreign factors. On the domestic front, the official sector of its

economy shrank, while the unofficial sector (i.e., the black market) expanded. The official sector has become so inefficient that it could no longer meet the people's needs. For instance, the rationing system in essence collapsed in 2001 and the government had to call on its people to secure their own food. As such moves undermined state control over economic activity, the government sought to restore unofficial economic activity to the officially sanctioned markets by adjusting its policy to market reality. Second, in October 2000, the government announced the end of "the arduous march," suggesting that the food shortages have eased. This reduced the fear of inflation in connection with economic reform.

On the foreign front, thanks to the inter-Korean summit held in 2000, North-South relations began to thaw. This has opened up the prospect of full-fledged economic assistance from South Korea. Second, as early as in July 2002, moves for a summit meeting between Japan and North Korea were already under way behind the scenes. Although talks on the normalization of diplomatic relations with Japan became snagged on the abduction and nuclear issues, at least there appeared to be the prospect of economic assistance from Japan as a result of the summit meeting. These domestic and foreign factors have made economic reforms in North Korea unavoidable on the one hand, and have actively prodded the government to pursue them on the other.

### **(3) Opportunities and Challenges**

The substance of the economic reforms being pursued by North Korea is basically sound, and some of the projects have achieved positive results. For instance, as the large number of kiosks that has mushroomed on the streets of Pyongyang attests, commercial activity has surfaced from the black market. There are reports that workers are returning to the official sector. A report by the Bank of Korea (the central bank of South Korea) states that these reform measures "aroused the people's will to work and contributed to the revitalization of the labor-intensive, light industries and the industrial distribution sector."

However, the fact remains that the economic reforms of North Korea have to be implemented in the face of extremely difficult economic and social conditions. At the present level, it is inconceivable that their effects will be felt throughout the country and revitalize the entire spectrum of economic activity, including production. After growing at an annual rate of 6.2 percent in 1999, the North Korean economy has expanded by 1.3 percent in 2000, 3.7 percent in

2001, and 1.2 percent in 2002. However, as its economy continuously registered negative growth between 1990 and 1998, the positive growth it has achieved in recent years is far from picking up the slack and lifting the economy to the level in the Cold War years. What is worse, many workers went half paid on account of the transitory effects of the economic reforms, and many urban households that have depended heavily on rations are experiencing great difficulties.

Unless North Korea overcomes several obstacles, it will be difficult to achieve meaningful results. First, taming inflation is the greatest challenge facing North Korea in the coming years. As of the end of 2003, there is no sign yet of hyperinflation. However, there are unconfirmed reports that in the black market, the price of rice rose two-fold, and the value of the North Korean won fell to about 1,000 won to the dollar.

Second, there is a problem of how to absorb idle workers displaced on account of the economic reforms. The government is supposed to solve this problem. However, if, as it is likely, the economic reforms produce a large number of displaced workers, it is possible the situation may spiral out of control. Already there is a report that the number of unemployed workers has increased in the northern region. Given the breakdown of the ration system, unemployment is likely to touch off serious social problems.

Third, higher food prices have not led to an increase in production as production remains dominated by cooperatives that are impervious to market competition. The basic cause of stagnation in the North Korean economy is not a short-term one but long-term and structural, and it is not easy to change a deep-rooted system.

Fourth, domestic progress in economic reforms may peter out for lack of improvement in foreign economic relations. If domestic reforms gather momentum, North Korea's need for foreign capital goods and funds would increase. However, unless the nuclear issue is resolved, and the investment environment in North Korea improves, few foreign firms would be interested in sinking their funds in that country. Moreover, if North Korea really wants to rebuild its economy, including its infrastructure, full-fledged economic assistance from Japan will be essential. But unless the issues of nuclear and missile development and of abducted Japanese citizens are resolved, diplomatic relations with Japan will not be normalized.

Lastly, the most basic question to be considered is what effects the economic

reforms will have on the current regime of North Korea. At present, the country's top priority is to sustain the regime of Kim Jong Il. However, progress in economic reforms could undermine its control over society, while those displaced on account of the economic reforms may challenge the rule of the Kim Jong Il regime. Whether or not the leadership of North Korea is prepared to brave such risks and go ahead with reform measures necessary to rebuilding the economy remains to be seen.

If the issues of nuclear and missile development and of abducted Japanese citizens were resolved, however, the countries concerned will more vigorously push ahead efforts for concerted engagement, and, by linking this with the reform movement of North Korea, could produce significant results. Economic assistance from Japan and international agencies is the only way to overhaul North Korea's economy, which is in dire straits. Moreover, the economic reforms would become an essential vehicle for North Korea to effectively utilize foreign assistance. If these two elements were coupled, they might, working in combination with the engagement policy of neighboring countries, bring about positive results not only for the North Korean economy but also for the regional economy. Indeed, this is the best scenario envisioned by South Korea's peace and prosperity policy. However, if this scenario is to have any chance of success, the issues of nuclear and missile development and abduction of Japanese citizens must be solved peacefully in ways acceptable to the interested countries, and North Korea must overcome many problems standing in the way of its economic reforms.

