
Tasks for Balanced Development of the National Economy

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The Background and Meanings of the Agreement on Economic Cooperation

According to the June 15th Joint Statement, "the South and the North have agreed to consolidate mutual trust by promoting balanced development of the national economy through economic cooperation and by stimulating cooperation and exchanges in civic, cultural, sports, public health, environmental and all other fields." The North-South economic cooperation was not directly mentioned, but implied in the following phrase: "promoting balanced development of the national economy." This expression, balanced development of the national economy, also epitomizes the nature of the current North-South Korean economic cooperation. It characterizes the economic cooperation as a means of developing the divided economy into the national economy on the principle of "symbiosis and balance."

The phrase, "unified development of the national economy," which had been included in the Basic Agreement of 1991, was deleted in the Joint Statement. The North might have opposed the expression, "unified," as it could imply an integration of the two different economic systems. From the viewpoint of the North's unification formula of federal system, the national economy is supposed to be premised on the maintenance of the South's and North's economic systems. Therefore, the North-South Korean eco-

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conomic cooperation is to pursue “symbiosis and balance” on the basis of mutual recognition of each other’s economic system, although it aims ultimately for a unified national economic system.

What is the background for this agreement? The South, since the start of the Kim Dae-jung government in 1998, has consistently pursued the “engagement policy” toward the North, with the goal of realizing “peaceful coexistence” through “reconciliation and cooperation.” The policy can be summarized as the following two elements. One is not to absorb the North, and the other is to establish reconciliation and cooperation first in economic and social fields and then gradually move on to the goal of a political unification. The rationale for such a reconciliatory policy, of course, was the realization that the continuance of confrontation and tension of the old Cold war period would be a great obstacle to the recovery and development of both the South’s and the North’s economies.

Meanwhile, the North has pursued the policy of “unification via federal system” on the basis of recognizing and maintaining the current two different systems. This policy focuses on the political aspect, arguing that the South should first become “independent” of the foreign influences (the U.S. influences, in particular) and then establish the so-called “great national solidarity” with the North for a “peaceful” unification. The background for this policy was the approach of separating “internal” and “external” matters. The national unification, as an internal matter, should be resolved independently by the North and the South themselves, while the military goal of establishing a peace system on the Korean peninsula, as an international matter, should be dealt with by the North and the U.S.

The North might have interpreted the Kim Dae-jung government’s engagement policy as recognizing the North’s political system, and thus begun the task of resolving the internal matter with the South. The background reason for this policy choice may be Kim Jong-il’s judgement that it was high time to pursue the “great national solidarity” through a reconciliation with the South. Moreover, he must have thought that the promotion of economic cooperation with the South at an official level would be necessary for the recovery and development of the North Korean economy.

The great national solidarity will be manifested, in its economic

form, as large-scale economic cooperation that aims for “symbiosis and balance” of the national economy. The economic cooperation, which had been pursued mostly at the non-governmental level until now, is to make a great leap forward by including cooperation at the governmental level and thus developing into “cooperation at the level of the whole nation.”

Comparison of the Economic Structures of the North and the South

The fact that the North and the South agreed to promote exchanges and cooperation for balanced development of the national economy testified that the economic structures of the two sides had been unbalanced. This structural imbalance will be analyzed here with primary focus on the North Korean economy.

Differences in Industrial Structure

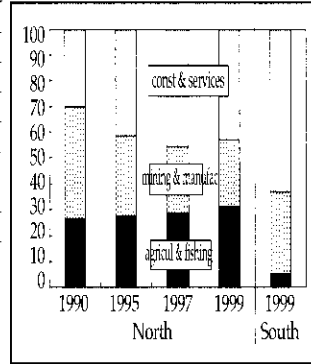
North Korea has been pursuing, since the fifties, socialist industrialization. As a result, the share of mining and manufacturing rose to 60% in 1987. With the collapse of the socialist block, however, the share dropped consistently since then, thus recording only 25.5% in 1997. This decrease can be attributed to the difficulties in providing energy and raw materials due to the shortage in foreign exchange, and to the decrease of real production due to the lack of infrastructure and the consequent transportation difficulties. The share of agriculture and fishing, on the other hand, has grown from 20% in 1987 to 31.4% in 1999. The share of private service sector has remained rather low, while that of governmental service sector has been relatively high, just as in any socialist economy.

In contrast, the South Korean economy can be characterized as a low share for agriculture and fishing and relatively high shares for heavy industries and private service sector.

<Figure 1> and <Figure 2> estimate the ratios of sectoral self-sufficiency, import and export for the North and the South Korean economies. These numbers show how much of the domestic demand can be met by the domestic production, and the relative

<Table 1> The Trend of Changes in North Korean Industrial Structure and North-South Comparison (%)

	North									South
	1946	1975	1987	1990	1995	1996	1997	1998	1999	1999
agriculture & fishing	59.1	21.8	20.0	26.8	27.6	29.0	28.9	29.6	31.4	5.0
mining & manufac	23.2	63.0	60.0	42.8	30.5	28.0	25.5	25.6	25.6	32.2
mining					8.0	7.1	6.7	6.6	7.3	0.4
manufac										
heavy ind					15.7	14.0	12.3	12.6	12.2	24.9
light ind					6.8	6.9	6.5	6.4	6.1	6.9
constr & service	17.7	15.2	20.0	30.4	41.9	43.0	45.6	44.8	43.0	62.8
electric, gas & water					4.8	4.3	4.3	4.2	4.5	2.6
construction					6.7	6.4	6.3	5.1	6.1	8.8
gov't service					20.7	22.5	25.1	25.3	22.8	9.8
private service					9.6	9.7	9.9	10.3	9.6	41.6



Source: Ministry of Unification, *Statistics on the North Korean Economy*, 1986; The Bank of Korea, *Estimates of North Korea's GDP*, every year.

importance of import and export in each of the two economies.

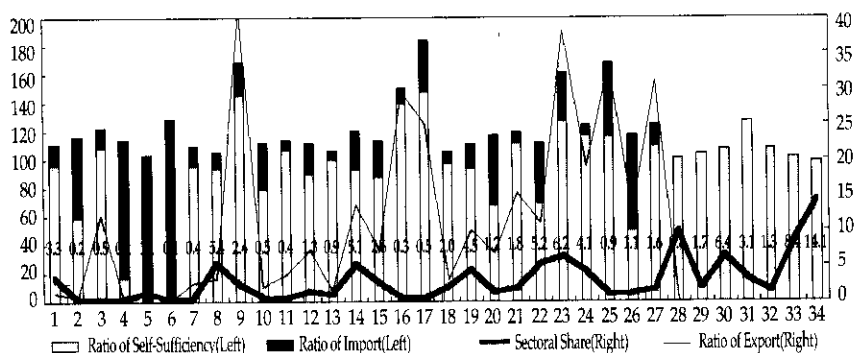
As can be seen, the South Korean economy is exhibiting rather high ratios of import and export dependency in most industrial sectors except construction and service sector. In a word, it is strongly linked to the international economy. In particular, industries such as textiles, petro-chemical, electronic, transportation machines show very high ratios of export orientation.

In contrast, the North Korean economy's industrial structure is characterized by its strong orientation toward domestic demand. The ratios of import dependency are high only in some industries such as crude oil, metal, textiles, pulp, rubber, machines, and automobiles. The economy is export-oriented only in industries like metal mining, clothing, non-ferrous metal, metal products, and electric products.

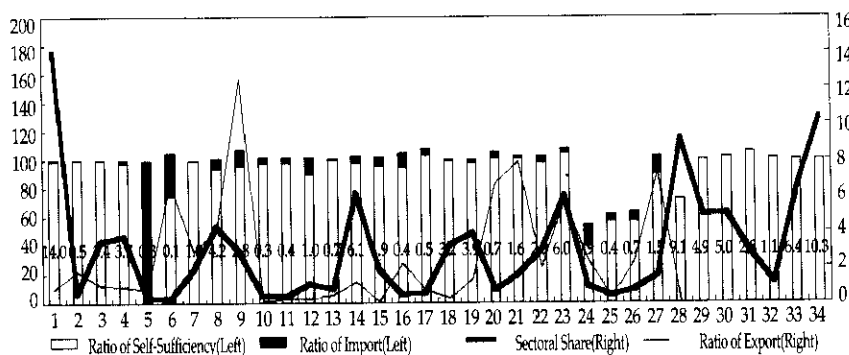
Differences in Economic Policies

North Korea's economic policies have been consistent since the beginning. Adopting the construction of a "self-sufficient national economy" as the economic development strategy, it has pursued such policy goals as an inward-oriented industrialization, a priority on heavy industries with a simultaneous development of agricul-

<Figure 1> Ratios of Self-Sufficiency and Import, and Sectoral Share for South Korea



<Figure 2> Ratios of Self-Sufficiency and Import, and Sectoral Share for North Korea



Source: Estimated on the basis of ERINA, *Industrial Linkage Tables for Seven Northeast Asian Regions* (1995).

ture and light industries, and a simultaneous construction of defense and economy. For implementation of these policy goals, economic management in the manufacturing sector is to be conducted by a peculiar business system called "Dae-an," where workers and party cadres first set the production target on the principle of "popular line, and then the manager executes it.

Since the mid 90s, the economic crisis characterized by the "three difficulties" in foreign exchange, energy, and food, has forced ordinary people's private economic activities to expand

with a tacit approval by the authority. With a recent recovery in the food shortage problem, however, the North Korean authority is now reinforcing the system of planned economy.

North Korea is not implementing those economic reform policies that China has implemented, including the abolition of collective farms, the price actualization, the separation of party and executive, and the transfer of authorities from the central to local governments. This negative attitude on reform seems to result not simply from the North Korean belief in the superiority of the socialist planned economy, but also partly from its concerns over possible harmful effects that such reform policies might cause on the regime stability under the confrontational situation. Paradoxically speaking, then, the North Korean authority might actually implement those economic reform policies in the name of "economic modernization," if peace is established on the Korean peninsula with improvements in inter-Korean relations as well as in North Korea-U.S. relations.

The most distinguishing feature of the North Korean economic policies during the reign of Kim Jong-il would be the principle of "calculating objective conditions and securing practical benefits." Meanwhile, the objective of North Korea's external economic policies is to "survive the system of global market economy while holding onto the socialist planned economy."

Principles and Tasks for Balanced Development of the National Economy

Establishing Foundations for the Development of the North Korean Economy on Its Own

The long-term objective for North and South Korean economic development is to make the two economic structures mutually cooperative and organically connected so that they could develop into a single national economy. In order to accomplish this objective, there are some important problems that the North Korean economy should resolve.

Above all, the North Korean economy should secure continu-

ing economic growth, as its economic growth rate has just turned positive in 1999. To help the North do so, the South should first understand the direction of the North Korean economy's future development by analyzing its current economic structure.

<Table 2> shows the estimates of sensitivity coefficients and influence coefficients¹ for each industrial sector of the North Korean economy. As can be seen in the table, industries such as steel, textiles & clothing, non-ferrous metal, metal products, and transportation machines are exerting strong influences on other industries. Meanwhile, industries that are sensitively affected by an increase in the final demand include chemical, steel, service, paper & pulp, non-ferrous metal, textiles & clothing, and electric & elec-

<Table 2> Sensitivity Coefficients and Influence Coefficients for North Korean Industries (1995)

Sensitivity		Influence Coefficients		Total	
chemicals	2.6704	steel	1.4929	ceramics	3.8343
steel	2.2983	textiles & clothing	1.4493	steel	3.7912
other services	1.6862	non-ferrous metal	1.3154	paper & pulp	2.7852
real state & finance	1.6784	automobiles	1.2657	non-ferrous metal	2.6482
paper & pulp	1.5850	metal products	1.2653	textiles & clothing	2.6050
electricity & gas	1.3418	ceramics	1.2550	other services	2.5469
non-ferrous metal	1.3328	other transp machines	1.2148	ceramics	2.4792
ceramics	1.2242	leather products	1.2094	general machines	2.3261
oil products	1.1987	paper & pulp	1.2002	real state & finance	2.3228
textiles & clothing	1.1557	general machines	1.1954	electricity & gas	2.2691
electric & electronic	1.1450	food & beverage	1.1942	electric & electronic	2.2218
general machines	1.1307	construction	1.1814	automobiles	2.0694
transportation	1.0752	chemicals	1.1640	food & beverage	2.0613
crude oil & natural gas	1.0550	other manufac	1.1590	metal products	2.0502
commerce	1.0506	rubber products	1.1149	other manufac	2.0186
agriculture	1.0000	precision machines	1.1014	oil products	2.0025

Source: Estimated on the basis of ERINA, *Industrial Linkage Tables for Seven Northeast Asian Regions* (1995).

¹ A sensitivity coefficient denotes how sensitively an industry responds to one unit increase in its final demand. An influence coefficient denotes the total effects that one unit increase in demand for an industry could have on all the other industries. If the coefficient for a certain industry is greater than one, it means that the industry's influence is above the average.

<Table 3> Coefficients for Production Inducement for North Korea (1995)

Dependence on Production Inducement					Coefficients for Production Inducement			
final demand	export	investment	consumption		consumption	investment	export	final demand
1.0000	0.0426	0.0753	0.8821	agriculture	0.3428	0.0480	0.2610	0.2322
1.0000	0.0597	0.2908	0.6495	forestry	0.0080	0.0059	0.0116	0.0074
1.0000	0.0416	0.0071	0.9513	fishing	0.0346	0.0004	0.0239	0.0217
1.0000	0.1104	0.4238	0.4658	coals	0.0079	0.0118	0.0297	0.0102
1.0000	0.0415	0.3603	0.5982	crude oil & natural gas	0.0212	0.0209	0.0232	0.0212
1.0000	0.1283	0.6765	0.1952	metal mining	0.0017	0.0098	0.0180	0.0053
1.0000	0.0792	0.7880	0.1328	other mining	0.0041	0.0402	0.0389	0.0186
1.0000	0.0555	0.0197	0.9248	food & beverage	0.1379	0.0048	0.1305	0.0891
1.0000	0.2062	0.0447	0.7491	textiles & clothing	0.0908	0.0089	0.3943	0.0724
1.0000	0.0255	0.6309	0.3436	wood products	0.0056	0.0170	0.0066	0.0098
1.0000	0.0036	0.5619	0.4345	furniture	0.0068	0.0144	0.0009	0.0094
1.0000	0.0418	0.2709	0.6872	paper & pulp	0.0351	0.0227	0.0337	0.0305
1.0000	0.0217	0.1688	0.8095	print & publishing	0.0251	0.0086	0.0106	0.0185
1.0000	0.0828	0.2425	0.6747	chemicals	0.1414	0.0833	0.2738	0.1252
1.0000	0.0395	0.3609	0.5996	oil products	0.0455	0.0449	0.0473	0.0454
1.0000	0.0646	0.4629	0.4725	rubber products	0.0055	0.0089	0.0119	0.0070
1.0000	0.0744	0.0715	0.8541	leather products	0.0129	0.0018	0.0177	0.0090
1.0000	0.0158	0.8663	0.1179	ceramics	0.0183	0.2202	0.0387	0.0927
1.0000	0.0619	0.7771	0.1610	steel	0.0279	0.2205	0.1691	0.1035
1.0000	0.1199	0.6585	0.2216	non-ferrous metals	0.0130	0.0634	0.1111	0.0351
1.0000	0.0899	0.6903	0.2198	metal products	0.0153	0.0790	0.0990	0.0417
1.0000	0.0293	0.8059	0.1647	general machines	0.0280	0.2248	0.0787	0.1017
1.0000	0.1168	0.6314	0.2518	electric & electronic	0.0465	0.1910	0.3402	0.1103
1.0000	0.0179	0.6931	0.2890	automobiles	0.0187	0.0735	0.0183	0.0387
1.0000	0.0051	0.8607	0.1342	other transp machines	0.0024	0.0248	0.0014	0.0105
1.0000	0.0205	0.7733	0.2062	precision machines	0.0085	0.0522	0.0133	0.0246
1.0000	0.1159	0.3420	0.5421	other manufac	0.0316	0.0327	0.1067	0.0349
1.0000	0.0019	0.9456	0.0525	construction	0.0194	0.5732	0.0111	0.2210
1.0000	0.0424	0.3985	0.5591	electricity & gas	0.0461	0.0538	0.0552	0.0492
1.0000	0.0145	0.2765	0.7091	commerce	0.1545	0.0987	0.0498	0.1302
1.0000	0.0215	0.2594	0.7191	transportation	0.0802	0.0474	0.0378	0.0667
1.0000	0.0195	0.2347	0.7458	communication	0.0274	0.0141	0.0113	0.0220
1.0000	0.0205	0.2771	0.7024	real state & finance	0.1919	0.1241	0.0884	0.1633
1.0000	0.0131	0.1429	0.8439	other services	0.3629	0.1007	0.0892	0.2569
1.0000	0.0449	0.4153	0.5398	all industries	2.0200	2.5465	2.6530	2.2359

Source: Estimated on the basis of ERINA, *Industrial Linkage Tables for Seven Northeast Asian Regions* (1995).

tronic. Comprehensively speaking, industries such as chemical, steel, paper & pulp, non-ferrous metal, textiles & clothing, machines, electric & electronic, and electric power can be classified as the important industries in the North Korean economy.

<Table 3> shows the estimates of production-inducive coeffi-

cients for each item of the final demand. According to the table, industries whose production is strongly induced by the domestic demand are agriculture, food & beverage, chemical, commerce, and other services. Industries whose production is much induced by the governmental investment are ceramics, steel, machines, and construction. Finally, industries whose production is strongly induced by export include clothing, chemical, non-ferrous metal, and electric & electronic.

From the above analyses, we may conclude that economic cooperation between the two Koreas should focus on the following industries so that the North Korean economy could increase industrial production and thus sustain continuing growth: agriculture, food & beverage, textiles & clothing, paper, chemical, non-ferrous metal, steel, machines, electric & electronic, electric power, and commerce.

Among the above-mentioned industries, those whose production is strongly induced by export, e.g., clothing, chemical, non-ferrous metal, and electric & electronic, deserve special attention.

Forming a Competitive Industrial Structure through Inter-Korean Economic Cooperation

In order for the North Korean economy to survive in the world market on its own feet, it needs an industrial restructuring with the aim of strengthening its competitiveness through exchanges with the market economy. Since it is also desirable for the South Korean economy to undergo an industrial restructuring, the two economies should strengthen their international competitiveness by maximizing the industrial complementarity between them.²

In strengthening the North Korean economy's competitiveness via cooperation with the South Korean economy, the foremost priority should be on the expansion of its infrastructure. SOC-related projects such as the construction and improvement of roads, railways, ports, airports, communication, electric power, and trans-

² For more on the directions of industrial restructuring for the North and the South Korean economies, refer to Chan-woo Lee, "Promising Industrial Sectors for Inter-Korean Economic Exchanges and Cooperation in the Era of IMF," *The Unified Korean Economy*, Hyundai Research Institute, March 1998.

portation bases, as well as land development projects such as the development of industrial complexes and tourist sites would be the prime target for inter-Korean economic cooperation.

Balanced development of the national economy demands that we secure foundations for the North Korean economy's spontaneous development and increase the industrial complementarity between the North and the South Korean economies. In order to accomplish these goals, we should concentrate our efforts on the following six areas.

- ① Expansion of infrastructure
- ② Increase of agricultural production
- ③ Stabilization of energy supply
- ④ Expansion of inter-Korean economic cooperation in industries such as clothing, chemical, non-ferrous metal, steel, machines, and electric & electronic.
- ⑤ Introduction of advanced technology and international standard system
- ⑥ Cultivation of manpower for trade and market economy management

Tasks for Stabilizing Inter-Korean Economic Cooperation: With Focus on the Signing of an Agreement on Investment Guarantee

In order to promote inter-Korean economic cooperation, it is necessary above all for both the South and the North to review all the relevant laws and regulations comprehensively and revise them, if necessary. Here we will omit an analysis on the revision of legal systems in general, and focus on how to secure institutional devices that are necessary to guarantee trade and investment.

In general, agreements on investment guarantee and prevention of double taxation should be signed for investors to expand their investment without worrying about investment risks. The two Koreas have already agreed to sign those agreements in 1992. According to the "Protocol on the Implementation and Observance of Chapter III, South-North Exchanges and Cooperation, of the

Basic Agreement," "South and North Korea shall determine, through agreement, the procedures for the guarantee of investment, the avoidance of double taxation, the procedure for arbitration disputes and other matters necessary for the smooth implementation of economic exchanges and cooperation." Moreover, the two sides have also agreed on the settlement by a clearing account, the principle of tax exemption, exchanges of industrial standards, and protection of industrial property rights. What remains to be done is to simply implement what was already agreed.

At the initial stage of economic cooperation, the most urgent institutional device is an agreement on investment guarantee.³ Of course, business risks are to be borne by investors themselves, but non-business risks should be mitigated by an agreement on investment guarantee. Given the reality that the two Koreas cannot but recognize each other as lawful governments despite the special relationship between them, signing such an agreement would be the only realistic way of protecting investors.⁴ Paradoxically, the signing would be also meaningful in that it would officialize the mutual recognition and thus institutionalize economic cooperation under the condition of peaceful coexistence.

If one examines various bilateral agreements on investment guarantee that are now being applied in the world, one can find some common elements among them, although their specific contents may vary. These common elements are shown in <Table 4>.⁵

As can be seen at the Table, an agreement on investment guarantee is an institutional device that secures compensations for erro-

³ An agreement on investment guarantee, of course, does not guarantee the success of investment. In making investment decisions, investors should put the heaviest weight on the prospect for the profitability of investment.

⁴ China has not signed an agreement on investment guarantee with Taiwan, since the former does not recognize the latter. Instead, the country enacted a special regulation for Taiwanese investment in China. East and West Germany did not even discuss the signing of an agreement on investment guarantee, as no investment was made between the two. For reference, North Korea signed agreements on investment guarantee with several countries in the last three years, including Egypt (August 1997), Rumania (January 1998), Malaysia (February 1998), Bulgaria (June 1999), Mali (September 1999), and Indonesia (February 2000).

⁵ An agreement on investment guarantee, in its present form, first appeared in 1958 when Germany and Pakistan signed an agreement to guarantee investment. As German investors lost many of their overseas properties after the Second World War, Germany was one of the most aggressive countries in protecting foreign investment. For more, refer to Kwan-ho Kim, *International Norms on Investment Protection*, KIEP, 1996.

<Table 4> General Contents of Bilateral Agreements on Investment Guarantee

Regulations on Investment Protection	General Standards	<ul style="list-style-type: none"> - fair and equal treatment and constant protection and security on investment - application of the more favorable one between domestic laws and MFN status in relation to management, use, possession and disposal
	Exceptions to MFN Status	<ul style="list-style-type: none"> - exceptions to Regional economic communities (customs unions, free trade areas, monetary unions, common markets) tax - exceptions to MFN status
	Expropriation	<ol style="list-style-type: none"> 1) definition: expropriation, nationalization, or measures with similar effects 2) conditions: public purpose, non-discriminatory method, and compensation 3) compensation: swift, appropriate, and effective
	Compensation for loss	<ul style="list-style-type: none"> - In compensating losses due to war, military confrontation, and national emergency, investors deserve the status of either natives or MFN
	Repayment by Proxy	<ul style="list-style-type: none"> - In case investors' home government or designated institutions compensate for the losses due to non-business factors, they succeed all the rights and claims the investors might have toward the local country.
Dispute Settlement	State vs. state	<ol style="list-style-type: none"> 1) deliberation: priority on diplomatic solution 2) arbitration: <ul style="list-style-type: none"> - Within two months after receiving a request for arbitration, a court of arbitration is formed, which is composed of judges appointed by each party and the head judge of a third country. - Decisions are made by the principle of majority rule and are binding. - Court costs are to be paid equally by the parties.
	Investor vs. state	<ul style="list-style-type: none"> - Priority on favorable settlement through negotiation and adjustment by concerning parties - If negotiation fails, the dispute is transferred to international court of arbitration. (ICSID) - Investors are to utilize domestic relief measures before going to international arbitration.

Source: Kim Kwan-ho, *International Norms on Investment Protection*, KIEP, 1996.

neous remittances and non-business losses as well as fair arbitration while obeying the concerned parties' internal investment-related laws and regulations.

The major forms of external economic cooperation for North Korea are "joint venture" and "contractual joint venture." Joint venture refers to a form of economic transaction where companies from more than two countries form a single company (called joint venture company) and the investing parties manage it collectively. On the other hand, contractual joint venture refers to a form of economic transaction where companies from more than two countries organize a single company (called contractual joint venture company) and only the North Korean party has the rights over its management. Foreign investment without any North Korean involvement is allowed, but only within the Rajin-Sonbong Free Economic and Trade Zone.

It should be noted, however, that all the North Korean laws and regulations on investment are applied only to investment by foreigners and Koreans abroad. Since South Koreans are not counted as Koreans abroad by the North's standard, South Korean investment cannot be protected by North Korean laws. Likewise, South Korean investment cannot be fully protected even by an inter-Korean agreement on investment guarantee, which is supposed to conform to the domestic laws of both sides. North Korea, therefore, should first devise new institutional measures, something like South Korea's "Law on South-North Exchanges and Cooperation," with which to treat South Korean investment favorably in both official and practical terms.

Concluding Remarks

The success of the summit has provided us with a firm belief that we can form an economic community and move to the goal of a peaceful unification on our own. As the vision for unification becomes more clear, we are in a greater need of realistic posture. The spirit of "symbiosis and balance" that seeks common prosperity on the basis of coexistence is required especially in the area of inter-Korean economic cooperation. ■■■