

## U.S. - NORTH KOREA ECONOMIC COOPERATION\*

### *N. Korea Hardly Attractive Economically*

In discussing the economic relations between the United States and North Korea, one obvious point is often overlooked: the economic benefits to the U.S. from such cooperation pale by comparison to the benefits from its enduring partnership with South Korea.

For example, South Korea's combined two-way trade with the U.S. may top \$ 43 billion this year - perhaps \$24 billion in U.S. exports. North Korea's total trade with the whole world is only \$2 billion. Even if the U.S. could instantly (some would say miraculously) achieve the same level of market access in North Korea as in South Korea, this would represent a mere \$200 million of U.S. exports per year. Realizing even this objective would depend critically on North Korea's economic performance and the availability of international financing. North Korea's track record in this respect is not good.

The same point could be made concerning investment prospects for North Korea. U.S. investment in South Korea reached about \$3.6 billion last year, and is running at \$300-400 million per annum. A comparable level of investment in North Korea would be roughly \$15 million per year. True, the level of foreign investment in an emerging economy like North Korea's could be much higher than in a mature economy like South Korea's. North Korea has recently launched an all-out offensive to attract foreign investment. But this is not the Cold War era, when abundant U.S. capital flowed freely to a selected group of capitalist economies. Today everyone - from the former Eastern Bloc to Vietnam - vies for the same scarce capital resources. U.S. firms are arguably the least willing to part with their cash.

Against this backdrop, it is hard to understand the concern that South Korean businesses

will be pushed aside if U.S. firms rush into the North Korean market. One can only conclude that this concern reflects political rather than economic considerations. One argument might be that if North Korea cooperates economically with the U.S. it will feel less pressure to resume South-North dialogue. The record shows, however, that the U.S. has been and will continue to be extremely cautious about lifting economic sanctions against North Korea. As in the light water reactor (LWR) project, moreover, South Korean firms can be expected to play a central role in U.S. economic cooperation with North Korea.

### *Current Sanctions in Force*

The U.S. maintains a full battery of legal barriers to economic cooperation with North Korea: the 'Trading with the Enemy Act' and the 'Export Administration Act' require licenses for all commercial contracts; the 'Trade Agreement Extension Act' denies most favored nation treatment; the 'International Traffic in Arms Regulation' prohibits arms sales; the 'Foreign Assistance Control Act', among others, bans bilateral foreign aid; and other amendments restrict support for lending from multilateral institutions. None of these measures will be easy to dismantle.

On January 20, the U.S. announced an initial package of sanctions easing measures to meet its commitment under the Geneva Agreed Framework. Sanctions were eased in the following areas: travel, journalism and telecommunication; financial transactions; trade in a specific commodity (magnesite); and energy sector projects. However, the comprehensive embargo under the 'Trading with the Enemy Act' remains in force. Relevant Treasury Department regulations prohibit U.S. persons from providing any

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\* This article represents the author's personal views and not necessarily the official policy of the U.S. Government.

goods, services or technology to North Korea without a license. They also prohibit entering into any binding agreements, including agreements for the delivery of goods, services or technology at a future date, without a license. Finally, U.S. sanctions may also be enforced against any persons determined by the Treasury Department to be acting substantially for or on behalf of North Korea (i.e., "specially designated nationals" of North Korea). U.S. firms - and their foreign subsidiaries - must keep these legal issues in mind in any and all discussions with North Korean representatives.

The measures make an important distinction between 'general' and 'specific' licenses from the Treasury Department. Certain transactions are generally authorized, i.e., Americans do not need to request licenses on a case-by-case basis. Such transactions include those related to trade in informational materials, travel to and within North Korea, North Korean travel to the U.S. (possible, but with a visa from the Department of State), certain telecommunications services and payments, certain dollar clearing transactions, and the operation of future liaison offices.

As a result of the new sanctions policy, all restrictions on group travel, the use of credit cards, and maximum per diem expenditures have been lifted; AT&T has received approval to set up telecommunications links; and U.S. banks no longer block North Korean funds used to clear dollar-denominated trade and financial transactions with third countries. Direct U.S. - DPRK financial transactions, however, remain prohibited, except in certain areas (e.g., trade in magnesite) or by license (e.g., humanitarian sales of grain).

As reported in the press, one U.S. firm recently signed contracts to import \$5-10 million of North Korean magnesite per year. At least one contract was signed directly between the U.S. firm and the DPRK. To date, another U.S. firm has received a Treasury Department license to negotiate magnesite contracts of similar magnitude. Licenses

have also been issued to U.S. Government agencies for heavy fuel oil shipments and spent nuclear fuel storage, as well as to one private firm concerned with the spent fuel storage. An additional license may be granted to another private company to establish a joint venture to operate the petroleum complex in Sonbong designated to receive heavy fuel oil shipments under the Agreed Framework.

The Jackson-Vanick Amendment prohibits the provision of food aid and/or concessionary financing to North Korea. However, U.S. regulations have long permitted licensing commercial sales and humanitarian donations of food to the DPRK. In March, the Commerce Department licensed a sale of U.S. grain to the DPRK, and the Treasury Department recently approved a small donation of Chinese-origin corn by a private U.S. charity having links to South Korea.

### *Future Cooperation*

Cooperation in the near term will focus first and foremost on the LWR project and related energy projects. Following the June 13 Kuala Lumpur Joint Statement, North Korea and the Korean Peninsula Economic Development Organization (KEDO) will begin detailed discussions on North Korea's LWR. The process will include the assignment of a South Korean prime contractor and sub-contractors. South Korea will play the central role in building and financing the project, which in turn is a prerequisite for continued U.S. - North Korea economic cooperation.

Further progress in easing sanctions against North Korea will depend on North Korea's implementation of the Agreed Framework and the resolution of other areas of U.S. concern, including: ballistic missile proliferation, terrorism, promoting inter-Korean dialogue, recovery of remains of those missing in action during the Korean War, and North Korea's conventional military threat. There is no particular road map,

but South Korean policy toward economic cooperation with North Korea will be a major factor in framing U.S. policy.

As relations improve, U.S. firms are unlikely to expose themselves to risk in North Korea without South Korean backing. In addition to international communications companies, a few consumer products giants may 'go it alone' to exploit the advertisement value of being the first to enter the exotic and hitherto closed North Korean market. Most, however, will favor joint approaches with South Korean firms having access to government guarantees. U.S. firms already operating in South Korea are arguably the best positioned to enter the North Korean market in the near future.

This is especially true in the light industrial sector, where U.S. manufacturers have long lost their general comparative advantage. The shoe industry, for example, has been cited as one area of potential interest. Although most of their production is done on commission, U.S. shoe manufacturers will want to maintain strict quality control, especially in an underdeveloped market like North Korea's. As in China, interested U.S. firms will prefer South Korean partners in such operations.

The same could be predicted for the textile industry, where garments made from U.S. designs could be sub-contracted to North Korean manufacturers. Even with a license, however, North Korean manufacturers will be unable to benefit from lower, most-favored-nation (MFN) tariffs. This is an obstacle today for Daewoo, which has been given the green light to begin joint manufacturing operations in North Korea. Should the U.S. permit imports of North Korean textile goods on an MFN basis, the problem of how to assign textile quotas will pose another hurdle to bilateral economic cooperation. Again, the most likely form of cooperation in this sector will involve joint ventures that target South Korea or other markets outside the U.S.

North Korea's emphasis on large, state-run

farms is an obvious match for U.S. firms, which are world leaders in modern agricultural production and management. But how will such farms pay for themselves, if authorized? The only practical possibility is for South Korea or other Asian markets to provide the import market. The purchasing power of the North Korea is simply too limited to support such ventures, in the absence of international financial guarantees. Once again, this means that South Korean companies and the South Korean government will have to be active in these ventures. The U.S. is required by law to oppose all lending by international financial institutions to Terrorism List (including North Korea) countries "by voice and vote". Obviously, if international financing from the Asian Development Bank and other institutions becomes available, the potential for cooperation in infrastructure projects will increase. As in the LWR project, however, the U.S. comparative advantage is in the engineering and management of such projects. The lion's share of the subcontracting will be taken up by firms from other countries, especially South Korea.

It is reasonable to conclude, therefore, that for U.S.-North Korean economic cooperation to reach its full potential, joint ventures with South Korean firms will be absolutely essential. This is precisely why the American Chamber of Commerce in Korea has asked the U.S. government to ease the regulations prohibiting overseas U.S. subsidiaries or joint ventures from dealing with North Korea without a U.S. license. So far, the U.S. government has retained this tough provision of the Trading with the Enemy Act. Even when this unique provision is lifted, however, it can be expected that U.S.-North Korea economic cooperation will be dictated first and foremost by the pace of inter-Korean economic cooperation.

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