

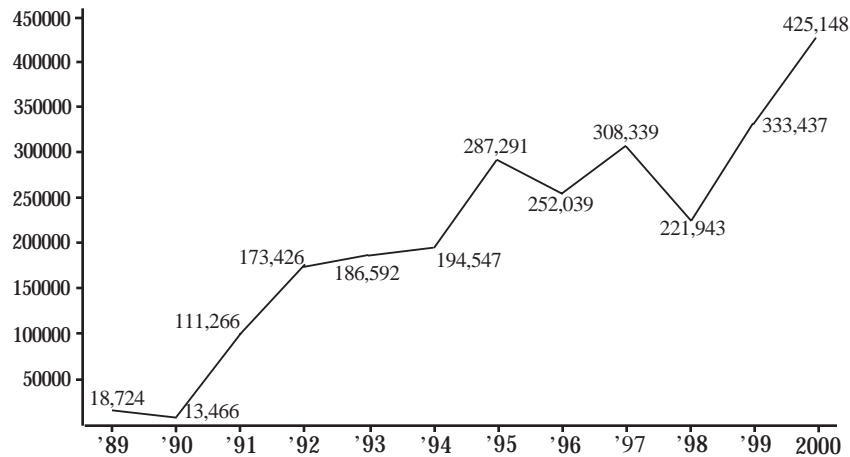
## **After the Summit: The Future of Inter-Korean Economic Cooperation**

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### **THE CHANGED ENVIRONMENT AFTER THE SUMMIT**

**A**fter the inter-Korean summit last year and the subsequent announcement of the June 15 Joint Declaration, South and North Korea were able to reconcile and expand cooperation with each other for the first time in half a century, since the division of Korean peninsula in 1945. In order to implement the agreement made between the two Korean leaders, four ministerial talks were held after the Summit. And also, based on the agreements reached during the ministerial dialogue, a series of inter-Korean meetings followed. These meetings included talks between defense ministers, military working-level talks, Red Cross talks and economic working-level talks. Through these meetings, the two Koreas discussed concrete ways to promote joint inter-Korean project, some of which are currently being undertaken.

Notably, the area of inter-Korean economic cooperation, the most visible change is that both Koreas have started to build a formal consultative body on the governmental level. That central consultative body held four ministerial talks between July 19 and December 12,

**<Figure 1> Inter-Korean Trade Volume** (Unit: 1,000 US\$)

2000, During which, both countries signed four agreements as stipulated in the joint press statement, and also agreed to hold working-level meetings on economic cooperation and to establish the Inter-Korean Economic Cooperation Promotion Committee (IKECPC). Two rounds of working-level talks, in September and November, and the first meeting of the IKECPC, on December 26, 2000, were held in Seoul and Pyongyang. All those meetings have contributed to establishing a formal inter-Korean cooperation mechanism. Until now, discussions at those meetings have focused on several issues: reconnection of the Seoul-Shinuiju Railway and the Munsan-Kaesong Highway; institutionalization of inter-Korean economic cooperation; completing the Imjin River basin joint flood prevention project; providing Food loans to the North; opening a fishing zone in the East Sea; and allowing visits by North Korean businessmen to observe the business environment in the South.

The institutionalized cooperation mechanism was a long-cherished desire of private investors who engaged in, or attempted inter-Korean economic cooperation. Since the signing of the 1992 Inter-Korean Basic Agreement, which legalized inter-Korean exchange,

inter-Korean trade has gradually increased year by year, although there have been ups and downs. There were also some astonishing investments, but most of those exchanges was based on individual contracts between North Korean authorities and South Korean business partners, Hyundai or Daewoo, and were not based on any common legal or institutional foundation. Genuine business cooperation was not able to expand or deepened. Unless such cooperation is enhanced, inter-Korean economic cooperation will not generate sufficient financial outcome in the long term.

#### **INSTITUTIONALIZATION OF INTER-KOREAN ECONOMIC COOPERATION**

In this vein, during the second round of ministerial talks, the two Koreas agreed to develop an institutional mechanism that minimized political and ideological influences in order to control and support inter-Korean exchange and cooperation. Subsequently, at two rounds of working-level meetings, they initiated agreements in four areas, including investment protection, prevention of double taxation, procedures for commercial dispute resolution and settlement clearance. The four agreements were signed formally by the heads of both delegations during the fourth round of ministerial talks and they will go into effect after both sides complete necessary internal procedures to ratify the agreements and exchange the documents.

##### *Investment Protection*

The Agreement on Investment Protection stated clearly that both sides would provide protection for assets of investors from the other side and guarantee free investment-related activities including the transfer of proceeds, and the ability to enter and stay in each other's territory. The agreement prohibited, in principle, any act of expropriation by the state and, when expropriation is unavoidable, it

stipulated a provision for the payment of sufficient compensation.

This enables South Korean businesses to invest in North Korea without fear of their investments being confiscated by North Korean authorities. It also enables them to carry out business activities freely in North Korea while being treated as well as, or sometimes even better than other foreign companies.

#### *Prevention of Double Taxation*

The Agreement on Prevention of Double Taxation on Income clarified the governmental rights of both South and North Korea on tax collection, so as to avoid double taxation on income generated during the process of promoting inter-Korean economic cooperation. Taking into account the considerable differences in the tax systems, the two Koreas prescribed in this agreement the ownership and scope of rights to collect tax on such types of income as business profits, interest earnings and royalties. The agreement also provided for procedures for avoiding double taxation, exchanging tax information and resolving tax disputes.

Thus, South Korean businesses investing in North Korea are now exempt from paying taxes twice (27 percent in South Korea and 13 percent in North Korea) on the same earnings, and thereby expect to enjoy a 13 percent tax deduction, leading to an increase in net income.

#### *Procedures for Commercial Disputes*

In the Agreement on Procedures for Resolution of Commercial Disputes, South and North Korea consented to create a joint dispute resolution body. The agreement prescribed the creation and function of a South-North Commercial Dispute Arbitration Committee and the procedures for dispute resolution. It also assured that both sides would respect decisions made by the arbitration committee.

Because of differences in the economic systems and customary business procedures, disputes are likely to arise during the course of

promoting economic cooperation. In the past, since the two Koreas had failed to agree on a procedure for dispute resolution, one side often had to suffer from unilateral loss. With the signing of this agreement, the two Koreas finally paved the way to quick and rational resolution of commercial disputes as they arise.

#### *Settlement Clearance*

In the Agreement on Clearing Settlement, the two Koreas agreed to settle the payment of certain traded goods as determined by mutual agreement through a special settlement clearance system. The agreement provided for matters related to the operation of the settlement clearance system, including the scope and quantity of the goods transacted through such a system, the maximum size of the credit line extended to each side and designation of a settlement clearance bank. In addition, the two sides agreed that the payment for the transaction of goods not included in the settlement clearance system would be made pursuant to the general means of settlement practiced in the international market, thereby paving the way to a system of direct account settlement between the two Koreas.

Up to now, accounts in inter-Korean trade had been settled indirectly either via a bank in a third country or through a middleman. The finalizing of the settlement clearance agreement makes direct settlement between the two Koreas possible. This will cut both the transaction time and costs of inter-Korean trade. Trade is expected to grow in the future, led particularly by an increase of trade in mutually supplementary areas.

The signing of these four economic agreements has, for the first time in history, established a set of common norms to be applied to inter-Korean economic cooperation based on consensus between the two Koreas. Economic cooperation between the two Koreas will be placed hereafter under a set of common norms and systems agreed upon and managed by the two Koreas. This may also contribute to speeding up the institutionalization of inter-Korean cooperation in

other areas.

In spite of the agreements, however, inter-Korean relations have been deadlocked since the inauguration of the new U.S. administration. Pyongyang halted all inter-Korean dialogue during the period of the U.S. North Korea policy review. In consequence, discussions of follow-up measures for the four achievements, as well as implementation of governmental-level cooperative business, have been delayed. It is hoped that with talks between the U.S. and North Korea, and resumption of inter-Korean dialogue, economic cooperation will be revitalized.

<Table 1> Inter-Korean Trade Volume (Unit : 1,000 US\$)

Year	Nominal Trade Volume	Non-Commercial Exchanges							Inflow	Real Trade Amount	Balance of Trade	
		Outflow									Nominal account	Real Account
		LWR	Aid	Heavy Oil	Mt. Kum-gang	Cooperation Project	Sub Total					
1989	18,724								18,724	-18,586	-18,586	
1990	13,466								13,466	-11,090	-11,090	
1991	111,266								111,266	-100,172	-100,172	
1992	173,426								173,426	-152,300	-152,300	
1993	186,592								186,592	-169,742	-169,742	
1994	194,547								194,547	-158,049	-158,049	
1995	287,291		217	10,778				10,995	276,296	-158,419	-169,414	
1996	252,039		1,437	12,782				14,255	237,784	-112,761	-127,016	
1997	308,339	17,842	8,389	29,019				55,250	2,788	250,301	-77,799	-133,049
1998	221,943	3,954	15,628	19,891	37,551	1,197	78,149	105	143,689	37,415	-40,629	
1999	333,437	14,434	43,426	39,512	40,575	6,332	144,279	122	189,036	90,228	-53,929	
2000	425,148	35,609	104,477	7,192	14,680	17,166	179,052	1,856	244,240	120,402	-56,794	
<b>Total</b>	<b>2,526,218</b>	<b>71,839</b>	<b>173,574</b>	<b>119,102</b>	<b>92,734</b>	<b>24,695</b>	<b>481,980</b>	<b>4,871</b>	<b>2,526,271</b>	<b>-710,873</b>	<b>-1,190,770</b>	

### A REVIEW OF INTER-KOREAN TRADE

In the past, the total volume of inter-Korean trade was under \$20 million annually. However, with the establishment of relevant rules and regulations, including the Inter-Korean Trade and Cooperation Act in August 1990, the trade volume exceeded \$100 million. Furthermore, since the adoption of the principle of separating business from politics as the overarching policy vis-a-vis the North, the Kim Dae-jung administration has allowed private firms to seek economic cooperation with the North based on their independent judgment and the economic feasibility concerns. At the same time, it has put in place various support measures, for example, Measures to Promote Inter-Korean Economic Cooperation (April 30, 1998), and the Guidelines for Providing the South-North Cooperation Fund to Inter-Korean Economic Exchanges and Cooperation Projects (October 21, 1999) among many others.

Accordingly, inter-Korean trade expanded again in the late 1990s and 2000, both in volume and range of products. While major trade products in inter-Korean exchanges had been zinc, gold, and iron until the mid-1990s, since then, agricultural, forest, and textile products top the list. Most notably, with an increase of processing-on-commission trade, the South has greatly expanded the export of raw or subsidiary materials for textile goods and electronic appliances to the North, after which the South has imported the processed products again.

Inter-Korean exchanges have been conducted in the form of business-to-business trade, and payments settled according to an

<Table 2> Firms and Items Involved in Inter-Korean Trade, by Year

	'89	'90	'91	'92	'93	'94	'95	'96	'97	'98	'99	2000
Manufacturers	30	38	100	147	127	145	258	333	442	378	581	652
Items	26	26	61	100	101	159	263	280	385	486	525	647

**<Table 3> Processing-on-commission Trade** (Unit: 1,000 US\$)

Year	'92	'93	'94	'95	'96	'97	'98	'99	2000	Total
Amount	839	7,008	25,663	45,892	74,402	79,069	70,988	99,620	129,190	532,671

international trade standard based on the U.S. dollar. Even so, inter-Korean exchanges temporarily dropped to around the 200 million-dollar level in 1998, due to the South's recessive economy. By 1999, however, it had risen to the 300 million-dollar level and in 2000, had increased to over 400 million dollars. This boost, however, has been attributed to the expansion of non-commercial transactions such as food aid and KEDO-related shipments of oil and light-water reactor (LWR) components since 1995. In fact, it is obvious that actual inter-Korean commercial interactions have remained flat, at the 1997 level. The business environment in the North is still stringent, preventing any expansion of commercial interactions between the two countries over the past five years. Moreover, the South has recorded a trade deficit with the North every year, except 1999 when it drastically cut imports from the North. Nevertheless, South Korean participation in inter-Korean exchanges is steadily rising, evidenced by an increase from 30 companies in 1989 to 652 at the end of 2000.

#### *Processing Trade*

One of the most effective ways to boost inter-Korean economic exchanges is through commission-based processing trade. Processing-

**<Table 4> Firms and Items Involved in the inter-Korean Processing-on-commission Trade**

Year	'92	'93	'94	'95	'96	'97	'98	'99	2000	Total
Manufacturers	4	7	9	18	38	48	72	132	151	479
Items	9	36	65	84	113	98	144	169	238	956

on-commission trade is a form of inter-Korean trade in which South Korean companies send raw materials to North Korean manufacturers for processing and then re-import the products in either finished or semi-finished forms. Commission-based procession trade, which commenced in 1992, had reached the 10 million-dollar level in 1994. By 1996, it stood at 70 million dollars, and had reached 100 million dollars by the end of 2000. In addition, the number of participating businesses and trade products in the processing trade has risen steadily, with participants increasing from four companies in 1992 to 151 in 2000. Trade products have been diversified as well. Once, only simple items such as agricultural products, textiles, and shoes were processed, but now color television, auto-wiring, computer monitor boards, and cassette tapes roll off North Korean assembly lines.

In another positive move, North Korea, during the fourth session of the 10th Supreme People's Assembly on April 5, 2001, enacted three trade-related laws including a new law on the promotion of processing trade throughout the country. Prior to this, North Korea had no law governing processing trade. The closest equivalent was the Regulation on Processing Trade in Free Economic Trade Zones enacted in 1996 exclusively for the Rajin-Sonbong area. The new Processing Trade Law is considered to be clear evidence of the North's deep interest in inter-Korean processing-on-commission trade. With its North's adoption of the law, processing trade could be included in the national planning system. In the end, it will play a positive role in opening the North's economy.

#### *Governmental-Level Cooperation*

Among the inter-Korean governmental-level cooperative businesses, the Seoul-Shinuiju Railway reconnection and Munsan-Kaesong road construction are highlighted. Under the plan, the South, with an estimated cost of 15.12 billion won—63.9 billion won for the railroad and 87.3 billion won for the road, will reconnect the twelve kilometers of railroad track from Munsan to the Military Demarcation

**<Table 5> Governmental Approval for Cooperation Projects**

Year	'90	'91	'92	'93	'94	'95	'96	'97	'98	'99	2000	Total
Permission	-	-	-	-	-	1	-	5	9	1	2	18

Line (MDL) and construct the six kilometers of track from *Tongil-daekyo* (Unification Bridge) to the MDL. The North will connect the twelve kilometers of track from the MDL to Kaesong. Both transportation projects will contribute to expanding inter-Korean exchanges. Moreover, they will add momentum to inter-Korean economic cooperation. However, the North has withdrawn its workers from the Seoul-Shinuiju railroad construction site, following the halt of inter-Korean dialogue.

During the second round of ministerial talks (August 29-31, 2000, Pyongyang), Pyongyang made a formal request for about one million tons of grain in the form of a loan. After a comprehensive review, the South Korean government decided to provide the requested food loan to North Korea. Subsequently, in the first working-level meeting for inter-Korean economic cooperation, both Koreas signed "the Agreement on Provision of Food Loan" on September 26, 2000, and the South's Export-Import Bank and the North's Chosun Trade Bank arranged the loan contract. The agreement stated that South Korea would provide 300,000 tons of foreign rice and 200,000 tons of foreign corn to North Korea in the form of a long-term loan. At the same time, it was stipulated in the agreement that transparency of food distribution should be guaranteed. As a result, after receiving the North's report on food distribution at the second working-level meeting (November 8-11, 2000), South Korean inspectors observed the

**<Table 6> Governmental Approval for Cooperation Partners \***

Year	'92	'93	'94	'95	'96	'97	'98	'99	2000	Total
No. of companies	1	-	-	6	4	16	13	2	1	43

\* Four of them were canceled on December 23, 1999.

Pyongyang distribution area. This was first occasion on which a South Korean delegation actually conducted on-site monitoring of food distribution. Previously, when the South provided aid to the North, on-site monitoring had been impossible.

#### *Private Investment*

Considering the size of inter-Korean trade, South Korea's investment to the North remains small. Of little there is, the *Minjok Sanup Chonghoesa* (National Industry General Corporation), established by Daewoo in the South and the North's *Samchonri* Corporation are models of direct investment and joint management. The Mt. Kumgang project is the first example of independent investment, operated solely by the South's Hyundai Asan Corporation. In addition, a joint-management investment, *Pyonghwa* (Peace) Automobile Corporation, is seeking to establish an auto assembly factory, and Taechang is attempting to open Mt. Kumgang *Saemmul* (Spring Water) factory in the North. For South Korean companies to invest in the North, however, they need the South Korean government's permission. Currently, the Ministry of Unification has approved 39 companies and 18 projects to conduct such cooperative businesses. In 2000, South Korea permitted Samsung Electronics to invest in a software development project with the North, and also approved the *Pyonghwa* car assembly factory. Since their agreement on August 22, 2000, Hyundai Asan Corporation and North Korea are implementing the project of Kaesong industrial complex which is expected to boost inter-Korean economic cooperation. In the field of agriculture, inter-Korean economic cooperation is also being implemented in order to resolve the North's food crisis. One type of

**<Table 7> Number of Mt. Kumgang Tourists**

Year	1998	1999	Nov. 2000	Total
Tourists	10,554 (23th)	148,074 (255th)	201,515 (351th)	360,143 (629th)

&lt;Table 8&gt; South Korea's Humanitarian Aid to the North

(Unit: 1,000 US\$)

Period	Total Aid	General Aid	Agricultural Development	Health & Medical Service
Jun. 1995-Feb. 1998	284,080 (100%)	280,090 (98.7%)	2,100 (0.7%)	1,890 (0.6%)
Mar. 1998-Nov. 2000	185,490 (100%)	42,690 (23.0%)	126,860 (68.4%)	15,940 (8.6%)
<b>Total</b>	<b>469,570 (100%)</b>	<b>322,780 (68.7%)</b>	<b>128,960 (27.5%)</b>	<b>17,830 (3.8%)</b>

cooperation involves a corn seed development project by the Kukje (International) Corn Foundation.

#### *The Mt. Kumgang Tourism Project*

The Mt. Kumgang project has boosted both citizen and material exchanges, representing the largest cooperative venture between the two Koreas since the division of the Korean peninsula. Since the commencement of the project on November 18, 1998 and up to November 30, 2000, a total of 360,143 tourists have visited Mt. Kumgang. However, due to Hyundai's financial difficulties, the Mt. Kumgang project is on shaky ground. After two and one-half years in operation, Hyundai Merchant Marine has threatened to scrap the project, unable to pay the \$16 million in entrance fees to North Korea since this February. What is more, all of its 450 billion won in capital has been wiped out by snowballing deficits. Hyundai-Asan, the branch responsible for North Korea projects, is currently negotiating with North Corporation on the issue, and at the same time it has asked the the South Korean government for help in saving the deficit-ridden project.

#### *Humanitarian Aid*

Since the late 1980s, North Korea has suffered from severe food shortages partly as a result of structural problems in the state-planned

**<Table 9> South Korea's Aid to the North** (Unit : 1,000 US\$)

Period		Jun. 1995-Feb. 1998	Mar. 1998-Nov. 2000	Total
Government	Sum	261,720	117,880	379,600
	Average	98,150	42,870	70,080
Private	Sum	22,360	67,610	89,970
	Average	8,390	24,590	16,610
Total	Sum	284,080	185,490	459,570
	Average	106,530	67,450	86,690

economy, and partly because of continued floods and drought. In 1995, North Korea requested food assistance from international organizations for the first time in its history. Out of humanitarian concern, the South Korean government, as well as South Korean citizens, have mobilized to aid the North. The South sent 150 thousand tons of rice worth 185 billion won to the North from June through October of 1995. In addition, the government has participated in humanitarian relief programs sponsored by UN organizations such as the World Food Programme (WFP) and the United Nations Children's Fund (UNICEF) since 1996.

The Kim Dae-jung government continued to offer humanitarian aid to the North, despite domestic economic difficulties. In the year 2000 only, the government provided 30 thousand tons of maize and 10 thousand tons of flour worth \$11 million to the North. And on March 3, 2000, the ROK participated in an international effort to fight infectious diseases in the North by pledging to provide \$500,000 worth of aid to prevent and treat epidemics in North Korea.

Together with food and medical aid, the South decided to also provide fertilizer in order to jump-start North Korea's agricultural development. In 1999, it provided North Korea with 155 thousand tons of fertilizer; and in 2000, sent 200 thousand tons.

Private sector assistance became possible after the government allowed the private sector to aid North Korea through the Korean

National Red Cross in 1995, and it expanded that permit to private economic organizations in 1997. Furthermore, as private funds for aid increased, the Red Cross societies from each side agreed upon the method of inspection, monitoring of the distribution process and notification of the result of the distribution, and established direct relief aid framework in 1997.

### OBSTACLES IN INTER-KOREAN ECONOMIC COOPERATION

#### *Recent Inter-Korean Economic Cooperation*

Although there were ups and downs, inter-Korean economic exchange has gradually increased since 1992. However, the prospects for the economic cooperation in the short- and medium-term are not bright. The volume of inter-Korean trade during the first two months of 2001 was 36.8 million dollars, a decrease of 30.9 percent from 53.2 million during the same period last year. The volume of South Korean imports from the North was 17.5 million dollars, a decrease of 27.9 percent from 24.3 million dollars. South Korean exports to the North also decreased by 33.4 percent from 29.0 million dollars during the same period last year to 19.2 million dollars. The net decrease was caused by a large drop in exports of machinery and transportation equipment, primary industry products, and electric and electronic products, although those of textile and chemical products increased slightly.

The decrease in inter-Korean trade was caused by several reasons: First, the South's recent staggering economy has cast doubt on the future of inter-Korean economic cooperation. Several economic institutions, including Bank of Korea, have been pessimistic about whether the South can recover in the second half of this year or early next year. To make matters worse, most South Korean companies have reduced or even cancelled investment. Moreover, since the business environment in the North is inhospitable, only a limited number of

South Korean companies—mostly, marginal companies—have shown interest. Considering South Korean business' pivotal role in inter-Korean economic exchange and cooperation, the short- and medium-term predictions for inter-Korean trade are gloomy. And while the South Korean government raised 500 billion won in South-North economic cooperation funds in order to galvanize inter-Korean exchanges, implementing the funds will not be easy, for the South Korean government to draw a consensus from its citizens.

Secondly, the business environment in the North lacks transparency. Even though North Korea has tried to improve its business environment, as evidenced by the opening of Kaesong Industrial Complex and North Korean leader Kim Jong-il's visit to Pudong in China, many foreign companies still consider the North one of the most difficult business partners. Even foreign companies, including those owned by Chongryun (pro-Pyongyang Korean residents' association in Japan) members, have not been successful in such investment since the mid-1980s, because of the harsh business environment. North Korea needs to establish a more concrete framework for transparency, such as laws on business investments and on special economic districts, and then it must faithfully implement that framework.

In 2000, South and North Korea established the Inter-Korean Economic Cooperation Promotion Committee, the first inter-Korean institutional mechanism, which should have put inter-Korean economic cooperation on the right track. However, North Korea abruptly postponed all inter-Korean dialogue, hence, the two sides have not held a second meeting to implement follow-up measures and to narrow their differences.

Thirdly, the international environment surrounding the Korean peninsula is uncertain. The Bush administration may not totally change its foreign policy toward the Korean peninsula, but it will certainly make partial changes. In that case, U.S.-North Korea talks will continue to be deadlocked. As a consequence, U.S. economic sanctions against the North will not be lifted any time soon, and will

remain a negative influence on inter-Korean economic cooperation.

*Systemic Obstacles in Expansion of Inter-Korean Economic Cooperation*

The fundamental differences in economic systems as well as the political confrontations between South and North Korea have hindered the expansion of inter-Korean economic cooperation. In order to implement stable and developmental inter-Korean exchange, those systemic obstacles should be removed.

First, establishing an efficient communication system between the two Koreas is the key to promoting the economic exchanges. Meetings as well as correspondence between the two Koreas have been strictly controlled since the division of the Korean peninsula, and South and North Korean businessmen have rarely had opportunities to meet each other so they could discuss with inter-Korean economic exchanges.

Secondly, the infrastructure for inter-Korean exchanges is deficient. In particular, the payment methods and logistical distribution system between the two Koreas are still primitive. Even though both countries have agreed to settle the payment on certain traded goods as determined by mutual agreement and through a special settlement clearance system, this method, employed among socialist countries in the past, is obsolete and rarely used in this day and age.

Furthermore, there have been repeated requests by South Korean companies to build and diversify the regular freighter route. Currently, transportation logistics between the two Koreas is dependent on irregular marine transport. This inadequate and unpredictable transportation has been a huge obstacle to expansion of inter-Korean exchanges. To make things worse, shipping between South and North Korea was stalled for six month beginning last November after North Korea denied the entry of Hansung Shipping vessels into Nampo Port. Those Hansung cargo ships transported more than 95 percent of the products manufactured under the

processing-on-commission trade agreement. Without a firm governmental agreement on maritime trade as well as on other routes, another major losses will be incurred. As an alternate solution, however, rebuilding the Seoul-Shinuiju Railway would quickly facilitate inter-Korean transportation flow by re-connecting the main artery of the national economy.

Thirdly, South Korean technicians must endure a long and complicated procedure when they enter the North. In processing-on-commission trade, a typical form of inter-Korean economic cooperation, the South usually consigns production of goods to the North and then imports the processed products from the North again. After China started to predominate in markets of medium- and low-priced products, the South began targeting medium- and high-priced items produced through high technology. In the case of textile processing, the North has sometimes denied entry to South Korean technicians arguing that since they (the North) are the experts on textile technology, they do not need technological help from South Koreans. Furthermore, sophisticated production facilities provided to the North for processing have broken down frequently due to poor handling by North Korean technicians. Then, as a consequence, malfunctioning equipment could not be repaired in a timely manner because of the lengthy procedure involved for South Korean technicians to enter the North. This in turned delayed the production schedule.

Lastly, North Korean currency is too highly valuated. With the exchange rate one of the most important factors in trade, North Korea's official exchange rate is 2.15 North Korean won per one U.S. dollar. However, in the Rajin-Sonbong industrial complex, one dollar is being exchanged for 200 won. This means that the official exchange rate is around 100 times more highly valuated than that in the market. The North's labor costs, real estate prices, as well as most retail prices are also too high. Thus, North Korea's official exchange rate should be adjusted to properly reflect its real economy properly.

### LESSONS FROM CHINA AND VIETNAM

China received a total of 406.9 billion U.S. dollars of foreign capital between 1979 and 1998, in order to implement its market opening. Of this, foreign loans were estimated at 127.1 billion dollars, 31% of the foreign capital; 26.3% of the foreign loans were from foreign governments, 19.2% from international financial institutions, and 54.9% from foreign private banks. There are four distinctive features regarding these foreign loans. First, the Chinese government was focused on obtain foreign capital. In the 1980s, which was the incipient period of reform and opening, the proportion of foreign loans was over 60% of total foreign capital. It dropped to 20% in the early 1990s, and remained only 18% during the late 1990s. During that time, China actively sought foreign loans, taking advantage of its huge domestic market. When it proclaimed its reform and opening, many advanced countries issued the country foreign loans since they were eager to target the huge market. With these foreign loans, China could implement various national projects. Moreover, as the projects proved successful, the inflow of private foreign capital, especially, foreign direct investment, greatly expanded.

Secondly, Japan issued a huge amount in loans to China. In total, 61% of all foreign loans were obtained from Japan. From April of 1980, when Japan signed a loan contract with China to September of 2000, Japan had issued loans of total 2,453.5 billion Japanese yen to the country. In particular, foreign loans from Japan have been issued, in line with the Five-Year Plans of China.

Thirdly, China promoted its economic autonomy, obtaining foreign loans for national basic projects from international financial institutions. Between 1979 and 1998, China obtained foreign loans totaling 24,367 million U.S. dollars from various international financial institutions, such as International Bank of Reconstruction and Development (IBRD), International Development Association (IDA), Asia Development Bank (ADB), United Nations Development

Programme (UNDP), and International Fund for Agricultural Development (IFAD); excluding International Monetary Fund (IMF) which aims at maintaining equilibrium the balance of international payments. While these loans were only 6% of total foreign loans, they played a critical role in the formative period of China's opening, since all of them were invested in national basic projects that improved the investment environment of China. Each foreign loan from international financial institutions was used for a different project: the loan from IBRD was used for transportation and energy infrastructure projects; IDA for agriculture, education, health, and water supply and drainage; ADB for communication infrastructure and the financial sector; and UNDP for education of technology.

Lastly, private Chinese companies were very active in obtaining foreign capital independently. China borrowed 69.78 billion dollars from foreign private banks between 1979 and 1998, which amounted to 17.2% of total foreign capital and to 54.9% of total foreign loans. The private loans had comparatively higher interest rates than foreign loans from international financial institutions and foreign governments. Nevertheless, Chinese private companies sought them actively, since it was very difficult for Chinese companies to use the official government loans. The U.S., which was reluctant to give official loans to China, induced foreign private banking institutions to provide Chinese private companies with commercial loans.

Vietnam has pursued its reform and opening through *Doi Moi* (Renovation) since 1986. However, it was not until 1989, when it withdrew its military from Cambodia, that Vietnam could obtain foreign loans. Vietnam obtained around 6 billion dollars from 1989 to 1998, and although the amount was paltry compared to loans for China, it was meaningful in terms of the domestic market in Vietnam. There are four characteristic features related to those foreign loans. First, improvement of the U.S.-Vietnam relations greatly contributed to Vietnam's attracting foreign capital. After Vietnam was communized, Washington imposed harsh economic sanctions against it in 1975, and in spite of its reform and opening in 1986, the U.S. did

not lift the sanctions. In 1989, however, Vietnam was able to improve foreign relations with Western countries, when it withdrew its military from Cambodia. Then, the U.S. and Vietnam began dialogues in August of 1990, and in July of 1993, the U.S. allowed international financial institutions to provide loans. Since then, the IMF, IBRD, IDA, and ADB have issued loans to Vietnam. From 1989 to 1993, around 300 million dollars of foreign loans were provided, and after the U.S. lifted sanctions in 1994, foreign loans increased to over 600 million dollars.

Secondly, the autonomy of the Vietnamese government could not be guaranteed. Before its opening, Vietnam was heavily dependant on aid from the Soviet Union, because its economy had been crippled by successive wars. Then, after the Soviet Union disintegrated, Vietnam had no other choice but to start over again by implementing drastic reforms and opening under the guidance of international financial institutions. As a result, unlike China, consultative groups from supporting countries and international financial institutions became decision-makers on Vietnam's foreign loans. In November of 1993, France, Japan, World Bank and UNDP jointly held the first Vietnam Support Meeting in Paris. In this meeting, 16 world organizations and 22 countries participated to discuss a support plan for Vietnam, including cooperative loans and rectification of the Vietnamese legal system. Moreover, in that meeting, Vietnam promised consistent and strong reform and opening; including transformation into a market economic system, an increase of social overhead capital (SOC), human resource development, and improvement of laws and regulations. Seven meetings have since been held to discuss the issuing of large-scale foreign loans. The consultative group chaired by World Bank has endeavored to increase Vietnam's financial know-how in order to utilize the foreign loans more systematically and efficiently. The results of all the outside consultation was that the Vietnamese government had to sacrifice its autonomy, and follow the reform programs set forth by international financial institutions.

Lastly, Japan played a very important role in Vietnam's foreign loans. In November of 1992, Japan, along with France, helped repay

Vietnam's IMF arrears, and enabled it to obtain foreign loans from international financial institutions. In the first Vietnam Support Meeting, they promised a loan of 550 million dollars to Vietnam.

North Korea can learn from the cases of China and Vietnam regarding foreign loans. First, the North should clarify its financial policy in order to obtain foreign loans. The choice for the North would be to adopt the Vietnam case, accepting the loan program of international financial institutions and trying to induce foreign loans from them, because it does not have a huge domestic market like China. However, it could follow China's example in maintaining its national autonomy.

Secondly, improvement of U.S.-North Korea relations is key to obtaining foreign loans. After Vietnam withdrew its military from Cambodia, the U.S. normalized relations with Vietnam and lifted economic sanctions against it. Only then, could Vietnam obtain foreign loans from international financial institutions and Western advanced countries. A case in point, North Korea recently tried in vain deal with the Asia Development Bank but was rebuffed because of U.S. objections.

Thirdly, North Korea needs to propose feasible national projects in order to induce foreign loans. In general, a lender country issues a loan according to its own evaluation of concrete projects proposed by the borrower country. Thus, North Korea should plan its national projects reasonably and propose them to the international community.

Lastly, loans from Japan will be very important during the incipient period of North Korean economic development. In China's case, as well as Vietnam's, the loans from Japan greatly contributed to improving market environment in both countries, during their early periods of development. In the North, it is expected that various loans from Japan—including ODA loans and compensation for Japan's colonial rule, will contribute to its economic development.

## CONCLUSION

The four agreements stipulated during a series of inter-governmental meetings remain future tasks for inter-Korean economic cooperation. Economic cooperation before the summit was an inducement for the North to sit at the inter-Korean negotiation table, and it worked as a carrot. Then, with the summit, it indicated its willingness to open. Now, the North needs to transform its market system in order to implement inter-Korean economic cooperation more successfully. At the same time, improvements in foreign relations with other countries will contribute to attracting foreign capital. To that end, military threats against the North as well as the North's threats against the outside world should be abandoned early on. The summit is evaluated to have greatly ameliorated those old strategies.

It is time the inter-Korean economic cooperation to be expanded into other fields of exchange. However, for this to happen, the North's progressive change is crucial. Pursuing only economic cooperation between the two entities is no longer plausible, because of their interlocking political and economic systems. Moreover, a superficial change of the North is meaningless. Given the fact that the North's National Defense Commission Chairman Kim Jong-il visited China, some have proposed that the North had begun to change fundamentally, learning from China's reform and opening. However, it seems too early to make such a prediction, because international relations are far too complex. Considering the time is ripe for the North to implement more substantial change, the strategies used by China and Vietnam to obtain foreign capital during their incipient periods of reform and opening could be very instructive, especially relating to inter-Korean economic cooperation.