Engaging North Korea

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ANU
September 2011
The North Korean Refugee Crisis: Human Rights and International Response
edited by Stephan Haggard and Marcus Noland

Witness to Transformation: Refugee Insights into North Korea

Famine in North Korea: Markets, Aid, and Reform
Stephan Haggard • Marcus Noland
Foreword by Amartya Sen

http://www.piie.com/blogs/nk
The Logic of Engagement: The Analytic Issues

- From sanctions to inducements (Kahler and Kastner; Drezner)
- Bargaining models: engagement as quid-pro-quo inducements
- Transformative models: engagement as having systemic effects
  - Kissinger and Ostpolitik
  - The Cuba, Iran and Burma debates
  - Kim Dae Jung
  - Etel Solingen, *Nuclear Logics*
The (Unarticulated) Logic of Engagement

- Cross-border exchange:
  - Enhances stakes of state actors in commercial relations
  - Strengthens private actors and de facto marketization, including market institutions and trust, which may then spill over into...
  - ...de jure marketization or reform
  - Ultimately constrains foreign policy behavior...
  - ...and changes coalitional alignments
The Logic of Engagement: the Political Issues

- Since the onset of the nuclear crisis, divided debate—in US and between US and China and South Korea—over merits of engagement

- Periodization
  - Bush 1: hostility to engagement and the logic of the Six Party Talks
  - Bush 2: return to (serious) talks, culminating in September 2005 joint statement
  - BDA
The Logic of Engagement: the Political Issues II

- Periodization (con’t)
  - The October 2006 test
  - The high-point of engagement: 2007-8
    - The February and October 2007 roadmaps
    - The initial disabling steps
    - The breakdown of 2008 (Cheney)
  - Obama administration
    - The early tests and the turn to multilateral sanctions
    - The Cheonan and Yeongpyong shelling
    - “Strategic patience”
The Six Party Talks

- What went wrong?
- US pressure strategy and sanctions flounder on coordination problems
  - China
  - South Korea through Roh Moo Hyun administration (2003-2008)
  - Cheney’s account and the difficulty of coordinating engagement.
Figure 5. China - North Korea Trade, 1982-2009

- Imports from DPRK
- Exports to DPRK
- Total Trade Volume
Figure 8
ROK Exports to DPRK by Type, 1993-2009 (MOU)

USD. Millions

- Commercial Trade
- Economic Cooperation
- Non-Commercial Trade
- Total Exports

Source: Ministry of Unification, Republic of Korea (http://www.unikorea.go.kr)
Figure 4. North Korean Trade with the World vs. the Middle East, 2000-2008

Index, 2000=100

Sources: KOTRA (Korea Trade-Investment Promotion Agency), IMF DOT (Direction of Trade Statistics)
Politics at the Top

- Kim Jong Il
  - Relies even less on the party and turns to *songun* or “military first politics”
  - But there was a short period of reform 1998-2002, including strengthened cabinet, that reversed with the onset of the crisis and from 2005 in particular
  - The perverse effects of sanctions
Foreign Ministry Statement,
October 25, 2002

New dramatic changes have taken place in the situation on the Korean Peninsula... Inter-Korean relations and the DPRK's relations with Russia, China and Japan have entered a new important phase...

The DPRK has taken a series of new steps in economic management and adopted one measure after another to reenergize the economy, including the establishment of a special economic region...

These developments practically contribute to peace in Asia and the rest of the world.

Almost all the countries except for the United States, therefore, welcomed and hailed them, a great encouragement to the DPRK.
Reform in Reverse: 2005-2010

- The assault on markets
  - Trying to revive the Public Distribution System
  - Restricting trading activities: moving people back into the state sector
  - Controlling the border
  - “150 day campaigns”

- Kim Jong Il’s stroke of August 2008
- The currency conversion of 2009
Price Levels in North Korea

Old NKW

- RICE
- CORN
- USD

January-08  | July-08  | January-09  | July-09  | January-10
“Partial” Reforms Associated with an Increase in Corruption, Inequality and Disaffection

- Corruption increased:
  - Totally Disagree: 35.3%
  - Disagree: 5.7%
  - Neutral: 32.1%
  - Agree: 54.1%
  - Totally Agree: 8.2%
  - Unclear/Don't know: 4.9%

- Had to pay bribes to engage in private activity:
  - Totally Disagree: 2.6%
  - Disagree: 4.1%
  - Neutral: 3.1%
  - Agree: 50%
  - Totally Agree: 17.2%
  - Unclear/Don't know: 21.3%

- Society became more unequal:
  - Totally Disagree: 28.7%
  - Disagree: 8.2%
  - Neutral: 55.7%
  - Agree: 4.9%

- I was better off:
  - Totally Disagree: 18.9%
  - Disagree: 21.3%
  - Neutral: 34.4%
On-the-Spot Guidance Visits by Unit Type
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Chairman</strong></td>
<td>Kim Jong Il (KWP Secretary General and Supreme Commander)</td>
</tr>
</tbody>
</table>
| **Deputy Chairman** | - Yon Hyong-muk (Chief Secretary, Jakang Province)  
- Lee Yong-mu (Vice Marshal) | - Kim Young-chun (Minister of People's Armed Forces)  
- Lee Yong-mu (Vice Marshal)  
- Oh Kuk-ryul (Director of Operations Department, KWP) |
| **Members** | - Kim Young-chun (Chief of General Staff, KPA)  
- Chun Byung-ho (Minister of Military Industry, KWP)  
- Kim Il-chul (Minister of People's Armed Forces)  
- Paik Se-bong (Chairman of the Second Economy)  
- Choi Yong-su (Minister of People's Security) | - Chun Byung-ho (Minister of Military Industry, KWP)  
- Kim Il-chul (First Vice Minister of People's Armed Forces)  
- Paik Se-bong (Chairman of the Second Economy)  
- Chang Sung-taek (Minister of Administration, KWP)  
- Choo Sang-sung (Minister of People's Security)  
- Woo Dong-cuk (First Vice Minister of National Security Agency)  
- Choo Kyu-chang (First Vice Minister of Military Industry, KWP)  
- Kim Jong-kak (First Vice Director General of Political Affairs) |
The Logic of Engagement: Doubts

- “Strong” states control the cross-border nexus
  - Either directly through SOEs or
  - Indirectly through involvement of public officials in corruption or even predation

- Externalities or spillovers from these exchanges to either market institutions, reform or foreign policy behavior may not materialize
Background

- China-North Korea natural experiment
- North Korea’s “marketization from below”
- Clear expansion of trade and investment...
- ...but of what kind?
The Nature of Cross-Border Trade

- The actors: who is engaged on both sides and to what extent private
- What is the nature of market institutions, by which we mean:
  - Networks (state vs. private)
  - Trust (extension of credit)
  - Institutions, including dispute settlement
  - Corruption
Survey

- Conducted November 2007
- 303 firms
  - 250 current
  - 10 quitters
  - 43 never-were’s
- Modality: mostly trade, some invest
- Variety of sectors
Sample characteristics

- Most private
- Most small
- Almost bimodal: A few large SOEs with long-standing ties
- 98 percent Chinese
- 40 percent report CEO can speak Korea
Again, a few SOEs with long ties

Most have entered North Korean market since 2000
North Korean counterparties

- Knowledge less complete
- Mostly SOEs—though this may be deceiving
- Considerable differences across modalities
  - Exporters most diverse
  - Investors most “official”
Business Environment

Perception of DPRK business environment: those doing business with DPRK
(share of those who agree with statement)

- New comprehensive trading mkt increases opportunity for us: 50
- It is getting easier to do business in DPRK all the time: 60
- New rules for foreign investors has helped my business: 40
- New DPRK system of taxation has helped my business: 30
- Reduction in DPRK trade barriers has helped my business: 50
- I am able to make profit in DPRK: 80
- Ban on the private trade in grain has hurt my business: 20
- Ban on cell phones has hurt my business: 30
- Risky to invest in DPRK: gov't can change the rules after we invest: 70
- It is risky to invest in DPRK because assets may be expropriated: 60
- Regulations in DPRK make it hard to do business: 80
- Impossible to do business outside the Special Economic Zone (SEZ) 70
- Tax in DPRK too high: 20
- Falling value of DPRK currency - problem for business: 50
- Quality of labor in DPRK - problem for business: 40
- Quality of basic infrastructure in DPRK - problem for my business: 80
## Introduction Networks: Decentralized

- Significant share of firms meet through direct contact
- Chinese businesses in DPRK play large role
- Governments on both side of border play small role except for DPRK in attracting FDI
- Some evidence of decentralization

<table>
<thead>
<tr>
<th>Introduction Network</th>
<th>Exporters % Share of Firms</th>
<th>Importers % Share of Firms</th>
<th>Investors % Share of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Contact</td>
<td>50%</td>
<td>27%</td>
<td>20%</td>
</tr>
<tr>
<td>Knew Management</td>
<td>6%</td>
<td>11%</td>
<td>14%</td>
</tr>
<tr>
<td>DPRK Family &amp; Friends</td>
<td>11%</td>
<td>14%</td>
<td>11%</td>
</tr>
<tr>
<td>DPRK Gov't</td>
<td>11%</td>
<td>19%</td>
<td>27%</td>
</tr>
<tr>
<td>Chinese Gov't</td>
<td>7%</td>
<td>10%</td>
<td>7%</td>
</tr>
<tr>
<td>Chinese Businesses in DPRK</td>
<td>31%</td>
<td>40%</td>
<td>37%</td>
</tr>
<tr>
<td>Chinese Family &amp; Friends</td>
<td>2%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Others</td>
<td>3%</td>
<td>3%</td>
<td>6%</td>
</tr>
</tbody>
</table>
Dispute Resolution Networks

- Large share of firms see no third party support or prefer private negotiation
- Minimal support through official DPRK channels
- Chinese government and courts relied upon especially by exporters...
- ...but firms of all types report high incidence of disputes and dissatisfaction with resolution
- In sum, weak, self-limiting institutional environment

<table>
<thead>
<tr>
<th>Dispute Resolution Channel</th>
<th>Exporter % Share of Firms</th>
<th>Importer % Share of Firms</th>
<th>Investor % Share of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>DPRK Central Gov't</td>
<td>11%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>DPRK Provincial Gov't</td>
<td>9%</td>
<td>9%</td>
<td>11%</td>
</tr>
<tr>
<td>DPRK local Gov't</td>
<td>12%</td>
<td>17%</td>
<td>21%</td>
</tr>
<tr>
<td>Chinese Gov't Officials</td>
<td>20%</td>
<td>12%</td>
<td>16%</td>
</tr>
<tr>
<td>Chinese court</td>
<td>17%</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>DPRK courts</td>
<td>7%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Other Chinese Companies</td>
<td>19%</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>DPRK Relatives &amp; Friends</td>
<td>11%</td>
<td>17%</td>
<td>16%</td>
</tr>
<tr>
<td>Other Informal Organizations</td>
<td>4%</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>No Third Party</td>
<td>26%</td>
<td>15%</td>
<td>1%</td>
</tr>
<tr>
<td>Private Negotiation</td>
<td>17%</td>
<td>31%</td>
<td>24%</td>
</tr>
<tr>
<td>Other (Third Country or Diplomatic Channels)</td>
<td>1%</td>
<td>2%</td>
<td>3%</td>
</tr>
</tbody>
</table>
Findings from multivariate analysis

- Small firms—and small private firms—(mostly exporters):
  - Are more likely to evade registration and regulation;
  - Feel less compulsion to bribe;
  - Have fewer disputes;
  - But more likely to see policy environment and property rights as a barrier to doing business
Some inferences

- Scale itself is a response to the environment: firms stay small to avoid predation...
- ...with private trade and investment self-limiting as a result
- SOE-SOE trade and investment dominates larger-scale transactions
Modeling trust

- Trust measured as extension of credit or loose settlement/payment terms
- Survey focused on main business partner, by type of activity
- What influences trust?
  - Introduction networks
  - Beliefs about dispute settlement
  - Density of firms in given sector: reputational effects or anonymity?
- Two models: simple and ordered probit on settlement terms
## Trust via provision of credit: Ordered Probit Models

<table>
<thead>
<tr>
<th>Trust: provision of credit to export clients</th>
<th>1=payment upon order</th>
<th>2=payment upon delivery</th>
<th>3=payment within 30 days of delivery</th>
<th>4=payment more than 30 days after delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intro Network: DPRK Public Sector</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Intro Network: DPRK Private Sector</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Intro Network: Chinese Public Sector</td>
<td>+</td>
<td>+</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Intro Network: Chinese Private Sector</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Intro Network: Direct Introduction</td>
<td>+</td>
<td>+</td>
<td>++</td>
<td>++</td>
</tr>
<tr>
<td>Dispute Help: DPRK public help, gov + court</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Dispute Help: Chinese settlement sources, gov + court</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Dispute Help: Chinese companies</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Dispute Help: Private DPRK help</td>
<td>++</td>
<td>++</td>
<td>+++</td>
<td>+++</td>
</tr>
</tbody>
</table>

- **Chinese and DPRK SOEs more likely to offer credit**
- **Small and private Chinese firms less likely to offer credit**
- **Direct introduction and private DPRK dispute channels positively associated with trust**
- **Length of relationship is positively associated but market concentration and trade volume upon entry are negatively associated; as more players enter, no evidence of reputational effects**
Conclusions

- Chinese networks
  - play an important role in introductions...
  - ....but neither public nor private networks are associated with greater credit
- Private and direct introduction networks have a significant impact: some evidence of decentralization
- DPRK public institutions weakly associated with credit
  - But not courts: contact with officials
  - *Guanxi* or connections are key
Conclusions

- Supporting the engagement model
  - Some evidence of decentralization and “flying below the radar”
  - Little evidence of Chinese support, in line with policy.
- Contrary to engagement model
  - Small scale is likely a response to weak institutions...
  - Corruption rampant and official contacts, not DS institutions matter
  - ...and SOE-SOE remains significant
- Self-limiting trade?