

The Political Economy of Korean Unification

Agenda Preparation

EDITED BY
YANG Un-Chul



THE SEJONG INSTITUTE

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Preface

It has been nearly a decade since the collapse of the Berlin Wall that began the swift process of German unification. Contrary to many expectations for a similar occurrence, the Korean peninsula remains as widely and tragically divided as ever. While reunification of the two Koreas also continues to be the most important national aspiration for all Koreans, there is now every indication that it could be a prolonged process. On the other hand, the geopolitical environment and South Korea's domestic politics increasingly favor the initiation of a *peaceful* unification process. The Korean unification thus faces critical long-term as well as short-term policy challenges that need to be carefully analyzed and prepared for.

The most immediate challenge, of course, is the current state of North Korea. By now, North Korea's dire economic condition is an all-too-familiar world tragedy. For several years in a row, the North Korean economy has posted negative growth rates, and its food and energy shortages have reached crisis proportions. The economy is in desperate need of reform and opening, but political uncertainties and competition with South Korea make it difficult for the new regime to concentrate its efforts on the economic problems. With no dramatic reform in sight, some predict the collapse of the North Korean regime within the next few years. Although it remains debatable whether North Korea will explode, implode or simply erode in the foreseeable future, it is obvious that the fundamental flaw of North Korea's economic system, evident since the 1970s, made the current failures virtually unavoidable.

Since the death of Kim Il Sung, North Korea seems to be muddling through

with its basic unity intact. Its new leader, Kim Jong Il, is clearly not the same charismatic and revered figure as his father. Thus far, the younger Kim seems to have been playing a mediating role. If Kim Jong Il opens the country to foreign ideals, he would risk undermining his own personality cult. That dilemma helps explain why Kim Jong Il has waited three long years to officially assume leadership of the ruling Korean Workers' Party while leaving vacant the ceremonial position of president. As Selig S. Harrison argued recently in *Foreign Affairs*, however, it would be morally indefensible and politically self-defeating for Kim Jong Il to reject outside aid in order to hold on to the *juche* ideology.

On the long-term horizon, South Korea must begin to work on active preparation for unification. In particular, Korea must begin to address actively the question of how to merge two completely dissimilar systems, and it ought to do this by first setting the long-term agenda properly. It should be clear by now that the previous focus on immediate returns is self-defeating and counterproductive. Specific steps need to be developed to achieve political rapprochement and economic cooperation, whereby the two Koreas would work together to build up a pattern of reciprocal benefits and to pave the road toward unification at minimum cost. To this end, North Korea must be induced to open up its doors to the South; this would be the step toward recovering the national homogeneity for both Koreas.

Confidence building is another important factor in the development of an ideal economic and political relationship between the two Koreas. A trustworthy and cooperative relationship in which the two countries supplement each other could lead to an eventual integration of the two into a single community. Since the two Koreas have entirely different systems, efforts to minimize political disorder and economic burden through economic interactions are critical. So far, it has been extremely difficult for the two Koreas to initiate such efforts. The primary reason for this lies in the fact that the potential costs are distributed asymmetrically; North Korea would face greater difficulties than South Korea in adapting to increased North-South contacts, which would necessitate the North to fundamentally reform its economic and political systems.

This book looks ahead to the future challenges South Korea must confront as it readies for unification. Meeting those challenges requires both a spirit of reconciliation and an eye to continued progress between the two Koreas. The essays in this collection put forth the integral aspects of the unification

agenda. Though by no means comprehensive, the collection aims to provide a substantive guide for the future.

In the course of preparing this volume, I would like to express my gratitude to all the contributors, and especially Dr. YANG Un-Chul for his work in editing. It remains to be emphasized that the views expressed in this book are those of the authors and should not be ascribed to the Sejong Institute, or to the persons and organizations whose assistance is acknowledged.

May 1998

HAHN Bae Ho
President
The Sejong Institute

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YANG Un-Chul
Editor

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Part I

Introduction

• Summary •

After the collapse of the socialist system in numerous countries, many Koreans have come to believe that the unification is not far away. Especially, German unification brought to mind an immediate question among Koreans; can the same happen on the Korean peninsula? Today, Koreans are questioning whether they can handle a possible collapse of the Northern regime and whether the South can address the ensuing economic ills. This chapter will identify major issues that could arise when North Korea is integrated into South Korea. It is clear from the German experience that even the West Germans, despite having had close contacts with East Germans for twenty years, did not adequately understand the East German economy; therefore, they were poorly prepared for economic integration.

However, it is now obvious that this German way of unification is not suited for the conditions of the two Koreas. Despite the dizzying pace of unification, Germany has failed to create internal social unity at the same rate. Although internal cleavage may develop in Korean society during the unification process, Korea can learn from Germany's errors and mistakes and thus, avoid the future problems and conflicts that could emerge in a unified Korean society.

All feasible unification scenarios will require South Korea to show a strong resolve to prepare for and achieve unification. The political and economic improvements of the two Koreas will accelerate the unification process. In this respect, South Korea needs to spur changes in North Korea by lessening mutual distrust and animosity through expanded economic cooperation. The most expedient choice for North Korea is to implement economic reform while keeping the current political power structure intact. North Korea should abandon its planned economic system and enter the international arena by adopting market mechanisms and providing profit-making incentives to its labor force.

The Political Economy of Korean Unification

YANG Un-Chul *

Give to all nations unity, peace, and accord.

- The Book of Common Prayer¹

There is absolutely no doubt that the people of the former German Democratic Republic will benefit from unification ... Even the most serious policy errors will not prevent this.

- Gerlinde Sinn and Hans-Werner Sinn²

I. Introduction

Are unity, peace, and accord in the Korean peninsula nothing but a prayer? The answer may be *yes or no*.³ After the collapse of the socialist system in

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1. *Barlett's Familiar Quotations* 16th edition, Justin Kaplan, ed. (Boston, MA: Little, Brown and Company, 1992), p. 49.

2. Gerlinde Sinn and Hans-Werner Sinn, *Jumpstart: The Economic Unification of Germany* (Cambridge, MA: The MIT Press, 1992), p. xii.

3. According to a recent survey conducted by the Sejong Institute, less than 6% of the respondents felt comfortable enough to *say no* to reunification. According to the Sejong survey, the majority of the respondents to the Sejong survey (56%), while favoring

numerous countries, many Koreans have come to believe that the unification is not far away. Observing the process of German unification brought to mind an immediate thought among Koreans about whether the same can happen on the Korean peninsula. Furthermore, the questions of whether Korea can handle a possible collapse of the Northern regime and whether the South can absorb the ensuing economic ills are being raised.

It is generally agreed that the driving force behind German unification was the unprecedented Soviet policies of Mikhail Gorbachev and the democratic revolution of the East German people. The latter, in turn, is believed to have been made possible by West Germany's economic success and mature and stable democracy, in which labor participation is firmly established. In Germany, building mutual confidence through expanded official and unofficial contacts had also been a critical factor. Exchange of visits among high-level government officials and private citizens, joint activities by private social and cultural institutions in both areas, and West German financial support for the construction of East German TV network all helped maintain social and cultural homogeneity between the two Germanies.

Given that Koreans have not held a summit meeting up to now, which in contrast, was first held in Germany twenty years ago, it will most likely take a long time to expand contacts and build trust between the two Koreas before unification is realized. Some see the possibility of a more sudden and dramatic fall of the North Korean regime through a popular revolt in comparison to the collapsed experience in Germany. This, however, does not seem very likely. Unlike East European countries, the North Korean regime had relied only slightly on the Soviet Union for its legitimacy, and its experience with a market economy or a parliamentary democracy is almost nonexistent. And in spite of recent signals that North Korea is changing slowly in some areas, the regime will most likely attempt to exclude political democratization, and instead, continue to propagate *juche*(self-reliance) ideology as the base of its legitimacy while insulating the people from the outside world. The chance of a successful popular uprising will, among other things, depend on the North Korea's economic performance, the permeability of outside information, and the flexibility of the regime to accommodate the aspirations of its people.

reunification with the North, answered that reunification should proceed slowly and with caution. For more survey on Korean unification, see *National Survey of Public Opinion* (Seoul: The Sejong Institute, 1997).

However, it is obvious that all feasible scenarios of unification will require South Korea to show a strong resolve to prepare for and achieve reunification. The political and economic improvements of the two Koreas will accelerate the process of unification. In this respect, South Korea needs to encourage changes in North Korea by lessening mutual distrust and animosity through expanded economic cooperation.

This paper attempts to identify major issues that will arise when North Korea is integrated into South Korea. It is clear from the German experience that even the West Germans, who had maintained close contacts with East Germans for twenty years, did not have an adequate understanding of the East German economy. Consequently, they were poorly prepared for economic integration. For this reason, a description of the North Korean macroeconomy is given before discussing the German experience with the process of unification. Then, the similarities and dissimilarities between the German situation and the Korean situation, and the issue of unification costs are briefly touched upon. This paper consists of five sections including brief introduction. Section II examines the present economic situation and possible economic reformation in North Korea. Section III reviews the experiences with and lessons from German unification. Section IV carefully examines various estimates on the costs of unification and their feasibility. Finally, concluding remarks will sum up this paper.

II. The North Korean Economy Today

Failed Autarky

North Korea's economic system has all the deficiencies of an autarchic system. The North Korean economy is one of centralized planning which is sustained administratively via direct commands and coordinated instructions. Likewise, all processes of resource allocation in North Korea are completely controlled by the Central Planning Board.⁴ For example, the price is predetermined

4. Although Nove extended the term Central Planning Board to a decentralized socialist economy, the term Central Planning Board applies to an explicit description of the role played by the Board in the North Korean Economy. Alec Nove, "Planned Economy," *The New Palgrave: Problems of Planned Economy* (New York, NY: W.W. Norton and Company, 1990).

not by the consumer preferences but by the orders or directives of the Central Planning Board. The state owns all natural resources and controls almost all economic activities including industry, mining, transportation and other services in the country. Besides these typical characteristics, the North Korean economy has several unique features. Its economic system is the world's most highly centralized, socialized, closed, and planned - even by communist standards. Its economic policy is based on the principles of its *juche* ideology, an ideology of self-reliance and the epitome of nationalism.⁵ One of *juche*'s objectives in the economic arena is to reduce the foreign debt. *Juche*-based economic modernization implies the mechanization and automation of all sectors of the economy without having to depend on external assistance. Also, within the dictatorship, the North Korean economic system lacks legal alternatives to the dictated economic relationships. Subordinates are unable to alter these relationships legally. The system lacks any tolerance or flexibility in allowing subordinates to offer valid feedback within the system. Political and ideological motivation dominates overall economic policy making and implementation. In addition, superiors are in complete control of the norms and indices as well as the parameters of project assignments, performance evaluation, and final rewards.⁶ As a result of having been functioning within an inefficient economic system for so many years, the North Korean economy is in big trouble. North Korean factories and power plants have become antiquated due to the lack of modern technology. Consequently, they can not be competitive in the international marketplace. Moreover, the absence of material incentives has led to low labor productivity.

A cursory look shows the extent of North Korea's macroeconomic problems (see Figure 1-3). Over the past several years, North Korea's GNP⁷ has been

5. Joseph S. Chung, "Economic Planning in North Korea," in Robert A. Scalapino and Jun-Yop Kim, eds., *North Korea Today: Strategic and Domestic Issues* (Berkeley: Institute of East Asian Studies, University of California at Berkeley, 1983), p. 167.

6. Within this scheme, North Korea's economic system was very effective in the postwar reconstruction of industry, the building of heavy industrial capacities, the collectivization of agriculture, and the development of military facilities. These economic phenomena resemble the experience of the former Soviet Union which excelled in terms of long-term output growth. However, both the former Soviet Union and North Korea suffered severe economic retardation mainly due to diminishing returns of substituting capital for labor. For a similar discussion of the former Soviet economy, see Padma Desai, *The Soviet Economy: Problems and Prospects* (Oxford: Basil Blackwell Ltd., 1987).

Figure 1. Real GNP Growth of North Korea

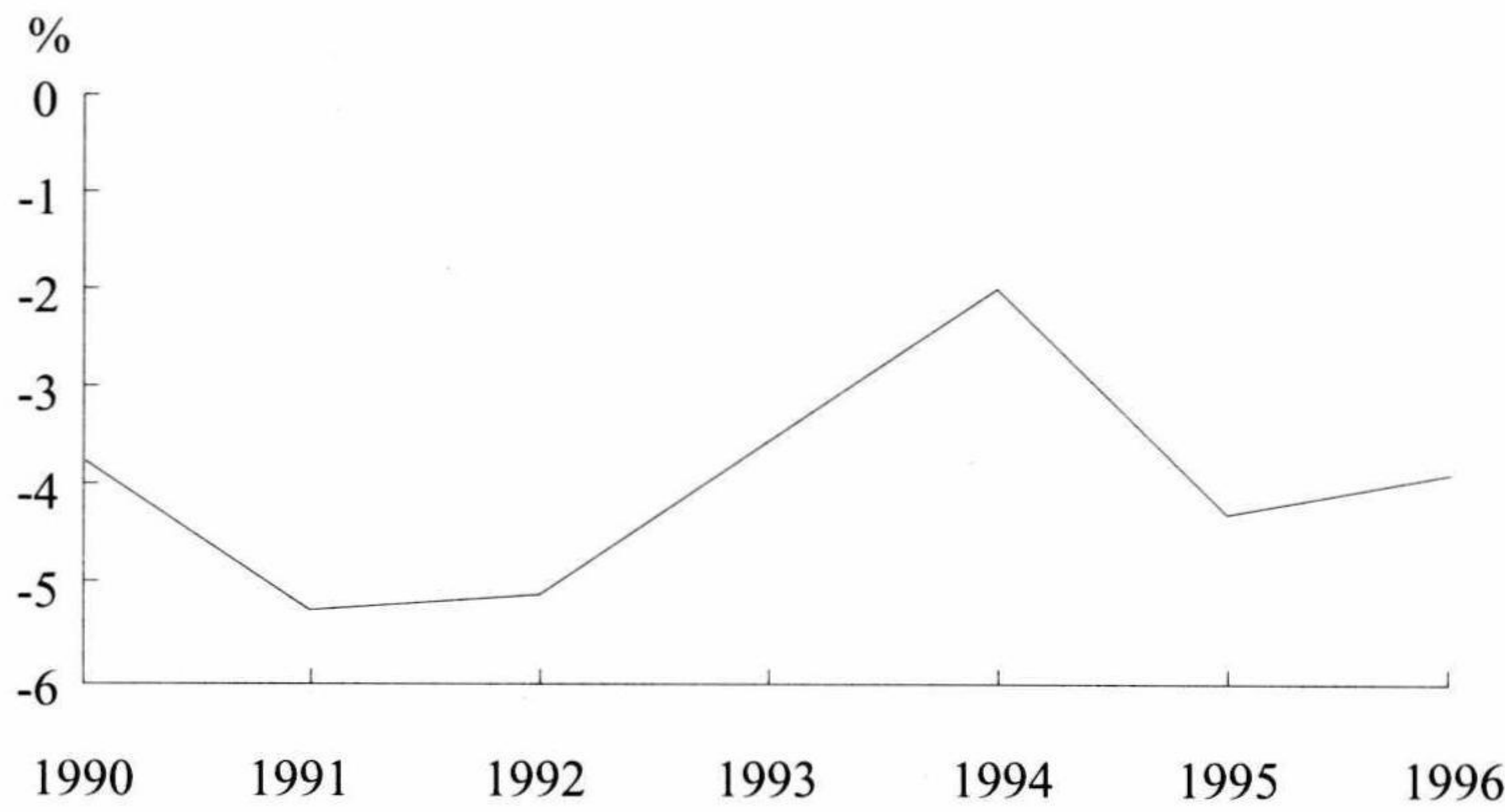


Figure 2. Grain Production of North Korea

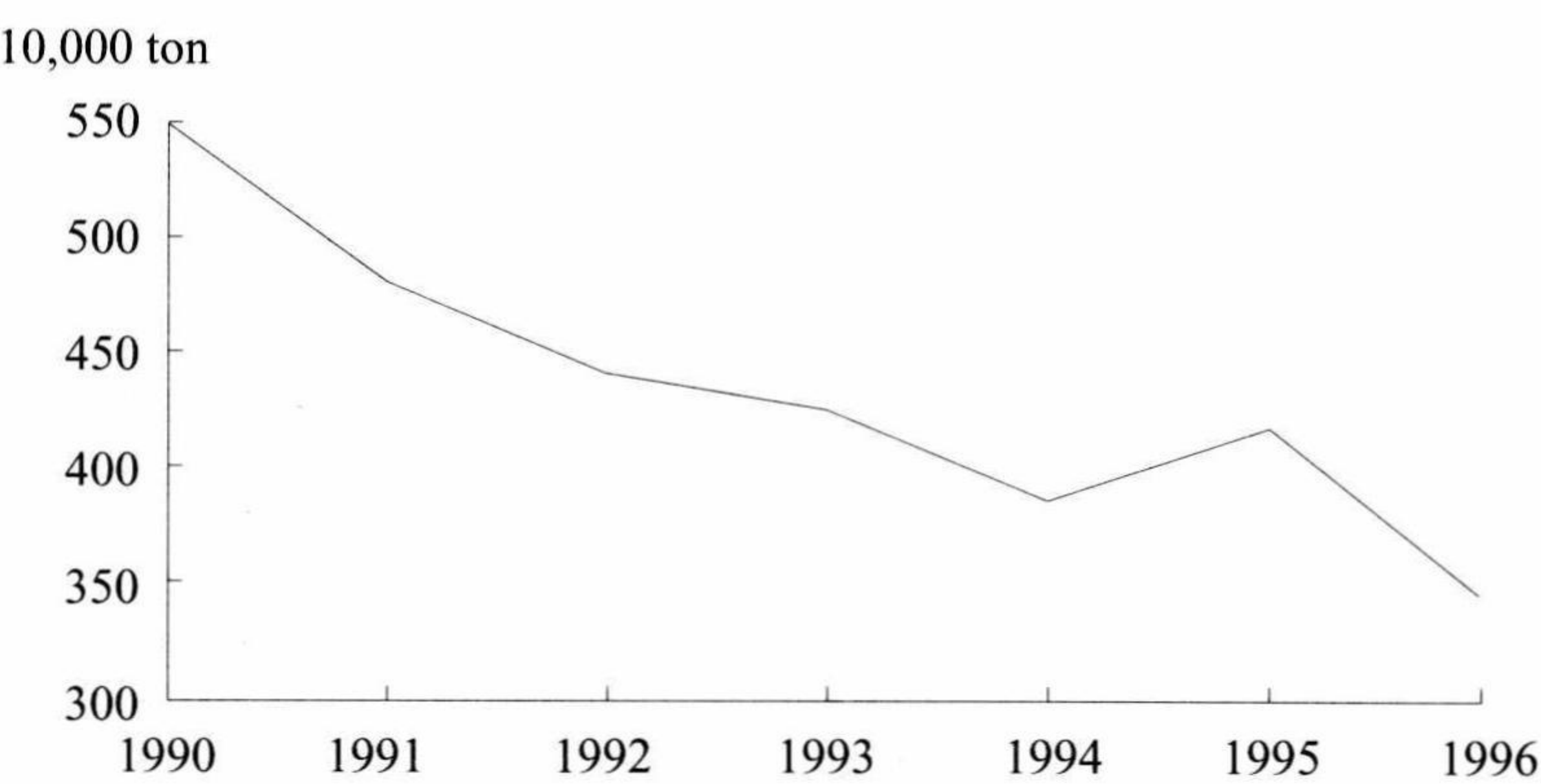


Figure 3. Exports and Imports of North Korea

