

### Research Focus

#### ***The Economics of the North Korean Settlement***

**Peter Drysdale\***

The 19 September agreement on principles at the six-party talks in Beijing on the political-security dimensions of the North Korean problem is a major step forward in resolving the Korean security crisis. North Korea is to come back within the International Energy Agency Nuclear Non Proliferation Framework. The United States has declared that it has no aggressive intentions towards North Korea. The other parties are to provide energy and food support. And North Korea and Japan are to resume talks on normalisation of their relations. This means the elements are now in place for working through the many details of implementation, despite North Korea's warning that, for it, a priority is the installation of a light water nuclear power station.

What are the prospects of Pyongyang now playing economic ball, by making a commitment to economic reform and opening the world's most isolated state to economic relations with market economies?

There are two key questions about the North Korean economy.

The first is whether the economic reform that was formally launched by Pyongyang in July 2002 has been sufficiently deep to induce what economists call a 'supply response' in the economy. If it has been, then there would be evidence of reform gathering its own momentum.

The second is whether there is credible political commitment to comprehensive economic reform. This question is of central interest to managing the political-security issues, since commitment to continuing economic reform implies a need for engagement and openness. The ratio of North Korea's exports or imports amounts to no more than 5 to 6 per cent of gross domestic product on the most generous estimate. So North Korea could not dream of trading its way out of its food and energy crisis without a significant increase in trade dependence. Commitment to continuing economic reform and openness ultimately requires a lasting political deal with the United States, Japan, China and South Korea to break the economic embargo strangling the North Korean economy. It also provides a critical lever that allows these countries to satisfy their various political and security concerns about Pyongyang's intentions.

No major firms from industrial countries will risk exploring investment opportunities in North Korea on any terms while the American embargoes remain, and while the IMF, the World Bank and other international organisations are inaccessible to North Korea. Neither circumstance will change without a permanent political settlement with Washington.

While there has been no clear high-level commitment to a North Korean economic reform strategy, of the kind initiated by Deng Xiaoping and the Chinese leadership in the early phases of their reform process, the rhetoric of reform in Pyongyang is now pervasive. A new national economy research

### Energy strategies

APSEG has initiated a major research project on China and East Asian Energy. The research is being directed by Professor Peter Drysdale and team members include Professors Ross Garnaut and Christopher Findlay and Dr Ligang Song. They will work in collaboration with experts from the major energy research centres in China (Chinese Energy Research Institute), as well as Japan (Japan Institute of Energy Economics) and Korea (Korea Energy Economics Institute). The agenda will provide for regular dialogues with participants from the energy and policy sectors in East Asia and Australia. The initial research will be presented at a meeting of experts in Beijing on 10-11 October. Annual conferences and regular publications as well as dialogues and workshops with industry and policy partners are planned over the five-year program.

### Events

**14 October**, Jeff Bennett, *Economics and the Environment: Friends or Foes*, seminar, Canberra. Contact: nieb@anu.edu.au

**19 October**, *The Promotion of Good Corporate Governance and Transparency in APEC's Financial Institutions*, symposium, Melbourne [www.pecc.org/finance/abac-aba-pecc-seminar.pdf](http://www.pecc.org/finance/abac-aba-pecc-seminar.pdf)

**10 November**, H.W. Arndt Memorial Lecture, *Asia in the Global Economy: Historical Dimensions*, Angus Maddison (University of Groningen), Canberra. Contact: Economics.rspas@anu.edu.au

**15 November**, *Roads to Riches: Economic Growth, Productivity and Development in 2005*, workshop, Canberra. [http://apseg.anu.edu.au/research/research\\_units/edges.php](http://apseg.anu.edu.au/research/research_units/edges.php)

### School Seminars\*

**5 October**, Peter Drysdale, *What's Going on in the North Korean Economy?*

**11 October**, Brian Head (Griffith University), *Evidence-based Policy: Do Networks Help?*

**18 October**, David Vanzetti, *Sink or Swim? Surviving Agricultural Trade Liberalisation?*

group has been put in place to advise Cabinet on managing the economic reform agenda. The line ministries are 'openly' grappling with the implications of the reforms and with the development of market forces already let loose, as well as with the issues that reform will pose down the track.

A modest Australian aid program, put in place in 1997 and directed at building North Korean capacities to manage the development of a market economy, has had a significant impact in this process, though this program is now in suspension.

The food and energy supply situation in Pyongyang has palpably improved since the depths of the crisis six or seven years ago. This occurred over a period in which food aid has remained steady, if not declined, and domestic food supplies have slowly recovered from their low point in the year 2000. Statistics on the overall food situation in 2005 are not yet available. A big question relates to the distribution of food supplies and how much it has favoured urban elites. But even hardened observers like Nicholas Eberstadt at the American Enterprise Institute – famous for predicting the collapse of the North Korean economy – agree that food and economic conditions appear to have improved over the last five or six years.

Two additional issues deserve note.

The first is that the recovery of domestic food production in North Korea after the year 2000 was achieved without substantial additional agricultural inputs. Seasonal factors have helped, but the steady lift in production must have been at least in part a result of market reform.

The second is that North Korea is a naturally food-dependent economy. Prior to the food crisis it relied – appropriately, given its limited arable land resources – on food imports as well as domestic production to secure national needs. Historically, in the 1920s and 1930s, Australia was a principal supplier of grain to this part of the Korean economy. It is unlikely that the recovery and potential growth of domestic food production will ever be able to secure national food needs without the addition of substantial food imports.

So Australia has a particular interest in the success of Korean reform and in the resumption of North Korea's reliance on commercial food imports. The resumption of large-scale commercial food imports will require access to international markets for other goods – especially labour-intensive exports in the early phases of transition – as well as a commitment to economic openness.

The process of economic reform in North Korea has been very messy, as evident in the inflation that has accompanied it, and more

fundamentally, in the very limited policy capacities to manage it and deal with its many complicated and unanticipated consequences.

In this context, Australia's withdrawal of support for training for North Korean officials in the development of capacity to effect the transition to a market economy would seem neither economically or politically wise.

It is now even more important to have a better understanding of what is going on in the North Korean economy and, where possible, to provide support for enhancing capacities to assist the reform process. Both tasks will be important to resolving the political and security problems with Pyongyang – in either the best event, in which the practical difficulties of implementing the six-party September agreement are satisfactorily sorted out, or in the worst-case event, in which it collapses. And both tasks are important to securing Australia's particular national interests on the Korean peninsula and Australia's broader interests in regional security.

\* Peter Drysdale is Emeritus Professor of Economics at the ANU and Visiting Fellow in APSEG. In March–April he led a UNDP mission to make recommendations on training priorities in North Korea's key economic ministries and agencies and in May he presented a keynote address to a Trade Policy Forum in Pyongyang on 'Opening Trade as a Key to Economic Growth'.

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**25 October**, Ray Trewin, *Emergency Safeguard Measures in Services – Worthwhile and Workable?*

\*Seminars are held at 12.30pm in Seminar Room 4, First Floor, Crawford Building

### **Short courses/training**

**7–25 November**, *Corruption & Anti-corruption* – a 3 week intensive course conducted by APSEG in conjunction with the NSW Independent Commission Against Corruption (ICAC).

**21 November–2 December**, *Organisational Finance & Budgeting* – examines key accounting concepts associated with finance

and budgeting in public sector management particularly from the context of organisational reform and viewed through the prism of accelerated economic and social development. [http://apseg.anu.edu.au/exec/exec\\_short.php](http://apseg.anu.edu.au/exec/exec_short.php)

### **Publications**

*Pacific Regional Order*, Dave Peebles, ISBN: 0 7315 3733 5 (forthcoming)

Asia Pacific Press publications can be ordered online at <http://www.asiapacificpress.com>, or by contacting Landmark Educational Supplies, Phone: 03 5625 4290, Fax: 03 5625 3756, [book.distribution@elandmark.com.au](mailto:book.distribution@elandmark.com.au)

*Reshaping the Asia Pacific Economic Order*, Hadi Soesastro and Christopher Findlay (eds) Routledge (forthcoming)

### ***Pacific Economic Papers***

350 East Asian Economic Integration and its Impact on Future Growth  
*Philippa Dee*

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