

## **Future Multilateral Economic Cooperation With the Democratic People's Republic of Korea: An Exploration of Issues and Options**

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This paper explores the challenges and opportunities for establishing a system of multilateral economic cooperation with the DPRK after an agreement is reached on the political, security and economic cooperation principles that will govern the DPRK's relations with the international community in the future. It is not the intention of this paper to address the content of such an agreement, nor to make recommendations for the negotiations process. Rather, the intent is to look over the horizon to the implementation phase of any agreement that is reached, to questions relating to how economic cooperation might be best organized and what this would mean for the roles and activities of multilateral organizations and for the choices of major stakeholder countries in the agreement as regards the balance between multilateral and bilateral instruments in pursuing their own interests. It is hoped that the process of visualizing and building consensus on future ways of working collaboratively on the many practical challenges facing the DPRK economy and society, will assist the DPRK and the international community develop new partnerships for action, once the overriding political issues have been resolved.

The challenges and opportunities facing future multilateral economic cooperation with the DPRK are unusual. While the experiences of other countries that have undertaken transition from socialist to market economic systems, or have moved from conflict into post-conflict situations, will be useful benchmarks for the DPRK's future, the situation of the DPRK will require thoughtful adjustment of models of multilateral cooperation that apply elsewhere in the world to fit the realities of this context. The legacy of history among the countries and societies of Northeast Asia, the important dimension of inter-Korean reconciliation and unification aspirations, and the evolving economic and political relations among the countries of Northeast Asia and their relations with the United States, Europe, and ASEAN countries, all need to be factored into thinking about how multilateralism can be used as an effective instrument for building a new framework of peace and prosperity for this region. In general, Northeast Asia has less well-developed regional multilateral cooperation mechanisms than other parts of the globe, and there is a historic opportunity to strengthen the institutional architecture for cooperation through the way the system is designed to support the DPRK. The objective of this paper is to explore issues and options relating to these themes as a basis for discussion. It is hoped that as a result of considered deliberation among stakeholder countries and organizations, a set of guiding principles and policy recommendations could be formulated as a contribution to the decision-making process at the appropriate time.

### **Context and Priorities for Economic Cooperation With the DPRK**

The economic, social, and political context for future economic cooperation with the DPRK will determine the priorities and sequencing of specific activities. This context will be partially defined by the agreements reached through the Six-Party Talks, policies adopted for bilateral

relations between each of the major stakeholding countries with the DPRK, and developments internal to the DPRK.

Already certain aspects of this context are clear, while others remain ambiguous and will need clarification. First, the DPRK economic system is changing as a result of both internal and external factors. The shift toward an expanding role for market mechanisms is now firmly rooted, both in the urban centers and along the Chinese border, and embraced legally. The DPRK is making efforts to improve energy and agricultural production with very limited success due to lack of capital for investment. The reworking of public finance, enterprise management, and the banking system is also under way, although not in a transparent or comprehensive way. Trade and investment with the ROK and China are growing, even in the face of continued delays in resolving the nuclear issues, and can be expected to accelerate after a political agreement is reached. In addition, the ROK is prepared to provide significant aid for reconstruction, especially in energy, transport infrastructure, and agriculture. Japanese investment and trade has been declining and future economic relations between Japan and the DPRK will be heavily influenced by the way the issue of abductees is resolved and how security issues such as the DPRK's missile program are addressed in addition to resolution of the nuclear issues. Russia can be expected to seek opportunities to advance its regional energy and transport interests in the wake of any agreement reached through the Six-Party Talks. Future economic relations with the United States are uncertain, given low private investor interest in the DPRK, although increased access to US markets and some level of foreign aid linked to human rights improvements and support for development of the market economy can be expected. Europe already has a framework for engagement that includes normalization of relations with most European countries, trade and investment, humanitarian assistance and development assistance, and human rights dialogue. This framework can be expected to mature and grow after a Six-Party Talks agreement has been reached. UN involvement will need to shift from a primarily humanitarian to a primarily economic development and governance focus.

Less easy to foresee are the likely dynamics of internal changes taking place in the political economy and decision-making apparatus of the DPRK. Already there are new social issues of urban unemployment and distributional effects of market forces among different segments of North Korean society. Realignment of the social contract between the State, enterprises, and households is inevitable, stemming from these developments and adjustments to the breakdown of old institutions and difficulties in replacing them with new policies and institutions needed for the transition to a market economy. The roles of the Workers Party, military, and cabinet are being reconfigured to adapt to these changes, but not in ways that are transparent to foreigners. Any future engagement will require organizational arrangements on the DPRK side that will allow for clear communications and decision making with foreign partners on a wide range of issues.

In this context, multilateral forms of economic engagement with the DPRK have particular significance. Primary among them are attributes of transparency, objectivity, and spirit of pragmatic cooperation. The efficiency of cooperative undertakings and sharing of risks among participants are also important factors.

Early activities for multilateral economic engagement with the DPRK will be the tasks of collaboratively assessing the socioeconomic situation in the DPRK and developing an overall economic cooperation strategy for DPRK linked to a realistic economic development policy and management apparatus. This can form the basis on which concrete discussions can lead to formulation of specific programs of cooperation based on priorities and rational sequencing.

### **Strategic Objectives and Guiding Principles**

An old axiom of organizational theory is that form follows function. In constructing a system for multilateral economic cooperation with the DPRK, there needs first to be an understanding of what functions the system will be expected to support, and definition of the key result areas by which to evaluate the performance of the system. The opportunity in Northeast Asia is historic and the consequences of a well-functioning multilateral economic cooperation framework are potentially far-reaching. Six interrelated strategic objectives could be considered a core functional framework:

- € Implementation of agreements reached through the Six-Party Talks.
- € Transition of the DPRK economy to a rules-based market-oriented system.
- € Pursuit of an economic development strategy for the DPRK that leads to sustainable growth and welfare improvements for all segments of North Korean society.
- € Expansion of inter-Korean economic cooperation and progress toward long-term reunification goals.
- € Integration of the DPRK in the international economic organizations.
- € Expansion of regional economic cooperation in Northeast Asia.

A critical first question is whether consensus can be built on a statement of strategic objectives for multilateral economic cooperation with the DPRK. This requires discussion within and among all major stakeholders, and in particular an understanding with the DPRK about the expectations for multilateral economic engagement, and what this means for modalities for communication and collaborative activities. There are also specific issues that need to be addressed in each results area.

### **Implementation of Agreements Reached Through the Six-Party Talks**

The Six-Party Talks aim to negotiate an agreement in which the DPRK would receive security guarantees and economic benefits in exchange for dismantling its nuclear weapons program. While the specific content of such an agreement has not yet been determined, certain features can be expected in any agreement that will be reached. One is that any economic support package will be phased in relation to progress in implementing a sequence of actions that result in verified nuclear dismantlement. In order to ensure that progress on the economic agenda is linked to and restrained by progress on the security agenda, it will be necessary to put in place political supervision of the economic assistance provided in each stage of the agreement. If the Six-Party Talks succeed, then the supervision arrangement will need to include at least all six parties and

possibly others such as the European Union (EU), if they are given a role in implementation activities.

There are several options for establishing a multilateral implementation and oversight mechanism for economic engagement with the DPRK in implementing whatever agreements are made. One is for the existing Six-Party Talks Working Group to provide the coordination needed. A variant of this would be to set up an economic subgroup or technical working group under the Working Group framework to supervise and coordinate the activities of bilateral and multilateral implementing agents. For example, the step-by-step development of relations between the International Financial Institutions (IFIs) and the DPRK could be guided by such an oversight group. Similarly, provision of energy assistance included in a negotiated agreement could be coordinated through such a group.

Another option would be to overhaul the Korea Peninsula Energy Development Organization (KEDO) by expanding its membership to include China and Russia, and revising its mandate. In this configuration, KEDO's board could be comprised of representatives of the Six Parties, and KEDO could be staffed with the expertise needed to manage and coordinate the delivery of economic assistance to the DPRK under the agreement. A broad mandate such as this might require a name change as well to "Korea Peninsula *Economic* Development Organization." Or, the mandate for KEDO could be limited to provision of energy assistance requiring international coordination. This would be essentially an adaptation of its original functions and capacities, simply replacing the Light Water Reactor (LWR) project with new projects. In either case, if the IFI's are to be given any role in the implementation of a Six-Party Talks agreement, a clear division of labor and terms of reference for operational partnership with KEDO would be essential.

### **Transition to a Market Economy**

The DPRK's transition to a market economy is already under way. But there are many issues that will require sustained engagement by the international community in policy dialogue, technical assistance, training, and investment to help the DPRK make a successful transition. The EU already is engaged in training activities related to the issues of transition and a number of DPRK delegations have visited China and Vietnam to learn from their experiences. Looking ahead, the IFIs, EU, and UNDP should all be expected to play major roles in supporting the DPRK's transition, as they have in other transition countries in Asia and Europe. Because of proximity and trade and investment relations, China, Japan, and ROK will also be active partners in these activities. Informal cooperation among these countries could supplement the activities of formal multilateral organizations, for example by central banks, ministries of finance, and ministries of trade as well as economic research institutes.

The two most critical issues that will need to be addressed are the establishment of a policy dialogue and aid coordination mechanism on transition issues, and reaching an understanding on division of labor and leadership roles among the donors on different parts of the transition agenda. These decisions should be made in conversation with the DPRK and be built on a foundation of trust in the DPRK's working relationship with the international community on this sensitive topic. The EU has already started developing this relationship, and UNDP has some

legacy issues with its earlier role in promoting market experimentation in the Rajin-Sonbong Free Enterprise Zone, but the IFIs have no established relationships with the DPRK in this area.

### **Economic and Social Development**

While the DPRK has embarked on a process of allowing an expanding role for market mechanisms in its economy, has implemented partial economic reforms, and has pursued economic cooperation projects with the ROK, it does not have an economic development strategy that can be supported by the international community. Economic cooperation in the future will require building a relationship between the DPRK and the international community that allows for debate about strategies and policy options, and underpins formation of partnerships in collaborative undertakings. A critical ingredient and starting point is the need for good information and especially statistics about the current conditions of the DPRK economy. The DPRK's willingness to collect and share this information and to engage in policy dialogue will be essential for the development of a working relationship with the international community on economic and social development. Equally important will be the willingness of the DPRK's partners in this process to appreciate the realities and constraints under which the DPRK economic policymakers face, and willingness to find practical and reasonable ways to cooperate with the economic team.

Multilateral mechanisms for engaging the DPRK on economic and social development challenges are an important complement to bilateral relationships. The IFIs, EU, and UN development organizations typically play prominent roles in most developing country settings. The DPRK's situation, however, poses special challenges to the traditional role of the global and regional multilateral organizations. The dominant trade and aid relationship that the DPRK has with its neighbors is an important contextual factor. Any economic development strategy for the DPRK must take into account its geographic proximity to three powerhouse economies, as well as the natural resource base in eastern Russia. Regional considerations as well as bilateral relations will be significant factors, requiring multilateral understandings and coordinated actions. In this context, the potential future role for the Tumen Commission as a mechanism to develop trade and investment along the DPRK's borders needs to be considered in addition to the roles for the IFIs, EU, and UN.

Another critical challenge is the military legacy on the Korean peninsula. The DPRK's pursuit of a military-first policy and segmentation of the military economy from the people's economy require an integration of strategy for restructuring of security arrangements with the strategy for economic and social development. This means that any economic engagement with the DPRK must proceed in tandem with a process for resolving the conventional military issues that will remain on the peninsula following any agreement on the nuclear issues in the Six-Party Talks. This includes questions relating to redeployment of military assets, integration of military-owned production enterprises in the people's economy system, and demobilization of military manpower and integration in the civilian labor force linked to job creation strategies.

### **Inter-Korean Economic Relationship**

Closely tied to the security realignment issues are the question of inter-Korean reconciliation and the linkage of economic cooperation between the two Koreas to any more general economic engagement with the DPRK by the international community. To the extent that eventual peaceful

reunification is an aspiration shared by both Koreas and they continue to pursue a reconciliation agenda that has economic, security, and social dimensions, the international community will want to find ways to support this process.

An important implication of the inter-Korean relationship is that future multilateral economic engagement with the DPRK must be coordinated in a different way than the typical developing country model. For the IFIs in particular, it will be important to integrate a “two-client” concept into their future role, where potential impacts on the ROK and inter-Korean relations will need to be factored into policy advice and financing provided to the DPRK. One way to deal with this challenge would be to develop agreed guidelines for managing these issues for adoption by the principal multilateral organizations involved, including the IFIs, UN, and EU. Another would be to include coordination of these issues under a redefined mandate for KEDO. A third option would be to establish a new institutional arrangement for coordinating involvement of the international community in inter-Korean economic and security activities that builds on the existing bilateral cooperation structure that has developed since the Joint Summit of 2000. In this case, the two Koreas would co-host international coordination meetings and cosponsor specific activities with partners from the international community.

### **Integration in the International Economic Organizations**

The DPRK is a member of the UNESCAP and receives support from the economic and social development organizations of the UN system, including UNDP, UNIDO, FAO, UNICEF, UNFPA, and WHO. It is a member of the International Fund for Agriculture Development (IFAD) and has received project loans from IFAD. The DPRK also has developed a cooperative relationship with the EU that includes discussions of issues relating to trade and investment relations and economics training as well as humanitarian assistance and human rights. In addition, the DPRK is a founding member of Commission for Development of the Tumen River Area and Northeast Asia (Tumen Commission) established in 1995 under the auspices of the UNDP, and has participated actively in the activities of the Tumen River Area Development Program (TRADP). These relationships indicate that the DPRK has some experience working with international economic organizations. But most of its activities with these organizations have been small scale and experimental. Furthermore, the DPRK is not a member of any of the IFIs nor of the World Trade Organization (WTO), which are the principal institutions of the international economic system.

The major issues needing to be addressed for integrating the DPRK into the international economic organizations are how the DPRK’s membership in the IFIs will transpire, what relationship and activities the IFIs develop with the DPRK, how the UN system shifts from a primary orientation of the provision of humanitarian assistance to development assistance, and how the DPRK will be supported in the longer-term process of accession to the WTO. In addition to these core issues, there are future possibilities for the DPRK to become a member of APEC and participate selectively in various working groups and adjunct private sector organizations, such as the Pacific Basin Economic Council (PBEC). It is also possible that the DPRK would be invited to join some ASEAN economic meetings and activities that are pan-Asian, in addition to the Asia Regional Forum (ARF) discussions on regional security.

A coordinated effort by the international community to help the DPRK join and expand its involvement in the international economic organizations would facilitate the process, since the governing bodies of these various organizations are guided by the countries that are already members. On the DPRK's part, the need for capacity for management and coordination of its activities and relations with international economic agencies would also need to be addressed.

### **Northeast Asia Regional Economic Cooperation**

There have been many papers written about the prospects for more organized economic cooperation in Northeast Asia, but apart from the Tumen Commission and recent joint research undertaken by China, ROK, and Japan as an off-shoot of the ASEAN +3 meetings, there has been very little accomplished at the governmental level. A new era of international economic cooperation with the DPRK would provide opportunities both to deepen integration of the DPRK economy with those of its neighbors and to advance regional economic cooperation possibilities that have been inhibited by the political and security dilemmas on the Korean peninsula. Notable among these are opportunities to pursue new initiatives in regional energy cooperation through cross-border infrastructure and expanded energy trade, rail and road transport projects that would stimulate investment and economic growth, tourism, and cross-border environmental protection activities. The Tumen Commission has been the only governmental multilateral economic cooperation mechanism that has been attempting to address these issues, but progress to date has been modest. Nongovernmental groups such as the Northeast Asia Economic Forum and the programs supported by the Economic Research Institute for Northeast Asia (ERINA) have produced a good network and many good proposals for collaborative activities that would become the starting point for discussions of ways to pursue a regional agenda.

There are two directions of thinking from which to approach the question of how to respond to these opportunities. One direction is represented by the "Grand Design" proposals advocated by Yasuo Sawai at the National Institute for Research Advancement (NIRA). This big picture approach envisages creation of new multilateral institutions for the region such as a Northeast Asia Development Bank and developing the institutional architecture around strategic cooperation in energy and transport and telecommunications infrastructure. The other direction of thinking is to start with concrete projects for which political will and financial resources can be mobilized and to build a new cooperation framework from the bottom up. This is represented by proposals to build a gas pipeline from Russia through the DPRK to the ROK in order to replace the present KEDO LWR project with a gas alternative, and to build a rail link from the ROK through the DPRK to Russia and on to Europe to reduce long-distance transport costs of freight in Asian-European trade. Regardless of which approach is ultimately adopted, there will be a need for political, legal, and financial commitments among the governments of the region to make any investment and institution-building a reality. To obtain these commitments will require a political process linked to the implementation and supervision of whatever agreement is reached with the DPRK through the Six-Party Talks. The longer-term consequences of deepening economic integration and cooperation among the countries of Northeast Asia through a shared objective in economic engagement the DPRK would be an increase in interdependencies and thus enhanced prospects for stability and peace in the region.

## **Sector Perspectives**

Continuing the form following function theme, it is useful to consider how to employ different multilateral economic engagement modalities in the context of the needs and issues specific to different sectors. In the short and medium term, the priority areas for engagement with the DPRK are most likely to include:

- € Energy
- € Agriculture and Food Security
- € Infrastructure
- € Social Development
- € Economic Reform and Governance
- € Foreign Investment and Trade

Two general principles that could be followed would be to differentiate the roles for multilateral organizations based on their comparative advantages and to build partnerships based on OECD best practice guidelines on harmonization and alignment for development effectiveness. There is an opportunity to design an international economic cooperation regime for the DPRK that will benefit from the collective experiences of donors and partners globally, as well as tailored to the specific context of the DPRK and Northeast Asia.

## **Energy**

There is no question that the highest priority sector for economic engagement with the DPRK will be energy, both because it is essential for economic recovery and because it is linked to the security guarantees and economic assistance commitments that will be integral to any agreement that results in the dismantlement of the DPRK's nuclear weapons program. For these reasons, multilateral cooperation with the DPRK in the energy sector will need to be closely aligned with security cooperation and be guided politically. However, there are many policy, technical, institutional, and financial issues that will need to be addressed in rehabilitating and developing the DPRK's energy sector, and it will be equally necessary that any energy assistance provided to the DPRK be based on a technically and economically sound basis. Also, because of the criticality of the energy issues, it is likely that whatever arrangements are put in place to provide the DPRK energy assistance in the future will serve as a model and precedent for cooperation in other areas where infrastructure investment is needed, for example in transport, telecommunications, and water.

A good case can be made for retaining a major role for KEDO in energy cooperation, if for no other reason than that if KEDO is disbanded, another similar mechanism will need to be created to bridge the political and the technical and financial requirements for the implementation stage of any agreement reached through the Six-Party Talks, as discussed above. By adjusting KEDO's membership to include China and Russia and by re-defining its mandate to align with commitments made in the nuclear agreement, KEDO would be capable of playing a coordinating role and supervising the delivery of energy assistance and policy dialogue with the DPRK. But KEDO would not need to be equipped to provide all of the expertise or resources needed for energy cooperation with the DPRK itself. Carefully constructed partnerships with the expertise and resources available in the World Bank, Asian Development Bank, and EU among the multilateral agencies, and with major bilateral donors, would permit a division of labor based on

comparative advantages in knowledge and resource mobilization capabilities. Such a framework would also provide a way to provide cross-border political and legal guarantees for private sector participation in future energy cooperation with DPRK, which will especially be needed for any future cross-border energy projects such as gas or oil pipelines or power trade agreements. This consortium of donors, private investors, and service providers working under KEDO's leadership and inter-governmental decision-making capabilities, could not only provide the coordination needed for managing energy cooperation with the DPRK but also could eventually form the underpinnings of a larger and longer-term energy cooperation framework for the Northeast Asia region.

As noted above, if KEDO is not re-engineered to play a future leadership role in energy cooperation with the DPRK, another mechanism will need to be invented to provide the bridge between the political and the technical and financial requirements for such cooperation. This could take the form of a special subgroup or committee under the Working Group established for the Six-Party Talks, or a new independent body with its own organizational and operational capabilities. In any case, a close working relationship will be needed between whatever mechanism is adopted and the IFIs once they become active in the DPRK. This is not only because of the cross-country experience and resources that these organizations can bring to the DPRK in its energy development agenda. Equally important is the fact that energy cooperation will need to be planned in relationship to an overall economic development strategy for the DPRK that will determine demand for energy, and the management of transition to market mechanisms with the policy and institutional reforms that will be needed for this process that are linked to pricing policy and regulation of the energy sector. Also, investment in the energy sector will need to be part of a comprehensive public investment program that is linked to a macroeconomic framework and financing plan. It is normally the role of the IMF and World Bank to work with governments on these issues, and the bridge to sector-level mechanisms for cooperation and decision-making needs to be explicit.

### **Infrastructure**

Apart from energy, the DPRK needs investment in road and rail transport, ports, irrigation system rehabilitation, flood control, urban water and waste, and telecommunications. Already, the ROK and the DPRK are cooperating in cross-border road and rail links and in flood control for the Injin River. Enclave infrastructure has also been built for the KEDO LWR project, for the Mount Kumgang tourism project, and for the Kaesong industrial zone pilot project. Russia is advocating rail upgrading and cross-border links for regional trade. China is also seeking to complete cross-border road links to the Rajin port. Infrastructure promises to be a critical area not only for economic reconstruction and development in DPRK but also to promote regional economic cooperation. As in the case of energy, international assistance and cooperation in meeting the DPRK's infrastructure investment needs must be linked to realignment of the security arrangements on the Korean peninsula, especially along the demilitarized zone.

Unlike for energy, it may be desirable to consider a differentiated approach in addressing the DPRK's other infrastructure needs, although an overall plan for infrastructure investment linked to a comprehensive economic development strategy will be needed. For infrastructure that is part of the inter-Korean agenda, including cross-border links and infrastructure provided in joint projects such as the Kaesong and Mount Kumgong initiatives, the planning and implementation

should be governed by an inter-Korean mechanism, that can be coordinated with developments on security agreements between the two countries and in the reconciliation process more generally. Multilateral organizations such as the development banks and EU might be invited by the two Koreas to support these projects through financing components for the DPRK's contribution and through technical assistance where international experience would bring value-added to inter-Korean undertakings.

For infrastructure projects on the DPRK's borders with China and Russia that support expanding regional trade and investment, the Tumen Commission would be a possible multilateral coordinating mechanism. This would include both rail and road linkages as well as telecommunications. Since Russia, China, the DPRK, and the ROK are already members of this group, the TRADP program in the future could be designed to further the regional agenda that involves all these countries. As in the case of the inter-Korean coordination mechanism, the development banks and EU could be invited to participate in TRADP projects as partners in mobilizing financing as well as providing technical assistance.

For infrastructure projects in the DPRK that do not have direct cross-border aspects, a national investment program supported in conventional ways by the development banks and bilateral donors could be pursued. To ensure the necessary coordination among these three mechanisms for planning infrastructure projects, an overarching coordination group led by DPRK and one of the development banks could be considered. This would also be the mechanism to ensure linkage to the national economic development strategy and macroeconomic management activities.

There has been advocacy and considerable debate about the need for a new Northeast Asia Development Bank in recent years. The primary motivation has been to create a regionally owned and managed institution that could mobilize the finances needed for infrastructure investment. The expectation is that the DPRK would be a major client of this bank, and it could also finance investments in other countries in the region to support the larger economic development and integration objectives envisaged in the "Grand Design" approach discussed earlier. Other options include establishing new investment promotion mechanisms, use of government guarantees, and innovative incentives for private financing of cross-border infrastructure projects. In any case, it can be expected that a major topic for discussion in the future will be what multilateral financing mechanisms will be most effective in mobilizing and delivering resources needed for the DPRK and regional infrastructure investment needs.

### **Agriculture and Food Security**

Since the mid-1990s the international community has relied on the World Food Programme (WFP) to take a lead role in mobilization and delivery of food aid to the DPRK. Other UN agencies have played supportive roles, notably FAO, UNDP, UNICEF, and WHO in addressing food security and malnutrition issues. International NGOs have also been important contributors to this effort, and the EU has been a significant donor in delivering food aid through ECHO and in engaging in policy dialogue with the DPRK. Coordination mechanisms are well established, both internally in the DPRK government through the Flood Damage Rehabilitation Committee and within the donor community through the Food Aid Liaison Unit in WFP and the UN Office of Coordination of Humanitarian Affairs. While most of the efforts over the past ten years have been guided by humanitarian objectives, the need to address the underlying causes of the

DPRK's food security problem is well recognized and some limited progress has been made in introducing improvements in agricultural production and stimulation of market mechanisms. While the UN Consolidated Appeal for the DPRK has been the instrument used by the United Nations for mobilizing resources for its programs, commitments have fallen far short of needs in recent years and the DPRK has recently decided to drop this approach for 2005. Bilaterally, China has also been a major supplier of food aid to the DPRK during the past decade, but has not participated in the UN-led system and not coordinated its policies and delivery with the rest of the international community. The ROK has also been a major bilateral supplier of food aid to the DPRK, but has been an active participant in international coordination.

There are three major issues that will need to be addressed in the future under a new phase of international community support for helping the DPRK meet its food security challenges. First is making a transition from a system of support based on humanitarian relief mechanisms to one based on development mechanisms, while retaining capacity to deliver humanitarian assistance to vulnerable groups. Second is integrating bilateral food and agriculture assistance with multilateral assistance in a strategic and coordinated way. And third is integrating food security policy and assistance in a comprehensive economic development strategy for the DPRK that addresses longer-term solutions while meeting short-term needs.

Making these shifts from the current situation will require a rebalancing of roles of the multilateral agencies. Leadership and coordination responsibility will need to migrate from WFP and OCHA to either UNDP or a development bank, either the World Bank or ADB. The development banks will need to provide the policy coordination necessary to link food security strategy with overall economic development strategy. Funding for agricultural rehabilitation will need to be coordinated with funding for complementary infrastructure in power, transport and water management, and integrated in a public investment program that is supported by the development banks and major bilateral donors and coordinated with policies and incentives for private investment in agriculture. A donor coordination system for food security will be needed that integrates policies and activities of major bilateral donors as well as the multilateral and NGO actors. It will be especially important to integrate Chinese and ROK policies and assistance in the policy dialogue and coordination mechanism. On the DPRK side, the Flood Damage Rehabilitation Committee will need to evolve or be replaced to be able to provide internal coordination and management of the issues that will need to be on the future food security agenda.

### **Social Development**

Engaging DPRK on social development issues will be highly sensitive but necessary. Changes in the DPRK society and political economy are inevitable as it moves toward a market economy and expands economic relations with its neighbors and the international community more generally. These changes are already taking place, adding uncertainty to the future course of governance within the DPRK. While the United States and Europe will give social issues high priority, these will tend to be cast in human rights terms. The ROK will give family reunions and national reconciliation greater weight in the short-term, and China will likely want to associate itself with a long-term evolutionary approach compatible with its own domestic policy. Because of concern about poverty and vulnerable groups, the social justice agenda will intersect with economic engagement with the DPRK, with a special focus on household security that will

embrace both the food security concerns for high risk groups and the health and social protection issues that accompany transition to a market economy.

The challenges for DPRK authorities and for the international community are how to relate to these inevitabilities and find common ground for cooperation. Education and training to acquire knowledge that will help the DPRK modernize its economy and integrate with the internal economic system is likely to be one area for such common ground, and the UNDP and EU are already engaged in this agenda on a limited scale. Pursuing cooperation in technical education is also feasible. However, international involvement in the DPRK's highly political basic education system can be expected to be minimal for the foreseeable future. Strengthening the health system and social protection are areas where international experiences and resources would be helpful for the DPRK.

It is likely that multilateral rather than bilateral mechanisms for working with the DPRK on these issues will be most effective, with UN agencies taking a lead in their areas of expertise, the EU active on social justice, and banks being developed in projects that require significant financing. This is one area where the DPRK sensitivities about the ROK will need to be handled carefully, and where trust-building and impartiality will be critically important. For this reason, engagement with the DPRK on issues of social change is likely to lag behind engagement on infrastructure issues.

### **Economic Reform and Governance**

In most transition countries the IFIs have played major roles in supporting the transformation process with policy advice on reform measures and their sequencing, technical assistance, and budget financing to help cover the costs of adjustment. The EU also has substantial experience and has a particular capacity to work with countries in developing their capacities to meet standards required for accession to the WTO or in the case of Eastern European countries to the EU itself. UNDP also has played a valuable role in working with transition countries on governance and institution-building—especially in aid management, legal system development, and parliamentary processes. All the multilateral agencies should be engaged in helping the DPRK design and implement economic reforms and develop modern capacities for economic management. Major areas of focus will be on pricing policies, macroeconomic management, foreign debt, the banking system, public finance, legal system, enterprise reform, and land reform. Chinese and ROK cooperation with these multilateral agencies in working with the DPRK to develop policies and a process of transition appropriate to its circumstances would be beneficial to help integrate the transition strategy with economic relations with its two largest trading partners.

### **Foreign Investment and Trade**

The security issues on the Korean peninsula and the DPRK's reputation on treatment of investors and foreign lenders pose special challenges for future multilateral cooperation with the DPRK. Private investors will evaluate opportunities in relation to perceptions of risks. The primary role of multilateral engagement in this area will be to lower these risk perceptions and to help the DPRK promote opportunities for expanding foreign investment and trade in ways that are seen as economically as commercially viable. A strong political commitment emerging from the Six-Party Talks to help the DPRK move toward joining the international economic system, backed

up by concrete steps to help the DPRK move toward membership in the IFIs would be a starting point. Early attention by the IFIs to basic statistical reporting on the DPRK economy and financial conditions would help build investor confidence. IFI financing of infrastructure projects would stimulate private sector bids for contracts under normal competitive bidding procedures. The DPRK joining the private sector arms of the World Bank, including the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) would be particularly helpful for the DPRK in lowering risks through their participation in foreign investment projects. IMF and World Bank efforts to help the DPRK overcome its foreign debt problems through Paris Club and London Club processes and through helping the DPRK install modern debt management capacity would all contribute to building an environment more conducive to attracting foreign investment.

The Tumen Commission can play a particularly useful role in promoting trade and investment in the DPRK along the Chinese and Russian borders, such as Rajin-Songbon and Sinuju. While earlier initiatives in these areas proved disappointing, a changed context could stimulate renewed interest, especially if Japanese-DPRK relations move toward normalization and Japan decides to become a member of the Tumen Commission and opens its markets to exports from this region.

In the energy sector, as discussed above, multilateral political and legal commitments given through KEDO or some other arrangement will be necessary to involve the foreign private sector in consortia to finance and/or operate cross-border projects.

The EU also has a valuable role to play in supporting the DPRK efforts to expand trade and investment relations with European countries, including the issue of quotas for import from the DPRK, and also helping to create a favorable climate for European private sector investment in the DPRK.

Various ideas have also been floated about creating new mechanisms for raising private capital for investment in Northeast Asia, including the DPRK. One is the proposal for a Northeast Asia Development Bank modeled on the existing multilateral development banks discussed earlier. Another is a Northeast Asia Fund, modeled on the Private Participation in Infrastructure initiative in the ROK that would involve setting up funds for private equity investment and infrastructure. A third idea is a proposal for a Northeast Asia Investment Corporation that would combine a private infrastructure fund with a public Asia Currency Basket Bond facility as a source of finance for Northeast Asian projects.

### **Crosscutting Issues**

One conclusion from the assessment of how different multilateral economic modalities could be applied to the future engagement with the DPRK is that the realities and complexities of the situation on the Korean peninsula will place unusual demands on any system that is put in place. Apart from deciding what roles should be given to different multilateral mechanisms, there are a number of crosscutting issues that will need to be addressed to make any system of economic engagement effective.

### **The DPRK Absorptive Capacity**

While the DPRK has received significant amounts of humanitarian aid over the past decade, it has limited experience with development assistance and foreign investment. The ability of the DPRK to absorb both knowledge and financial resources from the international community in the future will be a major constraining factor in expectations of what can be accomplished in specific time frames. To increase its absorptive capacity, the DPRK will need to make both critical choices about how it will coordinate and manage internal decision making and how to work with foreign partners to implement collaborative activities. It would be helpful if the DPRK assigns a high-level official coordinating responsibility for managing the interface of internal policies and processes with the requirements and procedures of external partners. This is one area where Vietnamese experience in working with both donors and foreign investors could be very helpful to the DPRK.

### **Aid Coordination**

The linkage of security and economic cooperation together with the integration of an economic development strategy for the DPRK with inter-Korean economic relations and the Northeast Asia regional economic cooperation agenda pose particular challenges for aid coordination in the future economic engagement with DPRK. A clear division of labor among different coordination mechanisms is likely to be the only practical way to ensure that the relevant issues are addressed and the pertinent parties are involved. Four potential coordinating mechanisms are: (a) a consultative group for the DPRK modeled on those that have been established for other countries, with the World Bank and UNDP playing lead roles in preparing for donor meetings with the DPRK authorities; (b) KEDO or a successor organization on energy cooperation with the DPRK and cross-border energy projects, linked to implementation of the Six-Party Talks agreements; (c) the inter-Korean economic coordination committee that could plan and co-host donor meetings for coordination of support to inter-Korean initiatives; and (d) the Tumen Commission for coordination of cross-border infrastructure projects and trade and investment promotion in the Tumen River Development Area.

To ensure appropriate coordination across these groups as well as support the DPRK's preparations and development of capacities for its responsibilities in aid coordination, UNDP could be mandated to take a lead support role in working with the DPRK and participating in the planning and follow-up of all four mechanisms, keeping all parties informed of agreements reached and implementation progress.

### **Development Effectiveness: Harmonization and Alignment Best Practices**

There is an opportunity in setting up a new system for economic engagement with the DPRK to take advantage of accumulated experience and research on development effectiveness to put in place practices with the DPRK that help optimize results and efficiency. The harmonization and alignment best practices advocated by the Development Assistance Committee of the OECD should be assessed for their potential application to the future program of activities in the DPRK. This could be integrated with a role given to UNDP for working with the DPRK on development of the aid coordination system.

### **Linkage of Informal and Official Engagement Mechanisms**

The DPRK already participates in some regional unofficial economic cooperation gatherings, such as the Northeast Asia Economic Forum, which meets annually, and ad hoc events organized on specific topics, such as on regional energy issues organized by ERINA and other nongovernmental groups. Aligning these informal networking and dialogue opportunities with the activities of the official multilateral organizations and intergovernmental groups would allow for a broadening for participation in debates about how to address a wide range of issues and provide bridges to official decision-making processes. One difficulty these informal gatherings have had in the past is that there have been few intergovernmental bodies to address with recommendations or to help focus the agenda at the informal level.

Similarly, networks of economic agencies and institutes among Northeast Asia countries could sponsor joint research and seminars that include the DPRK in the future, such as central banks, ministries of trade, and the institutes that are already collaborating between China, Japan, and ROK on topics of common interest emanating from the ASEAN +3 meetings, such as the recent work on a potential tripartite FTA.

### **Linkage of Economic and Security Cooperation**

Until a formal peace accord is negotiated on the Korean peninsula and the DPRK has satisfied the international community that it is not threatening any of its neighbors or global security interests, any multilateral economic engagement with DPRK will need to be guided at the political level both within the DPRK and among the participants and shareholders in multilateral mechanisms. Managing this relationship will place special demands on all parties. Primary will be the structure and sequencing of economic engagement activities that are included in whatever agreement emerges from the Six-Party Talks process. This will provide the essential framework for political oversight during the implementation phase. This linkage is likely to be explicit in conditionalities built into the agreement that would make moving to subsequent stages of economic cooperation contingent on achievement of results benchmarks agreed on the security agenda—essentially a road map. The activities of multilateral actors during this phase thus would need to be constrained by these conditionalities and their relationships managed effectively on a contractual basis between the multilateral agency and the authority supervising the implementation of the agreement. This could apply in particular to the potential role and activities of the IFIs before the DPRK is supported in applying for membership and could also apply to UNDP, with the mandates for action and their limits defined at the level of their respective governing bodies. The EU activities would also need to be in alignment with such understandings.

Farther down the road, a deepening of inter-Korean reconciliation could be expected to lead to an eventual peace accord and a partial demobilization of the DPRK military. An important linkage to economic cooperation at this stage will be a strategy for absorbing former soldiers into the civilian workforce. Both an infrastructure investment program and job creation in productive enterprises will be important means to absorb this labor and put it to more economically efficient use for the DPRK. The economic development strategy devised for the DPRK with multilateral support should aim to address these dimensions explicitly.

A future security architecture for Northeast Asia will need to evolve from any agreement with the DPRK that results from the Six-Party Talks. Energy security for the DPRK will be an integral part of any such future security architecture, as will the economic security implications of pursuing an outward-oriented economic development strategy in which increased trade with the ROK, China, Russia, and Japan will inevitably result in growing economic interdependence in Northeast Asia. Inter-Korean reconciliation will also eventually lead to increased integration of the two economies with security implications for both countries. All of these economic dimensions will need to be considered as part of the new security cooperation architecture.

### **Critical Choices**

Governments participating in the Six-Party Talks will have critical choices to make collectively and individually that will affect the shape of future multilateral economic engagement with the DPRK.

#### **KEDO's Future**

Should KEDO be dissolved? Should KEDO continue to perform a more limited role for a defined time frame? Should KEDO's mandate be revised to cover a different energy assistance commitment? Should the mandate be expanded to cover a broader range of economic assistance beyond energy? Should KEDO's membership be expanded to include China and Russia if it is to continue?

#### **IFI Relations With the DPRK**

When should existing shareholders support the DPRK in proceeding with an application for membership to the IMF, World Bank, and ADB? Will major shareholders support a membership in ADB before the IMF if DPRK seeks an ADB-first process? Will any of the IFIs be invited to engage the DPRK before a membership process is initiated; for example, in conducting an assessment of the DPRK economy and reform efforts, in providing training and access to their knowledge resources, or in providing technical assistance? Is the DPRK ready to work with the IFIs in accordance with their normal requirements, especially in sharing information and engaging in policy dialogue? Should the World Bank and ADB be given different mandates in the DPRK context?

#### **Realignment of the United Nations**

Should the lead UN agency in the DPRK shift from WFP to UNDP? Should UNDP be given a mandate to support DPRK aid coordination and management capacity-building and to perform an overall in-country coordinating role for the donors?

#### **Mandate for the Tumen Commission**

Should the Tumen Commission be given a mandate to take a lead coordinating role on transborder transport projects and trade promotion between the DPRK, China, and Russia? Will Japan join the Tumen Commission?

#### **New Regional Financial Organizations**

Is a Northeast Asia Development Bank needed? Should the idea of a Northeast Asia Fund or Northeast Asia Investment Corporation be explored?

### **China's Participation in Multilateral Economic Engagement**

China is both a borrower from the World Bank and ADB and a major aid donor to DPRK. Will China participate in a consultative group of donors under World Bank leadership? Will China coordinate its future economic assistance to DPRK with multilateral organizations working in the country? Will China join KEDO if it is given a new mandate? Will China channel some of its assistance through multilateral channels, such as the United Nations, KEDO, or the Tumen Commission?

### **Channels for Japanese Finance**

Will Japan join the Tumen Commission if normalization of relations talks with the DPRK move toward conclusion? Will Japan channel some of its future financial assistance through the World Bank and/or ADB?