

SINO-DPRK ECONOMIC RELATIONS: THE CHINA MODEL'S ROLE IN THE HERMIT KINGDOM

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I. INTRODUCTION

As one of the most isolated countries in the world during the Kim Il Sung dynasty, the Democratic People's Republic of Korea (DPRK) has an economy that has been far surpassed by the economic growth and rapid industrialization of its regional neighbors—most notably, China and the East Asian “tigers” of South Korea, Taiwan, Singapore, and Hong Kong. These economies witnessed the rapid development during the second half of the 20th century; the North Korean regime, on the other hand, has stagnated, despite the continued rise of South Korea and, in particular, China, its strongest ally. In fact, despite a common communist ideology, China's current pseudo-capitalist economy lies in stark contrast to the bleak reality of the Hermit Kingdom.

To be sure, North Korea's Stalinist economy under Kim Jong Il continues today, resembling the economy of pre-reform China. It is characterized by central planning and state ownership of the means of production. In accordance with its *juche* ideology, North Korea is focused on establishing a self-reliant economy that emphasizes military-oriented heavy industry—despite its impoverished economy, North Korea maintains a formidable military machine that includes the fifth largest standing army in the world. That said, many references are made to China's development experience as a model for North Korean economic reform.

This paper focuses on the North Korean economy with an emphasis on North Korea–China economic relations and the influence that interaction could have on North Korean economic reform and development. Specifically, the paper

addresses the DPRK's economic reforms and free trade zones, international trade, China-DPRK economic relations; and the predictive value (if any) that China's development experience may have for the DPRK.

II. OVERVIEW OF THE DPRK ECONOMY

The North Korean economy experienced moderate growth until the mid-1980s. However, in the mid-late 1980s annual growth fell precipitously, forcing the economy into crisis during the early 1990s. In fact, the annual growth of the gross national product of North Korea continued to decline throughout most of the 1990s. During that same decade, North Korea suffered the ravages of several devastating famines and floods. And though the country's economy rebounded in the late 1990s, it was more a reflection of the massive amounts of foreign aid it received than of any significant revival in the economy. That its consumption levels remain above the capacity of the domestic economy is indicative of North Korea's zero domestic savings. This low domestic savings rate is inadequate to reach the investment levels necessary to replace depreciation, leading to a continued decline in capital stock and accumulation. In fact, in 2006, the economy stood at a mere \$22.8 billion, a paltry figure in comparison with the vibrant economies of its regional neighbors, and 1.1 percent lower than in 2005. The North Korean economy has essentially caught itself in a technological poverty trap—a vicious cycle of low savings and little or no investment opportunities. Essentially, below a certain poverty threshold, a country is unable to achieve increasing returns to capital—poor countries fall deeper into poverty, while developed countries gain through increasing returns. Since the mid-1980s, the DPRK has been in a cycle of reinforcing poverty and declining economic growth.

The continued decline of the North Korean economy is attributable to several factors, both internal and external. Most significantly, the inefficiencies caused by the centrally planned Stalinist economy and the forced allocation of resources into military-oriented heavy industries (15–25 percent of gross domestic product) have hindered the growth of the domestic economy. The economic decline cannot be blamed completely on internal factors, however. The collapse of the Soviet bloc (one of North Korea's main trading partners and staunchest political allies) and the occurrence of several natural disasters left the North Korean economy unable to cope. The collapse of the Soviet economic bloc caused a precipitous drop in Soviet foreign aid, export markets, and artificially low oil price controls. Trade flows between the former Soviet bloc and the DPRK fell significantly, from more than \$3 billion in 1999 to just above \$230 million by 2005.

In fact, North Korea's policy of self-reliance belied the true reality of its biased dependency on the Soviet Union, China and other centrally planned economies. During the Cold War, the DPRK relied heavily on the Soviet economic bloc to help support its economy. After the collapse of the Soviet price system (far below global market prices), the surge in energy prices, for example, led to a severe reduction in North Korea's domestic output. An unfortunate by-product of this reduction was a food scarcity that had devastating consequences. The natural disasters in the 1990s exacerbated the food shortages, causing severe economic devastation and famine. Despite being shrouded in immense secrecy, estimates of famine-related deaths have ranged between 220,000 to upwards of 3.5 million. China replaced the former Soviet Union as the DPRK's largest trading partner and provided a substantial amount of resources during the North Korean economic crises. It should be noted, however, that China's aid to its impoverished neighbor is more a reflection of its desire to prevent political and economic chaos on its borders should the North Korean political system collapse than a pledge of support for the North Korean economic system itself. Given China's priorities in promoting its own economic development and its posturing as a pseudo-capitalist market, any assistance it provides is conditional.

In any regard, the mobilization of domestic resources and the central planning of the economy have been unable to reverse North Korea's economic decline. The triumph of global capitalist market forces over Soviet-style socialist economies in recent decades provides a strong case for economic reform and a gradual movement toward a market economy, as clearly demonstrated by China's experience. Even North Korea itself, as far back as the mid-1980s under Kim Il Sung, had begun to experiment with the idea of partial economic reforms. China has played a large role in this regard, as both a major economic trading partner and a model for economic reform, despite its communist government. Knowledge of the history of North Korean economic reforms and the influence China has had as a foreign trading partner and model of economic development is critical to understanding the North Korean story.

III. CHINA-DPRK ECONOMIC RELATIONS

Despite North Korea's isolationist posture and *juche* ideology, the DPRK is ironically still heavily enmeshed within the global trading system. Not surprisingly, international trade plays an important role in North Korea's foreign-dependent domestic economy, allowing the country to import food, technology and other goods that the domestic economy is unable to produce. The DPRK's international transactions have grown substantially since the famines of the 1990s, though the domestic economy has relied substantially on foreign aid to help finance these imports, in particular from China. As North Korea's neighbor and closest ally, China's economic relations with the DPRK have thus become especially salient.

During the North Korean famine in the early 1990s, for example, it was China that played a pivotal role in supplying foreign aid. Chinese economic aid has included not only official aid from the Chinese government but also private transfers from the sizable ethnic Korean community on the Chinese side of the border. This ethnic Korean population makes private capital flows into North Korea and often acts as a channel for funds originating in Korean communities outside China. In recent years, however, China's interaction with the DPRK has become increasingly market-oriented, in contrast to the noncommercial or aid component that predominates in North-South economic interaction. South Korea's economic relationship with the DPRK is heavily biased toward noncommercial exports in the form of financial aid support and investment in the Mt. Kumgang project and other cooperation projects.

A large part of China's increasingly market-oriented exports into North Korea is in the form of foreign direct investment (FDI). China has become the largest supplier of FDI into the North Korean economy—inflows into the DPRK surged sharply in 2003 to \$158 million, led primarily by Chinese and South Korean investments. North Korea sustained steady flows of FDI in 2004 (\$197 million) and 2005 (\$113 million). Chinese investments in the North Korean economy have ranged from small, informal investments to large-scale projects involving state-owned enterprises (e.g., mining).

China's increasingly dominant role in the North Korean economy is evident in the country's trade share statistics. The annual value of bilateral trade between the DPRK and China grew from \$370 million in 1999 to more than \$1.6 billion in 2005; North Korean imports of Chinese products more than doubled between 1995 (\$490 million) and 2005 (\$1.1 billion); and DPRK exports increased nine fold between 1995, when they were a mere \$64 million, and 2004, when they reached \$582 million. China's share of commercial exports surged from 19.3 percent in 2001 to 41.5 percent in 2004; imports rose from 28.4 percent in 2001 to 32.3 percent in 2004; and China accounted for 25.4 percent of total trade in 2001, compared with 36.0 percent in 2004. The proportion of China's share of North Korean commercial trade eclipses the country shares of the DPRK's other trading partners: South Korea's total trade share is the second largest at only 9.8 percent of total trade. In contrast, the economic importance of North Korea's other major trading partner, Japan, has decreased significantly in recent years to a mere 7.1 percent in 2004.

In sum, China remains North Korea's most important source for foreign investment and trade. China's economic integration with North Korea is largely commercial—in stark contrast to South Korea's growing official component of economic integration through aid and support (in excess of \$600 million in 2005, compared with China's \$200 million). China's overwhelming trade share

reflects its more sustainable and arguably more influential role in determining the development of North Korea's economy. Not surprisingly, South Korea harbors fears of China's economic colonization and its own potentially decreasing role and influence over its northern neighbor.

Official exchanges between North Korea and China have increased steadily in recent years and are another potential indicator of strengthening economic sway. Kim Jong Il himself has made numerous visits to China, an indication of the warming economic relations between the two countries and, more importantly, of China's increasing influence. In May 2000, Kim Jong Il met with Chinese President Jiang Zemin and Premier Zhu Rongji, with the clear intent of making educational site visits to high-tech industrial facilities. In January of that year, Kim Jong Il had declared during a visit to factories in Sinuiju that profit-seeking was a form of "practical socialism." Not coincidentally, his statements of pragmatism in economic thinking are reminiscent of Deng Xiaoping's philosophy of pragmatism during the early years of China's reform: "Be it a black cat or a white cat, a cat that can catch mice is a good cat." Eight months after his first visit to Shanghai in January 2001, Kim Jong Il made another trip there (followed shortly by a delegation of North Korean technocrats) for the purpose, analysts said, of ascertaining the potential for the DPRK to pursue market-oriented reforms similar to those of China. In an editorial delivered before his trip, Kim Jong Il called for the transition from "old thinking" to "new thinking," a clear signal of change in the government's direction. Despite the official *juche* ideology, Kim Jong Il reportedly asked his Chinese hosts if a market economy was compatible with socialism. Many officials have acknowledged off the record that Kim Jong Il became convinced of the advantages of a market economy. "A Directive for Economic Management" was issued in late 2001—decentralizing economic decision making and paving the way for more comprehensive economic reforms in July 2002. In April 2004, Kim Jong Il made yet another visit to China, touring factories and meeting with top Chinese leaders, including President Hu Jintao. In his meeting with Hu, Kim Jong Il commended China for its accomplishments under Jiang Zemin's "Three Represents," which reconciled market-oriented privatization with socialist principles. In March 2005, DPRK Cabinet Premier Pak Pong-ju made an official goodwill visit to China, particularly interested in touring large enterprises and factories on the outskirts of Beijing. At the conclusion of Pak's visit, the two governments signed two agreements: the Agreement on Encouraging and Protecting Investment and the Agreement on Cooperation in Environmental Protection.

But of all the official exchanges, the most historically significant is Kim Jong Il's trip to China in January 2006, during which he toured southern China's fastest growing regions. His trip was highly symbolic of Deng Xiaoping's famous Southern Tour in 1992 to promote China's special economic zones

(SEZs) and market reforms. In Kim Jong Il's own words, the visit was a resounding endorsement of the success of China's economic reforms under the socialist banner:

“The progress made in the southern part of China, which has undergone a rapid change, and the stirring reality of China, in particular, deeply impressed us. Still fresh in my memory is my visit to Shanghai five years ago that has changed beyond recognition. Touring various special economic zones making a great contribution to the socialist modernization drive with Chinese characteristics, we were more deeply moved by the Chinese people's enterprising and persevering efforts and fruits borne by them. In a word, our visit to the southern part of China convinced us once again that China has a rosier future thanks to the correct line and policies advanced by the Communist Party of China.”

Kim Jong Il's own “Southern Tour” was followed in March 2006 by a 30-member North Korean economic delegation led by his brother-in-law Jang Song-taek. That trip was widely speculated to be a precursor to economic reform measures modeled after China.

China's common ideology and its reconciliation of capitalist market practices with socialist thought make its economic development model particularly relevant and applicable to the North Korean regime, and the ongoing dynamic relationship between the two countries is strong evidence of China's influence on the DPRK. Though not as important as South Korea as a source of economic assistance, China remains an important provider of foreign aid to the impoverished nation, having sent food, medicine and oil shipments to the North as recently as August 2007 (and the year before, in July 2006). More importantly, however, market-oriented economic links are being forged between the two countries. For example, in March 2006, a North Korean trade delegation was invited by China's Ministry of Commerce to visit the northeastern border regions to observe the trade situation between the two nations; in May, a Chinese delegation reciprocated by visiting North Korea. In May 2006 and again in August 2006, China sent trade delegations to North Korea to promote increased cooperation in commerce, which both sides agreed would contribute to the development of stronger economic relations between them. In September 2006, a North Korean delegation representing 31 enterprises attended a product exposition in northeastern China, peddling mineral products, food, cosmetics, oil and farm products that were surprisingly well received by Chinese investors.

The frequency and depth of such interactions has led many observers to believe that the DPRK is eager to learn from the Chinese experience and is keen on

pursuing Chinese-style reform in its own development process. Thus, China's economic reform and development model is a particularly meaningful perspective through which to analyze and predict North Korean economic reform.

IV. ECONOMIC REFORMS

Historically, North Korea's foreign economic relations have largely been shaped by its autarkic development strategy of self-reliance. The DPRK developed into an isolationist, inward-looking economy that is reliant on import substitution. Yet, despite being virtually closed off from world trade, North Korea ran a chronic trade deficit with its trading partners.

Even with the DPRK's traditional insistence on self-reliance, its leaders have been amenable to receiving foreign aid, when convenient. Following the devastation of the Korean War, North Korea received substantial amounts of foreign aid, mainly from other communist countries, to rebuild its economy. Again, in the 1970s, the DPRK accepted inflows of advanced machinery and equipment from Japan and Western Europe to help modernize its economy in order to catch up with South Korea.

By the mid-1980s, however, North Korea began to rely more on exports to fund imports of advanced technologies and oil needed for industrial growth. The country's shift from its traditional policy of self-reliance was evident in the 1980s, when it experimented with a partial open-door policy—a policy that had been foreshadowed by Kim Il Sung's 1979 New Year's speech expounding the necessity of expanding foreign trade to meet the needs of an expanding economy. In 1984, the Supreme People's Assembly formally launched the partial open-door policy in its “For Strengthening South-South Cooperation and External Economic Work and Further Developing Foreign Trade” statement. The document underscored the need to expand economic and technical cooperation with the advanced industrial world as well as the developing world. Also in 1984, North Korea enacted a joint venture law, signaling an increasing openness to FDI. In 1988, despite still officially being in a state of war, North Korea established economic relations with South Korea. Since then, inter-Korean trade has grown rapidly, though noncommercial trade continues to occupy a significant proportion of North-South trade (31 percent in 2006, or \$421 million).

The most comprehensive economic reforms to date were enacted in July 2002: the DPRK announced its “economic adjustment policy,” a series of economic reforms that introduced pseudo-market mechanisms in production and consumer economic decisions. This was the first sign of a significant economic restructuring of Stalinist controls over the economy; again, similar to what China undertook in the early years of its reform period. Not coincidentally,

the reform measures were preceded by a succession of visits by North Korean officials to China. Although the Stalinist state did not abandon its socialist planned economy, it did reform several major facets of it. The adjustments included an end to the rationing system for daily commodities, excluding food; an increase in the prices of essentials and in wages; devaluation of the official exchange rate; abolishment of the foreign coupon payment system; increased autonomy for enterprises; authorization for the establishment of markets and other trading centers; and more opening of the economy to foreign investment. Although prices remain under centralized control, they are at levels closer to those of the free market.

North Korean economic reforms have also led to the increased use of currency, not ration coupons, in commercial transactions. After the reforms, prices set by the North Korean government on many essential items increased significantly. For instance, the price of rice increased 550 times, corn 471 times, diesel oil 38 times, and electricity 60 times. Wages also increased, though to a lesser degree: laborer wages increased 18 times and managerial wages (in a trading company, for example) 20 times. However, the wage and price reforms led to significant consumer inflation and many households were worse off as the increased wages could not keep up with surging consumer prices. Reforms in North Korean factories allowed for greater control over prices, procurement, wages and incentives, as well as profit sharing based on individual performance. Reforms in the agricultural sector continue to be implemented. In the 1990s, North Korea's agricultural work squads were reduced in size, and the agricultural sector was transformed into family-oriented operations, with individual farmers allowed to retain additional production over official production targets as profits, in a model similar to China's rural household contracting system. Again, not coincidentally, North Korea introduced the family-unit farming system and enterprise system reforms in January 2004, shortly before Kim Jong Il's visit to China. These measures were an expansion of March 2003 reforms that allowed merchants to sell manufactured goods, commodities and farm products in the general market. An inheritance law was also enacted that allowed children to inherit house leases, automobiles, bank savings and household appliances. These economic reforms are an indication of North Korea's adoption of Chinese-style adjustments to transform itself into a more market-oriented economy.

However, North Korea's economic reforms have been limited in scope and depth compared with China's more radical and comprehensive economic transition. The lack of trade is starkly evident in comparison with South Korea: in 2003, South Korea's total trade volume was 155.9 times larger than that of the DPRK. Moreover, North Korea's economic reforms have been motivated by the need to address the increasing seriousness of the problems created by its centrally planned socialist economy. Thus, North Korea's willingness to further open

its economy to South Korea and the rest of the advanced industrial world is related to its need to import advanced industrial equipment and technology to modernize its economy to help resolve the escalation of economic hardship (ironically, data for per capita food production indicate that for a 30-year period after 1961, growth rates in the DPRK exceeded those in South Korea).

V. SPECIAL ECONOMIC ZONES

During North Korea's early economic history, it pursued the political goal of proving the superiority of its system over that of South Korea. After the collapse of the Soviet economic bloc and in light of the continued decline of the North Korean economy, however, the DPRK has primarily concentrated its efforts on sustaining the current regime. In the early 1990s, the failings of the North Korean economic system in the face of China's robust economic miracle were impossible to ignore—after the famines, floods and collapse of the Soviet bloc, North Korea had few options. In a move that closely resembled China's partial market opening to foreign investment under Deng Xiaoping in the early 1980s, the DPRK established special economic zones (SEZs) through which the leadership could facilitate economic development and still maintain the regime. Profits from the SEZs would provide the North Korean government with access to much-needed hard currency to finance its severe current and capital account deficits and to facilitate trade with its trading partners. The FDI and foreign corporations established in these SEZs would facilitate the transfer of advanced industrial equipment and technology, as well as management skills, needed to modernize the domestic economy.

In the early 1980s, Deng Xiaoping had proposed opening such economic zones in China to fuel the country's economic development while maintaining its existing political structure. The SEZs of Shenzhen, Zhuhai, Shantou, and Xiamen were established in 1980 and 1981. Such special industrial complexes, physically separated from the rest of the country, allowed the government to control the inflow of FDI and the flow of outside information into the country without altering the political status quo. The largest SEZ—Shenzhen—sits right outside the border of Hong Kong and has become a major metropolitan area in mainland China. The phenomenal success of the SEZs motivated the Chinese government to enlarge the scope of its economic, technological and industrial zones—essentially laying the foundation for further economic reforms that led to the high growth rates in the Chinese economy over the past three decades. The Chinese experience has been a particularly salient example of the potential of SEZs in helping to develop the North Korean economy.

North Korea established its first SEZ in the early 1990s—Rajin-Sunbong near the Chinese and Russian borders. In 1991, FDI inflows spiked to \$134 million as capital was pumped into the North Korean economy to expand the Rajin-Sunbong economic zone. But the failure of Rajin-Sunbong to attract much

foreign investment led frustrated Russian investors and ethnic Korean investors in Japan to withdraw, and FDI into the domestic economy declined significantly. The volatility of inter-Korean politics (in contrast to the relative stability of the Chinese political environment) discouraged South Korean investors from getting involved in the North Korean economy. Moreover, the remote location of the SEZ and North Korea's underdeveloped infrastructure negated the benefits of low-cost labor and proximity to a major trading hub. These factors combined to create conditions for failure, and FDI failed to flow in as hoped. After the initial spike, FDI dropped to low or negative levels. In July 2002, the DPRK established the Sinuiju special administrative region (SAR) along the northwestern Sino-North Korean border, again modeled after the SEZs that had helped launch China's economic development. However, like the Rajin-Sunbong SEZ in the early 1990s, Sinuiju also failed to replicate the phenomenal successes of the Chinese SEZs. The failure of Sinuiju SAR was due in large part to external circumstances: the effort collapsed after China's arrest of Chinese-Dutch entrepreneur Yang Bin, governor of the SEZ, on charges of bribery, fraud and illegal land use.

North Korea's latest attempt to establish a free trade zone may prove that it has learned from its mistakes. Despite the failure of the Sinuiju SAR, North Korea has been committed to the development of the Gaeseong Industrial Complex (GIC), which was established in December 2002 along the border with South Korea. Managed by South Korea's Hyundai Asan and Korea Land Corporation, the GIC has developed rapidly. Much like the Chinese SEZs, Gaeseong is an avenue through which North Korea can allow FDI into the country without subjecting the entire domestic economy to the effects of world market forces. The 810-acre complex is primarily targeted toward small and medium-sized South Korean enterprises that seek to take advantage of cheap North Korean labor and production costs, and that may not be able to establish subsidiaries in China or other low-cost countries. In January 2006, 15 companies had established operations in Gaeseong; by 2007, 8,746 North Koreans were employed. The complex is to be completed in three stages and is projected to attract upwards of 1,000 enterprises employing 300,000 workers by the end of the third stage. Gaeseong developed in part as a result of former South Korean President Kim Dae-jung's Sunshine Policy of economic engagement with the North. Of the \$374 million cost for the initial stage, the South Korean government subsidized \$223 million.

The ultimate success of North Korea's SEZs, specifically Gaeseong, depends on a variety of factors, for which the China model can again serve as an example. Several of the factors that led to the overwhelming success of the Chinese SEZs are present in the North Korean scenario. The immense investment originating from the large overseas Chinese business community helped channel massive amounts of capital and management skill into China's four original SEZs. Many decades of high economic growth in South Korea have created a modern corporate sector that could

play a similar role in the North Korean economy. In addition, the proximity of the GIC to Seoul and its large South Korean business network could play the same role that Shenzhen's proximity to Hong Kong played in China's economic reforms. Shenzhen's coastal location and low-cost and highly disciplined labor force reduced transportation and labor costs; Gaeseong's favorable location and North Korea's highly literate workforce could be a key factor in the success of North Korea's SEZs.

However, unlike China—with its potentially huge domestic market, its high domestic savings rate, and the availability of domestic resources devoted to infrastructure development—North Korea's economy is impoverished and (unlike China) it holds little appeal in an increasingly competitive regional economy. The successful development of North Korean SEZs is thus highly dependent on South Korean investment.

But in contrast to the other SEZs, the importance of Gaeseong's success is readily apparent in both North and South Korea. Not surprisingly, in negotiations with the U.S. on the proposed free trade agreement, South Korea has tried (unsuccessfully) to have products exported from Gaeseong considered to have originated from a South Korean jurisdiction such that they qualify for duty-free status. The South Korean corporate sector's heavy involvement in the development of the economic zone, with explicit support from the South Korean government, has helped create the conditions necessary to attract massive amounts of FDI into the industrial complex and promote its success. More importantly, North Korea's vested interest in Gaeseong will ensure the DPRK's continued support of these partial economic reforms. The North Korean government earns inflows of hard currency from the GIC through leasing fees and a percentage of the wages South Korean enterprises pay to a North Korean government agency before they are distributed to workers in local currency. This inflow of hard currency denominated in dollars or euros is important in helping the DPRK manage its balance-of-payments problem and finance imports of the equipment and technology it needs to develop its economy.

VI. APPLICABILITY OF THE CHINA MODEL

A consequence of its socialist political structure, the North Korean economy remains one of the world's poorest. In particular, the DPRK's policy goal of developing a self-reliant economy and its emphasis on military-oriented heavy industries have caused the national economy to lag far behind those of its regional neighbors. North Korea experimented with partial economic reforms as far back as the mid-1980s, but its most notable economic reforms have been the 2002 establishment of the GIC and limited price and wage reforms. These economic reforms have elicited broad comparisons with China's economic reform and development process in the early 1980s under Deng Xiaoping. As the DPRK's closest political ally and largest trading partner, China is uniquely positioned to influence North Korea's reform path. China's

development model—rapid economic growth while maintaining the political status quo—has a predictive value for similar reforms in North Korea.

But the applicability of the Chinese development model is tenuous due to North Korea's fundamentally different economic and geopolitical conditions. China was able to establish its four original SEZs on the geographic and economic periphery, far from the traditional industrial centers. Geographically equivalent to a small Chinese province, North Korea cannot conduct open-market experiments on the periphery without concern about the potentially destabilizing effects on the national economy. In addition, China's open reform period followed the normalization of relations with the U.S. and Japan in the early 1970s. Normalized diplomatic relations with the two largest world economies laid the foundation for increased trade relations and access to global financial capital. North Korea, on the other hand, has yet to normalize relations with these two large economies, which substantially hinders the effectiveness of any economic reforms. In December 2007, there was speculation that President George W. Bush might consider restoring normal diplomatic relations with the North; however, this has not happened. Unlike China, which readily attracted foreign investment, North Korea struggles to attract foreign capital. Instead, the bulk of its foreign investment comes from China (which again is largely motivated by a desire to prevent the collapse of the North Korean regime) and South Korea (primarily in the form of foreign aid and noncommercial projects). Moreover, the agricultural sector constituted a large majority of the economy in pre-reform China: the breakup of collective farms and extensive rural reforms (such as the rural household contracting system) triggered significant gains in productivity that were a major driver in China's economic growth. In contrast, North Korea has a relatively small agricultural sector. The North Korean economy would have to rely on improvements in the productivity of the labor-intensive manufacturing industry, a formidable task for an economy mired in poverty and facing declining capital accumulation.

VII. CONCLUSION

The economic crises and famines of the past two decades illustrate the hardships North Koreans have faced under the centrally planned system. Moreover, the extent to which North Korea's self-reliant *juche* economy depended on other centrally planned economies (especially the Soviet Union) was evident after the collapse of the Soviet economic bloc in the early 1990s. In recent years, there have been signs that the economy is slowly rebounding after more than a decade of rapid decline. Partial economic reforms have helped the rebound, but a more substantial solution is necessary to bring the DPRK back from its prolonged isolation from the global economic system. Some observers see possibilities in North Korean adoption of the Chinese development model, but China's unique circumstances may preclude the development of a non-country-specific "China model" and its applicability to the DPRK.

THE DRAGON NEXT DOOR: REPUBLIC OF KOREA – PEOPLE'S REPUBLIC OF CHINA RELATIONS

Jason Cohen

I. INTRODUCTION

Starting with Seoul's recognition of Beijing in 1992, the fundamentals of the relationship between the Republic of Korea (ROK) and the People's Republic of China experienced a dramatic shift from wartime enmity to cooperative partnership. This transformation occurred along three main axes: political cooperation, economic links, and social, people-to-people connections.

Progress in each of these three areas was inevitable. Possessing common cultural and historical referents, the Korean and Chinese people found much to share in terms of music, the arts, and even pop culture. The so-called "K-craze" that swept Asia had a particularly dramatic effect on China, where Korean dramas, soap operas, and rock stars became household names. Moreover, once the economic floodgates were opened, trade and investment flowed across borders, and by 2004, China was the ROK's largest trading partner. China was already the largest destination for Korean foreign direct investment (FDI), surpassing the U.S. in 2002 and steadily widening the gap ever since. The maturing economic links also had a personal dimension, as more and more South Koreans followed investment dollars into China and settled there on a long-term basis.

Politically, the end of the Cold War effected a realignment that put the ROK's short- and medium-term goals more in line with those of China than of its American ally. Without the support of the Soviet Union, China was forced to sustain the failing regime in Pyongyang alone; China wished to strengthen the North Korean pariah state in order to avoid an economic collapse. Beijing also feared both the flood of refugees that a state failure of the Democratic People's Republic of Korea (DPRK) would unleash and the potential destabilizing