



US-KOREA 2011
YEARBOOK

JOHNS HOPKINS
UNIVERSITY

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2011: A YEAR OF TRANSITION

By Jae-jung Suh, Director of Korea Studies, SAIS

2011 was a year of transition, not just in a chronological sense from 2010 to 2012, but also in terms of the international politics surrounding the Korean peninsula. Whereas the previous year saw the heightening of tensions that brought the two Koreas to the brink of open confrontation, much of 2011 was spent on reigning in the rising war waves and steering the region toward calmer waters. A scurry of summits and diplomatic maneuverings across the Pacific helped calm the troubled waters, but the peninsula itself got caught in countervailing flows. On the one hand, Pyongyang and Seoul were pulled to negotiating tables by the centripetal force, but on the other hand, they were pushed further into their respective allies' boat as a safe haven. The troubled waters of 2010 calmed enough by the end of 2011 to allow for exploratory talks about resuming the Six Party Talks, a sea change that was also accompanied by the equally weighty developments: the ratification of the KORUS FTA by the US Congress and the opening of the North Korean Rason (formerly Rajin-Sonbong) and Hwanggumpyong/Wihwa Island special economic zones along the China-DPRK border.

The ominous clouds, thickened by the sinking of the *Cheonan* and shelling of the Yeonpyeong Island the previous year, began to part early in 2011. The January summit between US President Obama and Chinese President Hu generated the fresh air that was sorely needed to change the mood. The two leaders agreed, inter alia, on "the critical importance of maintaining peace and stability on the Korean Peninsula," and "the crucial importance of denuclearization of the Peninsula in order to preserve peace and stability in Northeast Asia." Together, they called for the resumption of dialogue, including inter-Korean talks and the Six Party Talks.

Pyongyang seemed to be in tune with these winds of change, and started the year by calling for dialogue and cooperation in its New Year's Joint Editorial, a move followed by what might be called the "charm offensive," including a grand proposal to hold a "broad dialogue and negotiation" with the South Korean government, political parties, military, and international organizations. While Pyongyang made ripples throughout the year with its usual blusters, the velocity of its dialogue offensive remained steady.

This current of goodwill, however, was met with a countercurrent in the South. President Lee Myung-bak demanded, in his new year's address, that North Korea show "sincerity" about peace and cooperation before talks could resume, a mantra that was to hold back Seoul as well as others for much of the year.

The meaning of “sincerity” was clarified as: Pyongyang taking “responsible measures” for the *Cheonan* and Yeonpyeong Island incidents, steps to prevent future provocations, and concrete actions to denuclearize. These tough demands, ostensibly made in response to the North’s aggression the previous year, created turbulence in what could have been productive flows.

Russia responded to this turbulence by dispatching its deputy foreign minister to North Korea. On his visit to Pyongyang in March, Alexei Borodavkin proposed the possibility of joint economic gains to generate the motive for political dialogue. He highlighted the “special prospect” of trilateral economic cooperation between Russia and the two Koreas such as railroads, a gas pipeline, and power transmission projects, while emphasizing the need for Pyongyang to take constructive steps toward better international relations, such as declaring a moratorium on nuclear and missile tests and giving International Atomic Energy Agency (IAEA) experts access to its uranium enrichment facility. Although Pyongyang repeated its previous position that it would “unconditionally” participate in the Six Party Talks, thus diplomatically rejecting Moscow’s proposal, the meeting confirmed that this “wind” toward dialogue still had momentum. More importantly, that meeting created agenda items that would be discussed in subsequent discussions about resuming talks.

The momentum gained power from a different direction in April when the North’s chief negotiator Kim Gye-gwan visited Beijing. His Chinese host, Wu Dawei, proposed a three step process to resuscitate the Six Party Talks, starting with a North-South talk, followed by a US-DPRK dialogue and the Six Party Talks. Soon afterwards, US Secretary of State Clinton visited Seoul, presumably to explore the three step proposal as a way to jumpstart the Six Party Talks. Shortly thereafter, Seoul delinked the *Cheonan* and Yeonpyeong Island incidents from the nuclear talks, clearing one of the main stumbling blocks. Japan too added to the momentum by highlighting in the so-called 2+2 meeting in June its agreement to achieve North Korea’s denuclearization through the Six Party Talks.

By then, all the pieces were in place to get past talking about talks. It would take the form of three steps, as Wu proposed, and involve discussing the agenda items proposed by Borodavkin. All there was left to do was to figure out specific modalities of their implementation. The rest of the year was consumed by diplomatic wrangling of those modalities, which was much more propitious than the cannon duel of the previous year. Starting with the North-South nuclear talk in July, a series of meetings were held. The United States and North Korea held two rounds of meetings, and according to the *Washington Post*, “near[ed] a breakthrough” by the end of the year when Kim Jong-il unexpectedly passed away. But even his death, as weighty and serious as it was, could not stop the momentum of the wind that was to lift the war clouds over the region.

As we now know, less than one hundred days passed before the talks resumed. Whether the resumption of the talks will result in “a breakthrough” remains a topic for next year’s Yearbook, but it cannot be overemphasized that 2011 was a crucial year of transition in which interchanges of dialogues cleaved a path through the war clouds, and the one that will become more appreciated as time passes. While this transition brought the regional actors together for talks about denuclearization and peace, another transition occurred almost simultaneously that was centripetal among allies but centrifugal in the region. North Korea became more integrated with China and, to a less extent, with Russia; and South Korea with the United States and Japan. The schism between these blocks was at times visible even as the region’s diplomats wrangled over the nuclear diplomacy.

Across the Pacific, ties between South Korea and the United States grew stronger. Among the most palpable were economic ties that received an institutional boost in 2011. American Congress and Korean Parliament ratified the Free Trade Agreement in October and November respectively and over different degrees of opposition. The American nuclear umbrella was made stronger over South Korea with the establishment of the Extended Deterrence Policy Committee. The US and Japan emphasized the importance of trilateral security cooperation, an emphasis shared by the US and South Korea. South Korea busily prepared for the transfer of the operational command from the Combined Forces Command as well as the relocation of the US Forces in Korea, as it placed its own military on a trigger happy posture by revising rules of engagement and creating the Northwest Islands Defense Command. Also, it is worthwhile to note that South Korea was successful in transitioning from an aid-recipient country to a donor country, attempted to develop its “green economy,” and established micro-financing programs as a remedy to neoliberal excesses, all of which have helped Seoul to emerge as a global player. Across the Yalu and Tumen Rivers, travels and exchanges grew between North Korea and its northern neighbors. The most significant of the travels was Kim Jong-il’s visits to Russia and China, which helped consolidate their traditional political relationship. Immediately following his footsteps were the “Strategic Dialogue” between Chinese Communist Party and Korean Workers Party in June and the launching of the Special Economic Zones in Rason and Hwanggumpyong. These were followed by increases in trade and exchanges. Following the Putin-Kim summit, North Korea and Russia concluded a memorandum of understanding on the gas pipeline project that would link Russia to North and South Korea. These diplomatic initiatives went hand in hand with Pyongyang’s ambitious projects to rehabilitate its economy. Kim Jong-il—who spent 2012 busily preparing the country to develop into a “Powerful and Prosperous Nation”—passed away toward the end of the year—perhaps an apt end to the year of transition that portended a new beginning the following year.

At the time of our writing of the Yearbook, a result of a semester-long study of Korea in fall 2011, there was no way for anyone to anticipate, much less predict, the dramatic transitions that occurred over the course of the year. But we managed to capture many of these in the Yearbook and offer an analysis of their causes as well as an assessment of their limits and potentials. That is largely thanks to our brilliant student authors' intuition and courage; they took on some of the most important aspects of the changes that were unfolding just as we were discussing these issues.

The Yearbook includes insightful contributions. Matt Chitwood seizes on the critical importance of the US-China summit in January 2011 and puts it in the context of North Korea's place in China's foreign policy strategy. Marc Janke and Kwang-yeon Lee broaden their strategic focus to issues regarding economic cooperation. Shelly Su analyzes one of the most consequential changes in the US-ROK alliance, the transfer of the operational command control, while Akito Nishiuchi puts his focus on the emerging blue ocean strategy of South Korean navy, and Benjamin Michener analyzes implication of Korea's demographic changes in the event of unification.

Other students help deepen our appreciation of other, equally important transitions in South Korea. Maggie Mazzetti takes a penetrating look at Seoul's efforts to transition to green economic growth. Rebecca Lee analyzes the impact and sustainability of one of Seoul's policy responses, microfinance programs, to counter growing income gap and enlarging debts. Alice Guilford assesses the implications of Korea's emergence as a development partner in Africa, while Alex Parcan compares the Korea-Chile FTA with the KORUS FTA.

All in all, the Yearbook represents the culmination of our semester-long intellectual endeavor to understand the past, present, and future of Korea. We have certainly enlightened each other in the process. We present the Yearbook, the crystallization of our collective wisdom, in the modest hope that others too will find bits and pieces of useful information and insights.

ACKNOWLEDGEMENTS

The publication of the Yearbook, a proud product of the “Two Koreas: Contemporary Research and Record” class taught at the Johns Hopkins School of Advanced International Studies (SAIS) would not have been possible without the help and support of many individuals. First and foremost, I would like to express my gratitude to the U.S. – Korea Institute Chairman Don Oberdorfer, Deputy Chairman Yong Shik Choo, and Director Jae Ku for their unsparing assistance for the Korea Studies Program, the “Two Koreas” class, and the Yearbook. I also would like to acknowledge many officials and scholars in Washington and Seoul who helped arrange professional meetings and took their precious time to meet with the class and/or individual students to discuss their research topics of interest. Thanks to the insight, knowledge, and generosity of these officials and scholars, the student authors were able to produce excellent works of research and analysis that are found in this year’s publication. Most of all, I would like to recognize the students of the “Two Koreas” class for their brilliance and diligence throughout the fall of 2011. Last but not least, my special thanks go to Angela Choi for managing all administrative and logistical details of the research trip, and Jenny Town for overseeing the production of the Yearbook.

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Previously, she interned at the Center for Strategic and International Studies, the Atlantic Council, and the Taiwan Ministry of Foreign Affairs. She has also served as program coordinator for the Southeast Asia Studies Program at SAIS. She received her B.A. in political science from the University of California, Berkeley, speaks Chinese, and is currently studying Korean language. On campus, she is an assistant editor for the *SAIS Review* journal and co-president of the Defense and Intelligence Career club.

YEARBOOK OVERVIEW

CHAPTER I: TRADE AND DEVELOPMENT

South Korea's Emerging Leadership as a Partner in African Development, by Alice Guilford

Alice Guilford examines how the Republic of Korea became the first ever aid-receiving country to emerge as an aid-donor and the domestic and international factors that led to this success. An analysis on how Korea's experience can be translated to Africa is conducted as the ROK's investment in Africa continues to grow, giving it a new leadership role in the international development community.

The Chilean-Korean Free Trade Agreement: History, Motivations, and Ramifications, by Alexander Parcan

Alexander Parcan examines South Korea's motivations for negotiating and ratifying the 2004 Chilean-Korean FTA. An analysis of how the ratification of the South Korean-Chilean FTA served as a fundamental turning point for South Korean attitudes towards bilateral trade and how this shift in attitudes influenced the ratification of the much larger KORUS FTA follows.

CHAPTER II: ROK ECONOMIC POLICIES

Smile and Sunshine: Assessing the Impact and Sustainability of Microfinance in South Korea, by Rebecca Lee

Rebecca Lee assesses the early successes and failures of ROK microfinance initiatives intended to link social welfare with economic development, as well as the Korean authorities' responses to administrative and economic challenges of these programs. She then discusses the history of the impacts of the Asian Financial Crisis on Korean society and why microfinance is a necessary component of the government's social welfare initiatives.

Assessing South Korea's National Strategy for Green Economic Growth, by Maggie Mazzetti

Maggie Mazzetti examines President Lee Myung-bak's National Green Growth Strategy and the extent to which it has addressed the issues at the heart of Korea's greenhouse gas (GHG) emissions problem. She also addresses whether or not the policies presented truly represent the Korean government's desire to adopt greener economic growth.

CHAPTER III: REGIONAL ECONOMIC COOPERATION

The Viability of the New North Korean SEZs, by Marc Janke

Marc Janke reports on the economic viability of the North Korean Special Economic Zones, including the two most recently opened SEZs in Rason and Hwanggeumyeong in June 2011. He presents evidence and data that suggest these SEZs can be both successful and unsuccessful and gives an analysis of the data to predict on the future viability of these economic ventures.

The "Pipeline Diplomacy" Russia- DPRK-ROK Gas Pipeline Project, by Kwang-yeon Lee

Kwang-yeon Lee examines the background, progress, and prospects for the proposed Russia-DPRK-ROK gas pipeline project with an understanding that energy diplomacy within the proposed multi-cooperative framework will have positive influence on the stability and prosperity of the region. He provides a close examination of economic and political benefits that each country may get from the cooperation and analyzes the challenges that result from constructing an ambitious development project with a risky partner, North Korea.

CHAPTER IV: UNIFICATION CONSIDERATIONS

Demographic Impact of Korean Reunification: Costs and Consequences for the North and the South, by Benjamin Michener

Benjamin Michener examines the potential demographic impact of a peaceful near-term reunification of the Korean peninsula utilizing a recently available North Korean census. He first discusses South Korea's demographic problems involving low fertility rates, gender imbalance, and aging population, then predicts the positive and negative consequences that reunification may bring to the Korean demographics.

CHAPTER V: SECURITY AND FOREIGN POLICY

North Korea in China's Foreign Policy Strategy, by Matt Chitwood

Matt Chitwood explores China's balancing of commitment to peaceful development and its role as a responsible international power vis-à-vis its foreign policy toward its ally, North Korea. He provides analysis of the historical basis of China-DPRK relationship, significant changes in China's policy on North Korea over the course of that relationship, and projections for China's policy moving forward.

Navigating the Blue Ocean: Strategy for the Korean Navy, by Akito Nishiuchi

Akito Nishiuchi examines the ROK's establishment of a larger and more capable navy that operates today not only around Korea, but also in troubled regions abroad. He proceeds with an analysis of the relevance between alliance management and Korea's new naval strategy.

The OPCON Transfer Debate, by Shelley Su

Shelley Su examines the issues surrounding the US transfer of the wartime operational control (OPCON) to the ROK, and assesses the merits of the three positions of the transfer: whether to carry out the OPCON transfer on the initially agreed upon transfer date; to reject the OPCON transfer altogether; or to delay its implementation. She then further examines the reasons why the Obama and Lee administrations chose delay as the best course of action.

CHAPTER I: TRADE AND DEVELOPMENT



South Korea's Emerging Leadership as a Partner in African Development

By Alice Guilford

I. INTRODUCTION

The Republic of Korea is the first and only former aid-receiving country to have emerged as an aid donor. In 1961, Korea was a former Japanese colony torn apart by a destructive war, with an annual per capita gross domestic product (GDP) of only \$82, putting it on par with the poorest African countries. From these humble beginnings, Korea experienced unprecedented economic growth over the next four decades, which eventually enabled it to join the Organization of Economic Cooperation and Development (OECD) in 1996, with an annual per capita GDP of \$12,732. In 1987, Korea also managed a peaceful political transition and has since consolidated into a liberal democracy. Today, Korea has become the eleventh-largest economy in the world, with an annual per capita GDP of \$30,000 in 2010. Korea's economic development challenged widely held beliefs within development theory and caused the international community to reconsider its approach to assisting developing countries throughout the world. This experience makes Korea uniquely qualified as an emerging aid donor to offer development advice to developing countries and take on a leadership role in determining international development policy.

Nowhere is more in need of fresh approaches to sustainable development than Africa. Of the 53 countries on the continent, 33 are considered Least Developed Countries (LDCs) by the United Nations, and half of all Africans live on less than \$1.25 a day. Since the end of European colonial rule in the 1950s and 1960s, African countries have experienced many challenges to their development, including corruption, poor governance, low productivity, and external and internal conflicts. Recent trends show a more optimistic future, but there is still a long way to go.

Africa has been the subject of multiple developmental initiatives. Western countries have traditionally led these efforts and have historically tied aid to conditions that were not always designed with the welfare of the recipient country's citizens in mind, sometimes rendering this type of aid unpopular. Throughout the Cold War, aid was tied to political loyalties, while the civil and human rights of the recipient populations were too often overlooked. Beginning in the 1980s, loans from international financial institutions (IFIs) were conditioned on the implementation of structural adjustment policies that required fiscal austerity and deregulation, compounding existing social problems. More recently, aid has been conditioned on efforts to encourage democracy and good governance.

In the new millennium, however, the emergence of new economic partners, led by China, has begun to seriously challenge European and American dominance in Africa. According to the United Nations' *African Economic Outlook 2011*, 38.5 percent of all trade with emerging partners in 2009 was with China, which totaled over \$120 billion. China has also increased its foreign-aid budget to Africa and has built much-needed infrastructure, primarily to support its own economic projects. The Chinese model is not tied to preconditions and, because of this, it has been criticized for sustaining the rule of authoritarian regimes by creating new rents that directly fund these regimes and remove incentives for reform. The Chinese also tend to provide their own capital and labor within a recipient country, and by doing so the elite minority benefits at the expense of the majority.

A new approach to development is needed that allows for equal, mutually beneficial partnerships that encourage sustainable economic as well political and social development. Korea can offer such a new alternative that supports social and political change, without following the top-down donor-beneficiary model that has created distrust among many Africans of foreign development initiatives. Korea's own development experience and emerging leadership in the development community present a third model for economic development in Africa: Korea can apply the most relevant aspects of its own experience to the individual circumstances of specific countries.

To better understand Korea's experience, how this has shaped its emerging role, and how this can be translated to Africa requires a closer look at both Korea and Africa. The first section of this paper examines Korea's development experience. This is important because it helps to separate out the domestic and international factors that made Korea's success possible and also to explore what parts of Korea's path might be relevant for African countries, many of which experience the same constraints that Korea overcame. The second section looks at Africa's development history. African countries' troubled political and economic history has contributed to their relative underdevelopment. They have also received considerable attention from the Western development community and, more recently, from emerging markets, led by China. Both of these models have shortcomings, suggesting a need for a different approach to development. The last section investigates how Korea is emerging to fill this need by offering its expertise and aid. Although as yet this represents a small percentage of assistance to Africa, Korea's investment in this form of cooperation is growing quickly and has been eagerly received by its African partners. Korea's emerging leadership role in the international development community is evidenced by Korea's admission to the OECD's Development Assistance Committee in 2009, the G-20's signing of the Seoul Consensus at the summit Korea hosted one year later, and the country's high-profile role as host of the Fourth High Level Forum on Aid Effectiveness in Busan in December 2011.

II. KOREA'S DEVELOPMENT EXPERIENCE

Korea's economic development over the past fifty years has prompted debate over the causes of development, as academics have tried to determine the most significant contributors to Korea's rise and developing countries have tried to emulate it. Korea's success is often called a miracle, suggesting that the country's transition was an anomaly that would be difficult to replicate rather than the result of carefully planned policy interventions.

Korea's Growth Strategy

In 1961, six years after the Korean War ended in the division of the two Koreas along the thirty-eighth parallel, the Republic of Korea was still struggling to rebuild the two-thirds of its infrastructure destroyed in the war. Korea's annual per capita GDP was just \$82. This placed the country in the bottom quintile worldwide, at the same level as Ghana and far behind Senegal and Mozambique. That year, President Park Chung-hee came to power in a military coup. The following year, he implemented the first of his five-year economic development plans.

Over the next three decades, the developing state closely monitored and directed economic growth. The government distinguished priority sectors and harnessed an exclusive, but highly competitive, core of elite businesses to carry out large-scale manufacturing and export-led growth. Korea's five-year plans focused on long-term management of industrialization, constant government reinvestment in the most successful industries, carefully controlled access to credit and funding, and industries that constantly adjusted to compete with global private-sector best practices. As a result, Korea's economy grew rapidly at a rate of 6.8 percent per year, increasing annual per capita GDP fivefold by 1987. Economic liberalization followed the 1987 transition to democracy and led in part to a financial crisis in 1997–98, briefly bringing Korea's economic future into question. Pragmatic reforms in the wake of the crisis, however, led once again to high growth rates. Today, Korea is the eleventh-largest economy in the world with an annual per capita GDP of \$30,000.

In the initial stages of Korea's economic development, outside observers and Korea's own citizens were pessimistic about Korea's economic future. Like Africa today, Korea did not seem to have the prerequisites for development. The population was poor and internally displaced, there was no strong middle class, there were no established markets, and the economic development it had experienced was as a colony of Japan. The authoritarian regime was seen as an obstacle that had to be overcome, because it was widely understood that government intervention only hindered the more efficient workings of the market.

The Roles of Foreign Aid and Democratic Transition

It is often overlooked that Korea received considerable foreign aid that played a vital role throughout the years of its reconstruction and the first decades of the country's development. Major international donors included the UN Development Program (UNDP), the World Bank, the Asian Development Bank (ADB), the US Agency for International Development (USAID), and Japan's Overseas Economic Cooperation Fund (OECF). According to the Korean International Cooperation Agency (KOICA), which oversees Korea's international development policy today, the supply of basic commodities such as food, clothing, medicine, and raw materials sustained many Koreans in the years following the war. Foreign budgetary assistance also enabled the Korean government to meet its expenditure obligations. Between 1953 and 1969, foreign aid accounted for 70 percent of Korea's imports and three-quarters of its capital formation. In the years following, foreign assistance continued to be an important source of government-directed capital and investment. By comparison, the World Bank reports that in 2010, mean official direct assistance (ODA) as a percentage of gross national input (GNI) to countries in sub-Saharan Africa was 4.9 percent. Few countries begin to approach Korea's early percentages of aid dependence.

Korea's successful transition from a highly repressive authoritarian regime to a consolidated liberal democracy proved equally important to its economic success. In 1987, President Roh Tae-woo was pressured to agree to extensive democratic reforms by society-wide protests. During the resulting elections, Roh decided to run for president and won with the help of a liberal coalition. He did not protest the one-term limit placed on the presidency and stepped down at the end of his term in 1992.

With the election of the Grand National Party's Lee Myung-bak in 2008, Korea passed Samuel Huntington's two-turnover test of a consolidated democracy. According to his theory, laid out in 1991 in his book *The Third Wave*, a democracy is on sound footing and can therefore be considered consolidated when its democratic institutions are strong enough to pass power between opposing political parties twice, through an electoral system. Though rising inequality, delayed private-sector reforms, and weak institutions suggest that consolidation may be ongoing, Korea nevertheless demonstrates a strong example of a peaceful democratic transition.

III. AFRICA'S DEVELOPMENT EXPERIENCE

Africa's development experience mirrors that of Korea's early years. Korea was a forerunner of both Africa's wave of decolonization in the early 1960s and its wave of democratization in the early 1990s. In the intervening years, Korea's early democratic hopes were taken over by authoritarian regimes in a pattern also seen throughout Africa. Like Korea, several African countries became the front line of confrontation between the two super powers of the Cold War.

Africa's Path towards Development

When Korea gained its independence from Japan in 1945, the only two independent African countries, Liberia and Ethiopia, were also the only two that had not been colonized by European powers. The so-called Scramble for Africa had culminated in the 1884 Conference of Berlin, where the colonial powers divided the continent and drew the borders of its present-day states with little regard for existing political or ethnic boundaries. It was not until the aftermath of World War II, beginning around 1960, that the majority of African colonies gained their independence from European powers.

Virtually all of these former colonies began independence with competitive elections and the intention to become fully democratic and to promote equality through economic growth. By the late 1960s however, most had slipped into authoritarianism. The Cold War divided the former colonies into two camps aligned with patrons that too often valued security and loyalty over reform and civil rights. Civil conflicts in Angola and elsewhere became proxy wars that inflicted massive casualties and destroyed infrastructure. Covert operations in countries like the Belgian Congo eliminated popular or democratically elected leaders and supported authoritarian dictatorships. By the time Korea began its transition to democracy in 1987, only three of the forty-eight countries in sub-Saharan Africa, and none of the North African countries, could be called democracies.

Upon close examination of economic growth and governance, the histories of Africa and Korea diverge even more. While Korea's steady economic growth has made it one of the largest economies in the world, most African countries are characterized by extreme poverty, rural populations, and underdeveloped economies. According to the UNDP's *Human Development Report 2010*, many African countries experienced little to no growth in the 1980s and 1990s. Some countries, including Zambia and Zimbabwe, actually rank lower on the UNDP's Human Development Index now than they did in 1970. In recent decades, this has been compounded by the failure of structural adjustment programs to spur economic growth as well as unforeseen crises brought on by global climate

change and the rapid spread of HIV. The World Health Organization estimates that the negative impact of HIV and AIDS on productivity and human capital in high-burden countries is responsible for a decrease of 1.7 to 2.7 percent growth per year.

Despite these challenges, the economic future of the African continent is looking brighter. In the last decade, African countries experienced some of the highest growth rates in the world, averaging 5.8 percent per year between 2000 and 2008. These growth figures actually put Africa ahead of East Asia for eight of the past ten years. The International Monetary Fund expects this trend to continue, estimating that growth in 2011 was 6 percent and projecting that growth for 2012 will be 6 percent.

Comparison of Korean and African Development Experiences

What accounts for the very different outcomes in Korea and Africa? Every country and every development process is uniquely influenced by factors specific to its location, history, and time. While some aspects of Korea's experience were specific to its circumstances, can and should certain aspects be shared with African countries?

Some of Africa's challenges cannot be solved by economic policies alone. Climate change, creeping desertification, and racial and religious segmentation all fall into this category. The burden of HIV and AIDS, as already mentioned, also has a significant effect on afflicted countries' demographics and human capacity. Other constraints include the colonial legacy, Cold War alignments, and destructive civil wars. In the early stages of its development, Korea also faced many of these constraints, but it either overcame them or used them to its advantage. For this reason, Korea can serve as not only a roadmap but an example that such a path is possible.

Despite these similarities, Korea had two advantages that only a few African countries share. The first was relative equality. The destruction of the Korean War removed both the power of the historical social classes and the country's hierarchical social structure. The GINI coefficient rates countries' income disparity, with zero being completely equal and one being completely unequal. According to calculations made by Kookshin Ahn in 1992, Korea's GINI coefficient was 0.34 in 1965, placing it well below the global average of 0.47 for that year. Korea's current GINI coefficient of 0.31 places the country in the seventy-ninth percentile of global income equality, only slightly less equal than its 1993 rating of 0.29. Combined with a population that was both racially and linguistically homogenous, this decreased internal strife enabled Korea to pull together under firm leadership to work toward a common goal in the first decades after the Korean War.

By comparison, African countries tend to be highly unequal and more internally fractured. Africa's mean GINI coefficient today is 0.58, above the global average of 0.52. The top six unequal countries worldwide are all in Africa, and only one African country has a lower coefficient than Korea. This indicates that, in African countries, elites have been able to effectively manipulate policies and capture rents. It also indicates a lack of societal cohesiveness that would induce leaders to reinvest in human and physical capital that would enable the country to develop as a whole. Similarly, because European powers arbitrarily determined the boundaries of African states during the 1884 Conference of Berlin, most African countries are not homogenous and often include several ethnic and linguistic groups with contentious histories. Colonial powers often made these tensions worse by playing them off against each other as a way to maintain control.

Korea's second advantage was its high investment in human capital and its history of valuing education. The priority placed on primary and vocational education created a skilled and flexible workforce, making it possible for Korea to both increase its productivity and take advantage of new opportunities as they arose. During reconstruction following the end of the Korean War, 10 percent of the government budget was dedicated to education. According to Korean Educational Statistical Yearbooks, the share of total government expenditures dedicated to the Ministry of Education had increased to 19 percent by 1967. From that year until the end of the Park Chung-hee regime in 1979, the ministry's budget averaged 17.4 percent of government spending and never dropped below 15 percent.

It was not simply the amount of resources dedicated to education that laid Korea's foundation for rapid economic development but also how these funds were allocated. As Kim Chong-sup and Hong Min-kyung show in "Education Policy and Industrial Development" in 2010, Korea's investment in education at any given time was not significantly higher than other developing countries in absolute terms. What made the difference was the government's ability to identify specific educational needs during each stage of development and to modify the allocation of educational spending as those needs changed. During Korea's reconstruction in the 1950s, the country's first priority was to achieve universal primary education. Primary education received 70 percent of education funding, and by 1965 Korea had achieved 100 percent primary school enrollment. The focus then shifted to secondary education, and the budget for secondary education steadily increased while primary education spending decreased gradually to a level that could maintain universal enrollment. Universal secondary school enrollment was achieved in the 1980s. A steady increase in funding for tertiary education followed. In 1970, tertiary enrollment was less than 10 percent, but by 1990 this had increased to 40 percent. The World Bank reports that tertiary enrollment in Korea exceeds 90 percent today. This targeted

investment in education allowed Korea to build and maintain a solid education structure and an educated workforce. Today, Korea's ration of education spending to GDP is one of the highest in the OECD.

Korea also made a simultaneous push to increase technical education. Beginning in the 1960s, President Park identified lack of skilled labor as a limitation on industrialization, and he used his five-year plans to develop a system for vocational training. This training focused on the needs of key industries, beginning with manufacturing and later moving into chemicals and new technologies. This investment was crucial to Korea's success in "catching up" to the developed economies of the United States and Japan, because it provided the skilled labor necessary for the targeted industries to become globally competitive. As Guilo Guarini and colleagues find in their 2006 analysis of Korean labor productivity, this investment allowed Korea to increase its labor productivity from 22 percent of US productivity in 1975 to 54 percent in 1999.

As previously mentioned, official direct assistance made up a significant portion of Korea's budget during the decades of initial education investment in the 1950s and 1960s, both directly through budgetary assistance and indirectly through taxes and revenue from foreign-aid imports and capital formation. This assistance allowed the government to dedicate resources to sectors that might not otherwise have been priorities in a budget constrained to providing only basic services. While inequality and ethnic tensions are only overcome through long-term efforts to forge national unity and through managed growth to distribute wealth more evenly, focusing on education is something that African nations can and should pursue more vigorously. This provides an opening for ODA and is an area in which Korea can share its experience and provide a model for development.

International Development Efforts in Africa and an Opening for a Third Way

For most of the history of development assistance, donor countries have been either European or North American. Particularly in Africa, former colonial powers Britain and France remained highly involved even after their departure; and during the Cold War the United States saw Africa as contested ground to be won from the Soviet Union. Development assistance was a way to further foreign-policy goals of donor countries, strengthening political alliances and ensuring access to natural resources; foreign aid was less concerned with the consequences of supporting unpopular leaders and overlooking human-rights violations.

By the 1970s, most African countries had abandoned their initial experiments with democracy and had become authoritarian regimes. Years of economic

mismanagement led to financial crises that brought governments close to bankruptcy and prevented them from paying for their bloated public sectors. International financial institutions stepped in to offer loans but tied them to unpopular structural adjustment programs. This forced austerity on already weak economies, resulting in rapid devaluation of currency, rising prices, and large-scale layoffs. This in turn contributed to social unrest and a growing distrust of the Western aid community. By the 1990s, this approach was understood to have been ineffective and at least partially responsible for the lost decades of economic growth that many countries endured. Development-aid focus then turned to promoting democracy and good governance, with the belief that democratization would bring economic growth and independence. While the individual stories of African countries vary, decades of aid have not been effective enough to produce the sustained growth necessary to lift Africa out of poverty. Deep distrust rooted in the colonial legacy and fostered through more recent disappointments has made it difficult for new solutions proposed by the West to gain credibility among the general population.

As China has grown in global importance, it has taken a more active role in Africa and challenged the dominance of Western development efforts. In the last decade, China has become the most important trading partner of many African countries, including the continent's largest economy, South Africa. Trade with China accounted for 38.5 percent of African trade with emerging markets in 2011 and totaled over \$120 billion. It is more difficult to quantify China's official direct assistance, however, because of lack of transparency. The International Monetary Fund estimates that China's development assistance to Africa was \$2.3 billion in 2006. Of this, \$1 billion was ODA and the remaining \$1.3 billion was debt relief. An additional \$0.9 billion was given in foreign direct investment (FDI).

Chinese development assistance does not follow traditional development models. There is not a centralized development agency attached to the Chinese Ministry of Foreign Affairs and charged with oversight and coordination of aid projects, as is standard in OECD countries. Instead, assistance is primarily distributed in the form of loans and grants through the Ministry of Commerce. This is because the primary purpose of Chinese development assistance is to further China's economic priorities and to gain access to natural resources. China favors highly visible infrastructure projects, such as highways and stadiums, which are often given in exchange for construction or extraction contracts or as necessary improvements in order to transport natural resources. At least half of the human and capital investment must be sourced from China as well, ensuring that revenue will feed back into its economy.

The Chinese development model has been criticized for being highly exploitive and unsupportive of sustainable growth. Chinese aid places no preconditions

on domestic policy; the imperative for smooth commercial relations means that China prefers to work with governments that will make the process as simple as possible. This approach favors weak government regulation and strong centralized control over decision making, characteristics that do not necessarily align with liberal democratic values. Use of Chinese labor and capital also means that partner countries do not benefit from increases in employment and revenue.

In some ways, Korea shares China's motivations in Africa. Like China, Korea is seeking a new role for itself on the international stage. Also like China, Korea faces pressing energy-security issues and must find new resources to fuel continued growth and meet the increasing demands of a growing middle class. Korea's involvement in Africa is fundamentally different from its neighbor's, however, as economic motivations are noticeably absent from initiatives to date. While China has been explicit about its intention to pursue strategic partnerships to further its own economic interests, Korea has chosen instead to focus on the needs and priorities of its partner countries, strengthening their institutions and building their capacities. In turn, Korea hopes to earn credibility in the international development community and gain a higher-profile role in international development forums.

Park Soo-deok, director of the African Division of the Korean Ministry of Foreign Affairs and Trade, addresses this topic in his 2011 paper "Ways to Share Korea's Development Experience with Africa." He argues that both Western countries and China have shortcomings that limit their effectiveness in African development. The West has lost Africa's trust because of its long and complicated history dating back to colonization. It is a relationship that will forever be charged with historical tensions and insecurities. China offers an attractive alternative in that it is willing to give money without preconditions. Park argues that this approach is not sustainable because it hampers long term social and political change by reinforcing the status quo—helping to keep incumbents in power.

Africa is in need of a new approach and Korea offers an alternative. With its own recent experience, Korea understands the pitfalls of development and the challenges facing African countries. It has struggled with the legacies of colonization, war, authoritarianism, and poverty. More importantly, it was able to overcome these challenges to emerge as a liberal democracy and an influential actor on the world stage. Because of this, it has the legitimacy that both Western countries and China lack. It is this that Park Soo-deok emphasizes when he says that Africans and Koreans share "a bond of historical and emotional sympathy." He continues, "Africans are eager to learn about our development experience. This is Korea's unique strength upon which we can build mutual trust."

IV. KOREA IN INTERNATIONAL DEVELOPMENT

Korea's Path from Recipient to Donor

Korea's role in international development has roots dating back several decades. Korea's rapid growth caught the attention of other developing countries early on, leading to an increasing demand to share its experience and advice. While still an aid recipient, Korea began to provide technical training to the governments of other developing countries through a program sponsored by USAID. Later in the 1970s, Korea began to provide modest amounts of in-kind aid through South-South partnerships to many African countries. In 1987, Korea established the Economic Development Cooperation Fund in order to offer grants and loans to the governments of developing countries around the world.

It was not until the 1990s, however, that Korea became a serious player in the international development community. In 1991, it consolidated its development efforts into the Korean International Cooperation Agency under the slogan "Creating a Better World Together." As this implies, Korea's development assistance has focused on equal partnerships and meaningful sustainable relationships with the governments of other countries. This differs from the traditional donor-beneficiary relationships that divide the world into two classes of countries. In 1996, Korea joined the OECD and, in 1999, became a founding member of the new G-20 summit made up of finance ministers and central bank governors of the world's nineteen largest economies plus the European Union. In 2009, Korea became a member of the OECD's Development Assistance Committee, a first for a former aid-receiving country and Korea's symbolic arrival as a developed country.

When Korea hosted the second G-20 summit in November 2010, it promoted a new model for development called the Seoul Development Consensus for Shared Growth (Seoul Consensus). In one of the summit's few successes, all member countries agreed to replace the discredited Washington Consensus that had led development thinking until the 1990s. This was a definitive shift away from structural adjustment programs led by international financial institutions and also an official acknowledgement of the development successes of emerging markets, including Korea. While the Seoul Consensus outlined six principles of development and nine target areas as part of a multiyear action plan, it also stressed that one development method would not fit all countries. It emphasized treating lower-income countries as full partners and giving their governments the flexibility to pursue policies they identify to be in their best interests. This important statement signaled a shifting world order in which emerging economies are increasingly able to exert their influence on behalf of developing countries.

One year after the Seoul Consensus, in November and December 2011, Korea built on this momentum as host of the Fourth High Level Forum on Aid Effectiveness. The choice of Busan as host city for the summit was symbolic. Busan had been one of the only cities to remain under South Korean control throughout the Korean War and it temporarily housed the government. Because of this, it became one of the main ports by which foreign aid entered the country. It later developed into a center of commerce and industry, and today it is the world's fifth-busiest seaport. Korea used this summit to highlight the effectiveness of aid in its own development history and to promote horizontal cooperation, integration of aid efforts between multilateral organizations and private donors, and the importance of developing domestic capacity.

Korea's Development Partnership with Africa

In parallel with Korea's increasing participation in international forums, Korea put its development approach into practice through cooperative partnerships with African countries. In preparation for the first Korean-African Forum in 2006, Korean president Roh Moo-hyun visited Nigeria, Algeria, and Egypt. It was the first time in over two decades that a Korean president had visited the continent in an official capacity, and he was warmly received. During the trip, President Roh announced his Initiative for African Development and committed Korea to triple its official direct assistance to Africa to \$100 million by 2008. Although this amount seemed small compared to the \$10 billion China planned to give over those three years, Korea's unique approach gave it legitimacy and respect uncommon in such relationships.

The first Korean-African Forum, which took place in 2006, was an initiative of then Minister of Foreign Affairs and Trade Ban Ki-moon. Presidents from the Democratic Republic of Congo, Nigeria, Ghana, Tanzania, and Benin participated, along with ministers from twenty-five other African states. The goals of the forum were to establish Korea as an official partner in African development and to present an alternative development approach. Three important decisions were made: Korea pledged to increase its number of diplomatic missions in Africa (then eighteen), to build a professional training institute for African studies in Korea to bring together Korean and African experts to develop effective policy recommendations, and to develop partnerships with the private sector to promote initiatives in Africa. Annual Korean-African Forums have since become central to Korea's development policy and have been held in Seoul each fall since 2009.

Korea's collaborative approach to development is illustrated in its partnership with Rwanda. Since 1997, Korean volunteers had gone to Rwanda to give trainings and do individual projects. In 2008, the Korean International Cooperation Agency

strengthened the relationship by placing five Korean strategic-planning experts in President Paul Kagame's Strategic Policy Unit for one year. The Koreans worked with representatives from government ministries to identify Rwanda's primary development needs and to find ways that Korea could offer assistance. At the end of the year, the Korean-Rwandan team of experts presented President Kagame with suggestions for increasing Rwanda's growth in key sectors where the country could be most competitive and Korea's experience best applied. KOICA, in coordination with the Rwandan government, chose to initially focus investment on technical training for skilled workers in the textile and pharmaceutical sectors as well as on offering wider educational opportunities for Rwandan students domestically and abroad in Korean universities.

Korea's focus on education makes sense given its experience and expertise. Education is Korea's largest sector of foreign aid, comprising just over 30 percent of its assistance. Of this, 30 percent goes to primary education, 49 percent to secondary and vocational education, 10 percent to higher education, and 11 percent to other educational projects. KOICA's three-part strategy for education assistance is based on Korea's own educational system. First, the strategy begins by helping countries develop educational infrastructure by building and renovating primary and secondary schools, universities, and vocational training centers. The second step is to improve the quality and relevance of education, which is accomplished by developing new curriculums and teaching materials and by training educators. The third step is to improve education management, done primarily in collaboration with governments by reviewing and revising education policy and instituting national standards.

In Tanzania, KOICA's aid has incorporated all three steps of this strategy. In line with the country's desire to become competitive in the communication technology sector, KOICA renovated some University of Dar es Salaam buildings to create state-of-the-art engineering facilities that would allow the College of Engineering to double its yearly graduates. To facilitate innovative instruction and increase education capacity, KOICA sent a team of Korean lecturers to share their professional and academic expertise with Tanzanian professors and students. KOICA also sent managers to assist in setting up an engineering faculty intended to be the best of its kind on the continent. This faculty would inform national education policy and set new standards.

Korea's expanding development cooperation with Africa is still very new and limited to small-scale projects, so no long-term studies have yet analyzed its effectiveness in comparison to other models of delivering aid. Qualitative evidence suggests, however, that these initiatives have been positively received and have become a foundation for lasting development partnerships. President Jakaya Kikwete of Tanzania expressed his gratitude that Korea's assistance in

developing much-needed vocational training programs had come at the right time, and President Kagame has spoken of his desire to emulate Korea's dedication to his own country's development. The Democratic Republic of Congo's president, Joseph Kabila, expressed these sentiments best during his 2010 trip to Korea: "It is a huge challenge for the Democratic Congo to win this war [against poverty and underdevelopment] and in order to meet this enormous challenge we are looking for reliable and respectable partners...Korea can be such a partner."

V. CONCLUSION

Korea's experiences as both a recipient and a donor of development aid give it a unique ability to bridge the gap between the two communities. As formerly one of the poorest countries in the world and an aid recipient, Korea can empathize with the pressures and challenges faced by countries in Africa. President Kabila emphasized this in a March 2010 meeting with Korea's director of the African Division of the Ministry of Foreign Affairs and Trade:

Just like many African countries, Korea went through colonial rule, civil war, famine and poverty. Under even worse conditions than many African countries, Korea achieved industrialization and economic growth in a short period of time, realized democratization on top of that, and became a G20 member envisioning a "Global Korea."

Korea does not have the same economic resources to devote to development assistance as China and other Western-led development agencies. Its power will instead come through knowledge and partnerships. As the only country in the world to overcome these challenges and become an open liberal democracy, Korea has the credibility to change the practice and discourse of development.

In Africa, Korea's development model provides an alternative to both traditional Western-led assistance and extractive Chinese aid. Korea's own experiences give weight to the belief that effective development policies must be based on the circumstances and strengths of an individual country. The relationship between donor and recipient must be one of mutual cooperation and respect, in which policy recommendations are neither made at the expense of local citizens nor intentionally undermine necessary institutions. This spirit of cooperation fosters open communication not only between the governments but also between the citizens of partner countries. In this way, Korean development initiatives are able to positively support political and social reform efforts while working to strengthen long-term economic growth.

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The South Korea–Chile Free Trade Agreement: History, Motivations, and Ramifications

By Alexander Parcan

I. INTRODUCTION

On April 1, 2004, the free trade agreement (FTA) between South Korea and Chile entered into force following the completion of negotiations on October 24, 2004. This agreement marked the first of its kind between two transpacific trade partners and as such represents a seminal moment in the development of the international trade system. The agreement is also significant for a myriad of other reasons. From a historical standpoint, Korea and Chile have approached the issue of free trade from very different viewpoints. Whereas the Chilean government has generally been open to bilateral trade agreements, the Korean government had never adopted one prior to this FTA with Chile. Therefore, this agreement represents an important shift toward bilateralism in international trade for Korea—a shift that has continued in recent years, with FTAs being signed with Singapore, the Association of Southeast Asian Nations (ASEAN), Europe, India, Peru, and, most recently, the United States.

Since 2004, South Korea has seen many benefits from its FTA with Chile. According to the Chilean embassy in South Korea, Korean exports to Chile increased nearly sixfold by 2008. Likewise, Chilean exports to Korea increased by more than four times during the same period. However, Korea has gained much more than economic benefits from this trade agreement. In negotiating with Chile, a relatively small but globally integrated economy, Korea underwent a learning process that contributed to future larger FTAs, such as those with Europe and the United States. As expressed by Chung Hae-kwan in his Spring 2003 article from *East Asian Review* entitled, “The Korea-Chile FTA: Significance and Implications,” “The successful completion of negotiations enabled the government to accumulate working-level knowledge and experience, and to gain confidence for a job well done.”

Given this context, the purpose of this essay is twofold. First, it examines South Korea’s motivations for negotiating and ratifying the FTA with Chile. Second, it looks at how this trade agreement served as a turning point for Korean attitudes toward bilateral trade and how this shift in attitudes influenced the ratification of the much larger FTA with the United States.

II. SOUTH KOREA'S FTA WITH CHILE: CONTEXT AND MOTIVATIONS

Cultural and Historical Context

After the Korean War armistice, it seemed as though South Korea would follow a path similar to many Latin American countries, including Chile, in its economic development. This path, known as import substitution industrialization (ISI) and developed by economist Raul Prebisch, espoused high import tariffs to encourage the development of domestic industries. Under President Syngman Rhee, ISI became a hallmark of the Korean development plan. However, as in Latin America, this plan proved largely unsuccessful, and by 1961 Korea's gross domestic product (GDP) sat at roughly \$72 per capita.

Such a startling lack of economic development was in part what led to the ouster of Syngman Rhee and his cronies and to the establishment of a new market-oriented military regime. Under the new president/dictator, Park Chung-hee, South Korea undertook development by further raising tariff barriers and also by investing in industries that pushed export capacity forward. Park's agenda complemented with the interests of many businesses that believed the capacity of South Korea's domestic market was exhausted. Contrary to the domestic market, foreign market presented a tremendously lucrative opportunity for competitive growth. In this way, export-oriented growth became a central aspect of Korean trade policy from a very early stage.

Adopting such a policy was a risky decision, and one that required a large amount of cohesion among South Korea's many different industries; ultimately, however, the decision paid huge dividends for Korea's economy. The country was able to substantially grow many of its export-oriented industries and, subsequently, through participation in international institutions such as the World Trade Organization (WTO), Korea was able to quickly and substantially increase GDP. By 1970, per capita GDP had increased more than 100 times, to over \$7,000.

Initially, this growth derived primarily from participation in multilateral trade groups and agreements, such the WTO and the General Agreement on Tariffs and Trade (GATT). South Korea used the WTO to promote trade with different countries and to build long-standing relationships with a number of trading partners. In addition, the country worked closely with both the United States and Japan in mostly informal capacities to push forward its economic development.

South Korea was far slower, however, to recognize the importance of bilateral trade agreements. Chile, by contrast, had come to highly value the role of bilateral FTAs in bringing about integration in the global economy and its

associated benefits. In fact, the use of FTAs to open markets for exports and promote laissez-faire economic ideals was so ingrained in Chile's trade model that it defined its foreign policy as a whole. South Korea, by contrast, had to go through serious reorientation to turn toward these kinds of agreements as a fundamental aspect of its foreign trade relations.

Perhaps the most significant shift in Korean trade policy in the last 20 years was the decision to move away from multilateral trade organizations and adopt FTAs as a matter of government policy. This shift was first promoted by President Kim Dae-jung and was subsequently expanded on in the 2003 FTA Policy Roadmap. South Korea had several motivations for undertaking this important shift. First, after the Asian economic crisis of 1997–98, and in particular with the 1999 failure of the WTO to spur a new round of trade talks, South Korea came to realize that it was vitally important for its continued economic growth to move beyond the sphere of largely ineffectual multilateral agreements and into bilateral trade arrangements. Moreover, for President Kim, under whose stewardship the FTA with Chile was negotiated, FTAs represented the path toward economic prosperity. As Chung Hae-kwan puts it,

“[South Korea] sense[d] the impending crisis; if it [did] not keep up with the trend of regionalism, Korean companies [would] be at a great disadvantage because of the preferential treatment provided for competitors in FTA signatory countries. Going it alone would not only lower competitiveness, but would eventually isolate Korea from the global market.”

President Kim outlined this ideology in his September 2006 article, “Regionalism in the Age of Asia.” In it he asserted the potential benefits of regionalism for all East Asian nations. He pointed out that he had supported these sorts of FTAs as far back as 1998, when he had urged the ASEAN Plus Three countries to push forward with an East Asian Community. Moreover, his vision for these regional FTAs superseded merely economic motivations, as he saw them as a tool to strengthen democracy, eradicate poverty, and bring about peace. Clearly, he was committed to FTAs in both a pragmatic as well as a deeply ideological sense.

Why Chile?

South Korea negotiated and signed an FTA with Chile for two specific reasons. First, there was a potential for significant economic benefits for South Korea, with major increases in trade on both sides of the deal. Second, and perhaps just as important, the FTA with Chile served as an important learning process for Korean leaders.

The economic basis for the FTA is self-evident and borne out by subsequent statistics. Conceptually, since South Korea and Chile have different specializations, opposite agricultural schedules, and a complementary industrial style, it is easy to see how both would benefit from a free trade agreement. All of these factors influenced South Korea's External Economic Coordination Committee to decide in 1998 that an FTA would be negotiated with Chile.

Ultimately, policymakers were correct about the economic benefits. Trade increased between the two nations many times over between ratification in 2004 and 2008, with South Korean growth in exports being particularly robust: it increased more than sixfold over this short period, with particular benefits for cars, trucks, construction machinery, and cell phones. Chilean exports rose more than fourfold in four years, with copper, iron, steel, and fruit products being the largest beneficiaries. Moreover, many of the Korean agricultural sector's initial concerns proved to be unfounded for two reasons. According to a 2008 document on the FTA prepared by the Chilean Embassy entitled, "Fourth Anniversary of the Korea-Chile FTA: An Assessment of the results,"

First, because Chile produces and sells agricultural products when in Korea there is little or very limited quantities from greenhouses farms, and second, Chile has always tried to have a diversified portfolio of consumers around the world following the old saying of not putting all the eggs in one basket.

In the end, Korean agriculture was not overwhelmed by Chilean products, in spite of dire predictions to the contrary.

The benefits for South Korea were not just economic. As Park Sung-hoon and Koo Min-gyo discuss in their June 2007 article, "Forming a Cross-Regional Partnership: The South Korea-Chile FTA and Its Implications," new trade theories suggest that more benefits can be reaped from trade where there are similarities in comparative advantage rather than dissimilarities. They also point out that in situations where there are large geographic distances between FTA partners, there may be only marginal positive effects for both countries. They conclude, therefore, that the economic benefits, while still providing something of an advantage, must not have been the driving force for South Korea's ratification of the FTA.

Nevertheless, South Korea's economic motivations for promoting the FTA cannot be completely discounted. In fact, when choosing which country to take on as its first FTA partner, Korea considered a number of options, including Turkey, Thailand, New Zealand, and Israel. Ultimately, it settled on Chile in no small part due to economic benefits and because South Korea wanted to gain a foothold

in the Latin American market. This was borne out in the FTA's subsequent economic benefits that the agreement brought for South Korean companies, particularly the significant benefits for the automobile and electronics industries.

On the other hand, Park and Koo's theory does largely hold, especially when comparing South Korea's motivations to those of its trading partner Chile. For Korea, a huge part of its calculations in negotiating and ratifying the FTA were the longer-term implications of reorienting foreign trade policy toward bilateral agreements. This reorientation largely envisioned new bilateral agreements with other partners in the East Asian region as well as with the European Union and the United States, reflecting South Korean leaders' concerns about the worthiness of multilateral agreements. The sacred cow of multilateralism lost its luster after the Asian economic crisis of 1997–98 and the failure of WTO talks in 1999. So South Korea turned toward bilateral FTAs, and this required a learning process that was subsequently acknowledged in the highest policy circles with the 2003 FTA Policy Roadmap.

Ultimately, this learning process is one of the more interesting factors of the Korea-Chile FTA. Many of the problems that South Korea faced in passing the FTA resurfaced in the process of passing the FTA with the United States.

The FTA Negotiation Process

From an analytical standpoint, a central part of any FTA is the negotiation process that precedes it. Any country that seeks to pass an FTA must work to assuage the concerns of both the negotiating country as well as those of domestic interest groups. In the negotiation process for the Korea-Chile FTA, South Korea ran into a number of significant problems, particularly with its agricultural sectors of fruit and rice production.

Interestingly, the negotiation and ratification process was much more inflamed domestically in South Korea than in Chile. Whereas the Chilean populace and business interests were accustomed to the benefits of FTAs and the opening of new markets, Korean people and businesses had no such prior experience. This played out in the form of protests and complaints by some segments of the Korean public, in particular the agricultural sector. Chile experienced no such problems.

Initially, South Korea tried to convince its agricultural sector of the importance of the FTA by pointing out that Chile was on a reverse agricultural schedule, given its location in the Southern Hemisphere; therefore, both the Korean and the Chilean agricultural sectors would benefit. But this argument proved insufficient. As a result, South Korea began the negotiation process with Chile

by pandering to its agricultural sector and requesting that pears and apples be excluded from the agreement. As negotiations continued, however, complaints from Korea's agricultural sector grew ever louder and the Korean government, due to inexperience in negotiating these kinds of agreements, lacked the political know-how to leverage support from those industries (such as automotive and electronics) that would benefit most from the FTA. The agreement was close to being derailed and was only rescued thanks to Chile's acquiescence on pears and apples in exchange for employing its own protectionist measures against Korean refrigerators and washing machines.

In this way, the South Korean agriculture industry was able to exert a great deal of influence over the final terms of the agreement. In addition to certain fruits being excluded, other Chilean agricultural products were given tariffs for periods of five to ten years. Vegetable juices were given a 10-year tariff, for example. Milk products were also given a very long 16-year tariff and chocolate products were given a 10-year tariff. For Chile, these tariffs were mitigated in the long term because the country would still be getting access to a new market for its goods and, most importantly, because the FTA levied no protectionist measures against the key Chilean industries of copper, iron ore, and zinc. The end agreement resulted in some important tariff limitations on the South Korean side as noted in Table 1, taken from Chung Hae-kwan's Spring 2003 article from *East Asian Review* entitled, "The Korea-Chile FTA: Significance and Implications." South Korea used this tool of tariff limitation to deal with the concerns of particular industry sectors, indicating that it had some learning to do.

Table 1. Korea's Tariff Limitation Schedule

(Unit: Korea's 10-digit HS codes, %)

Category	Total	Industrial Products	Farm Products	Forest Products	Marine Products	Main Description
Year 0	9,740 (87.2)	9,101 (99.9)	224 (15.6)	138 (58.2)	277 (69.5)	Mixed feeds, pure-bred breeding animals, silk, fabrics, coffee
Year 5	701 (6.3)	-	545 (38.1)	70 (29.5)	86 (21.5)	Bracken, roses, bean curd, wine, almonds
Year 7	41 (0.4)	1 (0.01)	40 (2.8)	-	-	Fruit juice, prepared fruit, meat of poultry or heading, soup, potatoes
Year 9	1 (0.01)	-	1 (0.07)	-	-	Other fruit juices
Year 10	262 (2.3)	-	197 (13.8)	29 (12.3)	36 (9.0)	Tomatoes, pork, cucumbers, kiwis
10S*	1(0.01)	-	1 (0.07)	-	-	Grapes
Year 16	12 (0.1)	-	12 (0.8)	-	-	Prepared dry milk
TRQ** + DDA***	18 (0.15)	-	18 (1.26)	-	-	Beef, chicken, mandarins
DDA	373 (3.3)	-	373 (26)	-	-	Garlic, onions, red peppers, dairy products
E****	21 (0.2)	-	21 (1.5)	-	-	Rice, apples, pears
Total	11,170	9,102	1,432	237	399	
<p>* Liberalization over a transitional period of 10 years on a seasonal basis ** Liberalization with tariff quota *** Tariff elimination schedule shall be negotiated after the end of the Doha Development Agendas of the WTO **** Customs duty applied shall not be eliminated</p>						

III. WHAT SOUTH KOREA LEARNED: LESSONS FOR FUTURE FTAS

The process of negotiating the FTA with Chile had important ramifications for other FTAs that South Korea was considering. In particular, the agreement with Chile prepared Korean policymakers for the FTA they signed with the United States in 2007 and finally ratified in 2011 (called the KORUS FTA). The Korea-Chile FTA also educated more than just the Korean government; other major players and interest groups also learned lessons.

The FTA negotiation process between South Korea and the United States differed in many ways from the one with Chile. Most significantly, the size of the economies involved in the KORUS FTA was very different and, by implication, so was the relative bargaining power of each country. On the other hand, similarities existed between the two processes, particularly concerning the contentious issue of agricultural exports to Korea.

In its FTA negotiations, South Korea was forced, mostly because of pressures at home, to enact domestic policies that overrode the otherwise free trade interests of the government's foreign policy. In the case of the Korea-Chile agreement, Chile was for the most part satisfied that the FTA met its core interest of expanding the overall scope of its international trade relations. As a result, Chile exacted relatively less significant protectionist measures from Korea. Overall, though, Korea did change its original plan because of internal political pressures. This substantiates the theory expounded by Park and Koo that the most important factor for South Korea in establishing an FTA with Chile was political rather than economic.

When it came time to negotiate the FTA with the United States, South Korea no longer demanded restrictive measures for its agricultural goods, even though the same exact issue came up regarding the import of foreign apples and pears into Korea. This time, however, Korea promised to *reduce* its 45 percent tariff rate on apples to zero over a 10-year period. For Fuji apples—a popular product in South Korea—the parties agreed to a 20-year tariff phase-out period. Pears were dealt with in a similar manner. The FTA calls for phasing out tariffs on non-Asian pears over a 10-year period and Asian pear tariffs over a 20-year period.

How is it possible that South Korea completely shifted positions on an issue that was so contentious during negotiations with Chile? As usual, money provides at least one explanation. From the Korean perspective, the US market presents a much larger economic opportunity for its exports (in particular, automobiles and electronics) than the Chilean market does. From the US perspective, the fruit market in Korea presents a potentially lucrative opportunity, because the United States believes it can be highly competitive. Korea produces 380,000 metric tons

of apples per year, and the US share of that apple market prior to its FTA was approximately 0.001 percent. Both Korea and the United States stand to benefit greatly from their FTA, so it is not surprising that the terms of this FTA would be different than those in the Korea-Chile FTA.

A second explanation, however, lies in the concept of trade policy management and in the domestic politics of South Korea. Comparatively speaking, the drama and debate surrounding the signing of the KORUS FTA dwarfed what was seen with the signing of the Korea-Chile FTA, and many of the same parties were involved. Of particular concern were the problems that the KORUS FTA would cause for key Korean businesses in agriculture and meat (especially beef).

In the Korea-Chile FTA negotiations, Korean agricultural sectors did not have a significant enough influence to push for major concessions in the form of tariffs on products that would compete with critical sectors of Korean agriculture, particularly apples, pears, and rice. With the KORUS FTA, the stakes were clearly higher. In response, many significant opponents of the KORUS FTA rallied together and tried to more loudly and directly voice their concerns through political channels. This took many forms, including interest groups such as the Korean National Assembly Members' Caucus against the Korea-US FTA and the Korean Alliance against the Korea-US FTA, the latter a coalition of more than 300 labor unions and civil-society groups. This alliance was petitioning the US Congress to stop the passage of the KORUS FTA as late as January 2011.

That the agreement passed without the same major tariff concessions seen in the Korea-Chile FTA, therefore, can also be chalked up to improved management of public opinion on the part of the Korean government and the leveraging of interests of the parties involved. These were all lessons that South Korea learned throughout the process of negotiating its agreement with Chile. This is also a point that Park and Koo would almost certainly echo.

Interestingly, because the stakes were much higher for the KORUS FTA, and the opposition much more organized, the South Korean government was forced to make a different kind of major concessions to interest groups that had not been necessary in the Korea-Chile FTA. Most prominently, the Korean government enacted large farm subsidies. According to a Korea Policy Institute article, President Roh in 2007 "promised to set aside \$119 billion to aid farmers hurt by the FTA."

This kind of concession is an example of the kind of learning that occurred for interest groups. Clearly, after the Korea-Chile FTA they had gained enough of a voice to elicit extensive government promises. The subsidies enacted go beyond the kind of exactions made in tariff limitation schedules; they are the kind of

cash-based subsidy that generally galvanizes a great deal of political support. The interest groups had learned how to be a major voice in the bargaining process and were therefore able to gain additional protectionist measures.

The government also clearly exhibited learning through both of these FTA processes. In the case of preventing tariff limitations on key agricultural items, such as pears and apples, the South Korean government showed that it can exert power in spite of public protests. However, this was not done without some concessions, as the government attempted to assuage agricultural concerns at home by offering subsidies and thereby garnering more popular support.

IV. CONCLUSION

In examining the FTA between South Korea and Chile, this essay isolates the challenges inherent for Korea in negotiating and ratifying such agreements. It also looks at the special-interest forces at play in such agreements, which resulted in substantial concessions by the Korean government. Free trade agreements only work when they make economic sense, and understanding and accepting this principle was a necessary precondition for South Korea to enter into an FTA. However, perhaps more significantly, South Korea used its deal with Chile as a testing ground from which it learned what it would take to galvanize disparate interest groups and public opinion.

This explains, at least to some extent, why the South Korean government made major concessions during the Korea-Chile FTA negotiations in spite of possible economic losses. The government, as much as anything else, was using the negotiation process to learn what it would take to successfully negotiate and ratify an FTA, both internationally and domestically.

Many of the Korean interest groups that were affected by FTA negotiations also underwent an important learning process. By the time that KORUS negotiations came along, interest groups were able to protest much more effectively than they had with the Korea-Chile FTA negotiations. They were thus able to influence the final agreement in some substantial ways, particularly regarding the inclusion of large subsidies for the agricultural sector.

In sum, it must be conceded that those in favor of FTAs in Korea won the day. With the KORUS FTA, proponents were able to enact policies that will allow for the kind of deep infiltration of foreign influence over agricultural products that was so feared in the Korea-Chile FTA negotiations. A prime example of this is that the critical items of debate during the Korea-Chile FTA—pears and apples—were not excluded from the KORUS FTA. Even though the KORUS FTA was ratified in tremendously acrimonious fashion, proponents of its passage won out

over those interest groups and political parties who opposed the FTA.

The broader results of the passage of the KORUS FTA are also worth noting. For one thing, the passage of the agreement was remarkably polarized politically. Some Korean experts claim that the entire ratification process was simply political theater, with politicians seeking to capitalize on populist anger, while others chafe at this characterization. The bill indeed passed in spite of widespread popular discontent, though both sides failed to see any merit in the arguments of the other. Party members for and against the passage of the KORUS FTA in fact displayed such a high level of distrust toward each other that ratification culminated in an almost farcical display; the KORUS FTA was passed in the dead of night, and a tear gas canister was set off in the South Korean National Assembly. The learning process discussed earlier, in which both policymakers and interest groups found better ways to further their own interests, was certainly responsible for this atmosphere in some measure. Whether the acrimony was merely a byproduct of long-standing political divides is the subject for another essay. But if nothing else, these battles played out in a very public, acrimonious, and partisan way because of what each political party was able to learn and effectively execute in the domestic negotiations surrounding FTA ratification.

CHAPTER II: ROK ECONOMIC POLICIES



Smile and Sunshine: Assessing the Impact and Sustainability of Microfinance in South Korea

By Rebecca Lee

I. INTRODUCTION

Over the past 50 years, South Korea's economic growth and significant development achievements have received international acclaim. According to World Bank statistics, the South Korean economy grew on average 7 percent annually from 1961 to 2005. From the devastation after the Korean War in the early 1950s to membership in the Organization for Economic Cooperation and Development (OECD) in the mid-1990s, Korea has witnessed enormous social and economic changes. However, in the late 1990s, the Asian financial crisis plunged the country into chaos. This 1997 foreign-currency crisis shook the Korean economy and society. Income polarization broadened and credit rationing by commercial banks increased, further exacerbating economic repercussions. Many low-income families and business owners could not get loans, as interest rates skyrocketed and financial institutions shied away from riskier lending. As a result, low-income families were forced to rely on private moneylenders, who demanded exorbitant interest rates. In the decade that followed, Korea implemented strict economic regulations in order to safeguard against future crises. Its social policy, however, has not advanced. Therefore, when the global financial crisis hit in 2008, Korea's economy quickly bounced back while the nation's poor were plunged further into poverty.

South Korea affords an interesting case study of the advancement of social welfare policy in a growing Asian economy. Successive governments prioritized progrowth, industrial development at the expense of social welfare, but this changed after the 1997 crisis. In 2000, the Kim Dae-jung administration adopted the concept of productive welfare, linking social welfare policy with economic development. According to James Midgely and Kwong-eung Tang's 2010 article, "Social Policy and Poverty in Asia: The Role of Social Security," Korea has continued to promote the productive welfare approach, bringing the idea of social investment to the fore.

One of Korea's most recent productive welfare initiatives came in December 2009, when the Korean government established the Smile Microcredit Bank

(SMB). The bank provides unsecured loans to low-income households through partnerships with private-sector companies. The result is the world's first government-led microcredit lending program, benefiting small business, traditional market businesses, start-up businesses, and nonprofit businesses. In June 2010, the Korean government launched a follow-up to the SMB, the Sunshine Loan Program, providing low-income families funding for living expenses to help them get back on their feet.

These programs have garnered both positive and negative feedback. Proponents argue that the government's microfinance efforts address an "incompleteness" problem in Korea's credit market (in which demand outstrips supply) and will eventually make lending more equitable. Critics, on the other hand, say that these initiatives distort market principles and have the potential to increase household debt and moral hazard. It is too soon to tell whether these programs will significantly reduce long-term interest rates, creating new openings in the credit market credit at every credit level and redistributing wealth. However, it is possible to assess the early successes and failures of these initiatives, to evaluate the Korean authorities' responses to administrative and economic challenges, to offer strategies for improving microfinance in Korea, and, finally, to make predictions of future success or failure.

In what follows, section 2 examines the economic impact of the 1997 Asian financial crisis and the 2008 global financial crisis on Korean society. It then investigates why microfinance is a necessary component of the government's social welfare initiatives. Section 3 outlines Korea's current microloan programs: the Smile Microcredit Bank and Sunshine Loan Program. Section 4 analyzes these programs' initial accomplishments and failures and asks whether Korean financial authorities have succeeded in correcting any inadequacies. Finally, section 5 offers potential solutions to several of Korea's microfinance challenges and attempts to predict whether these programs will effectively address the country's income inequality and credit rationing in the long run.

II. SOCIAL STRATIFICATION IN SOUTH KOREA

Since the 1960s, the South Korean economy has witnessed unprecedented growth. Economic development helped modernize industry, expand employment, eradicate absolute poverty, and elevate Korea to one of the world's largest economies. Nevertheless, the government had little success in building up the nation's social safety net. Throughout the 1970s, as argued by Youngsun Koh in his 2011 essay, "Changes in Income Disparity and Directions for Social Policy,"

the Korean government continuously introduced social security programs, such as health-care initiatives, pension programs, and unemployment insurance. These did little to mitigate poverty, but it was not until the 1990s, when financial liberalization swept the nation, that Korea witnessed a dramatic shift in income inequality and there was a rise in relative poverty, especially among the working-age population. These changes occurred with the growth of a knowledge-based economy and the accelerating pace of globalization, which put low-skilled workers at a disadvantage.

The Asian financial crisis struck in November 1997, further magnifying the holes in Korea's social safety net. According to Andrew Eungi Kim's 2004 essay, "The Social Perils of the Korean Financial Crisis," thousands of businesses went bankrupt overnight, unemployment doubled, banks were mired in more than \$52 billion in bad debt, and in 1998 the annual per capita gross domestic product (GDP) plummeted from more than \$10,000 to \$6,000. Perhaps most strikingly, according to Kim, the 1997 crisis, "not only halted the nation's decades-long economic growth, but also brought about fundamental changes in lifestyle, employment patterns, corporate culture, and worldview."

Ill-equipped to handle the already existing social welfare problems, the system could not accommodate the massive influx of those in need, and significant economic stratification occurred. From 1997 to 1999, the annual earnings of the top 20 percent of urban households increased from 4.5 to 5.5 times more than earnings of the bottom 20 percent of urban households. According to the South Korean 2003 Household Survey, the top 10 percent of Koreans make 6 times more than the bottom 10 percent. Additionally, the number of Korean households living below the poverty line increased from 2.8 percent in 1997 to 7.3 percent in 1999. The size of Korea's middle class also decreased, and that of the upper and lower classes increased. In 2005, the percentage of Koreans in the lower and upper classes increased by 3.7 percent and 1.7 percent, respectively, in comparison to 1997 figures. In his 2010 dissertation, "Optimal Strategies for Developing Microfinance in Korea and the Impact of Microfinance," Korean economist Youngeun Yoon estimates that 1,747,000 members of the middle class shifted to the lower class as a result of the Asian financial crisis, while almost half that number (945,000) moved from the middle class to the upper class.

These figures are borne out by South Korea's National Statistical Office published in 2006 (see Figure 1). Prior to the Asian financial crisis, Korea's GINI coefficient, which measures income distribution (0 being most equal, 10 least equal), was relatively stable at 0.28. By 2000, however, this figured had climbed to nearly 0.32 and has hovered near this level for more than a decade.

Figure 1.



The 1997 financial crisis also led to a severe credit crunch in Korea. Banks and other financial institutions rationed credit, especially to those most in need. Credit rationing results from imperfect information in the credit market. Banks, as suppliers of funds, have inferior information about the expected yields of projects. If the yields increase, then the expected return to banks may decrease.

The increased rates of return induce riskier borrowers to apply for loans, thus exacerbating the problem of adverse selection and the probability that borrowers may default on their loan. As rates rise, moral hazard also becomes a problem for banks; since a high rate of return boosts the relative attractiveness of riskier projects but carries with it a higher probability of bankruptcy. Changes in monetary conditions and structural changes in the financial sector led to a contraction in bank loans. This restructuring forced banks and other financial institutions to adopt risk-averse asset management and lending practices. As a result, interest rates increased, capital availability to lower-income brackets decreased, and banks insisted on collateral-based lending. These practices further drove down the supply of funds available to Korea’s increasingly impoverished population.

The impact of credit rationing on Korean households led to a jump in the number of individual bankruptcies from 1,435 in 1997 to 2,207 in 1998. In addition, according to Sung Jin Kang and Yasuyuki Sawada’s 2008 article, “Credit Crunch and Household Welfare: The Case of the Korean Financial Crisis,” overall retail credit sales decreased by 32 percent from 1997 to 1998 and the overdue rate to credit card companies reached 20.3 percent in 1998. Not surprisingly, the financial crisis led to excess demand for loans. Because Korea’s poor could

not offer enough collateral to secure loans and needed cash for urgent purposes, they sank deeper into poverty. In the wake of this crisis, the Kim Dae-jung administration responded with government assistance and social welfare programs.

The Korean economy and collective psyche emerged from the 1997 Asian financial crisis battered and beaten. In the decade since, the Korean government has instituted reform measures designed to make the economy more resilient in future financial crises. The country's social security sector, on the other hand, has stumbled since President Kim implemented welfare reforms in 2000. Suffering from inadequate funding and governmental mismanagement, Korea's social welfare system has not yet found the most effective methods for correcting societal imbalances and providing support to its neediest citizens. Therefore, when the global financial crisis occurred in 2008, Korea's economy recovered with relative ease and efficiency, while strains on society were further aggravated. According to Chan Woo Jeong's 2011 policy paper, "Community Finance in Korea: Policy Directions," the 2008 crisis led to increases in income polarization, which, in turn, eroded the economic vitality of those in lower-income brackets and further exacerbated household imbalances.

With lowered credit ratings, income and job insecurity, and increased debt, Korea's poor again found themselves unable to secure loans from the nation's financial institutions. In accordance with new regulations and to protect themselves from default, banks, insurance companies, credit card companies, and even community-finance companies, reduced community-financing levels and turned to collateral-based lending. As a result, banks—hesitant to extend loans to suboptimal candidates, such as low-income households or cash-strapped small to medium enterprises—experienced excess demand for loans while the impoverished class, unable to get loans from traditional sources, turned to moneylenders and their excessive interest rates. Moneylenders in 2010 charged of 48.5 percent interest on average, more than six times the rate banks demanded of their high credit balance clients.

Restricted access to financial services has caused rapid growth in Korea's moneylending market in recent years. When major financial institutions—such as banks, credit card companies, capital companies, or savings banks—refuse loans to households with low credit, individuals obtain loans from moneylenders at prohibitively high interest rates. Along with these exorbitant interest rates comes the increased probability of bankruptcy or overwhelming household debt. Thus, Korea's economy has been weakened by the vicious circle its relatively poor

borrowers are in: Low-income households are unable to improve their financial well-being because they cannot secure loans from large, reputable financial institutions; so they are pushed into high-interest loans that are difficult to repay and that, ultimately, degrade their credit rating. The more money they must dedicate to loan repayment, the further they sink into debt and the greater the likelihood of bankruptcy, which, in turn, erodes their already precarious financial situation. This “incompleteness,” demonstrated by excess demand in the credit market, signals the need for government intervention to bolster Korea’s loan and credit markets via state-sponsored programs and/or government incentives to private industry.

III. MICROFINANCE IN SOUTH KOREA: THE SMILE MICROCREDIT BANK AND SUNSHINE LOAN PROGRAM

Following the global financial crisis, countries all over the world took steps to help their most vulnerable and financially insecure citizens. In an effort to quiet South Korea’s rattled economy and ease social tensions, the government established the Smile Microcredit Bank in 2009 and the Sunshine Loan Program in 2010. These programs provide low-income households with microcredit loans to support small businesses and prevent Korea’s poor from falling further into poverty.

The Smile Microcredit Bank, an offshoot of the Miso Credit Foundation, developed out of the Thirty-First Emergency Economic Meeting in September 2009. President Lee Myung-bak had started discussions in January with the aim of “coming up with practical ways to overcome the global financial crisis,” as reported by the South Korean broadcast network Arirang. The details of the SMB initiative were outlined in a July 2010 statement released by South Korea’s Financial Services Commission (FSC). The SMB pledged, over the next ten years, to provide 2 trillion won (\$1.72 billion) in the form of microcredit to low-income households. This funding exceeds the amount pledged over the previous decade more than thirteenfold. Although the Korean government launched the SMB initiative, the bank’s funding and operation are managed by private organizations and NGOs. The SMB receives its financing through contributions from private-sector companies, such as Samsung Group, Hyundai-Kia, SK, LG, POSCO, and Lotte, as well as from other financial institutions. In a bid to draw more voluntary participation from the business sector, the government has offered tax incentives, designating a 50 percent tax reduction to those who donate to the Miso Credit Foundation. The SMB’s operations are overseen by private bodies, such as nonprofit organizations and volunteer workers that are equipped with the

necessary experience and skills.

According to the FSC statement, the SMB's target beneficiaries include small businesses, viable start-up franchises, non-franchise start-up businesses, start-up partnerships, and nonprofit organizations. Recipients will receive a loan between 5 and 100 million won (\$4,300–\$87,000), with a maturity date between one and five years. Interest rates will be set below the prime rate, which was anticipated at approximately 5 percent in 2010. The Miso Credit Foundation allocates funds to the financial institutions and organizations designated as branches of the SMB. These branches are independently operated. However, they do receive tax exemptions, since the SMB is treated as a charity organization under Korean tax law. Over the next decade, the FSC expects 200,000 to 250,000 low-income households to benefit from these loans. Moreover, the SMB initiative provides an avenue by which corporations can fulfill their social responsibilities while simultaneously allowing the government to reduce the financial blind spots in the Korean financial market. Finally, and perhaps most importantly, the FSC hopes the project will “arouse public sentiment towards charity and sharing their wealth, as well as expand[ing] the network of volunteer services.”

The Korean government followed up the SMB in July 2010 with its Sunshine Loan Program. Unlike the SMB, which targets small businesses, the Sunshine's intended recipients are low-income households. The Sunshine Loan Program is the government's response to banks' credit rationing and low-income households' heightened demand for cash since the 2008 global financial crisis. Through this microloan program, the government hopes to reduce low-income households' reliance on private lenders and credit providers and, thus, to eliminate the burden of paying higher interest rates. Additionally, Sunshine loans are intended to insulate the poor from changes in the base interest rate—the lowest non-Treasury interest rate investors can get. For instance, under normal market conditions, those with low funds and poor credit bear the burden of an increased base interest rate through higher interest payments. Sunshine loans, however, limit recipients' interest payments by mandating an interest-rate ceiling.

The Sunshine Loan Program will disburse approximately 10 trillion won (\$8.7 billion) over the next five years via private financial institutions. Sixteen regional credit guarantee foundations and the Korea Federation of Credit Guarantee Foundations (KOREG) will back these loans. KOREG will guarantee 85 percent of all loans, while the financial institutions themselves will be accountable for the remaining 15 percent; this is meant to prevent moral hazard and to encourage financial institutions to conduct a thorough assessment of each borrower's credit

worthiness. The loans will be extended to individuals whose credit rating ranges from level 6 to 10 or to small-business owners whose annual income is less than 20 million won (\$17,400). Delinquent households—those that have defaulted on previous loans or who cannot afford to repay their debt (and are thus undergoing a financial restructuring or are filing for personal bankruptcy)—will be ineligible. Financial institutions will set their own interest rates for Sunshine loans, but these rates will have a ceiling. The aim of the Sunshine Loan Program is to help low-income households start businesses, to provide operating capital for businesses, and to supply urgently needed living expenses. Ultimately, this program attempts to fill the “incompleteness” gap in the Korean loan market by giving low-income households access to financial services and decreasing their interest payments. If the average borrower receives a loan in the amount of 10 million won (\$8,700) and, if the maximum 10 trillion won fund is distributed in loans over the next five years, then this program has the potential to benefit one million low-income households.

IV. SUCCESSES AND FAILURES

Since their implementation, the Smile Microcredit Bank and Sunshine Loan Program have sought to restore the credit of low-income households, or those in default, and to reduce the interest rates of moneylenders and credit-specialized financial companies. In theory, these policies should help alleviate market failures in the South Korean economy caused by financial companies’ profit-maximizing practices. In the months following these programs’ launch, both faced administrative, financial, and political challenges. At the same time, these programs have garnered a positive response from the Korean people and have achieved a measure of success. Initially, both SMB and Sunshine loans encountered organizational and administrative obstacles. In the case of the SMB loans, complaints ranged from the strictness of eligibility requirements to insufficient public awareness and inaccessibility of bank locations. The more significant problems involved the credit-verification process for bad-credit households and the absence of adequate financial and business training and support for borrowers.

For many of SMB’s financial institutions, the easing of eligibility rules for low-income households was at odds with their credit verification systems. While commercial banks in Korea have a sophisticated mechanism for assessing individuals’ credit rating, no such system exists for verifying low-income earners’ ability to repay their debts. As a result, in the SMB program’s early stages, banks were turning away many of the small businesses and low-income earners that

the Smile loans were designed to help. To rate low-income earners properly, the government and the FSC will need to cooperate with private moneylenders—who will likely be reluctant to participate—to develop a system for assessing the characteristics of low-income individuals who, according to Yu Jung-suk, Samsung Economic Research Institute research fellow in his March 2010 *Korean Herald* article, “can repay their loans but will not take advantage of the system.”

The second obstacle the SMB program encountered was the lack of a sustainable support mechanism. According to University of Cambridge professor Chang Ha-joon in a March 2010 *Korean Herald* article, granting microcredit loans without proper training or support for borrowers can be a “very powerful form of poverty trap.” In response, SMB announced that it would overhaul its system to provide more effective support to its clients. To keep borrowers afloat, SMB plans to develop an evaluation system to monitor business performance. The results will then be used to set the amount and duration of the next loan. The bank will also outsource its employee education and training program to bolster staff expertise, and then these employees will disperse across the bank’s 95 branches.

As a result of these obstacles, by June 2010 only 3,958 people had received loans, for a combined total of 23.6 billion won. By June 2011, thanks to improvements in SMB’s credit-verification system and business-consulting practices, the FSC reported a total of 263.5 billion won (\$230 million) lent to 28,728 borrowers. Of the SMB’s beneficiaries, 62.5 percent had credit levels of 7 or 8 (at the very low end of Korea’s 10-point credit-rating scale), which indicates that financial institutions are confident in the new credit-verification system. The SMB initiative has succeeded in widening low-income earners’ chances of securing loans, and there is evidence of businesses being established. Yet, local community and SMB collaboration is still insufficient, and the business consulting and support needed to help clients succeed have not been successfully implemented.

The challenges encountered by the Sunshine Loan Program were the opposite of those initially faced by the SMB—Sunshine loans were popular and funds were disbursed rapidly. According to the FSC, on the first day of the Sunshine program 310 million won (\$270,000) in loans were issued. By day nine, 10 billion won (\$8.7 million) had been lent. In the program’s first month, 61,663 borrowers received a total of 545.3 billion won (\$463.3 million). This popularity challenged the Sunshine’s viability and sustainability in two ways.

First, officials worried that the program might run out of funds. According to the FSC, 2 trillion won (\$1.75 billion) had been set aside for loans from July 26, 2010, to July 25, 2011. But by early September 2010, approved loans had already surpassed 600 billion won (\$523 million), putting the program on pace to distribute all funds by November or December 2010. However, loan demand

slowed to a daily average of 3.6 billion won (\$3.1 million) between October 2010 and June 2011, down from 21.2 billion won (\$18.5 million) per day. As of the end of August 2010, most loans had been for basic livelihood assistance: 43,939 loans (71.3 percent), totaling 344.9 billion won (US\$306 million). The second-largest portion of loans was for operating funds, at 28.7 percent and totaling 200.17 billion won (\$175 million).

The reduction in daily loan amount resulted from the Korean government's addressing the second issue that challenged the Sunshine Loan Program— lax requirements. Unlike SMB loans, which impose strict requirements on borrowers, anyone with an annual income below 20 million won (\$17.5 million) or a credit rating between 6 and 10 (i.e., low credit scores) is eligible for a Sunshine loan. Thus, high-income earners with poor credit were taking advantage of the system, and crowding out those most in need. In addition, Korea's financial authorities were concerned about the potential moral hazard related to KOREG's 85 percent guarantee of all Sunshine loans. Many worried that lenders would not sufficiently assess risk because the government would bail them out in case of default or financial stress.

As a result, the FSC tightened Sunshine's lending criteria in September 2010. Under the new regulations, people with a credit rating of 6 or below who earn more than 40 million won (\$35,000) per year are ineligible. The FSC also stipulated that borrowers must seek Sunshine loans at banks in their own residential areas or an adjoining one. And to prevent financial firms from extending an excessive number of loans, officials increased on-site inspections. By June 2011, the Sunshine Loan Program had made 183,144 loans totaling 1.7 trillion won (\$1.5 billion). In addition, the FSC reports that 58 percent of those benefiting from this program have credit levels of 6 and 7.

V. EFFECTIVE STRATEGIES FOR MICROFINANCE IN SOUTH KOREA

Overall, the public has responded favorably to both the Smile Microcredit Bank and Sunshine Loan Program. However, critics argue that these social welfare policies are still inadequate for effectively helping the disadvantaged. First of all, some experts believe that microfinance should be based on market principles. They contend that government intervention distorts the credit market and discourages private-sector institutions from entering the industry without incentives. Furthermore, because programs like SMB and Sunshine loans distort market principles, they provide an unfair advantage to individuals with poor credit, effectively rewarding bad credit and the negative behavior associated with it. In response, one policy suggestion has been to assign specific roles for Korea's financial institutions to create a "multilayer" system that addresses citizens' credit needs at every level. Initially, these roles would be assigned by the government

and would occur in tandem with adjusted interest rates—not just for the low-credit individuals but for people at every credit level on the spectrum. This policy would regulate financial institutions' practices in the short run. Then over time, the rules would relax leaving in place a firm foundation for financial practices. A second critique of Korea's two microfinance initiatives is that a different agency within the government manages each program, leading to redundancy and conflicting approaches. To minimize these inefficiencies, an oversight board is needed to compile data, analyze program outcomes, and prescribe changes to both initiatives as needed.

Third, a problem of moral hazard for both lenders and borrowers exists. Low-rate financing backed by government guarantees encourages borrowers to apply for loans they may not be able to or intend to repay. At the same time, also because of government guarantees, lenders have incentive to extend loans to risky clients, knowing they will be bailed out if the loans are not repaid. Therefore, a mechanism is needed to minimize these moral hazard tendencies. For borrowers, there could be a more sophisticated system for evaluating low-credit individuals and their ability to repay their loans. Financial institutions and the government are in the process of creating this system, but it will take time before an effective assessment method is developed. Lenders could be made more responsible by increasing the percentage of loans that financial institutions guarantee. Doubling the current guarantee (from 15 to 30 percent) would significantly alter financial institutions' way of thinking and would thus minimize risky practices.

A fourth charge levied at the SMB and Sunshine loans is that they need to be accompanied by effective borrower education and training. At present, any such efforts are run by the regional branches of the lending financial institutions and tend to be ad hoc and loosely organized. A national-level training program that focuses on teaching loan recipients appropriate business skills would help remedy this. Each loan recipient could also be assigned a financial advisor at his or her local branch to monitor the borrower's progress and provide counsel. To do this, the government should create a department—perhaps an offshoot of the oversight board mentioned above—that focuses solely on borrower support and training. Without such measures, the worry is that these government loan policies are simply throwing money away, potentially doing more harm than good to Korea's overall economic development and especially to those on the lowest rung of the country's social ladder.

Finally, Korean finance authorities must enact measures that promote the sustainability of community finance, centered on microloans, based on market principles, and meet local demand for loans. Once SMB and Sunshine loans prove their profitability, community-finance companies will voluntarily expand their funding of such loans. In the meantime, however, if local

financial institutions continue to shy away from providing funds for low-credit individuals, the government could mandate quotas for lending to customers with poor credit. Through these obligatory quotas, a multilayer structure in the credit market should emerge naturally.

V. CONCLUSION

South Korea's decades-long prioritization of economic expansion over social development led to significant fissures within Korean society. In recent years, to ease tensions and maintain social stability, the Korean government has made a point of pushing social reforms—many of which have failed. Korea's most recent attempt at correcting economic imbalances has been the Smile Microcredit Bank and Sunshine Loan Program, and these, too, have faced numerous obstacles to success. However, through careful analysis of borrower and program data, strict regulations, and collective oversight, Korea's microfinance programs have the potential to help reduce income inequality in Korea as well as to solve the problem of credit rationing for poor households.

At present, skyrocketing household debt and education costs are further exacerbating problems within Korea's economy and, consequently, its society. Therefore, programs such as the SMB and Sunshine are needed to rectify issues of income inequality and to help provide access to capital for those who need it most. Certainly, these initiatives have encountered some stumbling blocks in their early stages, but, for the most part, officials have responded swiftly and effectively. Critics of these programs, such as Democratic Party assemblyman Chung Dong-young argue that they have not effectively addressed Korea's social welfare problems. Alternatively, proponents, such as Grand National Party assemblyman Kwon Teag-ky, point out that these initiatives are getting funds into the hands of those who need them. Because these programs are so new, however, we cannot yet determine whether or not SMB and Sunshine loans provide a sustainable model for tackling Korea's social welfare problems.

Ultimately, social reform is necessary in Korea. However, it will not come about until Korea's policymakers find a way to work together. At present, as demonstrated by recent partisan conflict and protests surrounding the most recent updates to the US-Korea Free Trade Agreement, bitter divisions between Korea's political parties severely hamstring the reform process on practically every issue. Therefore, it is unlikely that progress will be made on any policy measures until these groups make a good-faith effort to stop wrangling with each other for power and, instead, find ways to work together to create a more equitable economic model and, thus, a more harmonious society.

Assessing South Korea's National Strategy for Green Economic Growth

By Maggie Mazzetti

I. INTRODUCTION

Rapid industrialization coupled with limited domestic energy resources present South Korea with a daunting energy security issue. With domestic supply unable to satisfy burgeoning demand, the country must rely heavily both on imported energy sources and on its own increasingly controversial nuclear power plants. Furthermore, as South Korea's greenhouse gas (GHG) emissions continue to rise at a rate rivaling many of its developed counterparts, the government faces increasing pressure from the international community to curb emissions. Within this dynamic context, South Korea released its National Green Growth Strategy and set ambitious targets designed not only to mitigate growing emissions but to promote the adoption of greener principles at all levels of society.

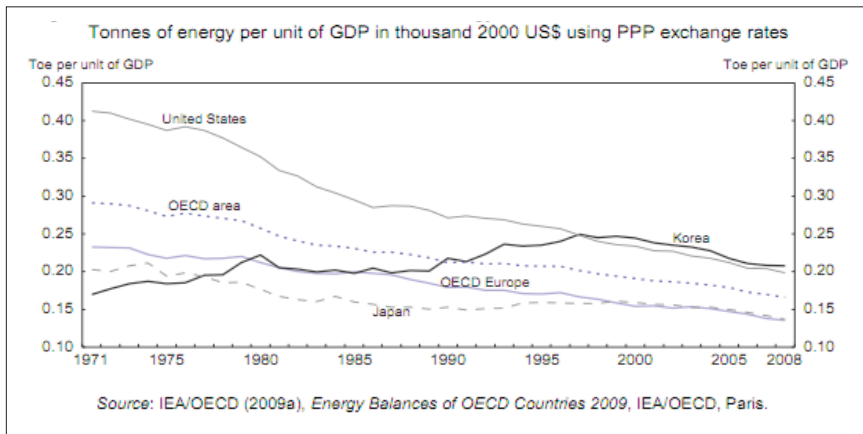
This essay examines the extent to which President Lee Myung-bak's green strategy has addressed the issues at the heart of the country's emissions problem and whether the policies truly represent a desire to adopt greener economic growth. A review of South Korea's remarkable growth over the last 30 years, and its subsequent environmental cost, provides a foundation for assessing the country's green policies prior to the National Green Growth Strategy. The concept of "green growth" is then defined and leads to a detailed discussion of South Korea's policies is presented. The essay concludes by examining the positives and negatives of South Korea's green policies and giving policy recommendations going forward.

II. KOREA'S INDUSTRIALIZATION AND ITS ENVIRONMENTAL COST

Over the last 30 years, South Korea experienced rapid industrialization that saw the country's gross domestic product (GDP) rise from just under \$88 billion in 1980 to more than \$1,450 billion in 2010, according to the International Monetary Fund. Dubbed the "Miracle on the Han River," this astonishing postwar growth has been fueled with imported energy to such an extent that today only a minute percentage of energy comes from domestic sources. The Korea Energy Economics Institute reports that, in 2010, domestic coal made up only 1.8 percent of South Korea's total coal use—and it was also only a fraction of the country's total energy mix.

In addition to such energy security concerns, South Korea's GHG emissions have skyrocketed, more than doubling between 1990 and 2007 and outpacing other countries in the Organization for Economic Cooperation and Development (OECD). The main drivers for increased energy consumption have shifted to the residential and industrial sectors, reflecting both higher standards of living and a booming export economy. Over the last century, climate records show that South Korea's average temperature has increased by 1.5°C, more than twice as much as the global average of 0.7°C. Seoul's temperature alone has increased by 2.5°C, according to a 2011 study published by the Nautilus Institute.

Figure 1. Korea has become one of the most energy-intensive economies in the OECD area



Within this context of near-complete energy import dependence and growing concerns over environmental impacts, President Lee Myung-bak introduced his Low-Carbon and Green Growth Strategy during a 2008 speech commemorating the Republic of Korea's 60th anniversary. This plan established a framework for institutionalizing greener growth practices and signaled a significant policy shift toward proactive green economic growth. The National Green Growth Strategy that followed outlined impressive targets and boasted funding equivalent to \$97 billion, or 2 percent of annual GDP. While it is too soon to analyze the strategy's effects on Korea's economy, the motivations behind this transition appear inconsistent with a true desire to promote sustainable growth. South Korea's green growth strategy has not yet led to any fundamental change in the country's economic growth model.

III. DEFINING “GREEN GROWTH”

A number of factors are essential to formulating an effective green growth strategy. First, a successful green economic strategy must encourage growth and development while protecting the environment; it must ensure that policy departs from a mindset of traditional growth first, environment second. Second, it must also target business and consumer behavior using a variety of market-based incentives, such as pricing the negative externalities of pollution through a carbon tax or cap-and-trade system. Without initiating change from the bottom up, fundamental behavioral shifts cannot occur. Third, investment in R&D further enhances technological innovation that in turn promotes greater energy efficiency and fosters job creation in more advanced sectors. Effective green strategies must avoid promoting short bursts of growth that will only result in short-term unskilled labor opportunities. Lastly, countries must establish both an effective monitoring system and an independent regulatory body to oversee implementation of green policies and must ensure that business or government interests do not hamper the efficacy of such regulation. Together these guidelines outline an effective policy structure for green growth.

IV. DEFENSIVE POLICY APPROACHES PRIOR TO 2008

Prior to South Korea’s major policy changes in 2008, the government had taken only defensive steps in promoting energy conservation and efficiency. According to the OECD Economics Department, in 1992 South Korea implemented its first mandatory energy-efficiency standards on 23 items, including refrigerators, air conditioners, and washing machines, requiring all units sold to achieve a minimum level of efficiency. This emphasis on efficiency continued through 1996, when the government began to award special labels to appliances that exceeded the efficiency levels required by law. Despite this push for greater efficiency in consumer electronics, South Korea did not establish firm climate change guidelines until 1999, when it enacted its First Comprehensive Counterplan for the Framework Convention on Climate Change. While this three-year plan took an important step in calling for modest emissions reductions, it did not significantly limit the energy use required to power the country’s burgeoning economy. Despite continuing to make progress in tackling GHG emissions, South Korea upheld this defensive stance toward its own economic growth through four incarnations of its Comprehensive Counterplan.

South Korea's ratification of the Kyoto Protocol as a non-Annex I country, which ensured it did not have to set a specific GHG reduction target through 2012, is another example of the country's defensive policy stance. Even so, South Korea's Second Comprehensive Counterplan established a basic framework for achieving set goals by enhancing GHG reduction measures, setting up the statistics infrastructure, and introducing programs to encourage citizen awareness and participation. After incorporating additional considerations from relevant ministries, South Korea released its Third Comprehensive Counterplan in 2005, which prominently featured adaptive projects designed to tackle climate change on a sector-by-sector basis. The Fourth Comprehensive Counterplan came during the transitional period between Presidents Roh Moo-hyun and Lee Myung-bak. Despite maintaining only modest emissions reduction targets, it made a notable step forward by enlisting cooperation from the international community. Although each of these plans arguably furthered South Korea's commitment to greener economic growth, they were maintained only so long as they did not rein in economic growth as a whole.

The use of environmental taxes has been one bright spot in South Korea's efforts to green its economy, but a large disparity between sector rates indicates that the government continues to protect industrial growth. According to the OECD, between 1994 and 2008 revenue from environmental taxes in South Korea rose from 2 to 2.5 percent of GDP, accounting for 9.5 percent of the country's total tax revenue compared to the OECD average of 5.4 percent. Additionally, the period from 2001 to 2007 saw the taxes on diesel and liquefied petroleum gas butane rise 2.4 times and 6.8 times, respectively. Despite these encouraging developments, taxes levied on the industrial sector have remained low to ensure the continued development of the nation's economy. Although the government took significant steps in 2001 by beginning to tax heavy oil used by industry, a 2011 OECD study indicates that by 2009 the tax had only risen to about 3 percent of the total price. While South Korea has made headway in the implementation of an effective environmental tax system, large disparities in tax rates continue to exist between sectors, suggesting that the government values its green push only so long as it does not interfere with the country's economic progress.

V. LEE MYUNG-BAK'S GREEN ECONOMY

In February 2008, a year after the release of the Fourth Comprehensive Counterplan, South Korea inaugurated a new president, former Seoul mayor Lee Myung-bak. Known primarily for being the CEO of Hyundai Construction, Lee seemed an unlikely candidate to adopt a green economic growth model.

However, he swept into the Blue House largely based on his reputation for having restored Seoul's iconic *Cheonggyuecheon* stream. In 2007, *Time* magazine named him one of its Heroes of the Environment, alongside former US vice president Al Gore, for Lee's efforts to show that "environmentalism can go hand in hand with development." In conjunction with his pledge to tear out the highway that he himself had helped build over the stream in the 1960s, Lee, as mayor cleaned up Seoul's transportation system by developing a cleaner, faster fleet of public buses.

Although President Lee's declaration of green growth as a "new national development paradigm" only six months after taking office came as a surprise to many, it was hardly a departure from the policies he had adopted during his tenure as Seoul's mayor. And just as he had used the public's charged sentiments toward the *Cheonggyuecheon* stream to fuel his political objectives, his announcement of his Low-Carbon and Green Growth Strategy on the country's 60th anniversary appealed to South Korean nationalism.

VI. UNVEILING A NATIONAL GREEN GROWTH STRATEGY

In July 2009, almost a year after President Lee's speech, South Korea announced its National Green Growth Strategy, the core vision behind its new development initiatives. The strategy established two primary targets: to be the world's seventh green power by 2020 and its fifth green power by 2050. However, neither of these targets was formally defined and both have since been removed from the green growth policy website (www.greengrowth.go.kr). In addition to these targets, the strategy outlined three major objectives: mitigating climate change and increasing energy independence, creating new engines for economic growth, and improving quality of life and enhancing the country's international standing.

To address the first objective of mitigating climate change and promoting energy independence, the National Green Growth Strategy calls for mandated GHG emissions reporting and promotion of forestation; reducing fossil fuel use while increasing non-fossil fuels in the overall energy mix; and reducing the country's energy-use intensity to the OECD average. Additionally, the strategy declares that launching restoration efforts such as the Four Major Rivers Project will assist in strengthening the country's overall capacity to offset the effects of climate change.

To achieve the second objective of creating new engines for economic growth, the government announced plans to promote the development of green technologies, with the goal of achieving an 8 percent world market share in

relevant sectors within five years. The government also aims to green existing industries through assistance to small and medium enterprises, and promote the country's green industries abroad through increased export targets. Furthermore, by introducing an emissions trading system and credit guarantees to green industries, the strategy aims to establish a sound foundation for a burgeoning green economy.

Lastly, to improve the quality of life for its citizens and enhance its global standing, South Korea plans not only to green its landscape through restoration projects, but also to encourage its citizens to adopt greener principles in their everyday lives, while the government itself takes a more active role in international climate change negotiations. To cement the country's status as a role model for the international community, the South Korean government also announced a target for expanding the green portion of its Official Development Assistance (ODA), from 11 percent of the total ODA to 30 percent by 2020. Together these policies, under the umbrella of three overarching objectives, map out the framework of South Korea's green economic strategy through 2050.

VII. SHIFTING TO A PROACTIVE GREEN GROWTH POLICY

President Lee's Comprehensive Plan on Combating Climate Change, announced in August 2008, called for an abrupt shift in policy. It adopted a more proactive stance toward green economic growth, utilizing the climate industry as a primary driver for that growth. Government ministries subsequently scrambled to produce short-term plans that integrated this new national strategy. Within five months, South Korea released several important proposals concerning new energy technology and green job growth, including the National Energy Basic Plan, the Industrial Development Strategy for Green Energy, the Long-Term Master Plan for National Research and Development on Climate Change, Comprehensive Measures for Research and Development on Green Technologies, the Vision and Development Strategy for New Growth Power, and the Green New Deal. In the last case, the Green New Deal focuses heavily on construction and calls primarily for the restoration of the country's four major rivers, a process that involves both the dredging of the rivers and the building of 16 new dams. The Green New Deal also outlines plans for the construction of 14 additional nuclear plants by 2030.

In addition to these development initiatives, the government laid out specific policies to tackle GHG emissions in four major sectors: building, transportation, industry, and energy transformation. In the building sector, the guidelines call

for a 31 percent reduction in emissions by 2020. For the transportation sector alone, plans call for a 33–37 percent reduction in emissions by 2020. Designated green transportation zones are also planned, and a discount point will be offered to the public with the ultimate goal of total passenger share reaching a 65 percent share of mass transit. Within the industry sector, an energy target-setting program began in 2010 for industries with an energy intensity of more than 0.5 million tonnes of oil equivalent. Lastly, the energy transformation sector plans to introduce a renewable portfolio standard by 2012 and work on constructing a smart grid. The share of nuclear in South Korea's energy mix will also shift to 41 percent of installations and 59 percent of generation by 2030. It is important to note that these nuclear targets were set prior to Japan's Fukushima disaster and it is unclear whether they will remain in place.

Three main pillars form the institutional framework for South Korea's green growth: the Framework Act on Low-Carbon Green Growth, the Presidential Committee on Green Growth, and the Five-Year Plan for Green Growth. As the green strategy's primary legislative manifestation, the Framework Act promotes and enforces green policies through several provisions, including basic principles for building a green economy and green industries; establishment of and support for companies investing in green industries; diffusion of green growth culture in both production and consumption; establishment of an integrated information management system for GHG emissions; and eventual adoption of a cap-and-trade system. The act also calls for the creation of an oversight committee to regulate green policy implementation.

That oversight body took the form of the Presidential Committee. Established under the supervision of President Lee, the committee oversees implementation of this new national vision. It mandates deliberation on issues concerning policy direction, evaluation of green targets, and the overall establishment, revision, and enforcement of the green growth strategy. The Five-Year Plan is a short-term approach to achieve the long-term objectives of the strategy. Its detailed implementation focuses on securing new growth engines in order to transform South Korea's economy into a green economy.

Table 1. The Five-Year Plan for Green Growth (2009–13)

Trillion won ¹						
	Total	2009	2010	2011	2012	2013
Total	107.4	17.4	24.2	25.7	20.6	19.4
Central government budget	98.9	17.4	20.5	21.9	19.6	19.4
Public enterprises' investment	8.5	-	3.7	3.8	1.0	-
<i>Memorandum item: total green technology R&D investment in all categories</i>	<i>(13.0)</i>	<i>(1.9)</i>	<i>(2.2)</i>	<i>(2.5)</i>	<i>(2.8)</i>	<i>(3.5)</i>
1. Adapting to climate change & enhancing energy independence	57.5	8.5	15.5	16.0	9.8	7.7
1. Effective mitigation of greenhouse gas emissions	5.4	1.0	0.9	1.0	1.1	1.3
2. Reduction of the use of fossil fuels and the enhancement of energy independence	15.4	2.8	3.8	2.9	3.0	2.8
3. Strengthening the capacity to adapt to climate change (Four Major Rivers Restoration Project)	36.7	4.7	10.9	12.0	5.6	3.6
	<i>(15.4)</i>	<i>(0.8)</i>	<i>(6.4)</i>	<i>(7.1)</i>	<i>(1.1)</i>	<i>(-)</i>
2. Securing new growth engines	23.5	3.9	4.1	4.7	5.3	5.6
4. Development of green technologies	7.6	1.5	1.4	1.5	1.5	1.6
5. The "greening" of existing industries and promotion of green industries	4.5	0.7	0.9	0.9	1.0	1.0
6. Advancement of industrial structure to increase services	9.7	1.4	1.5	2.0	2.4	2.5
7. Engineering a structural basis for the green economy	1.8	0.3	0.2	0.3	0.4	0.5
3. Improving living standards & enhancing national status	26.4	5.0	4.6	5.1	5.6	6.1
8. Greening the land and water and building the green transport infrastructure	23.9	4.6	4.2	4.6	5.0	5.5
9. Bringing the green revolution to daily lives	1.8	0.3	0.3	0.3	0.4	0.4
10. Becoming a role-model for the international community as a green growth leader	0.7	0.1	0.1	0.1	0.1	0.1

1. Actual budgets for 2009-10 and projections for 2011-13.
Source: Ministry of Strategy and Finance and Presidential Committee on Green Growth.

South Korea's geographic limitations affect the feasibility of the country's green growth strategy. For example, the large wind farms of western China are not reproducible in South Korea because of the latter's small land mass. To its credit, the Korean government has been exploring offshore options and recently announced plans to construct wind farms off the country's southwestern coast. The country's solar photovoltaic industry is enjoying strong government support, but solar remains significantly more expensive than fossil fuels. Although the National Green Growth Strategy has been heavily criticized for its continued adherence to nuclear energy, it is difficult to see how South Korea can meet its energy needs without it. Currently, renewables simply do not supply enough energy for the amount of space they require (as in large wind farms), making nuclear energy a likely essential component of the country's energy security strategy.

VIII. POSITIVE GREEN GROWTH DEVELOPMENTS

A number of positives stand out in South Korea's green economic growth strategy. First, the policies in the Five-Year Plan and the targets in the Comprehensive Plan on Combating Climate Change represent a notable departure from the government's earlier defensive position of promoting only those green policies that did not interfere with economic growth. There remains

significant room for improvement, but by declaring national GHG reduction targets, establishing a detailed short-term plan to achieve these targets, and creating an effective institutional framework, South Korea now has a more proactive stance toward transitioning to a greener economy. The government's adoption of the GHG and Energy Goal Management System in September 2011 further imposed concrete reduction targets on 497 major enterprises responsible for more than 68 percent of the country's GHG emissions.

The policies enacted since 2008 have resulted in some visible achievements, with notable increases both in spending on green R&D and in the number of green industry players. According to an Industrial Bank of Korea report, green technology investment by the country's top 350 companies rose by 34 percent in 2009 compared to 2008; and between 2009 and 2010 there was a 13.5 percent increase in total spending on green R&D. Not only has spending increased, but according to the UN Environment Program, South Korea has been incredibly efficient at distributing funds, with almost 20 percent disbursed in the first half of 2009 compared to the global average of 3 percent during the same period. These increases in R&D spending will aid in developing more efficient technologies and promoting long-term job creation. Furthermore, compared with 2007, the Presidential Committee on Green Growth reports that there are 2.1 times more companies, 3.7 times the number of employees in these companies, 7.3 times the quantity of exports, and 5.1 times the amount of private investment in South Korea's renewable energy technology industry. As with increases in green technology R&D, these positive economic growth numbers indicate that green initiatives are developing in tandem with South Korea's economy.

IX. REMAINING POLICY CHALLENGES

While South Korea has made encouraging progress in developing its green growth strategy, full implementation ultimately remains hindered by a continued preference for economic growth over a truly green transition. For example, the strategy relies on large civil engineering projects as “drivers of development” that, by their very nature, will themselves generate high levels of carbon emissions. On the positive side, the Five-Year Plan for Green Growth contains impressive measures designed to jumpstart the new economic model. Not only does it call for expanding government investment in green technology R&D from 2 trillion won in 2009 to 3.5 trillion by 2013—boosting such green R&D spending from 16 to 20 percent of overall R&D spending—but the plan also calls for spending an additional 2 percent of GDP per year through 2013 on green development projects.

Even so, a significant amount of this government spending will go toward the large construction projects, including the laying of additional railway lines for high-speed trains, river restoration, sewage facility infrastructure, and the government's controversial Four Major Rivers Project. With its heavy emphasis on dam construction and dredging, this project has attracted much criticism from environmental advocates, who claim that it may damage, rather than restore, the waterways. The impressive spending and rates of job creation outlined in South Korea's short-term plan are also somewhat misleading, as funding for the Four Major Rivers Project represents 64 percent of the total funding provided by the Green New Deal and is expected to generate 910,000 of the program's targeted 950,000 new jobs, according to a 2011 Nautilus Institute report. Furthermore, the Four Major Rivers Project will only create short-term unskilled jobs and does not solve the vital problem of creating long-term sustainable opportunities for the highly educated younger generation of Koreans who are finding it increasingly difficult to find work. Surprisingly, according to the Nautilus Institute study, government spending on green R&D currently accounts for only 12 percent of its total R&D spending, with the rest going to infrastructure construction projects, a clear indication that the government hopes to boost the economy through implementation of its green growth policies. The question remains whether this level of spending is sustainable or whether overinvestment will eventually lead to a "green bubble."

In addition to the construction-heavy domestic agenda, prescribed R&D spending places strategic emphasis on increasing industrial competitiveness in the global market, largely following South Korea's traditional export-led model of growth. Within this context, South Korea is following a form of market-driven green growth that emphasizes the economy first and the environment second. As a result, green "advocates" in South Korea increasingly hail from the business community, and thus far policy implementation has arguably favored those promoting green industry; policies addressing environmental issues such as climate change and emissions reduction get implemented only if they support government priorities.

Furthermore, South Korea's brand of green growth remains controversially green by international standards. Notably, South Korea's reliance on nuclear energy makes the country's strategy less green. The contribution from renewables is projected to increase only in small increments, from 2.7 percent in 2009 to 6.08 percent by 2020. Between 2020 and 2030, renewables are projected to jump to a 30 percent share of the energy mix, but it is unclear whether this lofty goal can be achieved given the long-term policy structure. The prospects for a greater focus

on environmental performance rather than on using “green” simply as a driver for economic growth appears limited by the paradox of so-called green growth.

In their current form, South Korea’s green policies primarily act as growth drivers for the country’s largest industries, including nuclear and construction. In addition to the obvious problems with the legitimacy of this “green” growth model, it remains unclear whether this strategy can truly achieve the industrial stimulus it claims. Green growth often reinforces technology dependency, and this will be especially true for South Korea, whose renewable energy industry remains in the nascent stages of development. Despite the large government investment in R&D, technology will lag behind global leaders for some time. As a result of this short-term import dependency, it is questionable whether the Green New Deal will be able to create the number of jobs it claims it can. While this technology dependency issue does not apply to the nuclear industry, and setting targets for increasing the number of operating plants ensures a source of job creation over the next few decades, there has been no reconsideration of the country’s nuclear dependence in the wake of Japan’s Fukushima disaster. If reliance on nuclear power is scaled back, the job-creation numbers will substantially decline.

The sustainability of South Korea’s green growth strategy remains questionable. Even if one considers this growth model to be fundamentally green, a number of factors reduce its chances at significantly changing the country’s environmental performance in the long run. As the link between low-carbon development and industrialization, green technology reduces the relative amount of pollution produced per unit. Despite this *relative* reduction in emissions, *absolute* levels will not necessarily fall; as the pursuit of green growth continues, additional pollution will inevitably be generated. Often, as efficiency increases, cheaper resources lead to the greater consumption of the resource. As the country consumes more energy, more GHG will be produced and released into the atmosphere. In the years following implementation of the National Green Growth Strategy, South Korea’s environmental performance has actually deteriorated. In 2010, the Environmental Performance Index ranked it 94th out of 163 countries, a drop of 43 places since 2008, making South Korea the lowest-ranking OECD member. For these reasons, South Korea’s current green growth strategy appears neither sustainable nor secure.

X. POLICY RECOMMENDATIONS GOING FORWARD

While it may be too early to comprehensively assess the failures and successes of South Korea's green growth strategy, a number of policy adjustments may help the country achieve a more successful transition to truly greener economic growth. First, South Korea's current strategy employs a top-down approach that fails to obtain consensus from the general population. Shifting to a more bottom-up approach that includes the whole of society in the transition process will aid in the shift toward a greener lifestyle. If the South Korean government puts more resources and autonomy in the hands of organizations that can begin this process of greening the everyday lives of its citizens, it might be able to implement change at the grassroots level. To further aid in changing energy consumption patterns, it may also be helpful to realign the goals of green development with those of sustainable development; the latter promotes more efficient energy use overall and will contribute to obtaining greater energy security. South Korea should also push for more local energy generation, as there is presently a large disparity between where energy is produced and where it is used. A more localized system would allow energy production to switch from the centrally controlled supply model to a more efficient, decentralized demand-management structure. It may also contribute to greater participation by local residents in production and consumption decisions, which in turn may contribute to greater energy efficiency and the overall stabilization, or even lowering, of national energy use.

Second, South Korea should consider implementing a cap-and-trade emissions trading system instead of relying solely on the proposed carbon tax. Such a system allows permit holders to emit a preset amount of GHG. Permits obtained in excess are then traded on an open market. Despite large start-up costs, once such a system is in place it offers several advantages. First off, it can aid in securing a more targeted level of emissions reduction. Second, unlike a carbon tax, it does not need to be adjusted for inflation or growth. Third, by encouraging firms to get involved and forging linkages with the international carbon market, the system is self-maintaining and can potentially aid in lowering the costs of reducing emissions.

Lastly, in creating effective drivers for green economic growth, the government should encourage innovation by increasing investment in green R&D and by establishing and utilizing connections between industry and universities. To facilitate the technological developments necessary to transition to a greener economy, greater public funding of nascent technologies is required, as many

such technologies do not have the commercial viability needed to attract private investment. Adopting these policy recommendations will help prevent South Korea from falling into the import dependency that will hamper its efforts to create domestic jobs and generate market-competitive technology.

XI. CONCLUSION

South Korea has made significant progress toward adopting a greener economic growth model, but the government remains reluctant to promote green policies that could potentially hamper economic development. While an effective institutional framework has been put in place, it only offers a top-down policy agenda and does not promote change in societal behavior at a grassroots level. Furthermore, the market-driven approach clearly sees the greening process as a potential engine for greater economic growth as a whole. The majority of funds detailed in the Five-Year Plan and the Green New Deal have been allocated to the construction and nuclear sectors, and yet such large-scale civil engineering projects and greater use of nuclear power are paradoxical to green growth. Furthermore, while it remains difficult to ascertain feasible alternatives to South Korea's nuclear power plants given the country's geographic limitations, stronger policies designed to tackle energy efficiency and reduce consumption could make headway in curbing the country's growing energy demand. If South Korea truly wants to adopt a greener economic model, it must find a happy medium between "only green and no growth" and "only growth and no green." Adopting policies that promote energy sustainability in the daily lives of citizens and in government regulation of domestic industry will help the country move toward a more effective greening of its economy.

CHAPTER III: REGIONAL ECONOMIC COOPERATION



The Viability of the New North Korean SEZs

By Marc Janke

I. INTRODUCTION

This is a report on the economic viability of the North Korean special economic zones (SEZs), including the two most recently opened SEZs in Rason and Hwanggeumpyeong in June 2011. What follows is an assessment of the investment potential of such regions, comparing widely divergent facts and opinions about the North Korean SEZs. The four SEZs considered are analyzed in two groups: the three northern SEZs (Rason, Sinuiju, and the islands), which were initiated with China in mind; and the Kaesong Industrial Zone, which is a South Korean project. The three northern SEZs will only be successful if China is willing to commit greater resources to their development. Kaesong, on the other hand, is effectively cut off from further growth until a more lenient South Korean political regime comes to power. Ultimately, SEZ development is in doubt because outside powers (China and South Korea) hold the keys to the success of these zones. Additionally, North Korea has not indicated a strong commitment to SEZ development, and thus the prospects are dim.

This essay's first section briefly sketches the background of the development of SEZs in North Korea. The second section introduces the four SEZs under analysis. The third section presents evidence suggesting that these SEZs *can* be successful, outlining factors that will affect success: fundamental factors (economic, physical, infrastructural, etc., that are concrete components of the potential for economic development) and behavioral factors (the perceptions and beliefs that cause people both inside and outside North Korea to behave in certain ways). The fourth section takes these fundamental and behavioral factors and reverses the analysis, giving reasons why the SEZs might *not*, and likely will not, be successful.

The line drawn between fundamental and behavioral factors is somewhat arbitrary. But making this distinction differentiates between what people are *capable* of doing (based on the physical resources at their disposal) versus what people are *willing* to do (based on how they feel about undertaking such action). North Korea, with its tumultuous history and passionate opinions both inside and outside the country, is a unique case in which the difference between *capabilities* and *willingness* gives insight into the country's potential for economic

development. The North Korean government has great potential to implement reform; the key is whether or not the government will be willing to implement such reform.

II. NORTH KOREA'S ECONOMY AND THE DEVELOPMENT OF SEZS

The CIA *World Factbook* provides some basic statistics on the North Korean economy. Estimated gross domestic product (GDP) for 2009 was \$40 billion, which is 350 times smaller than the current GDP of the United States and about 37 times smaller than the South Korean GDP. Per capita GDP for 2009 was roughly \$1,800. The economy is divided into three main sectors: agricultural (20 percent), manufacturing (50 percent) and services (30 percent).

A special economic zone is an area inside a country that has laws and regulations regarding trade, business laws, and other policies that are generally considered pro-free trade and more open than the rest of the country. China—with the creation of its SEZs in parts of Guangdong Province, Fujian Province, Zhuhai (directly across from Macau), and Shenzhen (directly across from Hong Kong)—is credited with this policy innovation.

III. THE NORTH KOREAN SEZS



Source: CIA, *The World Factbook*, North Korea

The Democratic Republic of North Korea (DPRK) currently claims four special economic zones. The first is the Kaesong Industrial Zone (KIZ), established in concert with the South Korean government in 2002 and the most well-known North Korean SEZ in the Western world. The second is Sinuiju. In 1991, the DPRK government made an initial attempt, and failed, to open up Sinuiju, a border city in the country's northwestern corner, directly across the border from Dandong in China's Liaoning Province. The North Korean government attempted to

revitalize Sinuiju in 2002. Following Sinuiju's lackluster performance, the *Financial Times* on June 9, 2011, reported that North Korea plans to open two more SEZs "located in the North Korean border city of Rajin-Sonbong (Rason). The other will be built on the undeveloped islands of Hwanggeumpyeong and Wihwa." Rason is in North Korea's farthest northeastern corner, across from China's Jilin Province and Russia's Primorsky Krai. The choice of Hwanggeumpyeong, Wihwa, and Bidan Islands (which Jamil Anderlini in the *Financial Times* on September 1, 2011 called "swampy undeveloped islets" in North Korea's northwest corner) is more puzzling, as the islands are so near Sinuiju and are surrounded by nothing but undeveloped wilderness.

Table 1. Specifications of North Korean SEZs

	Kaesong	Sinuiju	Hwanggeumpyeong /Wihwa	Bidan	Rason
Date Founded	2002	Pre-Korean War industrial center, re-founded in 2002	June 2011	2005	June 2011
Physical Location	on North Korea's southern border, in North Hwanghae Province	Sinuiju Municipality in North Pyongan Province, across the border from Dandong in Liaoning, PRC. (northwestern tip of North Korea)	Currently uninhabited islands near Sinuiju, in the Yalu River between China and DPRK	Large island near Sinuiju in Korea Bay	A combination of the two cities Rajin and Sonbong, which are located at North Korea's extreme northeastern corner, adjacent to China's Jilin Province and Russia's Primorsky Krai administrative region
Current Infrastructure	Most advanced of the four SEZs, due to heavy investment by large South Korean corporations	Some manufacturing facilities, both left from initial development in 1991, and also from its pre-Korean War status as a key Japanese manufacturing location	None, according to reputable blog 38 North	None	Very little, though main road is currently being expanded
Planned sector of economy	Low-end consumer goods such as shoes, clothes, and watches	Textiles, paper goods, enameled iron cookware	Labor-intensive manufactured goods	Financial center	Transportation and cargo shipping
Major international partner	South Korea	China	China	China	China
Current State of Completion	Complete, and operational until drastic cutbacks following the Cheonan sinking incident in 2010. Also curtailed due to US sanctions on North Korean products	Facilities in strong need of upgrades	None	None	Little to none
Possible rationale for location	On the border with South Korea	Former manufacturing site, location on the border with China and on the Korea Bay	Easy isolation as islands, very near China; changing flow of the Tumen River has made the island easier to access from China than from North Korea in recent years	Easy isolation as an island, very near China	Far removed from key population centers; China wants access to a seaport for the northeastern provinces

Kaesong Industrial Zone

The Kaesong Industrial Zone, located south of Pyongyang near the South Korean border, began in 2003 as a cooperative venture between the South and North Korean governments, with the purpose of improving DPRK economic development. South Korean firms were allowed into a special area to establish factories, and their investments were backed by the South Korean government. Hyundai Asan, the South Korean company responsible for management of the KIZ, writes in their informational pamphlet that by September 2011, 123 companies operated in the KIZ, with 48,242 North Korean workers producing about \$323.3 million worth of goods. *Asia Times Online* reported in June 21, 2011 that South Korean companies pay their workers \$61 a month, but including overtime this could be as much as \$90–100 per month. However, the DPRK government takes at least two-thirds of that, leaving North Korean workers \$20–30 per month at most. The *Asia Times* article observed that despite these incredibly low wages, the KIZ provides what are likely the most lucrative legal jobs available for common people in North Korea. Business is booming the KIZ; even though the number of companies operating there has fallen by more than half since 2008, the total number of North Korean workers has doubled over the same period. Choi Seong-keun of the Hyundai Research Institute confirmed in a personal interview that most KIZ factories are currently running at 100–120 percent capacity, unable to expand due to South Korean restrictions.

Sinuiju SEZ

The website *38 North* (www.38north.org) provides an excellent introduction to Sinuiju: “One of only two rail crossing points between the DPRK and China, Sinuiju is the North’s major gateway for rail and truck traffic. Much of Dandong’s [in China] foreign trade (estimates run as high as 80 percent) passes through Sinuiju.” The SEZ, originally established in 2002, was imagined as a transfer point for DPRK and Chinese goods that would develop into a thriving trade center. It was envisioned to have an entirely separate legal system from that of North Korea. He Tai Qing wrote in “*Dongbeiyi IT Gongtongti Zhanlue Yanjiu*” (“A Study on Northeast Asia Community Strategy”) on June 5, 2004 that according to the Sinuiju SAR Basic Law, the Sinuiju area has independent legislative, judiciary, and administrative authority. Excluding diplomatic administrative issues, the DPRK government does not intervene in the legal affairs of the area. The Sinuiju SEZ can administer separate regional visas and has its own regional flag. There is also foreign investment protection and the right to independently own and operate a business. In this sense the Sinuiju law is very much like

China's Shenzhen's law. Some scholars have suggested that the law concerning the political system in Sinuiju was modeled after Hong Kong, whereas the law concerning the SEZ's economic component is similar to Shenzhen. While this is factually true, how these Sinuiju laws operate in practice is a question that remains to be answered.

38 *North* lists some industries that continue to function in Sinuiju despite the dramatic recent curtailing: A Rakwon Machine Complex (quoted as being a "key production base providing equipment for much of the North's industry"), the Namhung Youth Chemical Plant, the September General Iron Enterprise, a textile machine plant, the Ryangchaek Bearing Factory, the Chonma Electrical Machine Factory, the Taeahungan Machine Factory, and the Sinuiju Condenser Factory. Kim Jong-il visited nearly all of these sites many times in order to emphasize their importance to the North Korean economy. In addition, a few remnants of the Japanese occupation remain. The Japanese attempted to build up Sinuiju as a center of light industry in the 1920s during the occupation period, and certain well-known factories, such as an enamel cookware factory, still remain from those times, although that particular factory is reportedly in dire need of an upgrade.

38 *North* writes that the Chinese are helping to build a bridge across the Tumen River from Sinuiju to Dandong to facilitate trade. The Inter-Korean Economic Cooperation program's plans to upgrade the railroad system from Sinuiju to Kaesong have been put on hold since Lee Myung-bak became South Korea's president in 2008. Liu Ming wrote in "*Chaoxian de jingji gaige: di san tiao daolu de tansuo ji bu queding de weilai*" ("DPRK Economic Reform: Exploring the Third Road and Its Uncertain Future") in June 2008 that China plans to build an "enormous residential area" in Sinuiju.

Rajin-Sonbong (Rason) SEZ

From a pre-SEZ attempt to establish a casino in 2000 and forced closure by the Chinese government, the Rajin-Sonbong SEZ (abbreviated Rason) was reborn in June 2011. Rason's strategic location is its single strongest asset for potential investment. It is located on the border of China, in an area that would give China a much-coveted seaport to the East Sea and enable its northwestern landlocked provinces to ship goods much more cheaply than they do now (first via land down the coast, then to the sea). The port is the northernmost ice-free port in the region, and China's support of development in the area is one of the most promising factors in evaluating this SEZ's potential success.

However, the Chinese government's actual commitment to the enormous investment that such a port and accompanying infrastructure will require remains to be seen. Andrei Lankov of *Asia Times Online* wrote in June 21, 2011 that there is only one single-lane paved road that connects Rajin to Sonbong. *38 North* reports that this 50-kilometer road to the border with China has been improved significantly and additional improvements are planned to be made. But such improvement is only a miniscule beginning of what would inevitably be a program of many years and billions of dollars.

In 1995, the DPRK government announced a new strategy for Rason: to turn it into a transfer point for traded goods from 2001 to 2010. There were grandiose plans for foreign investment of sums surpassing \$4.7 billion, but by the end of December 2000, only \$120 million had been collected. The majority of this was in the form of hotels, restaurants, and stores (service sector) from Chinese investors, which made up two-thirds of the investment total. Another 20 percent came from Japanese-North Korean Association funding, and less than 10 percent came from Western economies.

Virtually no information is available on Hwanggeumbyeong or the smaller island of Wihwa. Various Chinese sources, such as Ding Yuanmei in "*Zhongchao jingji hezuo xianzhuang yu duice yanjiu*" ("Chinese-DPRK Trade Partnership and Related Regulations") in 2007, and Liu Ming in the article mentioned above claim that the Chinese government is planning to assist North Korea in building a financial center on Bidan Island. These areas have been described as a "sandy island" and a "large rock." An ROK Ministry of Unification presentation in Seoul in November 2011 provided one insight into why North Korea may have chosen Hwanggeumbyeong: Though the island is undisputed DPRK territory, in recent years the flow pattern of the Tumen River separating China and North Korea has changed. The main current is now much stronger between North Korea and Hwanggeumbyeong than it is between China and Hwanggeumbyeong, making the island more difficult for North Korea to access. According to Seongkeun Choi of the Hyundai Research Institute, perhaps this was perceived as a benefit, in order to more effectively keep unauthorized North Koreans away from the island.

IV. THE NORTH KOREAN SEZS: CAN THEY BE SUCCESSFUL THIS TIME?

Though the odds are stacked against success for the DPRK special economic zones, useful insight can be gained by looking at the factors that might lead to such economic development success. To avoid the ambiguity of lumping together concrete capabilities with behaviors, we can separate these elements into two groups: fundamental factors (such as lack of electricity and modern

infrastructure) and behavioral factors (such as lack of trust within the international system).

One fundamental factor that supports North Korean SEZ development is the growth of trade. The June 7, 2011 *Chosun Ilbo* reports that first-quarter 2011 DPRK-China trade doubled compared to the previous quarter. Organizations like Inter-Korean Economic Cooperation (IKEC), as part of the Ministry of Unification, continue to work toward greater DPRK economic development. An IKEC presentation created circa 2007 reveals relatively ambitious plans for inter-Korean development, including expansion of existing facilities in the Kaesong Industrial Zone in addition to “tourism, residential and commercial districts.” Since 2007, these plans have been put on hold indefinitely—given today’s strained relationship between North and South Korea, it is doubtful that economic development projects between the North and the South will be fruitful in the near term. China’s plans, too, are largely projections rather than projects that have actually started. There are not enough real results yet to claim that the one-quarter increase in DPRK-China trade is more than a temporary bump based on renewed promises that will eventually fall through.

Another fundamental factor working in North Korea’s favor is its good educational system relative to its economic condition, especially in the information technology (IT) sector. Despite the deterioration of many DPRK school buildings and lack of necessary supplies, 99 percent of North Koreans, male and female, are literate and attend school up to at least middle school. The country’s relatively high level of human capital could be an advantage were it able to open up to international trade and foreign investment.

Nowhere are the results of this educational system more evident than in the IT industry. He Taiqing, in “A Study on Northeast Asia IT Community Strategy,” points out that North Korea may have advantages overlooked by many Western analysts. He claims that the DPRK software industry is “somewhat competitive” due to a talent-nurturing program begun in the mid-1980s: “North Korea in 1985 established a four-year institution for training computer technicians—called Choson Computer Science University—which in 1986 and 1990 established institutions for research and development of computer software, Pyongyang Information Center and Choson Computer Center.” He suggests that North Korea is supposedly attracted to IT development because it satisfies the strategy of “limited opening without systemic reform.” Paul Tjia, a Dutch strategy consultant with expertise in North Korea, wrote an article for *38 North* on October 31, 2011 supporting North Korea as an “up-and-coming IT outsourcing

destination,” particularly for European firms. He named website design, animation, administrative software, radio and mobile communication, medical diagnostics as IT fields in which North Korean firms have prior experience.

Still, while North Korea’s cheap IT sector will likely continue to grow, there are reasons to be skeptical. The first, as He Taiqing notes, is that North Korea is still agonizingly slow with such development. The second is that domestic IT development will be mercilessly scrutinized by the United States and other nations for its likely role in piracy and Internet crime. According to an October 17, 2006 Congressional Research Service report, despite North Korea being removed from the list of nations that sponsor terrorism, there are many US-imposed sanctions that will severely hamper development of a North Korean IT industry. These include steps to impede DPRK financial transactions internationally, ending the “supply, sale, or transfer to North Korea of conventional weapons, spare parts, delivery systems, or related items” and “prevent[ing] illicit trafficking in nuclear, chemical, or biological weapons,” among many other economic sanctions.

One main behavioral factor that could promote SEZ development is domestic pressure. Many scholars suggest that the North Korean government may have less of a choice on the issue of economic development than it did in the past. Bradley Babson, in a blog post “Rethinking Engagement with North Korea” on March 11, 2011, reported that the government experienced significant backlash in response to its crackdown on markets and has had difficulty controlling domestic inflation despite announcements to the contrary.

Related to this domestic pressure from the North Korean public is the pressure inherent in the succession of Kim Jong-un. Some Korea analysts have posited that Kim Jong-un could be eager to embrace reform in order to revive the economy, which would further stabilize and legitimize his succession. Patrick McEachern, in *Inside the Red Box*, published 2010 writes that there is strong evidence of institutional power struggles within the North Korean government. Though much of the government, as well as the military, does not want to open up the economy, the establishment of the SEZs indicates the search for a new strategy in the face of continued failure. Nevertheless, the overwhelming evidence, both in words and actions, points to a continuation of the status quo and an unwillingness to open up the economy. The power struggles between elites that McEachern writes about demonstrate different institutional interests within the DPRK state but do not suggest that the people who are fighting for power are necessarily looking for reform.

A final behavioral factor that might lead to successful development of SEZs in North Korea involves China. Simply put, China wants much of what North Korea has: namely, the Rason SEZ port (at Rajin), North Korea's abundant minerals, and the country's cheap labor.

Regarding the Rason SEZ port, Andrei Lankov wrote in the *Korea Times* on July 3, 2011:

With the Rason SEZ things appear to be quite straightforward—it's about reducing the cost of shipping. Northeast China, often referred to as Manchuria, is landlocked. Only a narrow strip of Russian and Korean territory, nearly 10 kilometers wide, divides it from the waters of the Pacific. Nonetheless, this is enough to create a logistical nightmare for Chinese business, in order to ship something overseas they have to first transport the goods to the nearest Chinese sea port, which is some 1000 km away. It is far more expensive to move things by land than by sea, so easy access to a North Korean seaport and shorter land routes would save a small fortune for Chinese business.

The Rason SEZ port is also the northernmost ice-free port in the region, which makes it especially valuable. Liu Ming wrote in *DPRK Economic Reform* published in June 2008 that a DPRK-China agreement on ports has been in effect for several years:

In July 2005, two Chinese companies from Hunchun signed an agreement with the North Korean government to rent the Rajin port for 50 years (Harbor number 3 and 4). The port will be managed by the joint venture company—Rason International Transport Company Limited, of which 50 percent is owned by the North Korean government and 50 percent is owned by the Chinese companies.

China also wants North Korea's mineral resources. North Korea is among the top 10 countries for copper, lead, and zinc deposits and also holds an abundance of coal and wood. It leads the world in deposits of tungsten, molybdenum, barite, and fluorite—in total, seven strategic metals—and also limestone from Musan. In all, 80 percent of DPRK land has minerals in it, with an estimated value of \$1 trillion, including 3–4 billion tons of magnesite (more than half the world's supply), 26 million tons of iron ore, and 4 million tons of immediately accessible uranium.

But North Korea is unable to utilize its natural capital, as its industrial infrastructure is on the verge of collapse. This is precisely where China could (and would be willing to) help. China and North Korea reportedly have an agreement that grants China exclusive access to rich stores of magnesite, which is a key component of glass and cement. In fact, Kong Jun, in “*Zhongguo dui chaoxian jingji yuanzhu neimu*” (“Behind the Scenes in China’s Investment in North Korea”) published on June 17, 2009, discloses that North Korea has allowed China privileged access to almost all DPRK mines, which has frustrated Japan and South Korea. According to media reports, China’s Shandong Guoda Gold Company has signed an €8 million, 25-year copper-extraction contract that will give it exclusive access to the lucrative copper stores in North Korea’s mountains. Prior to this, China’s Jilin Province Chamber of Commerce signed a contract with the North Korean government worth RMB 7 billion to secure Musan’s lucrative iron ore deposits. Beyond this, Beijing is also working with Pyongyang to get access to molybdenum mines near the North Korean capital as well as to oil fields in the Western Sea.

Another important aspect to consider is how the development of North Korea fits into China’s own northeastern development plan. The northeastern provinces of China have been relatively underdeveloped compared to its eastern seaboard. North Korean economic development would undoubtedly be a great boost to the region, as trade would increase between these provinces and North Korea. Likewise, there would be an increase of demand for Chinese industrial goods, which are often produced in China’s northeast. This was, in fact, one of the main hopes behind the initial development of North Korea’s SEZs. China’s belief in North Korea’s economic potential, however, has since become less optimistic. China’s hope for North Korea now seems focused on Rason as a transportation hub rather than as a site for domestic North Korean economic growth, as political risks associated with DPRK investment have not appreciably diminished. While China would undoubtedly like to see North Korean economic development as part of its own northeastern province development plan, to say that such development is more likely *because* it fits into China’s plan is a weak argument.

Given that China wants a port and mineral resources, the North Korean government does not have much leverage, especially in light of the enormous amount of aid that China continues to provide. As Kong Jun asserts in an excerpt from his 2009 article, “80 percent of oil aid to Korea and 92 percent of grain aid comes from China.” According to Kong, every year China sends 500,000 tons of oil to North Korea. Not only is this oil much cheaper compared to other sources,

but China often waits more than two years for payment. In 2006, says Kong, China's investment in North Korea was \$113 million, which was 97 percent of North Korea's total foreign aid for that year. Kong's statistics are somewhat questionable, as he assumes that the DPRK economy is half the size estimated by the CIA *World Factbook*, but there is little doubt that China provides the vast majority of foreign assistance to North Korea. As this aid dependence increases, North Korea may have to give in to China's will and put extra effort into making the SEZs a reality.

Even if China is successful in getting access to both the port at Rason and to DPRK minerals, it is doubtful that this will lead to significant economic development on the North Korean side. For one, the Chinese are infamous for sending in teams of their own laborers to complete projects in foreign countries (such as in China-sponsored infrastructure development in Africa). Even more importantly, both transportation and mining are industries in which it is relatively easy to skim off economic rents without reinvesting in domestic development. This fits the goals of the current DPRK regime quite well, making it unlikely that development based on China's self-interest can lead to economic development in North Korea's SEZs.

V. SEZ DEVELOPMENT: WHY IT WON'T WORK THIS TIME

There are several convincing arguments for why North Korea's special economic zones will not be successful this time around. As with the reasons for possible success, they break down into fundamental factors (physical capabilities) and behavioral factors (willingness of the parties involved).

The first fundamental factor is physical shortages—lack of food, electricity, and infrastructure. Choe Sang-Hoon in an October 24, 2011 *New York Times* article reported that North Koreans are currently suffering especially severe levels of malnourishment. From a basic labor productivity perspective, this undoubtedly makes DPRK workers less efficient than those of wealthier countries. Many public buildings and basic infrastructure, like sewage pipes and electric wiring—and even the machines to build them—are broken or nonexistent. In North Korea electricity is variable and unreliable; Hyundai Asan developed its own power plant in 2007 for use in the Kaesong Industrial Zone for this reason.

The primary behavioral factor working against North Korea is the way that it has gradually eroded the trust between itself and China. My interviews with North Korean experts revealed that China is only lukewarm about assisting

North Korea with its economic development. Marcus Noland, a senior fellow at the Peterson Institute for International Economics, expressed that the fact that upgrading the railroad from the Rason SEZ to Hunchun in China took 14 years “underscores the depths of North Korean insecurity and paranoia” toward opening up to the outside world. Noland wrote in “More China-North Korea Economic Cooperation” that because “China-DPRK trade has a noticeable seasonal pattern, dropping quite significantly during the winter months when the weather makes passage over mountainous dirt roads hazardous,” the improvement of the railroad to facilitate trade is a sorely needed and utterly obvious move. That it took so long is a demonstration of the massive psychological wall that the DPRK regime has to overcome to accept foreign trade.

There are also empirical indications that the DPRK government is not committed to reform. Choi Seong-keun of the Hyundai Research Institute in Seoul provided me with a fascinating chart that shows how North Korea alternates between China and South Korea when pursuing trade relationships. The chart demonstrates a clear inverse relationship between the growth rates of trade patterns between China and North Korea versus those between North and South Korea. This strongly suggests that DPRK overtures toward reform are not genuine but rather are only ways to sustain the status quo. In my interview with Mr. Choi, he postulated that the projections for 2011 would once again show further separation of the of Chinese and North Korean trade, with China increasing and South Korean trade changing to a downward trend.

Figure 1. Comparison of China-DPRK Trade and ROK-DPRK Trade

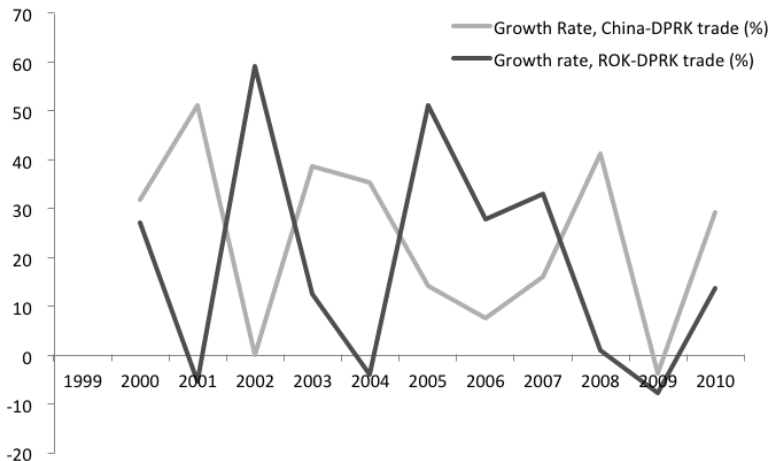


Table 2. Comparison of China-DPRK Trade and ROK-DPRK Trade

Year	China	Growth Rate, China-DPRK trade (%)	South Korea	Growth rate, ROK-DPRK trade (%)
1999	370		334	
2000	488	31.89	425	27.25
2001	737.5	51.13	403	-5.18
2002	738	0.07	642	59.31
2003	1023	38.62	724	12.77
2004	1385.2	35.41	697	-3.73
2005	1580.3	14.08	1055	51.36
2006	1699.6	7.55	1350	27.96
2007	1973.9	16.14	1798	33.19
2008	2787.3	41.21	1820	1.22
2009	2680.7	-3.82	1679	-7.75
2010	3465.7	29.28	1912	13.88

North Korea has a fundamental trust problem in developing the SEZs. Zhang Liangui, Professor of international strategic research at China's Central Communist Party School told the *Financial Times* in September 1, 2011 that "North Korea's past experience of working with other countries has left it with a serious credibility problem and this will stop a lot of foreign investment from even considering these new zones." This time around, the Chinese have more experience with DPRK fraud vis-à-vis investment projects. Chinese scholar Liu Tong writes in "*Zhongguo dui chaoxian touzi qianjing ji xu zhuyi de wenti*" ("The Prospects of Chinese Investment in North Korea and Issues that Require Attention") published in July 2009 that uncertainty and the way that international political events affect such investments constitute the biggest risk that companies face in China. He provides the example of October 2006, when North Korea tested its first nuclear weapon: the Dandong branch of China Construction Bank immediately ended a financial cooperation program, which made it extremely inconvenient for Chinese companies in North Korea to settle their accounts. A *Wall Street Journal* blog entry by Jo Dong-ho, an economist from Ewha University, commented on Kim Jong-il's May 2011 meetings in China, saying that "the Chinese side listed five points of agreement between the two countries, while North Korea listed only three." This demonstrates that the two sides have a fundamental communication problem, even though they are supposed diplomatic friends.

Another behavioral factor that impedes North Korean SEZ development is the country's culture of corruption and graft. Liu Tong is quite frank on the issue of local management inadequacies: "You must understand that some rent-seeking behavior is inevitable. Many DPRK officials have a weak and underdeveloped

understanding of the market,” says Liu, and, owing to many different reasons, “North Koreans regularly breach contracts, resulting in heavy losses for our [Chinese] companies. Examples of this are myriad. We need to do a strict credit analysis of these companies before doing business with them.” Hazel Smith, Professor at Cranfield University has written in “Don’t Expect a Pyongyang Spring Sometime Soon,” October 28, 2011: “In North Korea the market economy is irreversible but it is a market economy that is institutionalized within a culture of simulation, surveillance, and endemic cynicism.” She suggests that this “toxic heritage” could be “as detrimental to the future united Korea as the unregulated and unsafe development of nuclear power also taking place in the North right now.” Culture can change, of course, but if her estimation of North Korean business culture is accurate, this may well take a generation or more to fix and will be a severe impediment to business activity in the SEZs.

The final main behavioral factor that stands in the way of SEZ development is South Korean politics. According to a representative for Hyundai Asan from an interview conducted in November 2011, the conservative Lee Myung-bak administration hampered efforts toward North Korean economic development by denying further expansion of the Kaesong Industrial Zone after the sinking of the *Cheonan* in March 2010. Many believe that North Korean development would pick up again if a more liberal president comes into office. This is not to say that the Lee administration’s decisions were unjustified given the circumstances, but only that South Korean political sentiment is a significant barrier to SEZ development. To restate the example provided earlier, business in the Kaesong Industrial Zone is booming at 100–120 percent of capacity and would undoubtedly expand if the Lee administration would allow it.

VI. CONCLUSION: FAILURE PREDICTED

North Korean special economic zones will likely only be successful under the following specific conditions that depend heavily on factors external to North Korea:

- Continued resource shortages in China that will provide stronger motivation for China to pursue development in Sinuiju and transportation networks in Rason.
- A more liberal South Korean government that will allow continued investment in the Kaesong Industrial Zone.
- A nondestabilizing transfer of power from Kim Jong-il to Kim Jong-un in the near term. As Patrick McEachern writes in *Inside the Red Box*, Kim

Jong-un will likely need to do something to legitimize his hold on power, and developing the North Korean SEZs could be what he needs to bolster his rule.

If these conditions were fulfilled, North Korea would have a strong motivation to initiate economic reform. Even now, there are compelling reasons why North Korea would want to begin the process in earnest. One is the increasing monetization of the economy. Liu Ming notes in “*Chaoxian de jingji gaige: di san tiao daolu de tansuo ji qi bu queding de weilai*” (“DPRK Economic Reform: Exploring the Third Road and its Uncertain Future”) in June 2009 that recent developments in North Korea have shown increasing use of currency substitution for the previous rationed-goods distribution system. There has also been rampant inflation of the DPRK won on the black market in recent years. Liu notes that while the official DPRK won to US dollar rate is 141:1, it is trading for 2000:1 on the black market; euros trade at 180:1 officially and 3500:1 on the black market. In addition, says Liu, “forced planning on companies has reduced dramatically, and state-owned enterprises have more autonomous management capability.” Another benefit of reform from a North Korean strategic perspective is that it would build up a foreign reserves buffer against the continued imposition of sanctions. This would also decrease North Korea’s dependency on foreign aid. A reduction in dependency on aid would in turn further improve the strategic position of the DPRK and lessen the effects of negative public opinion toward the regime’s inability to provide adequate food to its people.

Despite these strong motivations, the three major conditions necessary for SEZ success are not likely to come to pass. China, while desiring North Korean mineral resources, already failed in developing SEZs in North Korea a decade ago and will not be naïve enough to repeat its previous mistakes. From the South Korean side, the increasing polarization of public opinion in South Korea makes it hard to believe that more lenient economic policies toward the North will come about anytime soon. Finally, even a successful transition of power from Kim Jong-il to Kim Jong-un would not guarantee the continued development of the SEZs. On the contrary, it is perhaps the uncertainty surrounding regime change that the Chinese have been moving so slowly.

The development of North Korea’s SEZs is held back both by fundamental factors, such as poor infrastructure and lack of electricity, as well as by behavioral factors, such as North Korean government paranoia and China’s lukewarm attitude toward investment prospects on the border. Under a specific set of

circumstances, the SEZs could provide a significant economic base for North Korea. Unfortunately, it is more realistic to say that North Korea is not yet ready to prove it can be a trustworthy international trade partner. What is perhaps most worrisome is that the reestablishment of these SEZs can be seen as a desperate move on the part of the DPRK regime to find a strategy that works in the longer term, and the initiative indicates just how precarious a position North Korea is in. Therefore, if these SEZs do fail, it will likely set the stage for something even more dramatic (and internationally newsworthy) in the near future.

“Pipeline Diplomacy”: The Russia-DPRK-ROK Gas Pipeline Project

By Kwang-yeon Lee

I. INTRODUCTION

The importance of energy cooperation is rapidly growing in Northeast Asian geopolitics. This essay examines the background, progress, and prospects for the proposed Russia-DPRK-ROK gas pipeline project. The quick development of this project since late 2011 prompts observers to question the incentives and motives of the three countries. Why are they interested in pursuing this project at this time? What are its expected benefits and risks? What are its potential implications in Northeast Asia? The proposed project will likely address Northeast Asian regional security and energy concerns as well as key political and economic issues. This essay argues that “pipeline diplomacy” operating within the proposed tripartite cooperative framework will have positive influence on the stability and prosperity of the region. The clear economic benefits involved for all three parties have provided new momentum for political initiative. Obstacles remain, with the “North Korea risk” being the project’s biggest challenge. Preparing for effective negotiation strategies to minimize such risks is important. One such strategy is Russia’s assurance to provide the Republic of Korea (ROK) discounted gas in case the Democratic Republic of Korea (DPRK) interferes with the gas supply to ROK. Above all, improved inter-Korean relations would help with implementing the pipeline project, as the frosty relations between the North and South pose the most formidable obstacle to launching the project.

This essay begins by discussing the development of Russia-ROK energy cooperation, analyzing the reasons for past failures to launch groundbreaking projects such as the proposed gas pipeline. It is then followed by a close examination of the economic and political benefits of the pipeline, from each of the three countries’ perspectives. The challenges of this project are then discussed, with emphasis on the “North Korea risk.” The essay concludes by assessing the prospects and implications of this energy cooperation project along with policy recommendations for project implementation.

II. THE BACKGROUND OF RUSSIA-ROK ENERGY DIPLOMACY

Russia-ROK energy cooperation has had three phases according to the ROK Ministry of Knowledge Economy's September 2008 Briefing on Russian natural gas. The first was from the 1990s to 2004 and had limited success. The second was from 2005 to 2007, during which important stepping-stones for further cooperation were laid. Lastly, the third and ongoing phase that began in 2008 has seen breakthrough agreements and discussions on energy cooperation.

During the first phase, two jointly attempted projects were largely unsuccessful due to limited economic practicality. The first of the two projects was the 1992 Sakha Republic Yakutsk gas field joint-development agreement. During 1994–95, the Russian consortium (Gazprom) and the ROK consortium (Korea Gas Corporation, or KOGAS, and 13 other companies) conducted a preliminary feasibility test. By the end of 1995, this first project came to a halt when the test concluded that the project would have low profitability due to poor existing infrastructure. The second project was led by a private sector and involved Russia, South Korea, and China in partnership to develop the Irkutsk Kovykta gas field in eastern Siberia. The three-country joint venture was announced during a 1999 Russia-ROK summit, and a feasibility study was completed in November 2003 with participation from KOGAS, Russia Petroleum, and the China National Petroleum Corporation. This adventurous project was repeatedly delayed and ultimately rescinded by the end of 2004 as Russia started to insist on Gazprom-led development of Eastern Siberia. These two mostly private-sector-led projects failed due to lack of both economic profitability and a central gas supply system in Russia's Far East. Additionally, they foundered on the complicated political decision of supplying gas either via DPRK territory or via Yellow Sea route.

During the second phase, from 2005 to 2007, two important developments helped to connect Russian natural gas to South Korea. First, as part of the Eastern Gas Program, Russia announced that it would build its so-called Unified Gas Supply System through four major gas fields in the country's Far East. Gazprom was also designated as the sole company that would develop these fields. Second, in October 2006 South Korea and Russia signed an agreement on cooperation in the gas industry, specifically identifying Gazprom and KOGAS as the companies responsible for natural gas delivery from Russia to South Korea.

During the third phase of Russia-ROK energy cooperation, from 2008 onward, cooperation accelerated between the two countries. According to Ju Jin-sook's

“The South Korea–Russia Summit and Feasibility of a Roadmap for Energy Diplomacy,” the two countries signed a series of memorandums of understanding on September 30, 2008, with promises to strengthen energy cooperation. Russia offered to build gas pipeline transiting North Korea and promised to engage in pipeline construction and negotiations with North Korea. Beginning in 2015 or 2017, Gazprom has agreed to supply at least 10 billion cubic meters (approximately 7.5 million metric tons) of natural gas to South Korea via North Korea for 30 years. By April 2010, KOGAS and Gazprom completed a joint feasibility study that recommended pipeline natural gas (PNG) via North Korea as the most economical method, instead of the compressed natural gas (CNG) or liquefied natural gas (LNG) methods. In August 2011, the final piece of the puzzle fell into place during a summit meeting between North Korea and Russia, at which Kim Jong-il voiced support for the gas pipeline going through North Korea. The two sides agreed to establish a governmental commission to lay out detailed plans on gas transit through North Korea in cooperation with South Korea. One month later, South Korean president Lee Myung-bak was quoted by *Bloomberg* as saying that the agreement was “a win-win for everyone involved.”

With North Korea’s support, the ambitious \$90-150 billion Russia-DPRK-ROK gas pipeline project is getting closer to becoming reality. The clear economic rationale and expected security benefits seem to provide the necessary political momentum from all three countries.

III. POLITICAL-ECONOMIC BENEFITS OF THE RUSSIA-DPRK-ROK GAS PIPELINE

In the Russia-DPRK-ROK gas pipeline project, the interests of the three nations converge and the political-economic benefits are clear. South Korea will acquire a stable natural gas supply while saving up to \$200 million from imports from the Persian Gulf. Russia will stimulate its far-eastern economy through development of eastern Siberian gas fields, and it can access export markets in Northeast Asia. North Korea will collect at least \$100 million per year for allowing the pipeline to cross its territory, while at the same time reducing its dependence on China.

In addition to each individual country’s benefits, the pipeline project promotes multilateral energy cooperation within Northeast Asia. Beginning with the construction of the pipeline, the project envisions three-way cooperation utilizing South Korean technology, North Korean labor, and Russian natural resources. Northeast Asian economic prospects will expand through further cooperation in transnational power connections, joint use of existing supply

infrastructure, shared know-how, and joint exploration and development of energy resources. Finally, the pipeline project also has the potential to be a catalyst for improving inter-Korean relations by promoting economic exchange.

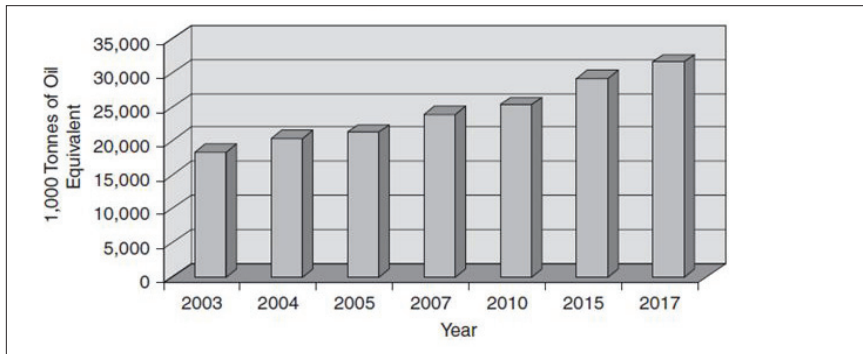
Benefits for South Korea

The Russia-DPRK-ROK gas pipeline project will help South Korea solve its domestic energy shortage and diversify its energy-importing markets. Cost savings of importing Russian gas and potential access to exploration and development of the Russian Far East are added benefits.

In 2008, the US Energy Information Administration stated that South Korea was the world's 10th-largest energy consumer and one of the top energy importers. It is the 5th-largest importer of crude oil, the 3rd-largest importer of coal, and the 2nd-largest importer of natural gas, which all comes through tanker shipments of LNG.

South Korea has three main goals for its energy strategy, as outlined by President Lee Myung-bak in his 2008 national address commemorating the 60th anniversary of the Republic of Korea: balancing energy demands, diversifying energy sources, and shifting to more environmentally friendly energy consumption. On the latter point, the Lee administration first adopted a vision of "green growth" at the 2005 Ministerial Conference on Environment and Development jointly hosted by the Ministry of Environment of South Korea and the UN Economic and Social Commission for Asia and the Pacific (UNESCAP). Despite ROK efforts to improve energy efficiency, the country's overall energy demand is expected to rise by 4 percent per year through 2015, according to the nonprofit Encyclopedia of Earth website.

Natural gas is the best choice for meeting South Korea's three-pronged energy strategy. Crude-oil consumption is on a downward trend, given the price volatility and geopolitical risk associated with relying on Persian Gulf oil. Likewise, coal consumption is expected to decrease, as its "dirty energy" makes it unattractive in light of global efforts to curb carbon dioxide emissions. South Korea's plans also emphasize the development of nuclear power plants in addition to natural gas—construction of a dozen plants by 2015 is in the works. But since Japan's 2011 nuclear tragedy, public fears are growing over the South's increasing dependence on nuclear power. Natural gas has thus emerged as South Korea's best choice for a future energy source. The future estimates of the country's rising demand for natural gas is described in the following figure.

Figure 1. South Korea's Natural Gas Demand, 2003–2017

Source: Ahn Se-hyun. "Framing Energy Security between Russia and South Korea." *Asian Survey* Vol. 50, No. 3 (May/June 2010), pp. 591-614

According to KOGAS, South Korea's demand for natural gas is expected to grow 7.2 percent a year through 2015. Importing almost all its energy, South Korea bought 32.6 million metric tons of LNG in 2010, up from 25.8 million metric tons in 2009. Most LNG imports come from Qatar, Indonesia, Malaysia, and Oman, according to an August 2011 *Moscow Times* report. As shown in Table 1, the LNG method is by far the most expensive way of supplying natural gas, compared to PNG or CNG, with PNG being the most cost-effective.

Table 1. Cost Comparison of Natural Gas Types

	PNG	LNG	CNG
CAPEX (\$ millions)	3,403	6,823	6,074
OPEX (\$ millions)	1,395	15,820	4,478
Transportation cost (\$/MMBtu)	0.31	0.94	0.60

Source: ROK Ministry of Knowledge Economy, "Measures for Acquiring Russian Natural Gas" (in Korean), briefing September 29, 2008.

Notes:

- PNG: Piped natural gas transported via pipeline.
 LNG: Purified and liquefied natural gas transported by sea.
 CNG: Compressed natural gas transported by sea.
 CAPEX: Capital expenditures expected to create future benefits, including acquisition and upgrading of physical assets such as equipment, property, or industrial buildings.

OPEX:	Operating expenditures for the ongoing cost for running the system.
MMBtu:	One million British thermal units. One BTU equals about 1,055 joules and is the approximate amount of energy needed to heat 1 pound (0.454 kg) of water from 39 to 40°F (3.8 to 4.4°C)
Construction period:	5 years
Operating period:	25 years

By utilizing PNG, the Russia-DPRK-ROK gas pipeline project can lower the transportation cost of importing gas by 67 percent, according to a KOGAS and Gazprom joint study. PNG can also contribute to reducing the overall gas price in South Korea by competing with LNG. Compared to the LNG method, the pipeline's strengths also lie in not needing to expand LNG ship-docking or gas-vaporization facilities, thereby incurring less capital and operating expenditures over the long run.

In addition to these economic benefits, the pipeline project will also help stabilize South Korea's energy supply. In the aftermath of Japan's nuclear crisis, the price of LNG rose 20 percent in the Asian spot market for natural gas, according to an October 2010 article in *Shindonga* magazine. After the pipeline is operational, if such a disaster occurs again and causes prices to spike, Russia would still have to sell South Korea the agreed-upon amount of gas at the contracted price regardless of rising demand and prices. South Korea will benefit immensely from this guaranteed supply of gas from Russia, and this guarantee will in turn encourage better energy planning by the government and businesses.

The pipeline project will also improve diversification of South Korea's natural gas supply both in terms of source location and source type. South Korea will be able to expand beyond its Middle East-focused supply line and reduce its overdependence on LNG. As the country's energy demands continue to grow, diversification of import sources and specialization in the most cost-effective import method will become paramount. Recently, higher energy costs contributed to a rising inflation rate that exceeded the central bank's target ceiling of 4 percent. Diversification of gas supply could reduce the cost of imports in the long run, according to a September 2011 report from *Bloomberg*.

Finally, engaging in the pipeline project will position South Korea advantageously to be among the first to develop Russia's eastern Siberian gas fields, deepening the Russia-ROK economic partnership. Korean companies will

also have the opportunity to tap into Russia's Eastern Gas Program, which is a Russian policy priority. Further cooperation in the petrochemical industry will also likely ensue, including further pipeline construction and LNG vaporization technique. Ahn Se-hyun's "Framing Energy Security between Russia and South Korea," published by *Asian Survey* in May/June 2010, lays out the full potential for South Korea: South Korea could participate in joint gas projects in the Sakha, Kovykta, and Sakhalin gas fields; in joint oil exploration in western Kamchatka; in constructing an oil complex in the Vladivostok area; and in building a power grid interconnection project in North Korea.

Benefits for Russia

Russia will derive several benefits from the Russia-DPRK-ROK gas pipeline project. Economically, the project will generate a stable cash flow from exports to South Korea, whose demand for natural gas is projected to be strong. According to *The 2011 International Energy Outlook* published by the US Energy Information Administration, South Korea's natural gas consumption would rise by 1.5 percent per year from 2008 to 2035. Strategically, the pipeline will enable Russia to diversify its energy-exporting market to Asia and to enhance its position in the region to balance China's growing influence. The pipeline project also has the potential to be a diplomatic legacy for President Dmitri Medvedev, who is entering his final year in office.

Taking each benefit in turn, stable gas exports to South Korea via the pipeline project are expected to generate \$3–5 billion per year and \$90–150 billion for the 30-year period of the Russia-ROK memorandum of agreement. Even though Russia is expected to spend about \$30 billion to develop the associated gas fields and pipelines in eastern Siberia and in its far-eastern region, the potential profits from long-term exports to South Korea are significant.

The project will also promote development in Russia's Far East, infusing the region with technology and capital for infrastructure building. As one symbol of this development, the Sakhalin-Khabarovsk-Vladivostok natural gas pipeline opened on September 8, 2011. It is projected to serve an important role in connecting Russian gas supply and Northeast Asian consumers. In the past, Russia has concentrated on developing western Siberia for European exports, but their infrastructure and facilities are showing their age. Thus, Russia has prioritized natural gas development in eastern Siberia and the Far East of the country, which, according to a 2008 briefing by the ROK Ministry of Knowledge Economy, together account for 3,400 billion cubic meters of Russia's domestic natural gas reserves (about 8 percent of total domestic reserves). The pipeline

project with the two Koreas will provide additional revenue from an as yet undeveloped part of the country, giving Russia necessary tools to advance its far-eastern region to the forefront of global natural resource markets.

Another benefit is that Russia will be able to diversify its export markets, adding new target markets in the Asia-Pacific region to its existing western and central European markets. While the old Soviet Union emphasized the importance of Russia's relation with Europe, the new Russia increasingly looks to its relations with Asia on its eastern border, as it expects the rise of Asia's share of the world economy. In December 2007, Russia's Industrial Energy Department announced its Eastern Gas Program, projecting up to 120.8 billion cubic meters of natural gas exports to Northeast Asian countries until 2030, as reported in *Shindonga* in October 2010. South Korea is an ideal stepping stone to the broader Asian market, due to its proximity and advanced energy consumption patterns (many Korean households use natural gas for heating). The pipeline project could establish the Korean peninsula as Russia's base from which to expand its energy products to Japan and China, which are among the world's top 10 energy consumers.

The pipeline project will also help Russia set a base price for exporting natural gas to emerging Asia-Pacific markets, which has been a challenge for Russia, especially with its trading partner China. Russia's Gazprom demands the European price (\$350–400 per 1000 m³), linked to changes in oil price, while the China National Petroleum Corporation demands the Turkmenistan price (\$235–250 per 1000 m³), delinked from fluctuations in oil price. Reaching an agreement is expected to be difficult, as the price difference is significant. Russia and South Korea have tentatively agreed to use the European price for the pipeline project, though negotiations are in flux. Russia's strategic benefit lies in leveraging the Korean price for future negotiations with China and Japan, both of whom cannot afford to overlook Russia's resource-abundant far-eastern region.

Russia is furthermore concerned about its diminishing influence in Northeast Asia. Through the pipeline project, Russia hopes to regain its influence over North Korea, strengthen economic exchanges and investment with South Korea, and counterbalance China's growing power in Northeast Asia. Following the financial crisis in 2008, Russia faced its own crisis of reduced influence in the region after experiencing negative gross domestic product (GDP) growth and the lukewarm success of its ambitious Eastern Gas Program. On the other hand, China is rapidly expanding its sphere of influence in North Korea, evidenced by China's 10-year lease rights to the Rajin port, giving China direct access to the

East Sea for the first time, according to the March 2010 issue of *Defense News*. Russia is concerned with Chinese commercial and navy ships navigating around the East Sea in close proximity to the Russian border. Thus, Russia is trying to increase its leverage with North Korea and regain its past status as a powerful player in the Northeast Asian region. As Russia prepares for the 2012 APEC (Asia-Pacific Economic Cooperation) summit to be held near Vladivostok, the pipeline project is an attractive initiative for increasing its regional influence.

Benefits for North Korea

North Korea's support for the Russia-DPRK-ROK gas pipeline project is recent and demonstrates DPRK interest in potential political and economic benefits. In the past, Kim Jong-il thought the project was premature, considering that a Russia-DPRK-ROK railway had not yet been built. Kim also did not want the pipeline project to overshadow initiatives such as the Six-Party Talks and normalization of relations with the United States. However, North Korea is left with no choice but to seriously consider the pipeline project at this point. After the *Cheonan* and Yeonpyeong Island incidents along with the shocking death of Kim Jong-il, the DPRK economy is worsening as tension rises on the peninsula and the economic blockade by the United States, Japan, and South Korea continues. In addition, China's aid has not satisfactorily met North Korea's rising need. The proposed gas pipeline has therefore become attractive.

Another interesting aspect to consider is that the rising US federal budget deficit may have contributed to North Korea's interest in the pipeline proposal. DPRK's *Chosun Central Television* broadcasted that the US deficit will rise to \$1.28 trillion for the 2011 fiscal year, citing US Congressional Budget Office statistics. A rising US deficit coupled with ongoing economic recession could have led North Korea to doubt the future feasibility of the US "denuclearization and monetary compensation" negotiation strategy, according to the *Pressian* news website in September 2011. In other words, North Korea may be worried that the United States will be unable to render compensation for denuclearization because of its own ongoing financial trouble. Regardless of whether this is true, North Korea is indeed lowering its expectation of US monetary input while increasing its optimism for gains from other countries such as energy-rich Russia. In that case, energy compensation from members of the Six-Party Talks might be a possible trade-off for North Korea's denuclearization. Russian presidential envoy Viktor Ishayev, who accompanied Kim Jong-il during his August 2011 visit to Russia, told the *Chosun Ilbo* that Kim is "prepared to let a gas pipeline be built through his country."

North Korea wants economic benefits and a reshaping of the power balance in Northeast Asia. The \$100 million annual transit fee that North Korea will reap from the pipeline project will bring economic benefits; and the increasing cooperation between Russia and North Korea will balance out the North's overreliance on China.

IV. RISKS

The political risks associated with North Korea are the biggest stumbling block to the project's success, both pre and post-construction. They are North Korea's unpredictability and the possibility that North Korea will leverage the completed pipeline for dangerous purposes.

Pre-construction Risks

We cannot know what North Korea's future perception of the pipeline is. According to the American Enterprise Institute, quoted by *Bloomberg* online in September 2011, the pipeline project will bring the most foreign influence into North Korea since the civil war, potentially to the point that the regime finds it intolerable. The proposed pipeline will run from the mouth of Tumen River through the Demilitarized Zone (DMZ), stretching across North Korea's eastern coastline for about 625 miles (1,000 kilometers). To construct a pipeline, road infrastructure is essential. These roads will connect to South Korea's east coast national highway and the future inter-Korean railway system. The roads will allow many individuals and companies from outside to lay down the pipeline and construct subsidiary facilities, such as pressurization and power transmission control systems. Just the act of opening up could bring big shocks and changes to North Korea. Compared to the Kaesong Industrial Park, Kumgang Mountains tourism, and light-water nuclear reactor construction, the pipeline project has a much larger potential to shake up the status quo of the North Korean regime, according to an October 2010 *Shindonga* article.

As a result, North Korea could demand a change in the pipeline's route for strategic military reasons, effectively raising the projected duration (two years) and costs (\$3 billion) of construction. Professor Kang Joo-myung of Seoul National University told the *Bangkok Post* in November 2011 that the project would likely face opposition from the North's powerful military, as the pipeline will traverse the heavily fortified inter-Korean border where many sensitive facilities are located. Afraid of triggering unnecessary costs and time, South Korea has asked Russia to be in charge of construction and to negotiate with

North Korea to prevent such risks. According to the *Energytimes* news website, KOGAS president Choo Gang-soo said in a September 2011 ROK Ministry of Knowledge Economy committee meeting that the company is negotiating with Gazprom for Russia to be responsible for pipeline construction costs, since South Korea's final gas purchase price will include initial pipeline investment funds and transit fees.

Post-construction Risks

On the post-construction side, North Korea could potentially use the completed gas pipeline to threaten South Korea, leveraging the North's control over the gas supply. For example, North Korea could (1) ask for unreasonably high transit fees; (2) disrupt the supply of gas through the pipeline by damaging the pipeline or stealthily smuggling the gas; or (3) blackmail South Korea with either of the above to satisfy its political motives, such as keeping nuclear weapons. Mark Fitzpatrick, at the UK think tank International Institute for Strategic Studies, warns that North Korea can cut the pipeline and attach any excuse to such behavior. South Korean critics point to the Kumgang Mountains tourism project to illustrate this risk. Once touted as a symbol for inter-Korean reconciliation, it has become a liability for South Korea in the face of worsening relations with the North. On August 22, 2011, North Korea warned that it would start to evict any remaining South Korean employees at the Kumgang tourist park. The North also threatened to auction off South Korean assets in the resort, which, according to a September 2011 *New York Times* article, amount to \$443 million. In a similar way, the gas pipeline could become the South's biggest liability vis-à-vis its relationship with the North.

V. OVERCOMING THE RISKS

Careful analysis of Northeast Asian geopolitics reveals that the risks that North Korea poses, while serious, are not insurmountable. In the long run, Pyongyang's ability to interfere with the pipeline faces severe constraints.

Any pipeline disruption could reduce the flow of transit fees to North Korea. The pipeline project is a much-needed foreign currency-generating machine that will provide North Korea a stable income of \$100 million per year. This is an attractive figure compared to the annual \$50 million generated by the Kaesong Industrial Park. Faced with a severe economic downturn, North Korea would be hesitant to endanger this financial influx. In addition, if the North intentionally interfered with pipeline operation, it would be violating a clear set of rules for

transit charges and would face penalties. To further avoid the risk of DPRK disruption, South Korea has proposed a gas supply process in which the gas first runs to Seoul before it runs back into North Korea, reaching Pyongyang. Such a mechanism would restrain North Korea, according to a November 2011 *Diplomat* article, since interfering with the pipeline would cut off North Korea's own gas supply.

Moreover, North Korea's interference could disrupt Pyongyang's relations with Moscow, and Pyongyang has a clear interest in maintaining that relationship. If North Korea obstructs Russian gas from reaching the final consumer, South Korea, North Korea risks losing future revenue by undermining Russia's trust. Russia is one of North Korea's few allies in the world, providing food and oil as well as balancing China's influence over the DPRK. To North Korea, disrupting the gas supply would be equivalent to "shooting himself on [sic] the foot," according to Professor Georgy Toloraya, vice president of the Unity for Russia Foundation.

Russia can provide an effective guarantee against this North Korean risk and a safety net for South Korean investment. Russia is wooing the North with a promise of writing off its \$11 billion debt from the Soviet-era in exchange for successful execution of the pipeline project. *AsiaOne Business* reported in September 2011 that Russia proposed North Korea an offer that would relieve 90 percent of its debt; Russia also promised to use 10 percent of the debt payments to implement joint projects such as the gas pipeline. If North Korea does obstruct the gas supply in spite of everything, Russia is willing to compensate South Korea's loss, immunizing the South from any risks. Gazprom has promised to provide the South with LNG at the price of PNG in the event of pipeline disruption by North Korea. And even if such a shipment of LNG gets delayed, it would not result in a national emergency for South Korea, for the pipeline gas supply will comprise 23 percent of the South's total natural gas consumption, a relatively small portion that could be covered by the South's own gas reserves and additional imports from the Persian Gulf. Nevertheless, South Korea should increase its gas reserves from its current size in order to ensure further energy security against potential simultaneous occurrences of the pipeline disruption and gas price shock in the Persian Gulf.

Many historical examples testify to the initial difficulty of constructing international gas pipelines; however, smooth operation usually follows the completion. The pipeline running through Azerbaijan, Georgia, and Turkey, as well as the Turkmenistan-Uzbekistan-Kazakhstan-China pipeline, are

both operating smoothly according to the October 2010 issue of *Shindonga*. The Russia-Ukraine gas disputes seem to be an exception. Once constructed, international gas pipelines link the participating countries in significant and mutually assured self-interest, thus no individual country will be able to easily disrupt operation.

VI. SOUTH KOREAN PUBLIC OPINION REGARDING THE PIPELINE

On a November 2011 research trip sponsored by the US-Korea Institute at SAIS, I had an opportunity to hear opinions from experts in South Korean government, businesses, and think tanks regarding the gas pipeline project. Many of them were not optimistic about the project's prospects, at least not within President Lee's term that ends in February 2013.

The main concerns were related to the North Korea risk discussed above and a lack of trust in conducting business with both North Korea and Russia. A Grand National Party member commented that the instability of the political situation in the DPRK makes South Korea's involvement difficult. Another parliament member from the Democratic Party commented that the Trans-Siberian Railway project seems a more likely possibility than the gas pipeline because the latter brings up politically sensitive issues, such as natural resources and national security. Representatives from a prominent think tank and a government ministry expressed concerns about the safety of a long-term contract with Russia, as South Korea possesses relatively little leverage over Russia to prevent contractual violation. An American scholar residing in Seoul raised an interesting question regarding potential restriction from the European Union and the United States on the technology needed for the construction of gas pipeline.

Other research institute representatives and scholars in favor of the project argued that the benefits outweigh the risks cited by the critics. The economic benefits include the commercial gains from a cheaper gas option, diversification and increased stability of the South's gas supply, and the potential for South Korea's involvement in the development of eastern Siberian oil and gas fields. The political benefits include improvement in inter-Korean relations, preparation for future unification of the two Koreas, and the positive impact the pipeline will have on future Six-Party Talks and the regional energy network.

Furthermore, proponents argue that the risks can be mitigated. The North Korea risk can be sufficiently taken care of by a carefully drawn contract with Russia

similar to the so-called Norwegian-type model. In this setup, the gas-supplying country (who is also the seller) possesses the rights to the pipeline and assumes responsibility for safe transfer of the gas supply to the buying country. Russia thus would be solely responsible for the transfer of gas through North Korea up to the DPRK-ROK border.

The Russia risk related to potential breach of contract regarding prices or supply can be discounted by the fact that such behavior would galvanize strong criticism from the international community, especially from the European countries that are also buyers of Russian gas. Furthermore, the potential Northeast Asian energy network may create a regional energy forum in which China, Russia, South Korea, North Korea, and Japan can discuss and agree upon collective monitoring of contractual energy agreements, reducing the likelihood of Russia's abrogating the pipeline contract. Regarding the pipeline technology question, proponents cite the fact that Gazprom, the Russian state-owned company that will likely build the pipeline, has been in charge of numerous domestic and international pipeline construction projects. The company's major recent undertakings include the Nord Stream and South Stream projects, which involved building highly technological onshore and offshore pipelines in addition to regular land pipelines. The pipeline construction through the Korean peninsula is expected to be less difficult than the previous projects completed by Gazprom, as it will only require land pipelines.

VII. CONCLUSION

The Russia-DPRK-ROK gas pipeline project is an important initiative with much uncertainty and political sensitivity, along with great potential for change of regional dynamics. In the long run, it has potential economic and political benefits for all three parties and for the Northeast Asian region as a whole. However, a stable climate of cooperation, exchange, and trust is essential for the project's success. The project badly needs an easing of tensions between North and South Korea. Current inter-Korean relations do not possess even the minimum trust required for such an undertaking. In the case of emergencies, such as gas spill or pipeline breakage, no effective response system is in place because of the frosty relationship between the two Koreas. However, it seems impractical to wait indefinitely until the inter-Korean relationship improves. South Korea is under time pressure. Russia is planning to supply the Sakhalin gas to Vladivostok starting in 2012 and it will be ready to supply South Korea by 2015 or 2017. China, on the other hand, is actively establishing an energy network in Asia. The Turkmenistan-Uzbekistan-Kazakhstan-China pipeline

opened in December 2009. In the same year, Russia and China announced a \$3.5 billion natural gas deal. A prudent but quick decision from the ROK government is needed. The following are policy recommendations that could move the project forward:

1. South Korea should immediately start building trust with North Korea in small steps. The most urgent need is building a communication system between the two Koreas, such as restoring the hotline system.
2. South Korea should start establishing additional natural gas storage and liquefaction facilities to increase available natural gas reserves up to 25 percent of annual consumption by 2017, in order to cope with potential supply interruptions by North Korea. Unlike LNG that must be stored after an incoming shipment, PNG is more flexible. However, the possibility of pipeline stoppage still makes it necessary for South Korea to keep natural gas reserves for future energy crises. According to the Ministry of Knowledge Economy's *Tenth Plan for Supply and Demand Strategy of Natural Gas* published in December 2010, the government is planning to increase the reserve ratio (reserve volume/yearly demand) from 10 percent in 2010 to 21 percent by 2024. Under the gas pipeline project's current scheme of supplying South Korea with 10 billion cubic meters of natural gas every year, the South would receive approximately 23 percent of its yearly gas demand from Russia via North Korea. The ROK natural gas consumption in 2010 was 42.69 billion cubic meters according to the CIA *World Factbook*. With the expected yearly increase in natural gas consumption until 2017, which is the proposed starting date for Russian PNG imports, the current ROK plan to increase the reserve ratio to 21 percent by 2024 is not adequate. The ROK government should be prepared to increase the reserve ratio to 25 percent by 2017.
3. In the gas supply contract with Russia, South Korea should clearly map out the extent of Russia's accountability for disruptive North Korean actions, including appropriate compensation should North Korea breach the contract. The Norwegian-type pipeline model, in which Russia is responsible for transferring gas through North Korea up to the DPRK-ROK border, would be appropriate.
4. South Korea should strive to shape the project within a win-win framework. In exchange for Russia's assurance for the potential North Korea risk, South Korea should compromise its economic profits for Russia's. Equal

distribution of risk-taking maximizes the chance of success in business. Sharing risks with Russia in this way would help gain Russia's trust and long-term support for the project.

The pipeline project's impact can go beyond the participating countries' individual political-economic considerations. It can provide a new roadmap for dealing with North Korea's weapons of mass destruction (WMD) program, contributing to stability in Northeast Asia. The current US and ROK strategies toward North Korea are caught in a vicious cycle. Promise of large sums of aid in exchange for giving up nuclear and missile programs does not seem to work. After the events in Afghanistan, Iraq, and Libya, North Korea considers its nuclear weapons as its only guarantee of security, not a simple bargaining chip for negotiation. The proposed gas pipeline through the Korean peninsula has potential to change the existing paradigm. The *Chosun Ilbo* reported in August 2011 on a recent discussion between Kim Jong-il and Dmitri Medvedev about resuming the Six-Party Talks on nuclear disarmament, with the potential introduction of a "moratorium on the production of nuclear materials and on tests." In the long run, Moscow could ask Pyongyang to drop its WMD program in exchange for more rail/oil/gas cooperative projects for economic growth, transforming North Korea from a risk into an economic partner. The pipeline project offers North Korea a chance to be integrated into the system of global economic interdependence.

The pipeline project is essentially a starting point for another type of Six-Party Talks, this time involving energy security and political stability. The plan to stabilize Northeast Asia through cooperation with North Korea has implications for all parties. These days, many Asian countries are concerned with stricter environmental regulation arising from climate change talks, rising geopolitical risks with Middle East oil, and stagflation. The success of Russia-DPRK-ROK gas pipeline project can potentially attract both China and Japan to join this pipeline network, further expanding the energy cooperation and economic interdependency in Northeast Asia. The United States has taken no official stance on the pipeline project, but Washington might find improved regional stability to be in its interest, despite worries over growing Russian influence in Northeast Asia. The more cooperative and optimistic regional atmosphere brought about by a new paradigm of cooperation would also aid future US negotiations with North Korea. With all of these important future considerations in mind, the ROK government's prompt yet prudent decision is needed.

CHAPTER IV: UNIFICATION CONSIDERATIONS



Demographic Impact of Korean Reunification: Costs and Consequences for the North and the South

By Benjamin Michener

I. INTRODUCTION

South Korea has industrialized at a remarkably fast rate, with per capita income rising from \$1,160 (Constant 2000 USD) to \$16,372 over only five decades according to the World Bank. This growth has been spurred on by a demographic dividend—a surge in working-age adults relative to the number of dependents, which has enabled high levels of investment and output growth. This dividend has now been exhausted; the demographic boon is becoming a demographic liability as members of older generations age and there are fewer children to take their place. South Korea faces three interrelated demographic challenges that will have significant economic and social implications. First, the population is rapidly aging, creating a high ratio of dependents to earners. Second, the population is shrinking. And third, South Korea has a skewed gender ratio within the younger generations, which will make it more difficult to rejuvenate the fertility rate.

While South Korea has responded to these demographic challenges by allowing entry to a growing number of foreign workers—as well as foreign wives—such stopgap measures are not a long-term solution. Large-scale immigration could alleviate all three of these challenges, but in a culturally, ethnically, and linguistically homogenous country such as South Korea, this is politically unfeasible. South Korea, however, is unique in that it is part of a divided country. Unlike other East Asian nations that are experiencing similar challenges, there is a pool of culturally, linguistically, ethnically homogenous people just waiting to join South Korea—the North Koreans.

A study of the impact of reunification has been notably absent from the literature on demographic change in Korea, with the noteworthy exception of a 1992 study done by Nicholas Eberstadt and Judith Banister. In 2008, however, North Korea conducted a second national census, which gives valuable information that was not previously available. This essay examines the potential demographic impact of a peaceful near-term reunification of the Korean peninsula, using data from this North Korean census.

Methodology

Assumptions are that (1) reunification will occur relatively soon; (2) reunification will be peaceful; and (3) the North will be absorbed into the South (rather than vice versa). Because the North Korean census data is from 2008, South Korea's 2008 data is also used to make comparisons to that of the North, even though more recent data is available for the South. Only demographic impacts of reunification are examined. The economic and social costs of reunification have been studied in great depth elsewhere.

Another key assumption is that the census data provided by the North Korean government, a regime notorious for its deception, are accurate. Given the size and nature of the North Korean state, it is presumably better able to conduct an accurate and comprehensive census than other states at comparable levels of development. North Korea also accepted guidance from the United Nations in carrying out the 2008 census, employing methodology that met international standards. The primary concern about census accuracy is whether the state manipulated the data for political or security reasons. For example, the 1993 census did not include actively serving members of the military, which severely skewed the gender ratio and several other metrics. The United Nations' involvement in the 2008 census lends greater legitimacy to the 2008 census data.

II. DEMOGRAPHIC TRANSITION IN SOUTH KOREA

South Korea has undergone the demographic transition from a high birth-rate/high death-rate country to a low birth-rate/low death-rate country. But unlike in other countries, South Korea's demographic transition has mirrored its rapid economic growth, which has amplified the benefits and consequences of this transition. In the first phase of demographic makeup, a preindustrial country has a high birth rate and a high death rate, resulting in a stable, low rate of population growth. A country enters the second phase of demographic transition as it industrializes, with improvements in nutrition and sanitary conditions leading to a drop in the mortality rate while the birth rate remains high. This causes a surge in population growth, which increases the child dependency ratio. Eventually, a country enters into the third phase of transition, in which the birth rate drops to the same level as the mortality rate. This results in low child and elderly dependency ratios, as there are few children being born and not many elderly to care for. The demographic bulge of working-age adults is the demographic dividend and this is when a country can experience rapid GDP growth. South Korea made great use of its opportunity to rapidly develop

but is now in the fourth phase of demographic transition, in which the bulge of working-age adults is aging and there are few youngsters entering the workforce to replace them. As a result, the dependency ratio will rise and the age profile of the population will rise dramatically.

Population Growth

Between 1955 and 1960, the population of South Korea grew an average of 3.39 percent per year. Fifty years later, between 2005 and 2010, population growth dropped to an average of 0.58 percent. The United Nations estimates that South Korea's population will begin shrinking within the next twenty years. Fifty years ago, the fertility rate (the total number of children a woman is expected to have in her lifetime) was 6.33, and there was concern that the population was growing too fast. The state implemented antinatalist policies to encourage smaller families; these policies included free birth control, withholding benefits for having three or more children, and sterilization incentives. By 1984, South Korea reached a fertility rate of 2.1, a rate at which a population holds steady. However, it was not until 2004—20 years later—that antinatalist policies were reversed. By this point, the fertility rate was 50 percent below replacement. Currently the fertility rate is about 1.29 children per woman. If the fertility rate does not rise soon, South Korea's population will begin to decline. At the current rate the population will begin to drop precipitously. If the fertility rate remains low (constant fertility), the population will rapidly drop. Only in the most optimistic estimate (high variant) will the fertility rate recover sufficiently to resume growth.

The South Korean government adopted a five-year plan to encourage larger families, setting a fertility-rate target of 1.7 by 2030. Maternity pay has been changed from a small lump-sum payment to 40 percent of pay, and employers are required to allow mothers flexible working hours. The government will pay for the school fees of second children, a potentially significant incentive in a country where the cost of education falls predominantly on the family.

Aging Population

South Korea's population is rapidly aging. The average age in 2008 was 36.4 but is projected to be 51.8 in 2050. In 2008, 10.3 percent of the population was 65 or older, while 24 percent was under 20. By 2050, 38.2 percent of the population will be over 65, surpassing Japan as the oldest country in the Organization for Economic Cooperation and Development (OECD). The percentage under 20 will

have dropped to 12.6 percent. A whopping 14.5 percent of the population will be 85 or older. South Korea's very favorable dependency ratio will deteriorate. As of 2009, every 100 South Korean workers had to support about 15 senior citizens. By 2050, there will be 72 senior citizens for every 100 workers. Old workers will retire faster than new workers enter the workforce. Between 2015 and 2020, the labor shortage for people 15 and older will nearly triple to 1,520,000 from 630,000. Figures 1 through 3 illustrate this rapidly changing population structure.

Figure 1: South Korea: Population Pyramid (2008)

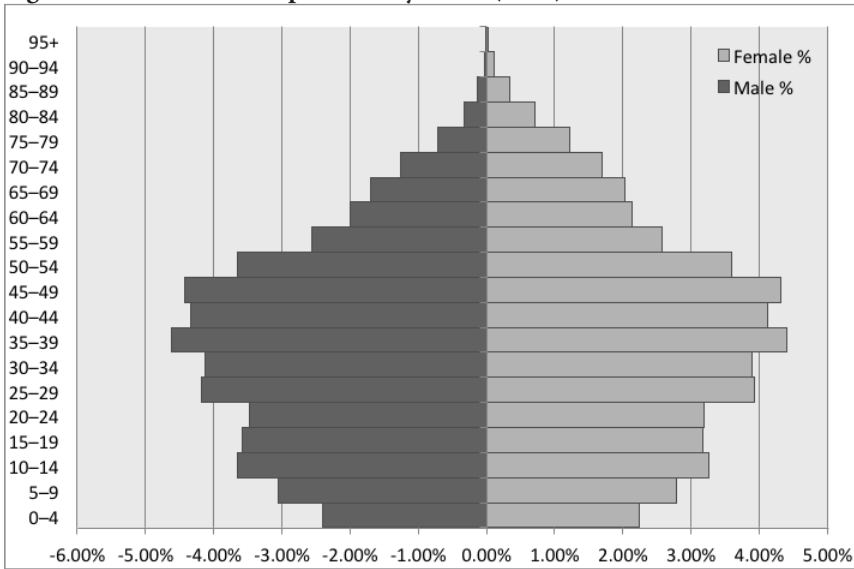


Figure 2: South Korea: Population Pyramid (2030)

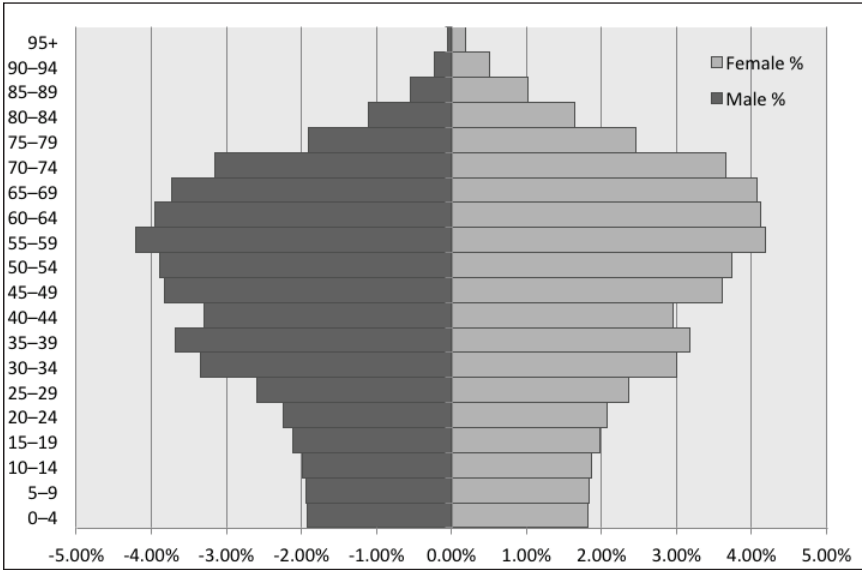
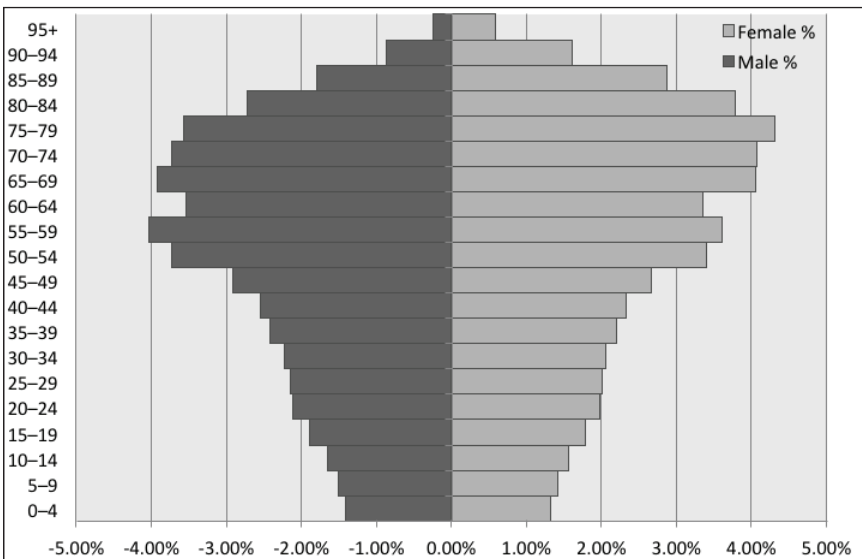


Figure 3: South Korea: Population Pyramid (2050)



South Korea has a more limited social security net for the elderly compared to other members of the OECD. South Korea also has one of the lowest rates of government spending as a percentage of GDP compared with other OECD nations. The largest shares of government spending go to defense and economic affairs, while a miniscule amount is allocated for social protection, the single-largest budget item for most OECD countries. The South Korean state similarly places a lower priority on health spending than other OECD members. As a result, the burden of caring for the elderly largely falls upon adult children. The positive side of this picture is that the state will be somewhat insulated from the double burden experienced by European countries, which have a declining number of taxpayers coupled with ever-increasing social security and health-care outlays. The downside is that the intergenerational transfers from working children to their parents could be much more significant. Statistical analysis by David Bloom, David Canning, and Jocelyn Finlay in 2010 found that each 1 percent increase in the old-age share of the population results in a 1.5 percent decrease in average annual economic growth rate over the subsequent five-year period.

Gender Disparity

South Koreans have a long-held cultural bias toward raising boys, as the son traditionally cares for the parents in their old age and carries on the family name. Technological advances that allow parents to know the gender of their child before birth, combined with a preference for small families, mean that when parents are only having one or two children, they make certain they have a boy.

In the 1980s, many countries in Asia saw a rapid increase in the proportion of male births. By 1990, more than 115 South Korean boys were being born for every 100 girls. South Korea has since been able to reverse this trend and bring male/female births back to a more balanced ratio. Shifts in cultural gender preferences as well as South Korea's legal environment are credited for this change. However, because of this temporary imbalance there remains a generation of young men who distinctly outnumber their potential mates. In 2008, there were 110.8 boys for every 100 girls in the under-twenty age bracket. According to the *Korea Statistical Yearbook 2008*, there will be roughly 414,000 more men in their thirties than there are women of the same age by 2030.

This gender disparity in an already small generation will inhibit efforts to boost the fertility rate. Some men have taken the initiative to bring in a wife from abroad. In 2008 around 11 percent of all marriages were with foreigners,

mostly foreign women marrying Korean men. This has created tension in such a homogenous country, and the children of mixed marriages often face discrimination.

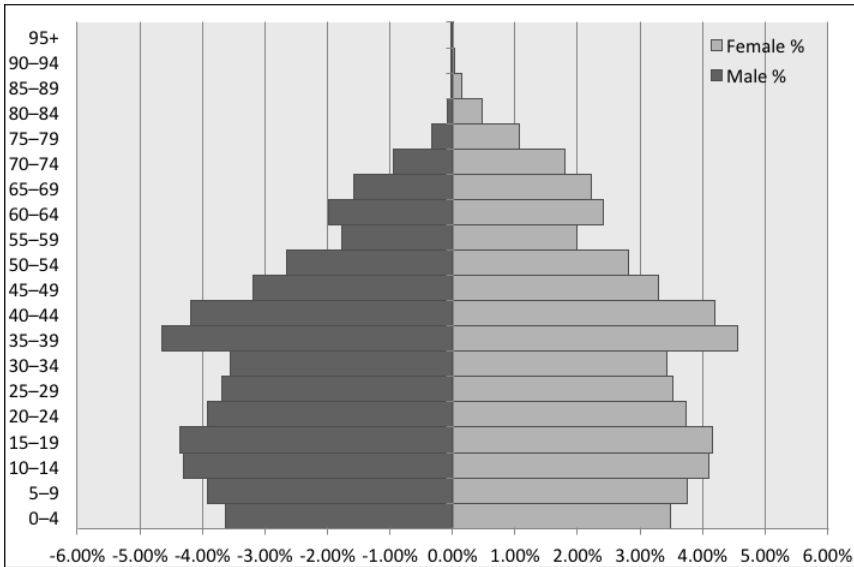
Immigration

Immigration would seem to be the obvious solution to all of these demographic problems. An influx of young migrants would create a more desirable dependency ratio by filling in the labor shortage. Some of these immigrants might also choose to find South Korean spouses, closing the gender gap. But this possible solution causes challenges because, besides being one of the most densely populated countries on earth, South Korea is also highly homogenous and insular, making immigration highly controversial. According to UN calculations in 2000, for South Korea to maintain an unchanging working-age population it would need 6.4 million immigrants (12.8 percent of the current population) between 1995 and 2050. South Korea has allowed entry to a growing number of foreign workers and foreign wives. The number of foreigners in South Korea rose from 270,000 in 1995 to 747,000 in 2005, which included 100,000 who entered for the purpose of marriage. But immigration is not a long-term solution. Immigrants to South Korea experience widespread discrimination. South Koreans lack experience coexisting with foreigners and some still believe that international marriages are “unnatural.” As a result, mixed-race Koreans have trouble finding regular work. According to Bum Jung Kim and Fernando Torres-Gil in 2009 more than two-thirds of mixed-race Koreans were unemployed and only 6 percent owned home. It seems likely that there will continue to be a high level of resistance to greater levels of immigration whatever the demographic need or economic argument. Perhaps an influx of North Koreans would be a more palatable alternative.

III. DEMOGRAPHIC CONSEQUENCES OF REUNIFICATION

Reunification of the Korean peninsula would have enormous economic, political, and social consequences for all Koreans. Demographic consequences would be less dramatic though perhaps still significant. North Korea, though geographically large, has about half the population of the South, and thus the overall change in demographics would be somewhat muted. Furthermore, North Korea has paralleled many of South Korea’s demographic shifts, though they have not been as dramatic.

Figure 4: North Korea: Population Pyramid (2008)

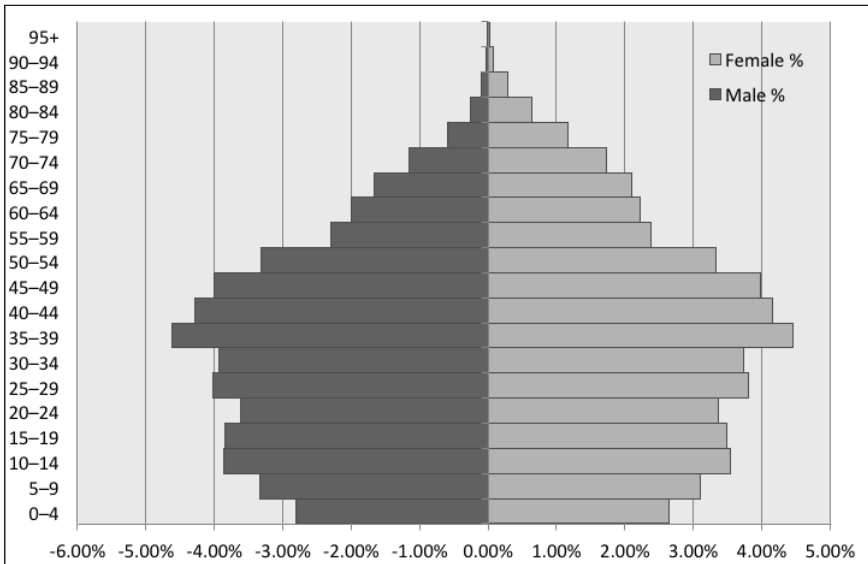


Will a United Korea Be Younger?

Comparing data from the 2008 North Korean census with South Korea’s census data for 2008 produces a mixed picture. North Korea is also an aging population. The portion of North Koreans aged 65 or over is 8.72 percent, only slightly smaller than the 9.28 percent of South Koreans over 65. However, those currently 65 or older are not the issue. The real concern is thirty years from now, when the baby boomer generation of workers—now in their 30s, 40s, and 50s—have retired.

Here, the picture is slightly rosier. The percentage of the population aged 35–64 will drop by more than 1 percent, while the percentage of the population under 20 will rise by more than 2 percent. These are not huge numbers, but they no doubt improve the outlook for South Korea, given the scope of the demographic problems the country is facing. Figure 5 illustrates the demographic pyramid for a unified Korea, which is slightly more evenly distributed than that of South Korea. The South Korean population in their 40s and 50s make up a greater share of the total population than they would in a unified Korea. A Unified Korea, by contrast, has a larger percentage of the population under 25 years of age.

Figure 5: Unified Korea: Population Pyramid (2008)



Will the Fertility Rate Rise?

In contrast to South Korea, which for many years actively tried to slow its population growth, the North Korean government, at least publicly, encouraged people to have large families in order to narrow the gap with the much more populous South. North Koreans, however, like their southern neighbors, prefer smaller families, and North Korean defectors have said that government clinics readily provide birth control. As a result, the growth rate in the North is not significantly different than that in the South. In 2008, the South Korean population was growing at 0.31 percent, with a fertility rate of 1.2. A closer look reveals that North Koreans have a higher crude birth rate than South Koreans: 14 per 1,000 women compared to the latter's 9 per 1,000 women. The two countries' population growth rates are more or less the same because North Korea has twice the crude death rate as the South: 10 per 1,000 people compared to the South's 5 per 1,000 people. The crude death rate can reflect the quality of health care as well as the age structure of the population. Because the percentage of the elderly population in the two Koreas is similar, it can be assumed that lower quality health care is the cause of the higher North Korean death rate. Infant mortality rates estimated by the World Bank confirms this: South Korea has an under age 5 infant mortality rate of 5 deaths per 1,000 births, similar to other

developed economies. North Korea's rate is more than six times higher: 33 deaths per 1,000 births, ranking it below Nicaragua and Vietnam. In the event of reunification, it is not unreasonable to expect that South Korea could utilize its superior resources, technology, and medical know-how to drive down the North Korean infant mortality rate relatively rapidly to a level closer to that of South Korea, and thereby lowering the overall crude death rate. This would cause a jump in the population growth rate, presuming that the North Korean birth rate did not simultaneously drop to the South Korean level. This is a fairly safe bet considering that birth rates—when birth control measures are freely available—are tied to decisions made within the family based on cultural norms and economic circumstances. The North Korean birth rate would probably drop over time, but presumably much slower than the death rate (perhaps over a generation), producing a tiny demographic dividend.

Will There Be a Gender Divide?

While North Korea's population growth has slowed much like South Korea's, and both countries are aging, the North differs from the South in that its population has not developed a gender disparity. The reasons for this are uncertain. It could be that no gender bias exists. Communist regimes are known to promote gender equality and, as the state provides pensions and health care for the elderly, parents may not feel that they absolutely need a son. It is more likely, however, that North Koreans lack the means to determine the gender of a fetus and/or abort unwanted female children. The net effect is that North Korea has a balanced gender ratio. This will not close the gender gap in a unified Korea but will shrink it as a percentage of the total population.

Internal Demographic Changes

While the overall demographic picture will not change much post-reunification, there may be huge demographic shifts within the peninsula. For example, though the overall population density of a unified Korea would be lower than that of South Korea, it is likely that many North Koreans, even if enormous resources are spent developing and creating jobs in the North, will move to the South in search of jobs and better economic opportunities, as it had happened after German reunification. As a result, the population density in the South, particularly in the major cities, could easily rise, while the North would become comparatively depopulated, leaving areas populated heavily by the elderly, as is increasingly the case in rural Japan. Thus, cities like Seoul may acquire a relatively young population and achieve a relatively balanced demographic structure, while

rural areas and cities in the North may find themselves aging faster than would have otherwise been anticipated. Similarly, if North Korean women begin seeking South Korean husbands—who, besides being more familiar with the capitalist system, are better educated and wealthier than their North Korean counterparts—then the gender imbalance in the South may be exported to the North. Reunification could lead to a younger, more populous, and gender-balanced South and a depopulated, aging, and gender-imbalanced North. South Korea would effectively export its demographic problems to the North.

Integration Prospects

The speculation that reunification will mitigate some of South Korea's demographic problems is also contingent on the assumption that North Koreans can be integrated into South Korean society and its economy. If North Koreans cannot acquire the right skills, or have trouble coping with high-stress capitalist work environments, then they will not be able to fill the holes in the workforce; rather, they will be an additional burden on the system. Similarly, if the cultural gap between the two societies is too large, South Korean men may remain out of luck in the marriage market. There are already signs that the South is having trouble integrating the recent influx of North Korean defectors. During the Cold War, defectors were rare; they were also well educated and usually had left the North for ideological reasons. They were treated as a valuable resource by South Korea and given state jobs. However, since the end of the Cold War, and with the food shortages that have beset the North, defections have rapidly increased from a few dozen a year to a few thousand. As of early 2012 there are more than 23,000 North Koreans living in the South, most of whom have arrived in the last ten years. They are not ideological defectors but economic refugees from the lowest classes of North Korea. The South Korean state provides them with some financial resources and training, but a high percentage remain unemployed or relegated to undesirable 3D (dirty, difficult, dangerous) jobs. More than 80 percent receive welfare because they are unable to acquire a regular job or earn so little that they still qualify. They went from being poor in a society of the poor to being poor on the fringe of a rich society.

While some reasons for North Koreans' failure to integrate into the South are well understood—such as low levels of human capital in the North, poor health, and discrimination of northerners by southerners—other reasons are more complex and difficult to address. For example, North Koreans have little social capital (low levels of trust, lack of family ties, no social network among South Koreans or among other North Koreans); as a result, they are not exposed to

new job or business opportunities and have no network they can rely on in times of need. Social connections are a key to success in a capitalist society, but North Korean refugees lack such ties. In interviews, North Koreans are unlikely to state that they trust anyone in South Korea. They also tend to avoid living or working with other North Koreans. Most avoid any contact whatsoever with their fellow defectors, yet they also fail to join or participate in South Korean social organizations. According to a 2005 survey by the Information Center for North Korean Rights, “isolation and loneliness” was the second-greatest problem that North Koreans living in the South encountered after financial issues. Many of these problems may be specific to defector, and so will not necessarily apply to the North Korean population as a whole in the event of reunification. However, after several generations of living in one of the world’s poorest and most oppressive countries, it is certainly possible that certain social pathologies may have developed that will make integration into South Korean society difficult.

Still, there are also signs that integration will not be impossible. The availability of inexpensive and relatively unskilled North Korean workers may bring to the North the low-skilled assembly jobs that South Korean firms have outsourced to China. North Koreans are likely to be just as capable as the rural Chinese migrants who currently work in these Korean-owned factories. They also speak Korean, which mitigates problems that may arise from language barriers. According to Byun Ha-jung at Hyundai Asan, North Korean workers at the Kaesong Industrial Complex are 90 percent as efficient as their South Korean counterparts. The Kaesong model—of South Korean capital, technology, and managers combined with North Korean labor working good, full-time jobs—may lead the way to integrating North Koreans into the South’s economy after reunification. Another positive sign of integration is the recent surge of marriages between female North Korean defectors and South Korean men, driven by specialized matchmaking services. Assuming that the matchmakers are credible in their reporting, as many as 1,000 North Korean women have married South Korean men out of the roughly 20,000 defectors (men, women, and children) in the South.

IV. CONCLUSIONS AND POLICY IMPLICATIONS

Low fertility rates leading to low population growth and population aging have important policy implications for the countries undergoing this demographic transition, such as South Korea. When considering its policy options, South Korea must take into account the effects of reunification. The possibility of reunification should be likened to disaster preparedness: reunification is not

necessarily imminent—or even likely in the near term—but there is certainly a chance that it could occur at any time, potentially with little or no warning. As a result, South Korean officials need to craft policies that are “reunification-friendly”—policies that will survive the reunification process until adjustments can be made to reflect the new reality. For example, if the two Koreas reunify, any given South Korean social welfare program could see its enrollment rise abruptly by 50 percent or more without a commensurate increase in revenue, which could become a budgetary nightmare without a well thought-out plan. Though there is pressure in any aging society for the government to provide more assistance to the elderly, any effort to do so in South Korea should take into account the implications of reunification so that, when it happens, the program will remain fiscally viable.

Similarly, the South Korean government needs to do more to prepare for the reintegration of North Koreans. Current programs to integrate North Korean defectors and refugees—such as a twelve-week crash course in South Korean residency and lessons on how the market economy functions are encouraging, but more needs to be done. If South Korea cannot integrate 2,000 refugees a year, what chance does it have of successfully integrating 24 million? Something as small as providing mentors to new arrivals to educate, inform, befriend, and act as an advocate could go a long way to tie newcomers to the South Korean society. Charitable organizations like the International Rescue Committee and Catholic Charities do this for refugees in the United States; the same could be done through either the state or civil society in South Korea.

In comparing the demographic data and trends of the two Koreas to assess the impacts that reunification may have on the populations, this essay finds two groups of contradictory pressures: in the South, reunification will create a younger population, a higher population growth rate, and a more even gender ratio; whereas in the North, reunification will likely lead to a larger pool of elderly citizens without a social safety net, a drop in total population, and greater gender disparity. Reunification can bring positive benefits to the South, but the North may need to bear the cost. If sufficient preparations are not made to ensure that the two states are reintegrated in a fair and balanced manner, then Korea may remain two separate societies even after they unify into one country.

CHAPTER V: SECURITY AND FOREIGN POLICY



Allies at Odds: The North Korea Factor in China's Foreign Policy Strategy

By Matt Chitwood

I. INTRODUCTION

The “special relations” between China and North Korea are truly unique. The countries have a long-standing alliance and yet their goals seem obfuscated and incongruent. North Korea hails China as its most important ally, its biggest trading partner, and its main source of food, arms, and fuel. Indeed, 90 percent of North Korea's energy imports come from China. Even more astounding is that China is the world's third-largest food donor, half of which goes to North Korea. North Korea hails China as its most important ally for good reason.

Conversely, China characterizes North Korea as its most troublesome ally. Keeping North Korea from regime collapse is a significant economic burden. The two nations share an 850-mile border that has allowed between 30,000 and 100,000 North Korean refugees to penetrate China. North Korea is an unpredictable tinderbox that riles up conflict and either calls China to its aid or gives China cause for ire. China *does* value North Korea as a strategic buffer against foreign military forces as well as a bulwark against US military dominance in the region. China's peaceful development emphasizes regional stability, mutual noninterference, and soft power. China asserts that its growing economic and military prominence in the region will not threaten other nations but will instead benefit them as it bears increasing international responsibility. Juxtapose China's peaceful development strategy with North Korea's actions. Consider North Korea's nuclear tests in 2006 and 2009, the moribund Six-Party Talks, the sinking of the *Cheonan* in March 2010, and the shelling of Yeonpyeong Island in November of the same year. These actions do not foster China's underlying development and foreign policy goals, yet China maintains its alliance with North Korea.

This essay explores how China is balancing its commitment to peaceful development and its role as a responsible international power vis-à-vis its foreign policy toward its ally North Korea. The sections that follow discuss the historical basis of this relationship, significant changes in China's policy toward North Korea over the course of that relationship, and projections for China's future policy.

II. THE EVOLUTION OF CHINA'S POLICY TOWARD NORTH KOREA

Five Principles of Peaceful Coexistence

To understand the complexities of the current relationship between China and North Korea, one must understand the journey that brought these two countries where they are today. China and North Korea's alliance has long-standing roots in their shared Leninist-socialist ideology. During the Japanese invasion of Manchuria, for example, Chinese and Korean Communists joined forces against the invaders. Korean Communists also came to the aid of the Chinese Communist Party during its years of civil war with the Kuomintang on the mainland. So it was no surprise when, in 1950, Chinese forces entered the Korean peninsula to aid their comrades in North Korea in an ideology-driven civil war against South Korea and UN forces.

Chinese involvement in the war was significant. Over the course of the war, 114,000 Chinese died, including Mao Zedong's own son Mao Aiyang. Moreover, the Korean War was the international embodiment of the ideological struggle that China had just dealt with domestically. The very cause of Communism was being fought out in its neighboring country, so the Chinese dutifully stepped up to support their comrades. This was the beginning of China's foreign policy toward what would become the Democratic People's Republic of Korea (DPRK) and was not the last time North Korea would draw China into conflict in the region.

Chinese aid did not stop with the end of the war. China played a key role in North Korean reconstruction efforts, forgiving debt and providing a four-year \$350 million grant, which is even more financial support than given by the Soviet Union.

The frustrations of "divided nation ideologies" also bonded China and North Korea as they both emerged from civil war in the early years of their alliance. The Korean peninsula was divided into North and South, while China was split between the People's Republic of China (PRC) on the mainland and the island nation of Taiwan. This shared experience assured mutual understanding and support as both China and North Korea dealt with questions of unification in the years to come. Mao Zedong even said that the countries were "as close as lips and teeth." These common bonds of shared history and ideological struggle form the core of the Sino-North Korean alliance and are imperative to consider even though the alliance has changed shape over the years.

China's so-called Five Principles of Peaceful Coexistence were also formidable in

shaping its foreign policy. These principles were initially outlined in China's 1954 treaty with India concerning Tibet and are as follows:

1. Mutual respect for each other's territorial integrity and sovereignty.
2. Mutual nonaggression.
3. Mutual noninterference in each other's internal affairs.
4. Equality and mutual benefit.
5. Peaceful coexistence.

These principles subsequently formed the foundation for China's foreign policy goals with other countries. They also explain China's principled solidarity with the North in the Korean War as well as China's expectations of other countries' policy toward North Korea.

China's alliance with North Korea also aligned with China's core interest of regional security. North Korea served as a strategic security buffer against possible attack from military forces stationed in South Korea. In the 1960s and 1970s, China viewed the roughly 60,000 US troops in South Korea as a threat to regional security. But North Korea's location between China and South Korea prevented those forces and missiles from being lined up directly on China's border. This has remained a core component of China's interest in North Korea as an ally. However, 1978 marked a change in the direction of China's economic policy, which had implications for its foreign policy. Deng Xiaoping had just taken the helm and he initiated China's opening up and reform. These reforms flew in the face of Communist ideology, but Deng's political acumen enabled him to deflect domestic criticism. Yet, his use of market mechanisms was antithetical to North Korean policies and was the start of a widening gap in the countries' mutual affinity. The schism between China and North Korea only grew, culminating with the Joint Communiqué of 1992 that established China's normalized relations with South Korea. This normalization did not happen overnight; rather, it took place over a decade and in several phases: from a one Korea policy, to a one Korea *de jure* and two Koreas *de facto* policy, to a two Koreas *de jure* and *de facto* policy. This allowed China time to adjust post-Mao foreign policy given the context of changing domestic, regional, and global sentiments.

China's New Security Concept

China's change in foreign policy to normalize relations with South Korea was significant. Normalization represented the official divorcing of China's foreign policy from its ideology and solidified a more pragmatic approach to its diplomacy

efforts. Jaewoo Choo, assistant professor of Chinese foreign policy at Kyung Hee University in South Korea, wrote in *Asian Survey* in 2008, “China now places more value on national interest, over alliances blinded by ideology.” This reflects the realist school of thought concerning national interest theory. No longer were generational ties and shared sentiment the basis of China’s foreign policy calculations. Rather, China turned to focus on economic development and finding its place in the changing global balance of power. China’s national interest and indeed the very survival of the state were at stake. Maintaining a peaceful strategic environment conducive to economic development thus became the core of China’s foreign policy.

Paramount to China’s economic development was regional stability, particularly along China’s own borders, as well as lessening the prospects for conflict with world powers like the United States. Wu Baiyi, deputy director of the Research Department at the China Foundation for International and Strategic Studies, wrote of this “new security concept” in 2001 in the *Journal of Contemporary China*. He described the three principles of this new Chinese foreign policy:

1. Sovereignty and the political, economic, and cultural pluralism of all nations must be respected.
2. National economic development requires mutual interest and common prosperity.
3. All parties must promote mutual trust and understanding while opposing any hegemonic behavior and avoiding the use of force in international affairs.

These principles have allowed China to engage both North Korea and the rest of the world in a flexible and interactive manner rather than being beholden to ideological constraints. However, normalized relations with South Korea yielded myriad implications for China’s relationship with North Korea, not the least of which involved North Korea’s own security concerns.

China and North Korea had signed the Sino–North Korean Treaty of Friendship, Cooperation, and Mutual Assistance in 1961, shortly after North Korea signed a similar agreement with the Soviet Union. Article II of this treaty stipulates that China and North Korea will use all necessary measures to oppose any country or coalition that attacks the other nation unprovoked. Yet, in 1992, China suddenly was engaging South Korea, much to the chagrin of the North. Moreover, the Soviet Union had collapsed just a few years prior, ending the Cold War. World powers were realigning and the resulting environment was not friendly toward

Communist regimes, rendering China's shift toward pragmatic diplomacy, which in turn made North Korea vulnerable.

China's cooperation with South Korea was also part of the former's emerging strategic ambiguity policy. Jaewoo Choo asserted in *Asian Survey* in 2008 that China believes itself to have the right to interpret the principle of intervention laid out in its 1961 treaty with North Korea. That is, China can decide when it wants to come to North Korea's defense. Experts say that this deters others from responding to the North's military aggression, although they also question if this deters North Korea from military aggression. Ultimately, China's change to a more pragmatic approach toward foreign policy was in its own national interest, but it made maintaining simultaneous good relations with both sides of the 38th parallel a formidable challenge.

Despite improved relations with South Korea, China was painstakingly scrupulous in maintaining what Council on Foreign Relations' Korea expert Scott Snyder described in January 2012 as a "formal equidistance between the two Koreas." Chinese state media was charged with evenhanded reporting on Chinese "special relations" with North Korea and its "normal state relations" with South Korea. High-level exchanges in Seoul were balanced with equivalent gestures in Pyongyang.

In 1993, the year following China's diplomatic normalization with South Korea, North Korea instigated the first North Korean nuclear crisis. Following its noninterventionist policy, China avoided taking an official role in the talks; however, because of its relationship with both North Korea and the United States, it engaged in shuttle diplomacy as liaison between the two countries. Through this experience, China gained stature as an international mediator and was described by one anonymous US government official that year in the *New York Times* as "the key to solving the North Korea crisis." China also began to realize the fundamental correlation between regional stability and denuclearization. A nuclear-capable neighbor would undermine China's efforts at peaceful development, and so denuclearization of the Korean peninsula became one of China's strategic goals. This is reflected in the Crawford Consensus of 2002 between US President George W. Bush and Chinese President Jiang Zemin, which articulated US-Sino collaboration to peacefully achieve North Korea's denuclearization. The Crawford Consensus also illustrates the inherent tension between China's goals; on the one hand, of regional stability and denuclearization of the Korean peninsula and, on the other, China's long-standing principle of nonintervention in other countries' domestic affairs. This became even more clear during the nuclear crisis of 2003–2005 and through the Six-Party Talks that began in 2003.

Six-Party Talks and China's Foreign Policy

In 1985, North Korea ratified the Nuclear Non-proliferation Treaty (NPT), which committed signatories to (1) non-proliferation, (2) disarmament, and (3) the right to peacefully use nuclear technology. However, in early 2003 the United States alleged that North Korea had a uranium enrichment program, leading North Korea to withdraw from the treaty. This ultimately led to the Six-Party Talks, a multilateral effort to end North Korea's nuclear program. China, the United States, South Korea, Japan, Russia, and North Korea all took part in six rounds of talks that were held between 2003 and 2007. Unfortunately, the talks were discontinued in 2009 after North Korea's failed satellite launch and UN Security Council sanctions, with ultimately little progress having been made.

China was strategically involved in the talks to further its interests of stability and denuclearization of the Korean peninsula. Recognized as the party with the best relations with North Korea, in February 2004 China used its influence on the leadership in Pyongyang and pledged \$50 million in aid and energy assistance to bring North Korea to the negotiating table. China hosted the talks and hoped to gain international prestige as the potential broker of peace and stability in East Asia. However, the talks reached one stalemate after another as North Korea and the United States struggled to overcome their deep mutual mistrust. North Korea repeatedly called for bilateral negotiations, while the United States insisted upon multilateral talks, neither party showing flexibility. In these deadlocks, China's brokering efforts proved ineffective. The only results from the first three rounds of talks were "chairman's statements" that simply reiterated participants' commitment to peaceful dialogue.

At some point, China realized the talks might fail to denuclearize the peninsula. Fearing blame and negative public perception, China started urging the United States and North Korea to resort to bilateral discussions, thereby allowing the Six-Party Talks to focus on broader regional stability issues. This revealed that China's interest in the Six-Party Talks was for its own benefit rather than for the collective goal of denuclearization. This self-interest extended to other parties as well. In the words of Scott Snyder, "Participating states placed their own immediate priorities and concerns above the collective need to halt North Korea's nuclear program."

Regardless of China's urgings, the Bush administration remained impervious to suggestions of bilateral talks with North Korea, as it sought for resolutions framed in multilateral terms. Meanwhile, China continued its shuttle diplomacy, perceiving no benefit to siding with either the United States or North Korea.

China particularly feared that harsh terms against North Korea would threaten regional stability. In a 2005 article in Singaporean newspaper the *Straits Times*, a Shanghai Academy of Social Sciences researcher, Zhang Zuqian, stressed the trade-off between North Korea's stability and denuclearization. He argued that the political, military, and economic risks attached to instability in North Korea were short-term compared to the benefits that would accrue from finally resolving the issue in a clear-cut way.

The fourth round of talks finally brought headway, and the parties issued a joint statement on September 19, 2005. North Korea asserted that it was "committed to abandoning all nuclear weapons and existing nuclear programs," it would rejoin the NPT, and it would permit the return of International Atomic Energy Agency (IAEA) monitors. In return, other talk participants offered food and energy aid to North Korea, and the stage was set for further normalization of relations and peace agreements. Unfortunately, this victory was short-lived. Accusations of North Korean money laundering in Macau instigated further provocative behavior on the part of North Korea. The country then proceeded with missile tests in July 2006 and conducted a nuclear test in October of the same year.

III. THE EFFECTS OF NORTH KOREAN NUCLEAR TESTS ON CHINESE POLICY

The First Nuclear Test and China's Foreign Policy

The nuclear test of October 2006 was a game changer for China. Prior to the test, China exerted much of its political capital exhorting North Korea not to test a nuclear weapon. It did so through public and private channels and relied on its supposed long-standing ties to carry the weight of its words. China was in a better position than all other players to sway the actions of North Korea. And to its credit, China had done much to support the country as its largest aid donor and champion of its regional security concerns vis-à-vis other international powers. Yet, despite Beijing's admonitions, Pyongyang conducted the nuclear test, which was a dramatic loss of face for China. To the international community, the nuclear test was seen as Kim Jong-il essentially fooling China and inciting international mockery. North Korea's actions also called into question China's efficacy in solving the DPRK nuclear crisis.

China has also struggled to see the benefits of economic reform in North Korea. It has closely cooperated with officials to develop trade and reform that will enable market mechanisms to operate within North Korea. However, two problems remain.

The first is that the government in Pyongyang lacks the authentic commitment to see economic reforms through to fruition. All policies fall secondary to *military-first politics*, which poses a substantial obstacle to economic progress. The second problem is the inherent tension between economic reform and regime survival. If the regime does not open up, financial collapse seems imminent, particularly when international aid is absent. Paradoxically, if it does open up, North Korea fears vulnerability to foreign powers and fatal political risks.

Prior to the October 2006 nuclear test, China's primary strategic interest was regional stability, particularly on its periphery. Denuclearization was not seen as a top priority, short of its contribution to the larger regional stability goal. However, North Korea's nuclear test raised the specter of rapid regional nuclear proliferation. China dreaded the thought of Japan, South Korea, or Taiwan citing this nuclear test as justification to develop their own nuclear programs. As a result, China began to question whether North Korea was a strategic asset or a strategic liability. Granted, China had been the lynchpin in bringing the country to the Six-Party Talks in the first place; however, despite the close ties between Beijing and Pyongyang, it seemed that China ultimately exerted little leverage over North Korea. The former presidential candidate of the United New Democratic Party, Chung Dong-young, concurred in a 2011 interview: "In actuality, Beijing has little control over North Korea." Daniel Sneider, of Stanford's Asia-Pacific Research Center, followed up in a 2006 *New York Times* article, asking, "Can China actually try to exercise that influence without destabilizing the regime? Probably not."

The more aid China offers North Korea, the more leverage North Korea seems to have over China. North Korea's utter dependence on China's economic aid could become a liability for the donor. This is particularly possible given that China's aid in part serves its interest in preventing regime collapse. North Korea's increased dependency means that there would be strong negative consequences should China reduce or withdraw aid. Gordon Flake, executive director of the Maureen and Mike Mansfield Foundation, said in 2011 that this makes China "hostage to" and "an enabler" of North Korean provocations.

In light of North Korea's nuclear tests and China's realization of its waning influence over North Korea, China conceded to UN Security Council Resolution 1718 on October 14, 2006. This resolution established sanctions against North Korea, including a mandate to cease its nuclear program and limitations on trade in military and luxury goods. By reaching a unanimous and consolidated agreement through the United Nations, China eased its influence over North Korea and granted the United States more influence in shaping China's foreign policy. Even

so, China feared that increased cooperation with the United States might bring regional political and economic strife, once again conflicting with China's primary interest of stability. China also continued to fear a US military response to North Korean provocations, which it also deemed unfavorable for the region. China's hope was and is a Korean peninsula that is peaceful, neutral, friendly, and open to China—and free from US military forces.

Gordon Flake describes the Chinese approach to foreign policy as the three no's: no nukes, no war, and no collapse. China's decision to endorse (and not just abstain from) the UN Security Council resolution heavily shifted China's policy priority toward *no nukes* while also moving the country into a more responsible international role. While China's voice of influence was decreasing and being joined by others in the region, China still had tools to help achieve its strategic ambitions: trade, aid, and economic ties; high-level exchanges; and diplomacy in the Six-Party Talks. However, the next major turn of events led to a further decrease in the effectiveness of these tools.

The Second Nuclear Test and China's Foreign Policy

In another provocative move, North Korea tried launching what was an alleged satellite on April 13, 2009. The launch failed and the international community asserted that the "satellite" was actually the test of a ballistic missile as a nuclear device. A UN Security Council Presidential Statement quickly condemned the act and sanctions were tightened. In a heated response, North Korea withdrew from the Six-Party Talks and declared that it would resume its uranium enrichment program. It also immediately expelled all IAEA monitors. And just one month later, North Korea conducted a second nuclear test.

Alan Romberg, a former US State Department official now with the Stimson Center, described this second nuclear test in *Time* as a "spit in the People's Republic of China's eye." The test not only revealed the waning influence of China over North Korea, but also showed that despite close ties with China, Kim Jong-il was deciding for himself how to run his country. China also demonstrated increased solidarity with the international community in its approval of UN sanctions. Once again, *no nukes* seemed to top China's policy priority list. However, China's enforcement of these sanctions has been less straightforward and the country is much criticized for its opaque trade and aid practices with North Korea. Trade of luxury goods has continued to increase despite sanctions, averaging \$11 million per month in 2009. Exact quantities and mechanisms of food aid have remained a mystery as well.

IV. US-CHINA JOINT STATEMENTS AND INTERNATIONAL CRISES

An analysis of the US-China Joint Statement issued by President Hu Jintao and President Barack Obama on November 17, 2009, helps to gauge China's foreign policy recalibration. Four paragraphs in the statement are devoted explicitly to nuclear nonproliferation, and the language regarding North Korea is clear: continue Six-Party Talks and implement the talks' September 19, 2005 joint statement, including denuclearization of the Korean peninsula, normalization of relations, and establishment of a permanent peace regime in Northeast Asia.

With China's new minimal leverage over North Korea and its fear of further nuclear proliferation in the region, stability and denuclearization have become its two-pronged strategy to reach its policy goals in Northeast Asia. However, these tactics ebb and flow in terms of priority. Kim Jong-il's health was also a complicating factor. He suffered a stroke in 2008, and Beijing was increasingly concerned about domestic stability and the succession of power to his son Kim Jong-un, then only in his late twenties. Some scholars suggest that China once again recalibrated its policy priorities to emphasize *no collapse* rather than *no nukes*. China's lack of enforcement of UN sanctions supports that view.

The 2009 US-China Joint Statement also said the following: "The Chinese side welcomed the start of high-level contacts between the United States and the DPRK." China was pushing for normalization of US trade with North Korea, perhaps a more central strategy for state-to-state relations, and for further regime stability. This strategy seemed to hold steady through the turmoil of 2010, including the sinking of the *Cheonan*, the shelling of Yeonpyeong Island, and discovery of evidence of a uranium enrichment program. The *Cheonan* incident occurred in March 2010, killing forty-six South Korean sailors. Contrary to international expectations, however, China remained silent on the event and never assigned blame to North Korea. On the contrary, Beijing actually welcomed Kim Jong-il twice in the following months. China's approach was proactive engagement and this seemed to be helping to stabilize the region.

Regional stability took a dramatic turn in November, however, in response to two key events. First, North Korea shelled Yeonpyeong Island in South Korea. Second, North Korea revealed to a visiting American delegation that it possessed a uranium enrichment program. Suddenly, China's foreign policy strategies appeared to be misguided and failing, and received strong international criticism. Instead of merely ignoring North Korea's misdeeds, US Secretary of State Hillary Clinton accused China of facilitating North Korea's actions by shielding it from

consequences. Reason suggests that China should strongly reconsider its foreign policy approach. The US-China Joint Statement of January 19, 2011, also suggests another recalibration of policy. This most recent statement emphasizes peace and stability as of the utmost importance, and says that the denuclearization of the Korean peninsula is tantamount to preserving that peace and stability. Perhaps more telling, however, are the three separate references to the 2005 Six-Party Talks Joint Statement in one paragraph dedicated to the Korean peninsula. According to Gordon Flake of the Mansfield Foundation, this is quite odd, given that the Six-Party Talks Joint Statement was never fully implemented and the talks themselves are all but dead. However, his point is this: North Korea has asserted itself as a nuclear power since 2006 and claims that the Six-Party Talks are about peace and security, not about denuclearization. Yet, Hu and Obama's references to the Six-Party Talks Joint Statement make it clear that North Korea's declaration of its uranium enrichment program violated that joint statement and that progress in the Six-Party Talks would only come in the context of that joint statement. Progress means both peace and denuclearization.

What the 2011 US-China Joint Statement does not say is also interesting, since what it fails to say exposes the limitations on US-China cooperation in dealing with North Korea. First, it fails to mention the specific UN Security Council resolutions (1718 and 1874) that China is particularly key, yet lax, in implementing. Second, the joint statement ignores and does not assign responsibility for the sinking of the *Cheonan* and the shelling of Yeonpyeong Island. The 2011 US-China Joint Statement also omits two key pieces of information. First, there is no agreement on the United Nations' role in addressing further conflicts on the Korean peninsula. An agreed-upon resolution process, and an expression of joint commitment to respect that process, would help provide accountability in the event of future disagreements. Second, the US-China Joint Statement calls for "concrete and effective steps to achieve the goal of denuclearization" and the other commitments in the Six-Party Talks Joint Statement, yet it does not clearly define what those steps are.

V. CHINA'S FOREIGN POLICY MOVING FORWARD

China has myriad competing interests to consider when defining its foreign policy toward North Korea. Even its own strategic interests are further confused in the context of considering other powers' strategic interests and compromise. It is in China's interest to maintain North Korea as a strategic buffer against military aggression, but it is also damaging to China's other international relationships to align itself with the "neighborhood bully." China wants to prevent collapse of

North Korea, but it also realizes that propping up the regime is costly. China wants to provide technical assistance and investment to North Korea while it is clear that there are no guarantees of financial security. Despite these competing and often shifting interests, there are three foreign policy objectives that stand out as constants: maintaining regional stability, protecting China's security interests, and increasing China's regional influence.

Maintaining Regional Stability

Maintaining stability on the Korean peninsula and in East Asia as a whole is paramount for China. With recent events such as the *Cheonan* sinking and the Yeonpyeong Island shelling, this seems a formidable task. However, these events themselves demonstrate the political, economic, and security costs of *not* maintaining stability. China already has significant investment in both North and South Korea, so its economic incentives are substantial.

China must also avoid North Korean regime collapse at all costs. In the event of the regime's collapse, an influx of refugees across the 850-mile China–North Korea border would place a tremendous economic, political, and social burden on China that it is not prepared to deal with. This could also potentially draw international attention to China's human rights record in dealing with refugees, which China prefers to avoid. China's construction-in-progress of a fence stretching along the most accessible part of this border reveals the importance of this potential refugee issue for China.

Stability in North Korea also ensures a strategic buffer between China and military forces in South Korea, preventing the unwelcome prospect of a democratic, nuclear-armed United States perched on China's border. A 2010 Congressional Research Service report on China-North Korea Relations describes China's steady flow of economic assistance *not* as an effort to sustain North Korea's human rights abuses or to prop up a nuclear threat; rather, it is a regular insurance payment that China remits to avoid having to pay the higher costs of North Korean collapse or a second Korean War.

Of note, the Chinese Communist Party's International Affairs Department is responsible for Sino–North Korean relations—not the Chinese Foreign Ministry. This party-to-party relationship aligns foreign policy incentives with pursuing a stability strategy, and these Chinese party members are among those least likely to pursue destabilizing policies toward North Korea.

Protecting China's Security Interests

China's sovereignty and territorial integrity are top priorities. Having nearby nuclear threats would therefore be contrary to China's security interests. A nuclear-capable North Korea might lead to nuclear proliferation for other regional powers, including South Korea, Japan, and Taiwan. A denuclearized North Korea, on the other hand, fits into China's long-term strategy for regional stability. This would dissuade other regional powers from taking steps toward nuclear proliferation and would reduce the saber rattling and brinkmanship that have repeatedly pushed the region toward armed conflict. Politically maneuvering to prevent a nuclear-capable North Korea, however, is difficult. Thus far, the nuclear aims of North Korea have not led to nuclear armament of the region. Moreover, China has managed its regional relationships well so as to avoid sparking such conflict. Leaders in Beijing recognize China's inability to control North Korea, and so China has been increasingly leveraging its international role in the Six-Party Talks to achieve these ends multilaterally.

Increasing China's Regional Influence

Were the North Korean regime to collapse or the two Koreas to unify, China would aim to be on the best possible terms with both countries in order to reap the maximum benefits. China has realized economic opportunity through normalizing relations with South Korea and trade continues to increase. China even signed the Economic Cooperation Framework Agreement with Taiwan for economic and political gains. Food and energy aids to the DPRK also give China leverage in aligning North Korean interests with its own, exerting economic influence while also encouraging reform. These opportunities come only through exerting influence and establishing mutually beneficial arrangements.

China's desire to host the Six-Party Talks exemplifies this approach. By mediating between the involved parties, China has gained valuable experience in international negotiation and has been able to regularly engage with foreign countries like Japan to help resolve long-standing differences. China also values its own bilateral discussions and senior-level meetings with US policymakers. South Korea's Ministry of Foreign Affairs and Trade asserts that North Korea is sending positive signals about moving forward with the Six-Party Talks early in 2013, so perhaps China will make further progress toward these goals in the near future.

VI. CONCLUSION

Being a rising power and an ally of North Korea requires tremendous responsibility. China has found it difficult to balance its commitment to peaceful development as an international power with its foreign policy toward North Korea. Ultimately, China's strategic interests can be summed up in the following three policies: maintaining regional stability, protecting China's security interests, and increasing China's regional influence. Over the course of its alliance with North Korea, China has encountered many conflicting interests, both internally and with the international community, and has attempted to resolve these in accordance with its underlying interests. At other times China has had to embrace the tension of conflicting interests and competing foreign powers.

Moving forward, there will be continued tensions and recalibrations of foreign policy priorities. In the immediate future, China will likely continue to focus on regional stability as it handles the aftermath of succession of leadership in North Korea. China is uniquely poised to take advantage of whatever opportunities result, thanks to its positive regional influence. Denuclearization will remain a priority for China only to the extent that it does not threaten Chinese security interests and increasing Chinese regional influence.

These policy predictions assume that the China–North Korea alliance will continue unabated. However, J. R. Kim of South Korea's Ministry of Unification pointed out in a 2011 interview that, in the summer of 2010, Chinese leadership held official discussions on whether or not to continue support of North Korea. Obviously, China decided to continue support; however, that Beijing leadership even raised this question is significant, which perhaps implies the alliance will not last forever. In the meantime, so continues one of the world's longest-standing—and most conflicted—alliances.

Navigating the Blue Ocean: Strategy for the South Korean Navy

By Akito Nishiuchi

I. INTRODUCTION

Since the Republic of Korea's establishment as a sovereign state in 1948, the Republic of Korea Army (ROKA) has served a crucial role. Even after the 1953 armistice that ended the Korean War, North Korea continued to make threats – such as the Blue House Raid in 1968 – which necessitated South Korea to have a strong army. It is not surprising, then, that South Korea primarily focused on building its army following the war, the prioritization that significantly influenced the country's domestic politics. From 1962 to 1993, the 30-year period during which South Korea experienced dramatic economic and social transformations, the country was led by three former ROK Army generals. Even after South Korea's democratization—symbolized by the Declaration on June, 29, 1987 by Roh Tae-woo and Kim Young-sam's succession in 1993—all of the chairmen of the Joint Chiefs of Staff came from the army with only one exception.

Historically, the army has been the strongest branch of the ROK military, with its troops accounting for 80 percent of all forces. Recently, however, there has been a move to strengthen the Republic of Korea Navy (ROKN). In 2005, the Roh Moo-hyun administration began an ambitious program to build a larger navy, including establishing the Maritime Task Flotilla and continuously deploying Aegis destroyers and larger submarines. In 2009, the navy dispatched a battleship far from its ROK homeport for the first time to the coast of Somalia to conduct an antipiracy operation. South Korean newspapers described these steps as transforming the ROKN into a “blue-water” navy (*Daeyang Haegun*).

This essay analyzes the factors that shaped the ROKN's new strategy and gauges whether this strategic trajectory will effectively enhance South Korea's national interests. It then examines South Korea's alliance with its neighboring countries and its specific effects on its naval strategy, as the expansion of the ROKN reflects South Korea's diplomatic relations.

II. SANDWICHED SOUTH KOREA? THE ROKN'S VIEW OF NORTHEAST ASIA

South Korean newspapers have described South Korea as a country that is “sandwiched” between Japan and China. This expression has been used especially regarding technology and manufacturing industries, but has also been applied in the field of national defense. In 2007, according to an article from the *Chosun Ilbo*, when the South Korean minister of national defense met the director of the CIA, the minister argued that South Korea occupied a difficult position between Japan and China, which is a common view in South Korea.

This belief in the strength of Japan and China in fact legitimized and accelerated the ROK plan to build a larger navy. The very name of the ROKN's first amphibious assault ship—the *Dokdo*, acquired in 2007—highlights this concern about Japanese and Chinese military expansion. The ship is named after the disputed island between South Korea and Japan. As another example, a 2010 defense white paper by the ROK Ministry of National Defense stated that China and Japan are vying with each other to build up their navies and air forces. As of 2007, neither Japan nor China possessed ships larger than the *Dokdo*, and this powerful assault vessel was touted as a symbol of the ROKN's new horizons. In 2008, the *King Sejong the Great*, South Korea's first destroyer featuring the Aegis combat system, joined the ROKN fleet. South Korean newspapers reported that this Aegis destroyer was superior to existing Japanese destroyers. The ROKN fleet has become a point of pride for South Koreans, and the navy has enlisted public sentiment to strengthen its own status.

The ROKN expansion also reflects diplomatic reality and how South Korea was positioning itself in the region. During the Roh administration (2003–2008), the president argued that the country should play a key role in Northeast Asia as a “balancer.” Also during the Roh administration, South Korea's relationships with both the United States and Japan were in turmoil. The 2006 DPRK missile launch in July and nuclear test in October, and the reactions that followed, revealed that there was no mutual understanding in terms of security policy between South Korea and the United States and Japan. This context makes sense of the ambitious plan of the ROK Ministry of Defense—announced in 2005 and called the Defense Reform Basic Plan (DRP)—to change the characteristics and makeup of ROK forces by 2020.

Per the original DRP, the total number of soldiers would be reduced from 680,000 to 500,000, a drastic downsizing of the ROK army. Given the army's history of dominance within the overall military, this reduction would be

unprecedented. At the same time, the plan called for strengthening the navy and the air force with new technology and equipment. For the navy, plans were to acquire two more *Dokdo*-class ships and six Aegis destroyers as well as to expand the submarine fleet. With these additional vessels, the ROKN would organize its so-called Maritime Task Flotilla. The DRP clearly indicates the ROKN's ambitious transition from a coastal force to blue-water navy operating in ocean waters globally, far from domestic waters.

It is not obvious, however, how the Ministry of Defense is deploying this plan based on an analysis of potential threats to the country. For example, Aegis capability is not necessarily effective to thwart the asymmetric threat of North Korea (and Aegis destroyers are expensive—ROKN's *King Sejong the Great* cost more than one trillion won). From a United States Forces Korea (USFK) personnel in Seoul, I heard the argument that the navy's acquisition of an Aegis fleet could be a first step in ballistic missile defense (BMD) cooperation between South Korea, the United States, and Japan. In fact, Japan and the United States have built such a missile defense system in response to the DPRK threat, and the Aegis ships in the US and Japanese navies are a vital part of this system. The ROKN Aegis ships would share the same data-link system, so technically cooperation between the three navies would be relatively easy. However, since South Korea is closer to North Korea—compared to Japan, for example—such a BMD system would provide limited benefit for South Korea, which is in fact why the ROK government declined to join in the US and Japanese BMD system. For South Korea, the DPRK conventional forces along the Demilitarized Zone pose a greater threat.

Lack of such trilateral cooperation is also a legacy of the Roh administration, and it is unlikely that the ROK, US, and Japanese navies would have shared certain objectives. This makes the reasons for ROKN acquisition of Aegis capability unclear. When the first Aegis destroyer joined the ROKN in 2007, many South Korean newspapers emphasized that the ship would cause a dynamic change in the maritime order in the Northeast Asia. Then—chief of naval operations, Admiral Jung Ok-keun, expressed in 2008 in an article in *Defense News* that the ROKN had to “make strenuous efforts to modernize its fleet to not only deal with North Korea's threat, but also [to] counter emerging regional threats.” It is not surprising, then, that Japan's Ministry of Defense asked for clarification regarding the details and objectives of South Korea's defense reform plan. The difference between the DRP's evaluation of expected threats and the actual threats faced by the ROKN remains a controversial issue.

The DRP is controversial for another reason: cost. The plan assumes that the ROK military budget will increase an average of 9 percent each year. Total expenditure required until 2020 is 621 trillion won. Even after the International Monetary Fund (IMF) shock in 1997, during which the ROK government had to enforce austerity measures, including for the military budget, the annual increase in the military budget went from 5.3 percent (in 2000) to 11.4 percent (in 2005), so a 9 percent annual increase was not necessarily unrealistic. Additionally, the South Korean economy made a resilient recovery from the IMF shock. However, since military expenditure is only one part of the national budget, it is subject to the continued good performance of the entire South Korean economy. In light of this, estimates by the Rand Cooperation in Bruce Benet's "A Brief Analysis of the Republic of Korea's Defense Reform Plan 2005," cast doubt on the feasibility of the military budget increase stipulated in the DRP.

The DRP is indeed ambitious. The plan calls for transitioning the ROKN to a blue-water navy, but what that means in practice is unclear. One significant Democratic Party politician, who served as a minister during the Roh administration, told me that he was not sure what pursuing a blue-water navy really meant. An officer of the ROKN expressed outright cynicism, telling me that politicians liked the idea of blue-water navy and so they wanted to use the term even if it was not well defined. As evidenced by coverage in ROK newspapers, naval expansion has indeed been popular and arguably has satisfied the South Korean people's pride, especially because it signals a more significant role for the country in the international arena. After acquisition of the *King Sejong the Great*, the *Joongang Ilbo* conducted a survey of people's opinions of military expansion, and 72.1 percent of respondents had a positive impression. Building military capability, especially that of navy, captures people's attention. Nonetheless, since military expansion takes a lot of time and requires an enormous amount of money, its efficiency should be carefully analyzed. With the advent of the Lee Myung-bak administration, changes in South Korea's circumstances accelerated a revisiting of the DRP.

III. JEJUDO: KOREAN NAVY'S FURTHER STEP TO SOUTH

The ROKN's expansion is reflected on the ground with its plans for a new base on Jeju Island (Jejudo). Jejudo is the southernmost island in South Korea, located in the East China Sea (or South Sea). The ROKN has naval bases around the Korean peninsula, such as in ports of Pyeongtaek, Jinhae, and Busan. But unlike these existing bases, the new one on Jejudo is farther afield from mainland South Korea, 100 kilometers distant, and thus reflects a new step for the ROKN.

The plan to build a naval base on Jeju was first raised in 1993. It was during the Roh administration in 2005, however, that substantial discussion and preparation took place. As if to symbolize President Roh's "balancer" argument, Jeju is located between Japan's Kyushu Island and China's east coast. Jeju is also close to Socotra Rock (in Korean: Ieodo), which is an epicenter of potential territorial dispute between South Korea and China. In addition, the strait between Jeju and the ROK mainland is the sea that the DPRK navy has to pass through when it moves vessels from its east to west coasts or vice versa. Jeju therefore has strategic value for South Korea.

The ROK Ministry of Defense plans to construct a new port on the island that can accommodate the newly organized Maritime Task Flotilla, with estimated completion in 2014. Resistance to building the base on Jeju is ongoing. However, because the successful opening of the military port is connected to the future of South Korea's blue-water navy—and is a litmus test for how serious the government is about such expansion—the development of Jeju's naval base is likely to continue.

IV. THE CHEONGHAE UNIT: AN ECONOMIC SUPERPOWER AND ITS NAVY

In the beginning of 2009, when I worked in Japan's Ministry of Defense, the ROKN was preparing to dispatch a battleship to escort commercial vessels in the waters off Somalia and to patrol the area for piracy. China had sent ships in December 2008, and both Japan and South Korea were about to send their own battleships, as if competing with each other. As a result, on March 13, just one day before the deployment of the Japanese destroyers, the ROK's so-called Cheonghae Unit, newly established for antipiracy measures, departed Busan. This unit consisted of one destroyer with one helicopter. This was the first time in ROKN history that military operations were conducted miles away from the Korean peninsula, and it was a milestone symbolizing the ROKN's transition to a blue-water navy.

In the years since 2009, some dramatic incidents have occurred, such as hostage rescues from pirates, which has given ROKN expansion a *raison d'être*. During the 1970s, the Middle East was not a security concern of South Korea. The ROK was a poor country desperate for foreign currency, and so many South Korean workers left to work and earn money under unfamiliar, harsh environment in the Organization of the Petroleum Exporting Countries (OPEC) countries of the Middle East. Twenty years later, the Middle East has become a crucial area for the rapidly developing South Korean economy, which deeply depends on

foreign trade and Middle East oil. The presence of the ROKN forces in the Gulf of Aden for securing this economic lifeline demonstrates how South Korea and the ROKN came to play a key role in the international arena.

Pirates are traditionally regarded as the “enemy of all mankind,” and the UN Convention on the Law of the Sea gives countries the authority to fight piracy. For South Korea, the Gulf of Aden off of Somalia is a crucial sea lane that connects Europe and Asia. Now that South Korea heavily depends on foreign trade for its economic prosperity, it is not surprising that it perceives a military interest in improving the security of the area. There are also US, NATO and EU naval forces in the region, along with the Chinese, Japanese, and ROK navies.

The trilateral deployment of the Chinese, Japanese, and ROK navies has provided a unique opportunity for the three countries to pursue the same objective. Indeed, visits to each other’s ships have taken place. Not only on ceremonial level, but also on a substantial level, cooperation between the ROKN and the Japanese navy is ongoing. For example, a Japanese patrol aircraft shares its reconnaissance information with the ROKN ship, and in at least one instance the helicopter dispatched from the Japanese destroyer closely cooperated with the ROKN in order to deal with a suspected pirate vessel. An ROKN officer who participated in the Cheonghae Unit told me that during the operation off the coast of Somalia there were opportunities to meet with officers from the other countries, such that he was able to enhance mutual understandings.

The ROKN, Japan’s Maritime Self Defense Force, and China’s People’s Liberation Army Navy have also cooperated on escort missions, which enable commercial vessels to pass through dangerous areas safely. Needless to say, with limited forces, each navy cannot provide enough escorts for their own country’s ships. Therefore, many merchant vessels have been protected by foreign navies. Such cooperation in foreign waters might influence what is possible in home waters, where the interests of South Korea, Japan, and China are different from each other. But the countries are deeply connected to each other via trade. As economic powers that have an interest in securing sea transportation, South Korea, Japan, and China might share similar objectives. For the ROKN, the Cheonghae Unit could be a breakthrough for future cooperation.

V. COLLISIONS WITH THE DPRK AND THE REEVALUATION OF THE DRP

On March 26, 2010, South Korea’s *Cheonan* sank in the Yellow Sea. Forty-six of the 104-member crew were killed. In May of that year, the Joint Civilian-Military

Investigation Group issued a report concluding that the sinking of *Cheonan* was caused by a DPRK torpedo attack. This incident had an enormous impact on the ROK navy and affected the fate of the defense reform plan. The ROKN was criticized for its inability to conduct antisubmarine operations. For example, Michael Finnegan, senior research associate at the National Bureau of Asian Research, argued in a 2010 article in the *JoongAng Ilbo* that the ROKN should immediately enhance antisubmarine warfare capability instead of purchasing expensive Aegis destroyers.

During the aftermath of the *Cheonan* incident, Kim Dong-sung, a Grand National Party member who sits on the National Assembly's Defense Committee, criticized the branches of the ROK military for each seeking to maximize its own share of the defense budget. This made each service claim to need cutting-edge weaponry, without consideration of actual requirements; fancy and new weaponry, such as Aegis capability and *Dokdo*-class ships, can easily capture politicians' attention. As a result, the relatively simple step of improving the navy's sonar system was not prioritized. In this way, the *Cheonan* incident provoked criticism that the ROKN had prioritized purchasing large and expensive vessels based on the logic of bureaucracy rather than military reality.

Even prior to the *Cheonan* incident the defense reform plan faced another challenge: increasing military spending by an unprecedented 9 percent a year. Since the 1980s, as the South Korean economy underwent economic growth, the defense share of gross domestic product (GDP) had declined. In 1981, the defense budget was 5.54 percent of GDP, a relatively high percentage that is not surprising given the Cold War context and the ongoing DPRK threat, such as the later 1983 Rangoon bombing. As South Korea became affluent, the defense percentage of GDP plunged. In 2002, when Roh Moo-hyun won the presidential election, the figure was at its lowest, at 2.39 percent. However, under the Roh administration this trend reversed, with defense spending reaching 2.79 percent in 2009. This fluctuation indicates that the increase of military spending per GDP caused a big shift from its long-term trend.

The worldwide economic downturn of 2008 also hit South Korea. Although the ROK economy suffered relatively limited damage and showed rapid recovery compared to other developed economies, the DRP had to be reconsidered. For President Lee Myung-bak, who had positioned himself as "CEO President" during the 2007 presidential campaign, the expanding military expenditure had to be reevaluated. The annual increase in the defense budget was lowered, from 7.1 percent in 2009 to 3.6 percent in 2010, which meant that the DRP faced a

serious shortfall in funding. Indeed, the *King Sejong the Great* was unable to fully stock its arsenal. Similarly, the *Dokdo* was unable to operate with a full regiment of helicopters. Such limitations have the potential to substantially undermine the capability and strategic value of the ships.

The DRP was officially revised in 2009. The target year for full implementation was extended from 2020 to 2025. The proposed number of future Aegis destroyers was reduced from six to three. And the acquisition of the next *Dokdo*-class ship was postponed for the time being. In this way, the DRP revision downsized the ambitious plan of building a larger navy, reflecting the reality of budget constraints. There might be another revision of the DRP in the near future. However, as of 2012, this downsized DRP will navigate the ROKN to the next stage.

VI. CONCLUSION

There are multiple issues surrounding both the idea of an ROK blue-water navy and its potential and implications for foreign policy. First, the idea can be attributed to a mixture of ideology and national pride. The Roh administration had as an ideal the pursuit of a more independent national defense. President Roh did not consider building closer relationships with countries such as the United States and Japan. Rather he dreamed to position South Korea as a “balancer” between Japan and China. South Korea had to expand its navy if the United States and Japan were not worth trusting. The change of diplomatic relations that occurred with the Lee administration encouraged revision of the ROK defense plan, which in turn has changed the trajectory of the ROKN.

Second, the reasons for a blue-water navy can be seen as a resulting from South Korea’s increasing economic power and the larger presence of the country in global politics. But neither the *Dokdo* assault ship nor the *King Sejong the Great* participated in the Cheonghae Unit that was sent to the coast of Somalia, in part because these ships’ advantages are not required to conduct escorting mission of commercial vessels; this indicates that the practical needs of a blue-water navy conflict with what people and politicians want to see. Smaller destroyers are enough to thwart pirates. However, these smaller ships do not tend to excite politicians and the general public. The more near-to-hand DPRK threat should also not be underestimated. The ROKN is tasked with finding a way to meet the demands of being both a functional navy of an economic power and a navy that South Koreans can take pride in.

Third, as the Cheonghae Unit showed, the ROKN can potentially play a larger role in the international arena and thereby build closer relationships with other navies, especially Japan's. Because of the countries' historical backgrounds and past disputes, there are many hurdles to cooperation between South Korea and Japan. But as the 2009 revision of the ROK defense plan indicates, it could be a burden for South Korea to continue building a large navy, suggesting instead a future dependence on Japan and US navies for regional security. South Korea must keep its economy in good shape so the ROKN should pursue building its power in a smart way, not simply to satisfy national pride.

The OPCON Transfer Debate

By Shelley Su

I. INTRODUCTION

The history of joint operation between the US and Republic of Korea (ROK) militaries dates back to the Korean War and South Korea's inception. At the time, the first ROK President Syngman Rhee (Yi Seungman) placed ROK forces under the control of the United Nations Command (UNC), in which US forces played a significant role. After a military coup in 1961, the UNC's authority was limited to "operational control." In 1978, the Combined Forces Command (CFC) was created, and operational control was shifted to the commander in chief (CINC) of the CFC. By December 1994, the CINC transferred peacetime operational control of South Korean units to the ROK Joint Chiefs of Staff.

This essay addresses the last phase of this process. It first provides an overview of the wartime operational control (OPCON) transfer that was proposed under Presidents Roh Moo-hyun and George W. Bush in 2007. It then discusses the goals of each country and assesses the merits of the three positions on the transfer: to carry out the OPCON transfer on the initially agreed upon transfer date; to reject the OPCON transfer altogether; or to delay its implementation. This essay further examines why the Obama and Lee administrations chose delay as the best course of action.

II. OPCON TRANSFER BACKGROUND

OPCON Transfer Conceived and Delayed

The final step in achieving full autonomy for the ROK military is to return wartime OPCON to South Korea. However, given the continued threat the country faces from the Democratic People's Republic of Korea (DPRK), it will be difficult to execute a widely supported, seamless, and secure transition. The ROK President Roh Moo-hyun came to power on a largely anti-American platform in 2003, and it was his administration that first proposed the handover in 2007. Since then, there has been much controversy over the necessity and prudence of such a step. On the one hand, the transfer can be seen as a testament to a more capable and bolder South Korea, ready to fend for itself. On the other hand, the transfer can be interpreted as a sign of abandonment by South Korea's staunchest

supporter, the United States.

There is something to the argument that the original proposal for dissolving the CFC and transferring OPCON was borne out of domestic and self-interested politics, not on-the-ground security considerations. During his campaign, President Roh proposed restoring sovereignty to South Korea by regaining wartime OPCON from the United States, and he called for a feasibility study of such a transfer as soon as he was in office. This study evolved into the current Strategic Transition Plan. Similarly, in the United States, Lt. Col. James Minnich suggested in his May-June 2011 *Military Review* article that President George W. Bush and Defense Secretary Donald Rumsfeld saw the transfer as an opportunity to increase the US military's strategic flexibility in the region. The transfer does not stem from new military circumstances faced by either nation. In Nam Chang-hee's 2007 *Korean Journal of Defense Analysis* article, he reports that conservatives and retired generals lambasted President Roh's plans, accusing him of having a poor understanding of the nature and effectiveness of the current CFC structure. It was yet another example of Roh's mishandling of the US-ROK alliance and a populist pandering to his young generation of supporters. In his keynote address at an American symposium addressing the OPCON transfer, Hwang Jin-ha (a second-term Grand National Party Assemblyman) described the proposal as two nations pursuing their respective interests based on their own strategic missions, not on common objectives for the future; and thus it was an inappropriate agreement.

By late 2009, under the Lee Myung-bak administration, murmurs of delaying the transfer began to emerge. ROK Minister of National Defense Kim Tae-yong said in January 2010 that the proposed transfer date of April 17, 2012 was perhaps the "worst time" imaginable given the DPRK's nuclear weapons posture. After private discussions at the Toronto G-20 in June 2010, Presidents Obama and Lee announced that the OPCON transition would be delayed by three years, to December 2015.

Executive branch ROK officials are hesitant to openly voice their opinions on the OPCON transfer delay, while members of the National Assembly are more forthcoming. Questioned about the transfer, one conservative assemblyman stressed the importance of balancing against China's "southern approach" in foreign policy; he did not consider the delay to be a disadvantage for South Korea. Rather, it was a strategic necessity. On the progressive side, Assemblyman Chung Dong-young, in a November 2011 interview, expressed disappointment and lamented that the OPCON transfer had been delayed.

Transition Plan

The so-called Strategic Alliance 2015 is a roadmap for the OPCON transfer that came out of the Two-plus-Two meetings held in July 2010 between the United States Secretaries of State and Defense and the ROK Foreign and Defense Ministers. In addition to detailing the transition, the plan also outlines new policies for US bases in South Korea. According to a 2010 whitepaper by the ROK Ministry of National Defense (MND), the United States and South Korea will replace the CFC with a “strong new combined defense system” following the OPCON transition. The transfer will disestablish the CFC and put the ROK Joint Chiefs of Staff in the lead, with a newly created US-Korea Command (KORCOM) as the supporting command. Each commander will have control over his or her own forces. Testifying before the US House of Representatives Armed Services Committee in April 2011, General Walter L. Sharp stated that the additional time provided by the delay will allow for synchronizing a “variety of ongoing transformation initiatives of which OPCON transition is just one”; the delay further allows time for the ROK military to strengthen and reinforce its capabilities in intelligence, operations planning and execution, and joint battlefield management.

A smooth transition is of utmost importance for both the United States and South Korea. The United States will provide bridging capabilities for those areas of the ROK forces that are not yet fully functional by the time of the transition, and US forces will continue to act as a deterrent against North Korea. Additionally, the United States will maintain a four-star-general position in South Korea to ease concerns and ensure effective coordination. Both sides are working diligently to meet the new 2015 transition deadline.

Security Goals

The OPCON transfer is both a political and a security issue, and it is impossible to untangle one from the other. The transition will have a direct and immediate impact on the entire Asia-Pacific security architecture and on military tensions between North and South Korea. The OPCON transfer has more than one goal and the transition will have many positive effects, but there will be downsides to achieving these milestones. On the bright side, many US and ROK military goals overlap. Both countries hope to continue their strong alliance. Both also want South Korea to have a strong and self-sustaining military capable of defending itself against the North. Both want to deter DPRK aggression.

Where US and ROK goals begin to differ is on the political side. Progressive voices in South Korea want to stress sovereignty. This might interfere with the US goal of a continued strong presence in Northeast Asia, which includes US forces in both South Korea and Japan. The United States also hopes to gain some strategic flexibility; it does not want constraints placed on its forces deployed to South Korea (US Forces Korea, or USFK). Many South Korean opponents of the OPCON transfer see the CFC and USFK as signals to the rest of the world of the strong US commitment to the Mutual Defense Treaty and to ROK security. In the long run, the United States is perhaps most concerned with North Korea's nuclear weapons threat. Although the nuclear threat also affects South Korea, the South also has to live with the consequences of a potential DPRK collapse. This means that the United States is more likely to focus on the nuclear problem, while South Koreans are more concerned with mitigating the likely chaotic collapse of North Korea. Consequently, South Korea is more likely to want to engage the North in plans for unification rather than only planning for securing nuclear weapons and walking away, as the United States might reasonably hope to do.

Some factions in both the United States and South Korea favor an immediate OPCON transfer, while others oppose the very idea of such a transition. A third group supports delaying the transition until at least December 2015. Such a delay is the best possible outcome because it best addresses both sides' military and political concerns.

III. AN IMMEDIATE OPCON TRANSFER

Perceived Readiness

The main argument for a prompt transition of operational control to South Korea is the positive reflection it would have on the abilities of the ROK military. It would give South Korea, which is quickly becoming a "first-class" country, the dignity and sovereignty it deserves. The OPCON transfer would be a vote of confidence underscoring the great military and economic strides that South Korea has made. A self-sustaining force is a more credible deterrence than the status quo. In March of 2010, Michael O'Hanlon of the Brookings Institution described the ROK military as among the top 10 in the world. To allay fears in South Korea, General Sharp, commander of the CFC, has made reassurances that the transfer will not weaken the US commitment to provide reinforcement on the Korean peninsula, regardless of the changing US force structure.

Former Defense Secretary Robert Gates, in a 2009 visit to the ROK, referred to

the OPCON transfer as South Korea taking the “proper lead role in the defense of its national territory.” Former Defense Secretary Rumsfeld, in response to President Roh’s suggestion of the transfer, said that it was only “natural” for South Korea to take back the reins, and Rumsfeld suggested to the ROK leader that he was “pushing an open door.” If the United States believed the ROK military was unprepared for the transition, and that it would put US soldiers at risk, it would certainly not push for the transfer.

Defense Spending

A fast-tracked, firm deadline for the OPCON transfer would encourage South Korea to assume responsibility for military preparation and defense spending, which would allay US concerns about the ROK free riding on US security. The United States would like to see South Korea share more of the burden of acquiring improved equipment and weapon systems that are compatible with US systems. ROK forces as a whole need improved war-fighting capability, but this is especially true for the navy and air force; likewise, more resources are needed for missile defense and state-of-the-art C4ISR (command, control, communications, computers, intelligence, surveillance, and reconnaissance). South Korea’s commitment to the OPCON transition can be measured through its defense spending and specific military upgrades.

Heritage Institute scholar Bruce Klingner argues in his July 2010 *Korea Times* article, “OPCON Transfer: Timing Isn’t Everything,” that one of the underlying deficiencies of the transfer plan is years of underfunded defense in South Korea. President Roh’s Defense Reform Plan (DRP) was an ambitious military modernization plan meant to turn the ROK military into a leaner and smarter force by 2020, putting more emphasis on sea and air capabilities. It was based on the collective long-term plans of the three military services, the Ministry of National Defense, and the Joint Chiefs of Staff. However, the DRP has been undermined by funding shortfalls. According to Klingner, the plan, conceived in 2005, necessitated approximately \$505 billion over the course of 15 years, which would have required a 9.9 percent military budget increase annually from 2006 through 2010. However, the average increase over those years was only 7.2 percent, and the MND only requested a 6.9 percent increase for the 2011 military budget. The DRP is now dangerously underfunded and behind schedule.

C4ISR spending is not called out in most measurements of defense spending, so it is difficult to assess progress in that area, but these kinds of resources are increasingly important as defense becomes more technological, and it is clear

that South Korea is not budgeting enough for this category. The United States wants to support the OPCON transfer by bridging capabilities and supplying big-ticket items, thereby allowing the ROK military to focus on improving computers and networking. However, South Korea has been more interested in acquiring big defense items for itself rather than focusing on C4ISR. The *Chosun Ilbo* reported in its November 2011 article, “US Worries About Growing Korean Arms Exports” on US concerns about ROK intentions to develop a defense-systems export industry. The United States has even suggested that South Korea might be developing such an industry based on stolen US military technology, a suspicion that arose after South Korea illegally disassembled a Tiger Eye (a key component of the F-15K fighter jet). If such actions are taking place at the expense of C4ISR improvements, the ROK military should reprioritize. The delayed OPCON transfer has given Seoul a second chance at meeting its own military goals, but it must somehow make up for budget deficiencies in time for the transfer in 2015 or risk being dangerously unprepared.

Domestic Realities in Times of Duress

ROK officials are not always strong supporters of US operational control in actual times of duress. In his May 2010 Center for Strategic and International Studies commentary on the OPCON transition, Raymond DuBois describes a serious security breach that happened in 1996 during President Kim Young-sam’s administration. A DPRK defector flew a plane over the Demilitarized Zone into South Korea, and President Kim angrily called for an immediate meeting at the Blue House with everyone “directly responsible for the defense of ROK.” Shockingly, no one from the Combined Forces Command was invited. “As far as the Blue House was concerned,” writes DuBois, “no one really considered the US CFC commander to truly have OPCON, and they further demonstrated that they did not consider him to be a key player in the defense of the peninsula.”

Do South Koreans genuinely trust that the United States will be there for them when the chips are down? Or is South Korea only using US forces as a deterrent against the DPRK and not seriously considering a day when the CFC may actually have to fight together shoulder to shoulder? If South Korea truly values the United States’ continued wartime OPCON, it might insist that CFC headquarters be located adjacent to the MND in Seoul rather than being relocated to Pyongtaek, as is the current plan. If South Korea is using US forces only for show, even to a limited extent, then the situation is at best a waste of both sides’ efforts and at worst dangerous to CFC service members. The CFC and wartime OPCON must be taken seriously. Suh Jae-jung of Johns Hopkins

University describes the ROK military in his 2007 book, *Power, Interest, and Identity in Military Alliances*, as in fact never having had its own doctrine because it has always adopted US military doctrine, regardless of the fluctuations in the actual threat from the DPRK. This cannot possibly be wise for the ROK military. In theory, the CFC and US OPCON may seem ideal, but in reality, it may be a moral hazard for South Korea. The OPCON transition would force the ROK military to be more introspective about its own doctrine and methods, pushing it toward greater self-reliance.

Ideology and Nationalism

Another interesting argument in favor of an immediate OPCON transfer is philosophical, as put forth by John W. Bauer, previous strategist in Special Operations Command Korea in “A Philosophical Case for OPCON Transition on the Korean Peninsula,” published in a 2011 issue of *Joint Forces Quarterly*. Bauer underscores how ideology and nationalism play a large role across the Korean peninsula. The DPRK regime consistently attacks the United States for its “imperialism” in South Korea and the ROK “puppet” government for falling into the US imperialist trap. With the removal of US wartime control over the ROK military, the DPRK loses the substance of this argument. An OPCON transition would thus challenge North Korea’s vision of the world. Further, South Korea could then actually be seen as a compelling alternative in the eyes of the starving and disenfranchised North Korean people.

Looking even farther into the future, in a DPRK collapse and unification scenario, such unification would go more smoothly if the United States was not in the picture. Successful unification must appeal to nationalism, and this would be difficult if the United States still had wartime OPCON of the ROK military. The North Korean people have been taught to believe that Americans are their mortal enemies, so Bauer argues that “the only true remedy for the North’s propaganda apparatus and its ideology of regime control is an ROK government firmly in the lead.” The ROK military must be able to function and make decisions completely independent of the United States or risk DPRK propaganda surviving in the minds of the North Koreans post-unification.

A Natural Course and Strategic Flexibility

The OPCON subordination of one nation’s military to another is not a permanent construct. Both the ROK military’s perpetual dependence on the United States and the weight of the US obligation are unhealthy for the alliance.

Changes to the CFC can be made while still maintaining the integrity of the Mutual Defense Treaty. Some left-wing scholars have suggested that ROK conservatives seek to keep America “hostage” through the CFC, which they argue is more anti-alliance than pro-alliance. In a way, this structure also keeps the ROK military hostage. In the event of a US conflict with China over Taiwan, for example, South Korea fears that it may be dragged into the fight because of its commitment to the CFC and US Forces Korea. Furthermore, when conditions change in the region and a large US military presence in South Korea no longer makes sense, Lieutenant Colonel Minnich predicts that both countries will be “scrambling to justify the future relevance of the alliance,” under heavy criticism from their citizens. Planning for the seemingly inevitable (albeit far-off) departure of US troops from South Korea is underway, for example, in the strengthening of US military ties with Australia; the United States will not be left without a presence in the Asia-Pacific region.

The OPCON transfer will unfetter US forces stationed in South Korea for global use and will finally transition USFK from leading to supporting the ROK military. The United States’ hands are currently tied in the region because it cannot use US troops in South Korea for purposes beyond conflicts on the Korean peninsula, because its forces are “deployed” to South Korea, not “stationed” there. Furthermore, the OPCON transition and CFC dissolution will remove the burden from US commanders of deciding where and how ROK service members should fight. The transfer will allow the US military more strategic flexibility and, as Minnich suggests, will “recast the ROK-US alliance as a comprehensive, strategic alliance for the 21st century” that addresses not just the DPRK problem but the security of the entire Asia-Pacific region. According to the US Department of Defense’s 2010 Quadrennial Defense Review Report, “when fully implemented, this change will enable forces to deploy from Korea, helping to expand the pool of available forces for global contingencies.”

Risks of an Immediate Transfer

The arguments for a prompt OPCON transfer are alluring because they represent certain ideals and also convenience, but ideals do not always prevail in the real world, and the most convenient option is not always the best one. Realistically, an immediate transfer is imprudent because it is too high a risk. ROK officials preach readiness but often do not seem to know where the OPCON transition actually stands. US officials also cannot be certain that an immediate transfer will truly pressure South Korea to meet its own defense spending and military modernization goals. A hasty transfer could leave South Korea vulnerable and

unprepared, with the newly divided forces not fully synced against a very real and continuing DPRK military threat. Such haste would also leave the United States with no sound reasoning to maintain its strong presence in mainland Northeast Asia. The United States may want strategic flexibility in the region, but the greatest threat in Northeast Asia is still North Korea.

IV. INDEFINITE POSTPONEMENT OF AN OPCON TRANSFER

Risks of Interoperability and Joint Operation Atrophy

Command structures are not just about logistics. If they are not coherent, command structures can put lives at risk during wartime. Desert Storm is a recent example of how crucial it is to maintain clear control over a wartime battlefield. Twenty-five percent of American casualties in that conflict resulted from friendly fire. In a modern high-speed, high-precision battlefield, knowing who are enemies and who are friends is vitally important. Sub-theaters are also not easy to separate out within an overall theater of conflict because lines between land, air, and naval operations may overlap. Taking the Desert Storm case, there was unified command, but friendly-fire killings were still numerous. Imagine, then, how complex structures of communication and control would affect risks when engaging with the enemy in the context of the Korean peninsula. The remarkable engagement of US and ROK forces that has been built up over decades would be lost in a transition to ROK leadership, which is a strong argument for postponing the OPCON transfer. As an example, ROK officers currently undergo English-language training, but after the CFC dissolution and OPCON transfer, perhaps such a requirement would be less enforced, and operational communication would suffer.

A Winning Structure

Another argument in favor of postponement is that the current joint structure cannot be improved upon. All ROK units are currently tied into the CFC, which serves as the coordinating body for Seoul's military. This seamless and transparent structure has proven effective and is the best system for deterring and defeating North Korea. Why replace it with two separate command structures that will work together quite differently and likely less effectively? Bruce Bechtol at the US Marine Corps Command and Staff College argued in his October 2011 testimony to the US House of Representatives Committee on Foreign Affairs that the OPCON transfer will create unnecessary bureaucracy and complication, with increased boards, coordination centers, and bureaus. The

transition will thus leave the US-ROK alliance worse off.

Michael O'Hanlon of the Brookings Institution categorically opposes the OPCON transfer, insisting that the command should remain exclusively in American hands for the time being. In a June 2010 Independent Task Force report from the Council on Foreign Relations, O'Hanlon writes,

I believe [the OPCON transfer] is a misnomer; current plans would not achieve OPCON transfer [as] much as the bifurcation of operational control between US and ROK forces on the peninsula, which would significantly complicate wartime operations... Unity of command is such a central principle to successful military operations that I cannot personally support the decision to dismantle it within the US-ROK alliance. Delaying the transfer beyond 2012... might mitigate the problem but does not solve it.

US Presence in Asia

If one of the unstated goals of the United States in South Korea is to have a strong presence in mainland Northeast Asia, beyond countering the DPRK and to perhaps balance China, then handing over OPCON makes the purpose of US troops deployed to South Korea a question for foreign observers. By recognizing the capacity of the ROK military in wartime, the OPCON transfer might encourage Beijing to wonder just what, or whom, the US military presence on the Korean peninsula (in addition to US bases in Japan) is geared toward. If the United States hopes to stay in the region and is using the continuing ROK-DPRK conflict as a crutch, then the OPCON transition would undermine the US argument for staying in South Korea.

Risks of Indefinite Postponement

It is unrealistic to indefinitely put off the OPCON transfer because serious planning and execution have already taken place. Furthermore, such a delay plays into the hands of DPRK rhetoric about US imperialism. It encourages free riding from the ROK military on US security and prolongs US overextension abroad and limits US strategic flexibility in the region. An indefinite delay also keeps South Korea from achieving full autonomy over its military. The OPCON transition and CFC dissolution may violate the key military precept of unity of command during hostilities, but hostilities have been ongoing for more than

50 years. It does not make sense to hold onto this position indefinitely simply because of North Korea's unpredictability.

V. A TEMPORARY DELAY OF AN OPCON TRANSFER

A temporary delay is the most reasonable option for the OPCON transfer plan. The bottom line is that the ROK military will not be prepared by 2012 to take over wartime operational control, and there is no pressing reason for pushing the transfer to happen at that time. Especially in light of recent DPRK provocations (the 2010 sinking of the *Cheonan* and artillery shelling of Yeonpyeong Island), as well as the original transfer date being in an ROK election year and close to the 100th anniversary of Kim Il-sung's birth, the delay was a practical decision in the best interests of both the United States and South Korea.

South Korean Dissent

Early on in OPCON transfer planning, ROK conservatives lambasted such a transition altogether, arguing that it would weaken the deterrence against the North. Opponents gathered 10 million signatures in protest against the measure. In the National Assembly, almost all Grand National Party representatives, which accounts for almost half the legislature, convened a parliamentarian's group and signed a letter opposing the OPCON transfer, which was sent to both the US Secretary of State and Secretary of Defense.

In a 2006 Gallup study, conducted while discussions of the OPCON transition were ongoing, 71 percent of the public was strongly against US forces leaving South Korea. Of course, US forces leaving South Korea is a much more extreme action than an OPCON transition, but ROK sentiment clearly preferred retaining a US presence. The strength of this preference is even more telling because the polling was done during a time when South Korea's public opinion of the United States was at a low point. The Pew Global Attitudes Project does not specifically show the 2006 percentages for favorable/unfavorable ROK public opinion toward the United States, but relatively speaking, the favorability ratings from 2002 to 2007 were low (between 46 and 58 percent) compared with 79 percent favorability ratings more recently in 2010. Even in the early 2000s, with such low favorability, South Koreans wanted US forces in their country. Asked in 2006 if they believed that South Korea could handle its own national defense and security, only 27 percent of respondents said yes, while 66 percent said that a US withdrawal would have a large negative impact on the stability of Northeast Asia.

The South Korean public wants a US military presence in their country for the foreseeable future, largely because of the perceived threat from North Korea. As long as the United States wishes to honor the Mutual Defense Treaty, as long as the DPRK threat exists, and as long as the ROK public expresses a preference for US OPCON over modernizing the ROK military, then the OPCON transfer should be delayed.

Military Realities

The DPRK conventional military forces are still very much a threat to South Korea, despite North Korea not having maneuvered in years and despite the increased strength of ROK conventional forces. Bruce Bechtol says that the DPRK military has continued to focus on its conventional forces even as it has built up its nuclear program; and US and ROK studies suggest mass civilian casualties (up to 200,000) in Seoul would occur on the first day of conventional warfare with North Korea. The ROK military needs more transport aircrafts. In the event of the breakout of war, US forces will primarily supply air support. Currently, the ROK Air Force only has ten C130s, which means that it severely lacks soft and hard transport. At the current level of readiness, an ROK special operation force going to North Korea would have to rely on the US Air Force for transport.

Still, despite South Korea's continued need for US military support, a myth about the ROK military's lack of power and control should be dispelled. South Korea now has, and will also have during wartime, control over its own forces. Bechtol explains:

In wartime and when the national command authority in Seoul agrees to it, the president in South Korea has the final authority, based on the advice by the Minister of National Defense and the Joint Chiefs, designated ROK forces shot to the commandment of CFC, who then answers to both the US and South Korea National Command Authorities and carries out their strategic decisions in command of ROK and the US forces as they carry out war fighting operations under a unified, combined force.

South Korea is not as constrained by the US military as opponents of the OPCON transfer delay might believe. South Korea is more likely to be swayed by US soft power than to begrudgingly acquiesce to US command during wartime

as a result of US operational control. In any case, US and ROK discord is unlikely, given that both sides agree on most defense and security issues.

Lastly, the fact that nuclear weapons are involved makes the stakes that much higher for cohesiveness in operations. In a DPRK collapse scenario, 8–10 nuclear weapons will have to be secured in North Korea before they are tampered with, fired, or sold to enemies of the United States. Will the ROK military be prepared to secure the weapons quickly and safely on its own? There is no doubt that the ROK military is strong. It can imitate US forces and carry out operations very successfully. However, the ROK military has not mastered operational planning for these types of nuclear-recovery operations, nor the invisible mechanisms and logistics often necessary on the civilian side. The ROK military is actively working toward reaching this level of military modernization and cohesion, but it has fallen behind on defense spending and on meeting goals and deadlines. The South Korean military bureaucracy is not yet strong enough to handle such complex operations, and until it is, a hasty OPCON transfer is a bad idea.

Timing and Permanence

The original OPCON transfer date of April 2012 is simply not a practical target. With the still-looming DPRK nuclear threat, the 100th anniversary of Kim Il-sung's birth, Kim Jong-un as the new DPRK leader, and South Korea's election year on the horizon, North Korea might be emboldened by an OPCON transition to strike at South Korea. As long as North Korea is a nuclear state, an OPCON transfer is going to be a dangerous move.

While those inside the conservative ROK government and military stress readiness by 2015 and the political suicide linked to another delay, outsiders are dubious. The unpredictability of South Korea's domestic politics and relations with North Korea will always have an impact on how and when the transfer moves forward. Unless a serious change in geopolitical circumstances requires the United States to retain wartime operational control, it seems that the OPCON transfer will take place sometime in the near future, if not in December 2015. Once South Korea takes control of its OPCON, such control can likely never be returned to the United States. The transition has been under discussion for almost a decade, and both sides have been preparing for it, so it is highly unlikely that the transfer will go back to "indefinite" status. Risks associated with a further delayed OPCON transfer are that it will be seen as a political fumble for both or either side, a chance that the transfer will not take place for a prolonged period, and that the result might be an inferior and bifurcated military force.

VI .DELAY AS THE FINAL OUTCOME

After discussions at the highest levels in both countries, the decision was made to delay the OPCON transfer. Nevertheless, the transition should still happen in the near future, either after ROK forces have achieved the recommended capability (hopefully by December 2015, a more likely possibility) or the DPRK nuclear program is no longer a threat (a less likely possibility). Furthermore, the reasons for the delay should be clearly explained to the South Korean people. The delay gives the ROK military time to prepare itself for OPCON and gives both the United States and South Korea time to better sync the new forces system in the face of the continuing DPRK threat. In the meantime, the ROK military can work on its necessary procurement and readiness training, and US Forces Korea can continue to support and provide bridging capability. Although the OPCON transition risks creating two less integrated forces, the transfer is necessary for the sake of placing confidence in the ROK military and giving ROK forces the full sovereignty they should ultimately have. No one can predict or plan for future DPRK actions, and the Combined Forces Command cannot wait indefinitely simply because the threat continues to exist. The US and ROK militaries must move forward with their OPCON transfer plan, but with caution in light of the risks the transition entails.

Since the decision to delay the transfer was made in June 2010, and since the Yeonpyeong shelling incident in November 2010, ROK officials have been reticent to give opinions about the OPCON transition delay. Most statements have been about the progress being made. Both US and ROK forces have continued to work toward the transfer, despite political party changes in both countries. This is a good sign, because it suggests that the issue is not as polarized as one might imagine. Both countries understand that they are allied nations even when presidential administrations change. Both sides recognize that a commitment has been made; for better or worse, they are working toward making the transfer happen despite the “glacially slow” progress as Bruce Klinger described in a July 2010 *Korea Times* article on transforming the military relationship. The OPCON transfer was alluded to in the United States’ 2010 Quadrennial Defense Review and was featured in the South Korea’s 2010 Ministry of National Defense whitepaper. Since the 2010 decision to delay the OPCON transfer, there have been no suggestions of a further delay, but it is too early to say whether or not another delay will happen. Currently, the only issues holding back the transfer are South Korea’s insufficient defense spending and North Korea’s continuing unpredictable, violent, and aggressive actions.

VII. CONCLUSION

In the end, the original reasoning for the OPCON transfer should not dictate an assessment of how wise the transfer is or when and how it should take place. It does not matter that the transfer idea was initiated during a time of anti-US sentiment in South Korea, as both countries have now embraced it. What should be of greatest consideration now is where the transfer is headed and how best to execute the policy in terms of preparedness, and timing in the midst of continuing outside threats. The OPCON transition will strengthen the US-ROK alliance while improving sovereignty for South Korea, increasing strategic flexibility for the United States, and hopefully resulting in a stronger and more self-sustaining ROK military. The transfer plan as outlined will also prove to South Korea that the United States remains committed to South Korea's security, even when the United States no longer holds OPCON. The transfer will also require the United States to rethink its force posture in the region, a long overdue reevaluation that might benefit US forces.

Alliances provide a net benefit for the countries involved, but not without sacrifices, because they also require diminished sovereignty. Governments in an alliance have to at times make compromises against their fundamental interests in order to maintain the relationship. In the case of the United States and South Korea, the greater goal of security and stability in the Northeast Asia region is worth the sacrifice the alliance requires. The Obama and Lee administrations decided that the delayed OPCON transfer was the option that best met the goals of both countries, and it is the most sensible course of action for the alliance to take.

Appendix I

OPCON Transfer Timeline

- February 2007 OPCON transfer agreement made during the Roh and Bush administrations' Security Consultative Meeting, with the transfer date set for April 2012
- February 2008 President Lee Myung-bak (GNP) enters office
- October 2009 Statements made after the Security Consultative Meeting suggest the OPCON transfer is proceeding on time despite whisperings of a possible delay
- January 2010 ROK Minister of National Defense Kim Tae-yong declares 2012 the "worst time" for the transfer, given the DPRK's nuclear weapons posture
- March 2010 Sinking of the *Cheonan*
- June 2010 Decision to delay the transfer to December 2015 is announced
- November 2010 Artillery shelling of Yeonpyeong Island
- April 2012 Initial OPCON transfer date
- December 2015 Current proposed OPCON transfer date



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