

# Positive Economic Inducements in Future Nuclear Negotiations with North Korea

BRADLEY O. BABSON

DECEMBER 2015

NORTH KOREA'S  
NUCLEAR FUTURES SERIES

US-KOREA INSTITUTE AT SAIS

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## POSITIVE ECONOMIC INDUCEMENTS IN FUTURE NUCLEAR NEGOTIATIONS WITH NORTH KOREA

Any future negotiations with North Korea will need to consider the role of economic incentives and rewards for making progress in meeting US goals of reducing Pyongyang’s nuclear weapons capabilities and risk of proliferation. This will require shaping a nuanced balance between the role of measures to maintain pressure to negotiate versus incentives and rewards that are meaningful to the North Koreans and have traction in the negotiations process. Changes in North Korea’s economic circumstances, external relations environment and domestic political context in recent years need to be taken into account when designing a strategy that relates to current North Korean leadership interests and challenges. Doing so will increase the chances of new negotiations being more successful in meeting US goals than previous efforts. This paper explores considerations for selecting positive inducements that will support a negotiation strategy that leads to a sustainable political solution to North Korea’s nuclear threats and that will position North Korea to pursue its economic future in ways that are compatible with reduced isolation and increased integration with the international community.

### Guiding Principles

Any new negotiation process with North Korea should be anchored in an expectation that *North Korea will negotiate in good faith only if it believes this will result in an improvement in its overall security interests*. Negotiating with an expectation of eventual regime collapse or subjugation, such as by buying time for other dynamics of change to undermine regime security, will not give North Korea the confidence to negotiate in good faith and deliver on agreed actions. North Korea’s essential security interests have not changed fundamentally since the Korean War, but the international and domestic context for protecting these interests has changed dramatically. In recent years, South Korean economic and political relations with China have blossomed, international sanctions have importantly—but only partially—curtailed North Korea’s ability to pursue its economic aspirations and the North Korean people are more aware of their growing freedom to pursue their own interests through an expanding market economy despite continuing social control efforts by the state. An appreciation of these changing circumstances affecting the regime’s overall security calculus will help identify inducements that will resonate with the North Korean negotiators.

*Economic security is an essential component of overall national security*. In the present context, any negotiation strategy with North Korea should take into account that North Korea will seek to enhance its longer-term economic security interests, not just relief for immediate

humanitarian and economic needs. While Kim Jong Un is a young and relatively inexperienced leader, he is future-oriented and committed to seeking new ways to pursue economic development. The generational shift in leadership underway across North Korean society has been significantly affected by the famine of the 1990s, growing the role of markets and increasing knowledge of the outside world. Thus, it should be expected that North Korea will seek meaningful measures to advance sustainable economic development in future negotiations.

A corollary of this principle is that *any commitments to financial aid or investment as part of a negotiation should be evaluated from the perspective of how this would contribute toward improving North Korea's longer-term security interests in an economically rational way.*

The light water reactor (LWR) project under the Agreed Framework, under which the United States agreed to facilitate the building of two 1,000 megawatt LWRs, did not meet this test. At that time, the economic logic of the Agreed Framework was less meaningful to the North Koreans than establishing a mechanism to sustain an active relationship with the United States. As a result, the lack of inclusion in the project of improvements to the power distribution grid that were essential to being able to place the LWRs in service, absence of a coherent overall energy development plan within which the LWRs would have a clearly defined place, and inattention to energy pricing policies and issues related to operation and maintenance meant that the LWR project would not realistically help alleviate North Korea's electricity needs. This lack of economic rationality would have eventually threatened the sustainability of the political achievements in constraining the nuclear weapons program. As it was, the Agreed Framework collapsed in 2002 after the disclosure of a secret uranium enrichment program. Heavy fuel oil provided under both the Agreed Framework and Six Party Talks was intended to alleviate shortages of coal due to North Korean difficulties in reopening flooded coal mines. Similarly, the Six Party Talks agreement to provide equipment from lists prepared by the North Koreans for rehabilitation of hydropower power stations was not based on a transparent, technically and economically evaluated plan, nor was it substantial enough to have a major impact on alleviating North Korea's energy deficiencies. North Korean negotiators may or may not have understood the implications of the economic value of the agreements they reached, but ultimately, the potential benefit to the economy was questionable. Future negotiations that include economic rewards should ensure that the underlying economic rationale and requirements for successful and sustainable negotiations are addressed.

A final basic principle for positive economic inducements (as well as pressure measures) is to *seek multilateral support for them.* The past 20 years have made clear that the national interests of North Korea's neighbors and primary economic partners do not coincide. Policies on economic engagement with North Korea have been fractured and incompatible. The absence of a coherent policy for how to use economic relations and incentives to advance the denuclearization of North Korea have been a source of frustration for all major parties that North Korea has exploited in pursuing its own interests. A future negotiations strategy will need to accept this reality and be grounded in efforts to expand common ground while acknowledging limitations imposed by competing national interests.<sup>1</sup>

<sup>1</sup> For a more detailed discussion of these dynamics, see Bradley Babson, "Dilemmas of Financial Engagement with North Korea," 38 *North*, March 26, 2015, <http://38north.org/2015/03/bbabson032615/>.



## Considerations in Designing Positive Economic Inducements

A number of considerations are important for shaping a future strategy of using positive economic inducements in nuclear negotiations with North Korea. These concern both North Korea's motivations to accept such inducements and its willingness to deliver on commitments.

### *Humanitarian Aid for Vulnerable Groups*

While the humanitarian needs of North Korea have figured prominently in US-DPRK relations from the onset of the famine in the mid-1990s, neither the Agreed Framework nor Six Party Talks agreements included humanitarian aid as a formal component. Humanitarian aid was considered a parallel framework for engagement that would improve the environment for progress on the nuclear front but it was not conditioned on progress. As North Korea slowly recovered from the depths of the famine era and deterioration of cooperation on the nuclear issues with the collapse of the Agreed Framework in 2002, donor fatigue led to a significant reduction of humanitarian aid from the United States as well as from the international community more generally. The initiative to reinvigorate a nuclear dialogue by proposing a US humanitarian assistance program under the so-called Leap Day agreement in 2012 failed when North Korea pulled back from the deal and launched a satellite. This failure can be viewed in part as the unwillingness of the United States to put a more substantial incentive on the table in a changing domestic context in North Korea. Offering humanitarian aid is more palatable for the United States than outright economic assistance. However, from the North Korean perspective, it reinforced an image of weakness in meeting social needs. At that time, Kim Jong Un was occupied primarily with regime transition and gaining support from the military establishment. He had also just made promises in his 2012 New Year's speech to improve the livelihood of all North Koreans. With expanded cross-border trade with China and most families meeting household needs in the growing market economy, risk of famine had receded. Thus, seeking support to address humanitarian needs has not been a high priority in North Korea's external relations in recent years. An agreement to provide modest humanitarian aid in exchange for a moratorium on nuclear and missile tests was not incentive enough to overcome domestic political considerations. Any future strategy to provide positive inducements related to the nuclear program will need to be more robust.

### **The “Byungjin” Policy: Two-pronged Commitment to Pursuing Both Nuclear Development and Economic Development**

In April 2013, Kim Jong Un announced the adoption of the “byungjin” (parallel development) policy at a meeting of the Workers' Party Central Committee as a new strategic policy guideline.<sup>2</sup> While the policy of pursuing national defense and economic development in parallel is not new, and was followed both by Kim Il Sung and Kim Jong Il, the rearticulation by Kim Jong Un does represent an advance in concept. First, nuclear development is conceived as both maintaining national defense deterrence and using nuclear power peacefully for energy. Second, it includes the missile program and emphasizes commitment to the space program for

<sup>2</sup> A good summary of the policy and its implications is Cheon Seong-Whun, “The Kim Jong Un Regime's ‘Byungjin’ (Parallel Development) Policy of Economy and Nuclear Weapons and the April 1 ‘Nuclearization Law,’” Online Series CO 13-11, Korea Institute for Korean Unification, April 23, 2013, [http://www.kinu.or.kr/upload/neoboard/DATA01/co13-11\(E\).pdf](http://www.kinu.or.kr/upload/neoboard/DATA01/co13-11(E).pdf).

both military and peaceful purposes. Third, it reinforces the notion of North Korea becoming a “strong and prosperous nation where people can enjoy the wealth and splendor of socialism” by strengthening defense capacity and focusing on economic construction. It thus reinforces the high priority that Kim Jong Il has given economic development since his first New Year’s address in 2012.

One basic question is whether North Korea can further develop its nuclear and missile programs, while at the same time achieving significant progress in economic development. Recent US policy has been to try to deny North Korea the ability to achieve these ambitions by maintaining strong military deterrence, adding economic sanctions and seeking to persuade other parties to increase pressures on North Korea. Legislation in Congress could further ratchet economic pressure by expanding financial sanctions, although an executive order signed by President Barack Obama in December 2014 already provides the legal authority to apply further pressures.

There are two aspects to consider from an economic perspective when shaping a future nuclear strategy in the context of the *byungjin* policy. The first is whether pressure alone can deny North Korea the ability to develop its nuclear program and simultaneously improve its economy. The second is how to balance military and peaceful uses of nuclear and missile capabilities in a way that might be acceptable to both sides in a negotiation.

As for the first aspect, there are good reasons to be skeptical that pressure alone can deny North Korea the ability to both develop its nuclear program and improve its economy. One is that China, South Korea and Russia each have interests that make it unlikely they would adhere to a policy that applies sufficient economic and financial pressure on North Korea in a coordinated way to force Pyongyang’s acquiescence on its nuclear program.

Despite increasing Chinese dissatisfaction with North Korea, it is unlikely that China would agree to endorse economic pressures that would risk either regime collapse or large-scale refugee flows into China. In fact, China is seeking to change North Korea from within through its economic engagement policies. South Korea has a long-term interest in maintaining stability on the Korean peninsula, improving inter-Korean relations where possible and pursuing a strategy to support improvements in the North Korean economy that would lessen the economic costs of eventual unification. Russia, meanwhile, is seeking to enhance its influence in North Korean affairs through cross-border cooperation, not pressure. And given the current state of US-Russian relations and Moscow’s desire to be an active player in security and economic engagement with both Koreas, if the United States seeks more cooperation to pressure North Korea, Russia would likely do the opposite and bolster economic support for Pyongyang.

Another factor to consider regarding North Korea’s ability to develop its nuclear program as well as its economy is the impact of North Korean domestic economic policy and initiatives. Under Kim Jong Un, North Korea is pursuing two tracks to improve its economy. One is to promote import substitution to reduce needs for foreign exchange for domestic industries and consumption of consumer goods. The other is to seek productivity gains in domestic production. The priority means are advances in the application of science and technology in various sectors; changes in agriculture policy and management to reduce size of production units and increase incentives to produce for personal profit through sales to markets; and the decentralization of

decision making in enterprises to allow for more productive use of labor and capital. There are also signs of new initiatives to bring money accumulated in market economic activities into the banking system. These initiatives could lead to a more efficient allocation of domestic savings for productive investment. While modest, these new initiatives for “economic management in our own style” are likely to result in meaningful gains in the use of domestic resources for economic development.

In addition to the potential of these state-sponsored initiatives, the continuing growth of the market economy and its role in providing jobs and improving the standard of living for North Korean people is having a positive impact on economic development. Altogether these developments have the potential to increase the productivity of capital and labor without external support. In light of the traction, however modest, that North Korea is experiencing in its internal economic development efforts and tolerances of the market, it is not surprising that the North Korean leadership is confident in its commitment to the *byungjin* policy and that it can achieve both goals involving the nuclear program and the economy.

The second aspect of the *byungjin* policy that is relevant for future negotiations on the nuclear program is the expansion of the concept of nuclear development to include peaceful as well as defensive activities. In a negotiation context, the North Koreans potentially could trade their nuclear weapons program for a combination of alternative ways to meet their national security needs and peaceful use of nuclear power. If the negotiation is artfully crafted, the North Koreans could claim that they are still following a *byungjin* policy, even if the internal content would be modified by the agreements reached.

This would also mean that the light water reactor idea could well reemerge as a component of the positive inducements in the negotiation. If this were the case then, in keeping with the principles discussed earlier, any new approach to cooperation on the development of the LWR agenda would need to be set in the context of an economically rational and technically sound energy development plan, with attention paid to the power grid and appropriate balance of nuclear and non-nuclear sources of electric power.

### **North Korean Vulnerabilities on Economic Development**

Notwithstanding the discussion above on the prospects of North Korea developing both its nuclear program and its economy, an important perspective to consider for a future nuclear negotiation strategy is how to exploit North Korean economic vulnerabilities using positive inducements.

One powerful vulnerability is the fact that by publicly stating to the North Korean people in his first New Year’s address that they will never again have to tighten their belts, Kim Jong Un has tethered the perceived legitimacy of his regime to being able to deliver on this promise. Economic development that improves the lives of ordinary North Koreans and not just an inner elite in Pyongyang is a high priority. Kim Jong Un will have a strong incentive to seek opportunities to help him deliver on these expectations.

Another looming vulnerability is North Korea's extreme reliance on trade and investment from China. A slowdown in the Chinese economy will have a decidedly negative impact on the North Korean economy. There is already evidence that export earnings are declining because of lower commodity prices and slowing demand in China for North Korean raw materials, notably coal. While North Korea can be expected to intensify its self-reliance efforts, it is in Pyongyang's interest to diversify its external economic relations, especially with South Korea and Japan, but also with the Association of Southeast Asian Nations. This is likely to have an impact on North Korean diplomacy toward relations with these countries. Thus, linking improved economic relations with a number of important trade and potential investment partners with progress on the nuclear issues will have more traction in this environment than in recent years. This implies careful consultation and coordination, especially with South Korea and Japan, to build a multilaterally supported approach that provides positive economic inducements for a reinvigorated nuclear negotiation process.

A long-standing vulnerability is North Korea's energy needs. The availability of electric power continues to be a major problem. While North Korea has ample coal reserves, it does not have the capital or technology to invest in new-generation power plants. While efforts are being made to rehabilitate and expand hydropower resources, progress has been slow, and hydropower is itself vulnerable to freezing temperatures in winter. Helping North Korea address its energy needs was a central inducement in both the Agreed Framework and the Six Party Talks and can be expected to be a priority area in any future nuclear negotiation.

### **Opportunities to Exploit with Positive Inducements**

***Evolving Economic Rhetoric and Policy.*** Kim Jong Un has given the cabinet a lead role in economic development strategy and policymaking, turning away from Kim Jong Il's reliance on leadership from the Workers' Party that led to the failed currency reform and effort to eliminate the growing market economy in late 2009 and early 2010. While North Korea has now embarked on a policy of introducing "improvements in the economic management in our own style," these cannot be considered comprehensive and coherent economic reforms. The evolution of rhetoric in official media, foreign press interviews and diplomatic talking points demonstrates shifts in orientation and policy evolution from the closing days of the Kim Jong Il era. Therefore, it should not be assumed that North Korean thinking and willingness to talk about substantive economic issues will be as constrained in future nuclear negotiations as they were in previous ones. Talk is now quite open about how to attract investment in Special Enterprise Zones, make changes in agriculture under the "pojun" policy<sup>3</sup> and decentralize enterprise management. There are also indications that the Ministry of Finance and the Central Bank are being given leeway to move forward with financial system innovations that would mobilize private savings for economic development and bring the banking system closer into compliance with international standards.

Markets are officially tolerated and, in reality, North Korea is now a mixed economy with significant reliance on market economic activity in addition to state-directed activity. Many

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<sup>3</sup> The "pojun" policy is the policy of reducing the size of agricultural work units and allowing significantly more of their production to be retained for sale through markets than under the previous policy.

enterprises today have a foot firmly in both, even though the legal and financial systems in North Korea have not evolved in line with the expansion of the role of markets. Despite these realities, socialist rhetoric is dominant in the official media, and the role of markets has been ignored in all New Year's statements on economic progress and forward-looking policies. Also, while sales and the trading of assets (such as housing units) are active, official rhetoric and policy retain the view that the state owns all assets and ignore the growing reality on the ground. Widespread corruption is usurping the space normally filled by a legal and financial system designed to accommodate private ownership of assets and market transactions.

In this environment, there are potential hooks of positive developments that could be exploited in a future nuclear negotiation and also areas to avoid because of political sensitivities and policy gaps.

***Sanctions.*** An important component of a positive inducement strategy for the nuclear program would be the removal of sanctions that constrain North Korea's ability to attract foreign direct investment, expand commercial trade and participate in a transparent, legally grounded international financial system. Such sanctions have led North Korea to adopt non-transparent methods of conducting international business and have distorted incentives for investment and trade by North Korea and its economic partners. Selective removal of sanctions would thus improve prospects for North Korea to pursue an outward-oriented economic development strategy and integration into the international financial system in ways that will serve its long-term economic security interests. In practical terms, bilateral sanctions would be easier to remove than multilateral sanctions, and there will be considerable resistance from the US government and Congress, as well as the United Nations Security Council, to removing sanctions prematurely. One option to consider is the suspension of sanctions where this is legally feasible, with full removal dependent on continuing progress on the nuclear agenda.

***Special Enterprise Zones.*** The North Korean government is giving high priority to the development of Special Enterprise Zones (SEZs). In 2014, a line item for SEZs was added to the national budget approved by the Supreme People's Assembly. Laws that have been approved for the SEZs go a long way toward meeting international expectations on paper, though major obstacles exist to North Korea's ability to realize its ambitions for SEZs as an engine for economic growth and absorption of foreign capital and technology. Among these are risk perceptions of investors that are strongly influenced by North Korea's isolation, lack of standing in the international financial system and political and security risks. Another major obstacle is lack of funding for the infrastructure (such as power, water and telecommunications) that is required to attract investors to an SEZ. North Korean officials have reached out in foreign academic exchanges to gain advice on international experience in successful SEZs and expert opinions on their situation and efforts. This is a good sign of willingness to work with international expert advice on a high-priority economic topic. A negotiation that leads to an agreement on the nuclear program would significantly improve potential SEZ investors' political risk perceptions. These would be further improved if the positive inducements for reaching an agreement also include support for steps that would help North Korea move toward participation in the international financial system and funding for infrastructure investments in high-priority SEZs that have significant economic potential.

**Agriculture.** North Korea's priority focus on improving agricultural productivity through the new field management system provides an opportunity for tangible assistance to help overcome some of the obstacles it is experiencing in implementing the new approach. The reduction in both the number of people in the work units and the size of land plots that is accompanying the breakup of the large-scale cooperative farms revealed two major issues. One is how to provide a large number of field units with equipment that is appropriate for the smaller plots of land. Instead of field units negotiating shared use of a small number of large tractors and other equipment used for the former cooperatives, it would be desirable to provide more small-sized tractors and harvesting equipment as is now prevalent in China. Similarly, technical expertise on the use of pesticides, new seed varieties and innovative management practices needs to be available to all field units that are operating independently. Previously, experts at the larger cooperative level provided this knowledge for the cooperative as a whole. What farmers now need is a system for obtaining up-to-date technical knowledge through a restructured extension service. Technical assistance and training to build such new knowledge delivery systems to support the agricultural management policy would be one area where international support could be helpful.

**Energy.** A future strategy for inducements to help overcome North Korea's energy vulnerabilities should be grounded in an economically and technically appropriate framework. Ideally, this should start with a collaborative assessment and formulation of a multiyear energy development strategy and plan that could underpin a program of evolving support for the plan in a future nuclear negotiation process. Early tangible support could focus on filling gaps in the hydropower rehabilitation needs and the existing program of building small-scale hydropower systems in rural areas; it could also meet local needs at the provincial level. Linkage to the local grid would also need to be included. Another possible focus could be on reducing energy losses by upgrading priority sections of the existing distribution network. A pilot program of community solar power development could also be considered. Larger projects that might be included as eventual rewards in the nuclear weapons agenda could include new conventional power generation plants using domestic coal with emission control technology and development of a LWR program for power that is rational in the overall power generation plan and complemented by necessary improvements in the distribution system. Funding for conventional power generation and distribution projects could be provided bilaterally or eventually multilaterally if and when North Korea becomes eligible for loans from international financial institutions, including the Asian Infrastructure Investment Bank. Simply resurrecting the Korean Peninsula Energy Development Organization (KEDO) is probably not a good idea, as it did not involve China or Russia, both of which would be necessary in a new arrangement—although an energy coordination group of some kind would be useful in view of the potential number of actors involved.

**Money Laundering.** In January 2015, North Korea announced that it had been granted observer status at the Asia/Pacific Group on Money Laundering (APG), linked to the Financial Action Task Force (FATF) of the Organization for Economic Cooperation and Development. North Korea has attended meetings of the APG for several years and has signaled its desire to become an observer. Being granted observer status under APG will give the North Korean financial authorities access to technical guidance from the APG Secretariat to make the legal and organizational improvements needed to work toward meeting membership requirements. This

development is significant because for the first time, North Korea will be working with outside financial experts in a disciplined process to make important changes in its financial system management that would be recognized as meeting international standards.

It is also noteworthy that the Central Bank president said in an interview that the effort to come into compliance with APG requirements was being coordinated by a national committee. This committee is chaired by a deputy premier of the cabinet and includes officials from the Central Bank, Foreign Ministry and Finance Ministry, as well as law enforcement authorities.<sup>4</sup> This signals high-level attention and support for this initiative, as well as a meaningful effort to integrate different parts of the North Korean bureaucracy in the various measures that are necessary to succeed.

How the APG process unfolds will provide North Korean financial authorities with experience working with foreign technical experts on changes in the financial system and its management. It will test the political will of the North Korean leadership to accept the legal and transparency requirements they will need to adopt to achieve eventual membership status. It will also be a test of whether cross-agency cooperation and coordination can be effectively managed in a high-profile undertaking of this type. It is noteworthy that Cuba undertook a similar process while still under US sanctions and is now in compliance with FATF standards. The example of Cuba is a good model for North Korea and one that could be encouraged if one important objective of financial and economic engagement with North Korea is to find ways to help Pyongyang integrate in appropriate ways with the international system of financial relations based on non-political criteria and performance in meeting standards.

Support for helping North Korea meet its commitment to comply with FATF standards could be a possible area for inclusion in a positive inducement strategy on the nuclear program. This would reinforce the objective of helping North Korea achieve more stable long-term economic security through disciplined integration in the international financial system.

***Asian Infrastructure Investment Bank (AIIB).*** The establishment of the AIIB in June 2015 provides an opening for a new dynamic of economic engagement with North Korea. While North Korea's overture to become a founding member was rejected by China (the sponsoring country), the potential for AIIB to play a significant role in North Korea's economic future is a consideration that could be exploited in a positive inducement strategy for the nuclear program. The fact that the United States and Japan are not founding members could initially make it easier for North Korea to make concessions that might pave the way toward membership and eventual investments. Such an approach would require multilateral support, but could proceed in a gradual, phased way.<sup>5</sup>

This could begin by supporting observer status for North Korea within the AIIB. Such a step would allow North Korea to learn how the AIIB conducts normal business and why the bank adopts particular governance policies and operational procedures. A supplementary technical

<sup>4</sup> "N. Korea launched anti-money laundering body," *The Korea Herald*, February 3, 2015.

<sup>5</sup> For a more detailed discussion see Bradley Babson, "Could the New Asian Infrastructure Investment Bank Change the Dynamics of Economic Engagement with North Korea?" *38 North*, May 26, 2015, <http://38north.org/2015/05/bbabson052515/>.

assistance program could help the North Korean government address policy and capacity obstacles to its eventual membership in a step-by-step manner.

A second phase could aim to build confidence in developing an operational relationship between North Korea and the bank, both by helping Pyongyang prepare projects for potential financing and by funding some smaller North Korean initiatives with grants. Membership and access to loan financing would come when North Korea satisfies all of the necessary technical and political conditions for AIIB membership, which include prior membership in the International Monetary Fund (IMF). These could be linked to specific stages in the implementation of a multilaterally supported nuclear agreement.

Advancing North Korea's regional integration through the AIIB would reward it with a meaningful economic incentive that could also help advance the cause of dealing with serious security challenges. By helping Pyongyang fund infrastructure that it badly needs for economic growth, the bank could help foster discussions in political talks on security issues—not just on nuclear issues, but also on other opportunities for multilateral cooperation in Northeast Asia—and potentially by creating greater economic interdependence with other state participants in AIIB programs.

***Relations with the IMF and World Bank.*** In 1997, when North Korea was facing famine and economic collapse, it hosted an assessment mission from the IMF. This led to a report to the IMF Executive Board but no further advancement in relations, as the North Koreans signaled that, while they were interested in receiving technical and financial assistance, they were not prepared to accept IMF requirements for open reporting of national financial and economic statistics or be subject to conditionality for assistance. In early 1998, North Korea hosted an “exploratory” mission from the World Bank to learn more about its policies and ways of operating. In 2000, North Korea was informally consulted and then formally received an invitation to attend the annual meetings of the IMF and World Bank in Prague as a special guest.<sup>6</sup> In the end, the North Koreans did not attend due to embarrassment of the treatment of their delegation en route to the earlier annual meeting of the United Nations General Assembly in New York.

In mid-2001, an informal meeting of IMF and World Bank officials took place in London under South Korean auspices to discuss the requirements and process for North Korean membership. Potential follow-up progress was disrupted by the events of 9/11 and suspended after the breakdown in the Agreed Framework in late 2002. While formal relations have not progressed, informal interactions between North Korean officials and those from the IMF and World Bank have taken place occasionally in the context of track 1.5 meetings (in diplomatic terms, meetings between official and private actors). North Korean academics now have access to the internet and frequently visit the websites of the international financial organizations (IFIs) in their research.<sup>7</sup> North Korea has for many years been attracted to IFIs both for knowledge and financial resources, but it remains wary of the institutions' transparency requirements, influence over policies and political dominance by the United States.

<sup>6</sup> The author was personally involved in these initiatives.

<sup>7</sup> From the author's informal conversations in Pyongyang in 2013.



While North Korea has never been a member of the IMF or World Bank, Cuba was an early member of both organizations but withdrew in 1964 and 1960, respectively. With Cuba now normalizing relations with the United States, its reintegration in the international financial system is under active consideration. Should that occur, North Korea will be even more isolated in remaining outside the system. Similarly, Myanmar's recent transition from an isolated and sanctioned relationship with the international community to one broadly supported in its efforts to open up and reform has been accompanied by greatly needed support from both the IMF and World Bank. The IMF in particular has played a critical role in helping Myanmar establish credibility for its economic reforms, both internationally and domestically. To pursue its long-term economic security interests, access to technical assistance and a path for eventual membership in the IMF and World Bank would be a meaningful part of a positive inducement strategy for the nuclear program.

### **Strategy for Structuring a Positive Economic Inducement Plan**

**Sequencing.** In approaching the task of constructing a plan that provides positive economic inducements, it is important to distinguish among three distinct phases:

1. *Pre-Agreement.* Items selected as overtures prior to reaching a nuclear agreement should help build trust and motivation to negotiate in good faith. These should be modest in scope, easy to deliver, attractive to North Korea and help Pyongyang move in desirable directions from the US perspective, even if other issues come up that delay or prevent reaching a nuclear agreement.
2. *Signing of an Agreement.* Items selected for delivery upon signing an agreement should provide tangible positive rewards for actions already taken, provide new incentives for proceeding with implementation of the agreement that can either be rescinded or halted if there is a delay or breakdown in the implementation plan, and form the platform for more expanded inducements dependent on progress during the implementation phase.
3. *Implementation of Agreement.* Items selected for delivery upon reaching key milestones during the implementation phase should provide substantial and not easily reversible benefits that are commensurate with actions taken on the agreed plan.

To sustain the achievements of the nuclear agreement, the ultimate objective is for North Korea to believe that its economic security interests have been significantly enhanced and that other measures have allowed the country to maintain its overall national security in an acceptable way.

**Clustering.** In considering options for specific items to include in a positive economic inducement plan, it is also useful to cluster possible actions in relation to specific objectives. Possible clusters from the considerations discussed earlier in this paper could include:

1. Meeting urgent high-priority social protection needs.
2. Improvements in economic management for improving livelihoods of ordinary people.

3. Support for expanding and diversifying foreign direct investment and commercial trade.
4. Support for integrating with the international financial system.
5. Support for capital investments in public infrastructure.

Specific items and their phasing should thus be framed within a matrix of these three phases and five clusters. Some items may be relevant for more than one cluster. Below are examples of how these could fit together (specific clusters enumerated).

***Possible Measures for Phase 1: Trust Building and Incentives to Negotiate***

- Provide targeted social protection support to vulnerable groups. (1)
- Offer to provide technical assistance and capacity building for development of a new knowledge distribution system for farmers. (2)
- Offer to collaborate on a technical review of energy needs and to prepare a plan to meet high-priority needs in hydropower, upgrade local power distribution systems and install community solar power systems in the provinces. (2, 5)
- Agree to consider a LWR for power generation as a possible part of a longer-term energy investment program subject to economic and technical justification. (5)
- Offer to provide support for technical preparation of infrastructure investment plans for high-priority SEZs. (3, 5)
- Agree to support North Korea for observer status at AIIB and special guest status at the IMF and World Bank. (4)
- Offer to provide support for technical collaboration on meeting APG requirements and national economic and financial statistics. (4)

***Possible Measurers for Phase 2: Value Linked to Real Progress and Future Commitments***

- Expand targeted social protection support to vulnerable groups. (1)
- Provide a package of support for agricultural development including provision of small tractors and support for implementing new knowledge extension services to farmers. (2)
- Provide infrastructure (for example, power, water, waste, telecommunications and transport) for an agreed high-priority SEZ on a pilot basis. (3, 5)
- Provide a package of energy investments, including a high-priority program for rehabilitation of hydropower plants and the distribution system, small-scale rural and provincial hydropower projects and community solar power projects. (2, 5)

- Agree on whether a LWR or new conventional power generation capacity is a higher priority and take next steps for advancing technical preparation of the project and first phase investments. (5)
- Support IMF and World Bank technical assistance in economic management and financial system capacity building. (2, 4)
- Support AIIB technical assistance in infrastructure investment planning and project design. (2, 4, 5)
- Suspend selected sanctions to stimulate investor interest in SEZs and enable transparent financial transactions in keeping with APG requirements. (3, 4)

***Possible Measures for Phase 3: Increased Value in Tandem with Implementation of Nuclear Agreement***

- Continue targeted social protection support for vulnerable groups. (1)
- Support membership in the IMF, World Bank, Asian Development Bank and AIIB. (2)
- Provide infrastructure investment for priority viable SEZs. (3, 5)
- Provide support to a multi-donor energy investment program, including power generation (with or without a light water reactor), upgrading of the distribution network and an energy efficiency investment program. (3, 5)
- Provide support for an expanded agricultural development program. (2, 5)
- Remove sanctions that are no longer relevant to their original objectives. (1, 2, 3, 4, 5).

**Conclusion**

The changing internal and external context for any future serious nuclear negotiation with North Korea will require a new approach to providing inducements that will lead to more successful outcomes than previous negotiations. The priority now being given to economic development by the new generation leadership in North Korea provides a number of potentially attractive opportunities and measures to encourage and support a new nuclear negotiation. Elevating the economic dimension of the negotiations to a higher standard than was adopted in the past is worth exploring. In fact, it may be essential for achieving the political and security objectives of the United States and in bringing North Korea closer to integration in the international community in ways that will improve longer-term stability on the Korean peninsula.





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