

Avoiding Apocalypse: The Future of the Two Koreas*

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In 1991, I had the great privilege of visiting the KDI. As many of you know, there are two buildings in KDI: one old and one new. The old building is hot in the summer and cold in the winter. Perhaps it is fitting that the people studying North Korea stayed in that building, myself included. This was during the time of German reunification and I was amazed by what I took as my Korean colleagues' over-optimism regarding South Korea's ability to handle an East German-style collapse of the North. I thought this would be a very interesting topic to pursue when I returned to the United States. No one showed any interest in the subject, however, so I pursued other interests.

I was preparing to leave the Council of Economic Advisers of the White House in the fall of 1994 when Kim Il-Sung died. Suddenly, the life expectancy of the North Korean regime went from decades to weeks. The notion of collapse and absorption by South Korea and unification became a great concern. The funders who had earlier told me that my idea for study on the North was arcane and uninteresting, called me and offered me money for the study.

It would be tedious for you and tiring for me to try to summarize the whole book. What I would like to do instead is to focus on three questions. The first question is whether recent events indicate a fundamental strategic reorientation on the part of North Korea, or is it simply a tactical maneuver? If the answer to the first question is that a fundamental strategic reorientation has indeed occurred, then the second question is, whether the North Koreans are capable of successfully reforming their system. Intent does not necessarily translate into achievement, so put another way, if the decision has been made to undertake reform, are the North Koreans likely to be successful in doing so? If the answer to both of these questions is "yes", the final question is, what are the ultimate intentions of the North Korean regime? Would the gains to economic reform be put to use to serve the pressing material needs of the North Korean people, or would they be put to other purposes, i.e., military modernization?

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Let's begin with the first question. As we all know, there has been a flurry of diplomatic activity on the part of North Korea in the months preceding the summit between the North and South. Indeed, some of you are representatives of countries which are now engaged in processes of normalization of relations with North Korea. The question is whether the timing of this activity indicated a fundamental change in stance or was this simply a tactical maneuver to take advantage of the electoral calendars in South Korea and the United States. I would argue that the trip that Kim Jung-Il took to Beijing at the end of May gives us some evidence on this point. As you know, the North has been absolutely scathing in their denunciations of the reforms which occurred in the former Soviet Union and Eastern Europe, which have been likened to diseases, germs, and vermins to be kept at bay, describing reform as "honey-coated poison" on the lips of the imperialists and opening as "a Trojan horse tasked with destabilizing socialism."

In 1994, North Koreans went so far as to describe the Chinese as "traitors to the socialist cause", but subsequently toned down the rhetoric as their economic difficulties increased and they became more dependent on China for support.

During North Korean Supreme People's Assembly Chairman Kim Young-nam's visit to Beijing last year, the two countries agreed to an "I'm OK, you're OK" formulation, in which they agreed to pursue socialism according to their respective national characteristics.

During Kim Jung-Il's visit to Beijing in the end of May, the public pronouncements were very different. Kim noted the "great achievements" of "opening up the country" by the Chinese reformer, Deng Xiao-peng and said that he "supports the reform policy pursued by the Chinese side". This was an enormous departure from previous formulations and would seem to signal a new receptiveness on the part of the North Koreans, both of the notion of reform, which they have consistently dismissed, as well as possibly opening up a role for China to act as a mentor or a tutor with regard to reform and opening up a centrally-planned economy.

However, I have to say that the evidence is not unambiguous. While it is true that these remarks made by Kim Jung-Il were widely broadcast in Beijing, they have not been widely broadcast internally in the North. It would be naïve to assert that Kim Jung-Il believes that people in North Korea will not learn of widely-broadcasted

statements in China, and I do not believe that is the case. Rather, it would be difficult for the leader of North Korea to venture onto foreign soil and then, in effect, announce that the North's economic policies for the last fifty years were mistaken. I think that while the statements in China probably signal a new interest in receptiveness to the notion of economic reform and modernization, a politically-acceptable face-saving method of introducing these ideas into North Korea has to be devised. So, the fact that these remarks were not broadcast in North Korea does not necessarily indicate that the North Koreans are playing some kind of a game, rather, it is an understandable political move on their part. Nevertheless, one has to note that these ideas have not been introduced in the North Korean media. Today, we have this odd situation in which the North Koreans have made favorable statements about economic reform outside of North Korea but have yet to make such statements inside of North Korea.

Nevertheless I am hopeful that things are moving in the direction of reform. Supposing that they are, let's examine the second question, what are the capabilities of the North Korean regime? In my mind North Korea faces two great obstacles in successfully reforming its economy, but has one great advantage on its side.

Let's look at the obstacles first. In Asia, one sometimes encounters the following syllogism. There are two ways to reform centrally-planned economies: the unsuccessful European big bang approach and the successful Asian gradual approach. North Korea is an Asian country; therefore, it will adopt the successful Asian gradual approach and begin growing at 10% per year upon commencing reform. I think this view is fundamentally mistaken. In Asia we have two large centrally-planned economies that have been relatively successful in the reform processes: China and Vietnam. However, when China and Vietnam initiated their reform they both had more than 70% of their labor force in the agricultural sector. We do not know exactly how many people in North Korea work in agriculture, but it is probably in the order of about 30-35%, that is to say, less than half as much. The reform processes in China and Vietnam were strongly driven by the existence of this large rural labor force. They could liberalize the agricultural sector, get a pretty rapid supply response, and then start moving labor out of agriculture into the emergent non state-owned light-manufacturing sector. In theory, you could then tax that sector to provide a financial cushion for restructuring of the old state-owned heavy industrial sector. Because of differing starting points and different economic characteristics, that agricultural-driven path of reform may simply be unavailable to North Korea. In economic terms, North Korea

actually looks more like some parts of the former Soviet Union or Eastern Europe than it does China or Vietnam. As a consequence, the sort of problems that North Korea may encounter if and when it begins reform may be more like the sort of problems faced by the Soviet Union or Eastern Europe than those faced by China and Vietnam.

The second big obstacle and second point of difference between North Korea and China and Vietnam is a political one that has to do with the divided nature of the Korean peninsula. I will start with the case of Vietnam because that is the simplest and most straightforward. In the case of Vietnam, the North Vietnamese and their Viet-Cong allies won a civil war. They unified the country and the government in Hanoi became the sole definers of what it meant to be Vietnamese. And in the late 1980s when they began to adopt the reform policies of *doi moi*, ideologues in Hanoi could come up with rationalizations or justifications that *doi moi* was really what Uncle Ho had in mind. And in their case, they may have not been that far off, since my impression of Ho Chi Minh is that he was less of an enthusiast for central planning than the leadership in Pyongyang.

Although similar, China is a somewhat more complicated case. Until recent months I do not think anyone would argue that the government in Taipei presented a real ideological threat to the government in Beijing. And in the late 1970s when the Chinese began their reforms, again, they could come up with slogans and justifications that reform and opening was really what Marx or Chairman Mao had in mind.

The task that confronts would-be reformers in Pyongyang is a much more difficult one because of the divided nature of the peninsula. North Korea is the junior partner, both in size and achievement. Movements toward opening and reform that would bring North Korean society closer to that of South Korea could undermine the fundamental ideological underpinnings of the regime. The dynastic nature of the regime makes this even more difficult, in that the son is, in effect, going to have to disavow the policies of the father. This is not to say that successful reform in North Korea is impossible, it is simply to say that it would be a difficult political act for the Pyongyang regime to successfully carry out. If North Korea were to reform, there would be enormous changes in the North Korean economy and inevitably in North Korean society.

One example is that there would be a tremendous increase in international trade exposure with most of that trade coming from South Korea and Japan, two countries

with which North Korea has a very troubled history. So the process of economic reform and opening could be difficult in technical terms and could present certain political challenges that are difficult as well. Those are the big obstacles. But of course North Korea has one big advantage that most centrally planned economies have not had: South Korea. With the possible exception of East Germany and to some extent China, because of the presence of Taiwan and overseas Chinese communities, most centrally planned economies have not had an ethnically related group of entrepreneurs with technology, capital, international distribution systems and so on, ready to invest. So the one big advantage that North Korea has is South Korea, along with a supportive international environment of countries around the region who wish to see the regime survive and not collapse. Suppose then that the North Koreans are able to pull off this kind of tricky balancing act and through the assistance of South Korea, Japan, China, possible even the US, are able to successfully reform their economy, what are the ultimate intentions of the North Korean regime? To what purpose would the North Korean regime put the gains of economic reform? Would it be to address the pressing material needs of the people or would it be to other purposes? I think the answer here is uncertain.

It could be that the Kim Jong-il regime has made a calculation that the best way to preserve their own power and perquisites within the North Korean system is to constructively engage with South Korea and the rest of the world and moving down a path of economic reform, although risky, presents them with the greatest likelihood of ultimate success in preserving themselves within their system. Or, it could be purely opportunistic. It could be that North Korea intends, essentially, to adopt the techniques of economic reform without the values. Thereby using economic reform to generate increasing income and wealth but not subscribing to the dominant values of the international system. In that case, South Korea, the US and others could be confronted with a strengthened adversary on the Korean peninsula. How can we tell?

Despite the reported stabilization of the economy and indeed recent growth, if the figures from the Bank of Korea are to be believed, North Korea has increased its reliance on international food assistance. For example, if you look at the share of food coming into North Korea provided on a concessional basis, that number goes from approximately zero in 1994 to around 85-90% today, this means food aid has crowded out imports of food on commercial terms. Food aid, in effect, is a kind of implicit balance of payments support; money that otherwise would have been spent importing

food can now be used for other purposes since the food is now arriving in the form of concessional assistance. The question then is “to what purposes do you put that implicit balance of payments support?” And in the case of North Korea in the past year there are reasons for unease. Within the last year North Korea has purchased the Kazakh Air Force and, according to American and South Korean military officials, engaged in the largest and most expensive military maneuvers in a number of years. It appears that, at least in this regard, the North Korean regime has revealed a preference for guns over butter.

So what are the policy implications of this? Focusing on South Korea, it seems that President Kim Dae-jung is fundamentally correct that the policy should be aimed at supporting constructive transformation of the North. If you analyze the interests of South Korea, from a military standpoint, North Korea already holds Seoul hostage because of forward deployed artillery on the DMZ. So one might as well engage with the North Koreans and see if you can reduce tensions and improve relations, because the added military threats that North Korea can bring on South Korea, due to the gains of economic reform, are marginal and are more the concern of the US which fears the proliferation of weapons of mass destruction. From the South Korean standpoint, they are already over that Rubicon, therefore, they might as well engage with the North Koreans and to try to achieve better relations.

Therefore, it seems that the goal of South Korea ought to be to domesticate North Korea in order to engage in a process of economic engagement, which creates in North Korea stakes in continued involvement with the South. This amounts to attempting to defang North Korea from a military standpoint and while at the same time rehabilitating its economy and ultimately achieving national unification. The problem from the South Korean standpoint is that this carries risks to economic relationships here in South Korea. The financial crisis has temporarily reversed a 20-year trend towards disengagement of the South Korean state from direct intervention in the South Korea economy. In other words, for about 20 years the South Korean state has been backing out of the economy, allowing the private sector greater scope. The financial crisis has resulted in a situation in which the state owns a substantial share of the banking sector and can indirectly influence many other parts of the financial sector more broadly. As a consequence, in some ways the state today has greater influence on business decisions than it did in 1996 on the eve of the crisis. The problem is that despite the good intentions of the South Korean government, politics and economics are inseparable in

the North – even in theory. Any significant economic interchange with the North will be highly politicized. As a consequence, this opens up the possibility in South Korea that the government will be tempted to intervene in the economy directly in order to promote foreign policy goals in the North, which would be to the detriment of the South Korean economy.

For example, today, the best-known case of North-South economic cooperation is the Mt. Kumkang project by Hyundai. According to the South Korean newspapers, Hyundai is losing more than \$100 million per year on this project. In terms of its relationship with the South Korean government, the fear is that the South Korean government will be tempted to use its influence to reward Hyundai or other firms that, in essence, “do it’s bidding in the North.” For that reason, the apparent likelihood that Daewoo Motors will be taken over by Ford is a very good thing. I was afraid the government would be tempted to steer Daewoo Motors towards Hyundai Motors or the Daimler-Chrysler-Hyundai alliance, thereby giving Hyundai Motors an effective monopoly on the South Korean passenger car market as a kind of reward for its activities in the North. The fact that this has not occurred, at least, it looks like it will not happen, is a very good sign.

Another example would be Hyundai’s dealings with North Korea. As you know, the contract Hyundai signed with North Korea has a number of provisions, of which the Mt. Kumkang project is only one. Probably the most important part of that contract is for the establishment of a special economic zone. Hyundai and the North Korean government have been engaged in a long running argument about where that zone should be located. Hyundai wants to establish it in the economically rational location of Haeju, while the North Koreans want to locate it in the extreme north west of the country for internal political reasons. If this zone is established, its location will give us valuable information. It could provide some evidence of North Korean thinking on issues of economic reform. But these examples from Hyundai’s experience in dealing with both the South Korean and North Korean governments indicate the scope for politicization of this process of economic engagement.

So what should South Korea do? South Korea should emphasize forms of economic engagement that hold the greatest prospect of encouraging systemic transformation in the North. One could imagine a kind of ranking of these forms of engagement. At the bottom would be Mt. Kumkang. Almost like handing a check directly to the central government, the project can be literally, and figuratively, fenced off from the rest

of the country and the economy. Given the degree of mistrust between North and South Korea, that kind of project may have been a necessary first step to establish some kind of trust. Having made that step now, I would be skeptical of further projects of that sort. Somewhat better would be the mining enclaves that are being discussed or special economic zones in remote parts of the country like the existing one at Rajin-Sonbong. Again, these are marginally better than the Mt. Kumkang project but they are ultimately enclave economies that can be fenced off from the rest of the economy and do not hold much prospect for future systemic transformation. Bonded warehouses or other forms of special trade zones in urban areas of North Korea would be more preferable. That would increase the exposure of the North Korean populous to South Korean firms and presumably have some effect of educating North Koreans about the workings of a market economy. Of course, the best form of engagement would be free investment by South Korean firms throughout North Korea. That would not only have the educational aspect, but importantly, it could establish competition among North Korean local jurisdictions and party organs. They would have to compete for investment on the basis of efficient provision of infrastructure, low corruption, etc. This would be the most desirable form of engagement and, of course, this is a form of engagement about which the North Korean government presumably is most concerned.

This is the bottom line. South Korea has been shaken by its financial crisis. Although in macroeconomic terms the economy is doing quite well, the recent bank strike indicates there are still issues to be resolved coming out of the financial crisis. The process of constructive disengagement of the state from the economy – the development of a state role as a more neutral arbiter of property rights and less as an agent to directly rearrange the economy – that had been going on for 20 years was, hopefully, only temporarily disrupted by the financial crisis and will continue forward in the future. The continuance of structural reform and the constructive disengagement of the state would be a difficult process for any country under any circumstances. The existence of North Korea adds an incredible additional layer of complexity to the problem that South Korea now encounters. Yet North Korea faces a supportive international environment. South Korea, Japan, China, even the US want to see a domesticated, well-behaved North Korea survive until a more consensual form of national unification can take place on the Korean peninsula.

The three questions are whether North Korea is willing to change, whether it is capable of managing change, and, ultimately, to what purposes would it apply the gains from

economic reform? I think that it recognizes the need to change. I am skeptical about its ability to successfully manage reform. I remain wary about the purposes to which it would apply those gains from reform. I think the most likely outcome is a kind of muddling through in which the North Korean regime engages in a series of *ad hoc* adjustments while being supported by its neighbors for whom continuation of the status quo is a relatively desirable outcome compared to the risks of collapse or instability.

Questions and Answers

Q: It seems to me there is a great likelihood of a second round of a moral hazard game which the Korean government initiates and banks follow, supporting big conglomerates in direct assistance or direct investment in North Korea and then usually big conglomerates follow. Then another round of moral hazard can cause a second South Korean crisis. My current assessment is that, unfortunately, because of the 1997 crisis, we are about 5-10 years backward in the sense that you correctly pointed out. So we need 5-10 years of painful internal restructuring and it is unfortunate that this North Korean issue came at this moment because I do not think we have full capacity to directly engage ourselves in very aggressive North Korean projects. So my proposal is to support North Korean liberalization indirectly, as far as possible, through the IMF, the World Bank or the Asian Development Bank rather than engaging ourselves directly because that causes very different types of moral hazard and if those projects fail then the consequences could be much more direct and dangerous than the crisis we had in 1997.

A: The problem is one of degree. I think the moral hazard issue in South Korea could not be eradicated under any circumstances. I think privatization of the banks would go some substantial way to try to remove the direct ability of the state to influence lending decisions. At the same time one ought to recognize that there is an externality here and that the South Korean government may have a legitimate interest in promoting economic engagement with the North. And so the question from an economist's standpoint is "what is the most efficient means of doing that?" You are right that there are risks of moral hazard in terms of the financial system, so it seems that you should regularize financial market behavior here in South Korea while at the same time, for example, you could use the tax system to provide some tax incentive for investment in the North, recognizing there are some externalities in terms of South

Korea to engagement in the North.

The point you raised about the international financial institutions is an important one. Let me say two things. One, I don't think one should exaggerate in a quantitative sense the impact the international financial institutions are likely to have in North Korea. Their impact is more likely to be as a source of technical assistance, training, provision of relatively un-politicized advice, especially if bilateral relations with the US or South Korea took a downturn. The actual money that the international financial institutions would be likely to lend North Korea would be relatively low. Lending programs might reach into the low hundreds of millions of dollars annually with the concessional component of that being pretty small. This is not a lot of money. The one big potential financial claim that North Korea has on the international system is the settlement of post-colonial claims with Japan. Based on the deal Japan made with South Korea in 1965, in the year 2000 North Korea should receive roughly \$20 billion. Of course, North Korea is not going to get this much from Japan. Within the Japanese government my understanding is that their discussions are in the order of \$5-8 billion. This would presumably be in the form of a package involving, like the 1965 package for South Korea, a combination of grants, low interest loans, trade credits, etc. and presumably this would be spaced over a period of time. That money could go a long way in helping the North Koreans pay off their defaulted bank debt which still hangs over them and makes it difficult for them to enter capital markets, even if they wanted to.

One of the interesting developments in the last several years has been the increasingly tight coordination on policy between the US, South Korea and Japan. This is due to two factors. One is the election of President Kim Dae-jung and his willingness to engage with the North. Second, is the August 1998 missile firing over Japan. Those two things have really contributed to a much closer relationship, which has been manifested in the whole Perry process. As you know as part of the missile talks with the US, the US has largely removed its economic sanctions against North Korea. That action was heavily criticized by conservatives in the US. I think that criticism was a bit misguided in the following sense. If the North Koreans do something bad, shoot another missile for example, the US President can simply re-impose sanctions. Sanctions removal is reversible, so if things go in the wrong direction we can re-impose sanctions. The settlement of post-colonial claims with Japan contains an element of irreversibility. Although it's likely to be spread out over a number of years, once the funds are disbursed, the money is more or less gone, even if it takes non-cash forms.

So, in the case of settlement of Japanese reparations, I think that it is very important that Tokyo, Seoul and Washington coordinate their actions very closely because this is the one big money claim the North Koreans have on the international financial system. And it is one claim that is basically irreversible.

Q: Do you have any estimation on the necessary infrastructure investment needed? In other words, in this age of globalization, how can you attract direct foreign investment? You have to provide enough social infrastructure that can compete with neighboring countries like China or actually, countries all over the world. Unless you have basic social infrastructure, ports and harbors and roads and telecommunications, I don't think private money will flow into North Korea. So you have to have basic infrastructure provided. So I wonder how much it would cost to provide this in North Korea?

A: To use a Seoul metaphor, one can take the (expensive) black taxi or the (cheap) silver taxi. Let's begin with a ride in the expensive black taxi. Given plausible parameters about the state of the two economies, the degree of cross-border migration, the rate of technological change and other factors, one obtains estimates in the order of hundreds of billions of dollars of investment needed to be made in North Korea to bring North Korean incomes up to a level that would choke off the incentive for mass migration to the South. Transfers on this scale would have implications for South Korea's growth rate, the distribution of income within South Korea, etc.

In contrast, if we take the silver taxi, North Korea remains an independent state and there is no abrupt integration of labor market, and as a consequence, it will be possible to maintain a much greater divergence of income levels for a much longer period of time. One must keep in mind that North Korea is a relatively small country, with population of only around 20 million, which appears to run a structural grain deficit every year of around 2 million metric tons. So if one does a kind of book-keeping – how much food, how much energy, how many essential imports that can't be produced at home, such as pharmaceuticals, spare parts, capital goods, it appears that you can keep the North Korean economy afloat without further deterioration and possibly some growth, though not great prosperity, for say \$1-2 billion per year of recurrent financing charges. The question is “what is the stock investment needed in infrastructure?” The estimates for necessary investment that various people have made for various sectors: energy, transportation, telecommunications, etc., are in tens of billions of dollars.

One last thing on this point is that today, for understandable diplomatic reasons, we find ourselves in a kind of odd situation in which we, the international community collectively, are going to spend about \$5 billion building North Korea two light water nuclear reactors. Those reactors, if and when they are completed, will essentially be unusable, in the sense that North Korea does not have an electrical grid that is capable of handling that much electricity. When they are all brought online they will generate more electricity than North Korea can use. That is to say, to make those light water reactors usable there will have to be additional investments and rehabilitation of the electrical grid and probably construction of transformers on the Chinese and South Korean borders in order for North Korea to export electricity. If one took that same amount of money and spent it on other forms of infrastructural investment, one would have much higher payoffs. Therefore, for understandable diplomatic relations, we find ourselves in a position where collectively we have committed a fair amount of money to investment projects that have pretty low rates of economic return. If we could reach a political agreement to reallocate some or all of that money, one could generate much higher rates of return in North Korea that would make more sense in narrow economic terms.

Q: Of course it will require lots of money to bring North Korea to the level of South Korea in the future but South Korea is going to tame North Korea so that it can come into the world circle. I am an adviser to the Minister of National Unification and we know that we cannot afford to invest huge amounts in North Korea overnight. So at the moment it would require US\$6-10 billion to provide North Korean infrastructure which would be good enough to attract foreign investment for North Korean development. This amount of money could not be provided by South Korea at the moment. We need at least \$6-10 billion to clean up the banking sector at the moment, so I think Japan can contribute in terms of compensation to North Korea and the US and international organizations. You said that \$5 billion could be provided collectively by international circles. How did you estimate this amount of money?

A: I believe that is the budget of KEDO.

Q: When President Kim met Kim Jong-il in June they agreed the North Korean leader would visit South Korea sooner or later. We expected him to come on August 15th, but it is increasingly clear he will not come within two or three months maybe not even this year. Eventually do you think he would come?

A: One should be patient and not push things too hard or too fast, or there could be some big mistake that could really set things back. So it is better to be patient and it may be good for elite people like you to try to communicate this to the public because there seems to be a kind of euphoria, a wild swing in public sentiment and we should really exercise a certain amount of caution.

Q: I think you made some good points about the Mt. Kumkang project but at the same time you seem to be at risk of underestimating the political impact that project has had. It seems to me that that project was the key to persuading the regime that it was in its interests to engage with the South. And if President Kim's aim is to ensure peaceful coexistence surely that is what it is all about. If you can persuade the other side to engage, quite apart from the legitimate criticisms you can make about the economic impact of the project, if it is going to lead to a more normal situation between the two Koreas, is it not worth it? And would the summit have happened without the Mt. Kumkang project? I suspect not.

A: I have absolutely no idea if there would have been a summit without Mt. Kumkang but I think that this may well have been a necessary first step. Given the amount of historical enmity and the degree of mistrust between these two governments, the first step, that did not make sense on narrow economic terms, may have been necessary. The more important point is that going forward, having made that first step, having established trust and having had a summit, projects like Mt. Kumkang, which are quite questionable on economic grounds, are no longer necessary. Having gotten over the early stages, I think one can now use a little more firm judgment.

Q: Could you tell us about the US foreign policy after November Presidential election especially if there is a Republican victory?

A: Let me answer that question in two ways. I think there is probably a kind of misimpression in Asia in general, that Governor Bush is certain to win the Presidential election. Let me point out a few things. There are opinion polls that were taken in June and at that point Governor Bush had a large lead over Vice-President Gore. Numerically, it is the same lead that Governor Dukakis had over then Vice-President Bush in June of 1988. It is the same lead, numerically, that President Carter had over Governor Reagan in June of 1980. Which is simply to say that there is historical

precedent for leads of that magnitude in June to disappear by November. Indeed, my guess is that if you polled the American people less than half could name the prospective nominees of the two major political parties. American people don't typically focus on this until after Labor Day which is at the beginning of September. So one should discount some of these polls that you see now. What the pollsters find is that when they ask people why they have this preference, it is generally on personality. As we get closer to election day people focus more on issues, and most people believe Vice-President Gore seems to have a better grasp of the issues, especially foreign policy, than Governor Bush. So one can expect some narrowing.

In terms of foreign policy towards Korea, what would it look like under Governor Bush? If you look at his foreign policy advisers they are basically the second and third tier people from his father's administration. So they are a pretty solid bunch of Republican internationalists. The issue of Korea has become very partisan in the US, where Congressional Republicans have criticized the Clinton administration severely for being too soft with the North Koreans. The problem of course, is that while peaceful coexistence and transformation may be the first best policy from the standpoint of South Korea, from the standpoint of the US the first best outcome is the elimination of the Kim Jong-il regime. That would eliminate the direct military threat that it poses to 37,000 US troops in Korea and civilians, plus US troops and civilians in Japan. Plus it would eliminate the larger strategic threats that are posed through the export of weapons of mass destruction and missile delivery systems to other parts of the world. The US can't achieve its first best solution for structural reasons. To do so would require the cooperation of South Korea, Japan, and China. They are not going to do it, so the US is forced back into a second best solution of having to deal with the North Koreans even though it does not want to do so. As we as economists know, choosing among alternative second bests is difficult. In terms of US politics, it is a politically and emotionally unsatisfying outcome, and as a consequence, Republicans in the Congress have severely criticized the Clinton administration. The problem of course, is if the Republicans take control in January 2001, they are going to confront an environment, which, in structural terms, is very similar to the environment that exists today. They might want to eliminate the Kim Jong-il regime but South Korea, Japan, China are not going to want to cooperate. And for structural reasons they are going to be forced into the same second best solutions that the Clinton administration has. The rhetoric may be harsher, and at the margin they may be less willing to appropriate money to support projects in North Korea. But in the end, for basic structural reasons,

they are going to be forced back into a policy that I think looks quite similar to the policy we have today. So although the rhetoric may be very harsh, reality is that in January 2001, whether Vice-President Gore or Governor Bush gets elected, I think there will be considerable continuity in US policy towards Korea.