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# **A PRECARIOUS ACCORD**

## **Navigating the Post-Summit Landscape**

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Security

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## Executive Summary

Throughout 2017, diplomacy remained almost dormant as North Korea blazed through a record set of nuclear-related activities and demonstrated its ability to launch ballistic missiles with an intercontinental range capable of reaching North America. But at the end of the year, in December, the nuclear and missile tests went silent. From the first day of 2018, the diplomatic bustle has been nonstop and marked by unprecedented meetings among leaders. Seemingly overnight, Kim Jong-un's priority shifted from nuclear-armed missiles to economic development, a change that had been on the radar for several years but never seemed to come. What explains this radical shift in the most immediate security threat in Asia? Based on an understanding of the power and peril of diplomacy of the past 18 months, how should officials move forward to establish a durable peace on a nuclear-free peninsula?

A series of summits, culminating with the inaugural meeting between the U.S. and North Korean leaders, provides an opportunity both to look back at the recent past and to reflect on what comes next. One key lesson from past summits is that the descent is more perilous than the ascent: The climb is exhausting, and the thrill of achieving great heights distracts from the tremendous effort yet required. There are multiple challenges emerging from the spring summits, but for the United

States, the largest remains whether it will be possible to eliminate North Korea's nuclear threat this time around. Has Kim Jong-un offered the irresistible concession of what could turn out to be but a portion of his nuclear capabilities in exchange for badly needed relief from economic and military pressure?

The world is in uncharted territory because of the two-step summit process: first, the inter-Korean summit on April 27 at the Demilitarized Zone (and the subsequent, less-publicized Moon-Kim summit a month later, on May 27); and second, the meeting between President Donald Trump and Chairman Kim in Singapore on June 12. But these developments represent a new chapter, a third significant attempt, in a long history of seeking diplomatic engagement with and nuclear disarmament of North Korea.

The first effort to stem North Korea's then-embryonic nuclear weapon development came in the 1990s. The breakup of the Soviet Union prompted the United States to remove its remaining 100-or-so tactical nuclear weapons on the peninsula.<sup>1</sup> The two Koreas signed a non-aggression agreement in December 1991, followed the next month by a commitment "not to test, manufacture, produce, receive, possess, store, deploy, or use nuclear weapons; to use nuclear energy solely for peaceful purposes; and not to possess facilities for nuclear reprocessing and uranium enrichment."<sup>2</sup> Rapprochement quickly gave way to the first nuclear crisis in 1993–1994, when North Korea balked at international inspection of its main plutonium nuclear reactor at Yongbyon. But diplomacy again prevailed in the form of the 1994 U.S.-DPRK Agreed Framework. A multilateral effort emerged on top of that bilateral deal, which committed to replacing North Korea's graphite-moderated nuclear reactors with light-water reactors, strengthening the nuclear nonproliferation regime, and normalizing relations between Washington and Pyongyang.<sup>3</sup> The Agreed Framework eventually faltered over the disclosure of a clandestine uranium-enrichment facility, and diplomacy gave way to heightened brinkmanship.

A second attempt to find a diplomatic breakthrough with North Korea centered on Six-Party Talks among both Koreas, the United States, and China, as well as Japan and Russia. In the landmark Joint Declaration of September 19, 2005, North Korea pledged it was "committed to abandoning all nuclear weapons and existing nuclear programs." For its part, the United States provided negative security guarantees, reaffirming its promise that it had no nuclear weapons on the Korean Peninsula and had "no intention to attack or invade the DPRK with nuclear or conventional weapons."<sup>4</sup> Only a



North Korean leader Kim Jong-il and South Korean President Roh Moo-hyun meet for the second-ever inter-Korean Summit on October 2, 2007, in Pyongyang, North Korea. (Pool/Getty Images)

year after the historic accord, North Korea conducted its first nuclear test. The Six-Party Talks managed to restate the 2005 commitments in a 2007 Joint Statement, but as with the Agreed Framework, the multilateral deal also failed to materialize.<sup>5</sup>

Since the beginning of the Trump administration, a strategy of “maximum pressure and engagement” helped to spur a diplomatic leap forward, both for peace and disarmament. Even if a new diplomatic framework eventually founders over tough issues of implementation and verification, the new vision of North-South peace achieved at the April 27 summit by Chairman of the DPRK State Affairs Commission Kim and President Moon significantly raised expectations, especially within democratic South Korea, for future normalization, if not unification.

The Moon-Kim and Trump-Kim summits—as well as the spate of other high-level meetings involving China, Japan, and Russia—have raised new opportunities and uncertainties. But whether the latest diplomatic opening is different this time is a question that can only be answered in the coming months and years. The post-summit environment remains long on promise but short on concrete achievements. Converting this summitry into a sustainable, effective diplomatic process that abolishes Pyongyang’s nuclear-weapon-related capabilities and their means of delivery is the study in diplomacy that this report seeks to analyze. The ultimate aim of convincing North Korea to swap nuclear weapons for peaceful economic development is an uphill battle.

The following recommendations for diplomatic and economic engagement with North Korea should help guide U.S. and other policymakers.

#### **Maintain pressure but recognize reduced leverage once the process begins.**

Maximum pressure is, for the moment, to be set aside so long as talks make progress. But unless sufficient pressure is applied throughout negotiations, North Korea will have every incentive to cheat and manipulate the process to buy time and leverage the particularities of its regime, such as power concentrated in one leader and an opaque system of governance. In the past, the temptation has always been for the United States and others to let up on pressure the moment a broad agreement is reached. Pressure alone may be insufficient, but diplomacy without persistent pressure would likely repeat the mistakes of the past. Sanctions should be peeled away slowly and in proportion to the level of genuine cooperation from North Korea on denuclearization. Even assuming full cooperation, some sanctions should

remain, and the ability to reverse sanctions should be a routine part of policy planning. Similarly, it should be possible to reduce military tensions without reserving the ability to swiftly mobilize a strong deterrent and response force, or to bring back the threat of military options should Pyongyang abandon its commitments. Although the Moon and Trump administrations successfully stuck to the same strategy prior to the summits, the expectations raised at the Panmunjom summit put the onus on the United States to begin relieving pressure on North Korea. Still, the Trump administration should have an ambitious list of Chinese entities to sanction should diplomacy collapse. But Xi’s embrace of Kim in Beijing in late March and again in early May suggests that, if he has not already begun to do so, he will prioritize providing North Korea with carrots to continue engaging well before the United States would prefer.

#### **Even assuming full cooperation, some sanctions should remain, and the ability to reverse sanctions should be a routine part of policy planning.**

##### **Match concessions and sanctions relief to the importance of specific North Korean actions.**

The pragmatic way forward would be to calibrate big concessions from North Korea with larger rewards, to include some relief from sanctions. Smaller concessions should receive smaller rewards in the form of confidence-building measures, exchanges, and investments that cannot be converted into support for North Korea’s military programs, should the search for a sustainable diplomatic framework fail. For instance, there is a concern that some potential investments in North Korea could provide dual-use technologies that could enhance Pyongyang’s clandestine military programs; investments should be vetted for such unintended consequences. Action-for-action is still a sensible principle on which to proceed. But as for its implementation, this means that only genuinely significant actions by North Korea deserve significant rewards. If North Korea does allow international verification of its full nuclear inventory, and move within the next two years or less to dismantle key elements of the nuclear and missile programs, then sanctions should remain in place and major investments should be held in abeyance.

**Demand full disclosure of North Korea's nuclear dossier and urge North Korea to accept the International Atomic Energy Agency (IAEA) Additional Protocol.**

Ensuring North Korean disclosure and maximum verification towards complete, verifiable, irreversible dismantlement (CVID) will be essential if a diplomatic breakthrough is to be sustained this time. While CVID will remain a long-term goal, the priority for sustainable diplomacy will require a timetable in which substantive steps for dismantlement occur within a relatively short window, probably by 2020, the final year of President Trump's first term in office. Early in the negotiations, North Korea must divulge the extent of its nuclear holdings, from weapons and fissile material production to other facilities scattered throughout the country. Half-hearted measures—like attempting to sell the Yongbyon nuclear facility outside of Pyongyang once again, or destroying a nuclear testing site that was apparently damaged during the mammoth September 2017 explosion, for example—would not constitute anything close to full disclosure. (U.S. intelligence is aware of fissile material production facilities beyond those at Yongbyon.) A declaration from North Korea of its significant facilities and inventory would be a vital step toward testing Kim's commitment to CVID.

**Ensure constant international coordination to keep key actors working on a common strategy and implementation plan.**

To keep all states committed to the same basic strategy, the Trump administration will need to enhance both bilateral and multilateral mechanisms while retaining control of the policy's overarching trajectory. Reviving Six-Party Talks would be a sensible starting point for a multilateral framework. Four- or Five-Party Talks, by contrast, are both problematic propositions. The United States could imagine leaving Russia out, but China would likely then object to including Japan, a U.S. ally that Washington will not allow to be sidelined. In addition, active diplomacy in Northeast Asia will be required to ensure Washington is not excluded from important discussions, such as potential developments between China and Russia, or among China, South Korea, and Japan.

**Build up effective channels of communication with North Korea.**

Channels of communication with North Korea have never been adequate or robust, and, if nothing else, the current period of rapprochement allows new opportunities for routinizing contacts. The current absence

of reliable, authoritative channels of communication with Kim Jong-un hampers diplomacy and could lead to crisis-level instability. The intelligence agencies of North Korea, South Korea, and the United States were invaluable in establishing the summit diplomacy. Those channels should be maintained going forward, given the sensitivity of many of the issues to be discussed and the location of people inside North Korea with knowledge about nuclear weapons. But if the process gains further momentum, expert dialogues should expand to include more senior military officers, top party officials, and scientists, as well as special envoys and diplomats. Permanent liaison offices in Pyongyang and Washington could provide a platform for expanded contacts.

**Prepare for contingencies.**

Unexpected success is a possibility that requires agile planning and diplomacy. Still, devastating failure remains more likely, and one means of enhancing the likelihood of this failure would be for a key actor such as South Korea to think that the diplomatic process, once begun, is more important than effective security outcomes. Both the ROK and China might find a flawed diplomatic agreement that diffuses tensions but leads to de facto acceptance of North Korea as a nuclear-weapon state preferable to the military tension of the fall of 2017. This is one of the key dangers of the current haste to reach dramatic diplomatic breakthroughs. It is essential that both Presidents Moon and Trump seek new ways to increase pressure even further if a deal is flawed. The volatility of the Korean Peninsula demands that the United States and the international community remain prepared for failure. Although there are no good military options, the collapse of negotiations and the deployment of North Korean nuclear-armed missiles are two of the scenarios most likely to make preventative war more appealing for the United States. Thinking through ways to return to the less lethal but still effective strategy of maximum pressure would be a sensible diplomatic contingency plan.

**Reward substantial progress with sanctions relief and incorporate North Korea into the global trading system by sponsoring it to seek membership in the World Trade Organization.**

China's enforcement of sanctions from the fall of 2017 through early 2018 slashed North Korea's abilities to export any significant quantities of its most important goods. But North Korea's foreign trade situation was neither sustainable nor secure even before these sanctions. As such, removing economic sanctions alone will

not be enough: For North Korea to diversify its trade and make it more sustainable, it needs to be integrated into the international trading system. The international community should consider, at the appropriate time, sponsoring North Korea for World Trade Organization (WTO) membership as an inducement. This would be a lengthy process, but it would produce salutary effects along the way. WTO membership would be crucial to North Korea's aspiration to join the global economy and would both increase and diversify its foreign trade. Membership would also require the country to strengthen its capacity for monitoring and gathering statistics on its economy, a task with which the United States, South Korea, and the U.N. should stand ready to assist. The WTO would also require that North Korea undertake a wide range of economic reforms in both micro- and macroeconomic management, and free up its own system for foreign trade to allow freer competition for domestic actors. Here, too, the United States, South Korea, and other parties involved should stand ready to help North Korea with capacity building for such reforms.

## **For North Korea to diversify its trade and make it more sustainable, it needs to be integrated into the international trading system.**

### **Assist North Korea's agricultural reforms.**

The North Korean regime has yet to announce any broad, sweeping agricultural reforms along the lines of what China implemented in the 1970s. Within the international community, China would likely be open to supporting North Korea with expertise in farming reform, having itself gone from a collectivist, socialist system similar to North Korea's in the late 1970s to a more market-based system by the early 1980s. A possible material inducement could include a limited supply of machine tools and other equipment. Such support must be tied to North Korean reforms of the ownership structure of land and agricultural production. In the long run, its farmers must be able to privately own the land they work, but in the more immediate term, any support for North Korean agriculture should be given only as the country takes tangible steps toward letting farmers dispose of their full production and toward levying taxes on them as regular producers in a market-based system.

### **Assist North Korean authorities in constructing a functioning monetary system.**

North Korea's monetary system is deeply fragmented, fragile, and dysfunctional. Many North Koreans hold whatever savings they have in foreign currencies such as the RMB or U.S. dollar, rather than in the North Korean won. The United States, South Korea, and other parties involved should offer Pyongyang assistance for capacity-building—training to North Koreans on central bank management and macroeconomic data collection, for example—as a carrot in the diplomatic process. North Korean capacity to implement policy and monitor the stability of its currency might be more robust than many believe. But the country's monetary system is still lacking in many respects, as evidenced by the relatively low credibility of the won and the public's preference for saving in foreign currency.

### **Facilitate and enable North Korea's special economic zones (SEZs) to seek foreign investments, but do it the right way.**

The North Korean predilection for SEZs, or special economic zones, dates back to the late 1980s. Only in recent years, however, has the government adopted laws and regulations that hold up to international standards. Potential investors still face overwhelming political and commercial risks. North Korea lacks a judicial environment that investors can trust, and it also largely lacks the sort of infrastructure required to support commercial success for foreign investors. Above all, the tensions around North Korea's nuclear program make most investors shudder at the very thought of taking their factories to the country. That said, SEZs remain part of North Korea's economic strategy: Kim Jong-un designated over a dozen new areas as SEZs in 2013 and 2014. The North Korean preference for SEZs is hardly surprising. In theory, they allow the regime to reap the benefits of foreign investment without risking unwanted foreign social and political influences. Indeed, Thae Yong-ho, a former North Korean high-level diplomat, said in an interview in May 2018 that Kim Jong-un hopes to use the SEZ-model to gain revenue from tourism and foreign manufacturing while keeping economic reforms isolated from the rest of North Korean society.

With the right form of engagement and incentives, this need not be the case. If done right, SEZs can provide a starting point for institutional change in the economy, allowing the government to experiment with economic policy changes on a smaller scale before implementing them on a broader, systemic scale.



**Support judicial reform for a sound institutional environment.**

In many realms, North Korea's judicial system only exists nominally, and no individuals or businesses are afforded the right of due process. North Korea's judicial system will eventually require a full-scale overhaul. But for the purposes of attracting foreign investments and spurring domestic economic activity, a few specific measures would go a long way. For foreign investments, the laws that exist on the books contain several key tenets for incentives and protections, such as land use and transfer rights, property rights for buildings, managerial discretion in production, hiring and wage setting, among other issues.<sup>6</sup> But for foreign investors to be able to trust that those laws will be enforced, North Korea would need to allow for international commercial arbitration; and when the first cases arise, it would need to be able to show that its courts rule impartially in cases between national entities and international investors. Chinese and other international businesspeople with experience in North Korea have often been cheated on contracts and deals; North Korea must take concrete measures to change this reputation. Domestically, the state must codify and formalize the market system to a greater extent, enact protections for private property, and create transparent laws to guide the increasingly vibrant market sector. Here, a wide range of actors within the international community should stand ready to help with broad reforms of the North Korean judiciary, to assist in the creation of organs for oversight and judicial independence.

**Help create a functioning financial sector.**

North Korea largely lacks a financial sector in the conventional sense. In the past few years, the country has seen a modest growth of financial services, such as debit cards and ATMs, but this has not translated into any significant or widespread use by the public. Indeed, much of this growth is exclusively targeted at tourists and other foreigners in the country, rather than at North Korea's own population. This dynamic is a major stumbling block for any economic progress. With the growth of the market economy, the so-called *donju*—a nascent, urban, entrepreneurial middle class—has risen to become a relatively wealthy social class, with a significant amount of funds to invest but no real options for placing their money, since no commercial banking sector exists. One of the main reasons for the boom in construction in North Korea over the past few years is that it is one of few sectors where citizens can invest their money; even real estate investment cannot be done in a judicially safe

or transparent manner. For any substantial and sustainable economic growth to take hold, North Korea needs a financial sector that can mobilize both domestic and foreign resources to spur development in sectors such as industry, agriculture, and other parts of the real economy.

Whether change comes quickly or slowly on the peninsula, these guidelines can help inform U.S. and other decisionmakers as to how to move forward with peace, disarmament, and economic development. While the recommendations are focused on the two Koreas, there is no doubt that a significant shift in relations between the two Koreas as well as between North Korea and the world would bring profound change to all of Northeast Asia. To ensure the verification of commitments and the preservation of a strong alliance, diplomacy will remain a vital instrument in managing the North Korea issue.



**“Diplomatic strategy seeks advantage for the state by measures short of war. It is directed at ensuring that as many paths as possible lead to peaceful gains vis-à-vis other states and as few as possible lead to setbacks, the requirements to use force, or the need to defend against aggression. Diplomatic strategy must be judged by what it prevents as much as by what it achieves.”**

**—Chas. W. Freeman, Jr.<sup>7</sup>**

## Introduction: The Power and Peril of Diplomacy

**T**he June 12 Trump-Kim summit represents not a conclusive new end state, but rather another inflection point to what a brighter future might hold. We may be on the cusp of a new era in which North Korea ceases to be a belligerent actor self-isolated from the connectivity and prosperity of Northeast Asia and the world. Then again, we may be experiencing another short-lived attempt to resolve more than seven decades of division, conflict, and confrontation on the peninsula. Given the poor alternatives, even a relatively low probability of finding a diplomatic resolution to the North Korea problem is worth trying. U.S. relations with North Korea since the arrival of the Trump administration are a fascinating, living study in diplomacy, with a violent past and an unknown future.

Ever so quickly, North Korea appeared to metamorphose from a military threat to a diplomatic problem. How could perceptions of North Korea undergo such a sea change, swinging from military escalation to unprecedented sanctions to talk about permanent denuclearization and peace? Thus far, military might has overshadowed the role of non-military instruments of power. But whether diplomacy and economic development can sustain the current attempt to end a longstanding cold war is a question that for now defies a clear answer.

Diplomacy—combined with economic, military, informational, and other instruments of power—is creating an opening that could change the course of history. Diplomacy is one of the most versatile tools of statecraft: It can defend vital national interests without casualties and the high price of war; it can mobilize other actors around national policy, building international coalitions to share burdens, confer legitimacy, and lower the transaction costs should harsher measures be required; and, sometimes, it can create breakthroughs that many assumed were impossible.

Although North Korea poses myriad challenges to security and human rights, the immediate goal of ending its nuclear weapons program is worthy of serious diplomatic testing. Deterrence may keep the peace, but eradicating North Korea's nuclear arsenal would significantly reduce the risk of catastrophic war. Diplomacy could end the peninsula's divisions and integrate an outlier state into a prosperous and advanced Northeast Asia. Preventing nuclear proliferation on and off the peninsula, and establishing a durable peace, would be a monumental achievement.

When Kim Jong-un emerged from Panmunjom, climbed down the steps, and walked across the Military Demarcation Line separating North and South Korea to shake hands with President Moon Jae-in, live video captured an encounter that seemed transformative. Notwithstanding widespread doubts as to whether peace and disarmament can be realized, April 27, 2018, is a hopeful moment in a long storyline punctuated by failure. Ahead of the June 12 Singapore meeting between President Donald Trump and Chairman Kim Jong-un, diplomacy assumed a life of its own since the April inter-Korea tête-à-tête at Panmunjom.

Miracle or mirage, summit diplomacy made an impact. Whether lasting peace on a nuclear-free Korean peninsula is taking root remains to be seen, but on April 27 the two Korean leaders—and most surprisingly, North Korea's leader—commanded the global center stage. Accepting enormous risks, together the third-generation representative of a dictatorial family dynasty and the progressive social justice lawyer democratically elected to the highest office last May, ended the day by issuing a stunning Panmunjom Declaration that called for replacing the 1953 Armistice—which nominally brought an end to the Korean War and established the Demilitarized Zone—with a peace treaty by the end of the year. In the meantime, the two Korean leaders also pledged to take more practical steps, including moving forward to complete rail and road links on the eastern corridor of the peninsula, first agreed to in the October 4, 2007 Declaration.<sup>8</sup>



North Korean leader Kim Jong-un and South Korean President Moon Jae-in shake hands over the military demarcation line on April 27, 2018. The two leaders met for a historic inter-Korean summit meeting, the third-ever meeting since the peninsula split in 1945 and the first since 2007. (Korea Summit Press Pool/Getty Images)

President Trump also gambled on diplomacy by agreeing to meet with Kim, in Singapore on June 12. Many fear the summit makes Kim appear an equal to the president of the United States, and few are convinced that Kim's surprising offers of denuclearization and peace are definitive. Assessing fundamental change is necessarily a process. Peace and denuclearization are linked, but they are not weighted equally by different leaders. While a peace treaty is foremost in the mind of President Moon, for President Trump denuclearization is the *sine qua non* for achieving peace. For Kim, both peace and denuclearization may mean something else altogether, such as a weakening of the U.S.-ROK alliance and only a partial trimming of Pyongyang's nuclear capabilities.

Perhaps no country in the world has such concentrated political power in a single individual as North Korea. Kim Jong-un is the 34-year-old grandson of Kim Il-sung, the founder of North Korea (officially, the Democratic People's Republic of Korea, or DPRK). On September 9, 2018, Kim will preside over the 70th anniversary of North Korea. At that point, after just seven years in power, the third-generation Kim will have transcended the diplomatic accomplishments of both his grandfather and father. Although his father, Kim Jong-il, managed the first two inter-Korea summits, only Kim Jong-un has demonstrated nuclear and missile prowess and agreed to a first-ever summit with the American president. In 1994, Kim Il-sung was set to meet South Korean President Kim Young-sam in Pyongyang, but he died of a heart attack several weeks before their July 25 rendezvous.<sup>9</sup> And in 2000 and in 2007, Kim Jong-il hosted South Korean Presidents Kim Dae-jung and Roh Moo-hyun. But crossing into South Korean territory on live television and signing a document committing the two leaders to completing a permanent peace regime and a nuclear-free peninsula surpassed previous diplomatic milestones, both in theater and in setting expectations.<sup>10</sup> Although much of the joint statement both leaders signed in April borrowed language from the previous two inter-Korean summits, the Panmunjom Declaration evinced a tone of permanence and irreversibility not yet matched by objective fact. Beyond the agreement itself, the summit meeting represented a personal accomplishment for the North Korean leader: It transformed a reclusive tyrant into a statesman.

But the spring of summitry may give way to a summer, autumn, or winter of diplomatic failure. The fears and traps abound. Will Kim manage to bust the pressure arrayed against him without abandoning his nuclear weapons seen as crucial to the survival of his regime? Is

he simply making a tempting offer that will never come to fruition and conceals other threatening capabilities and malign intentions? Will détente and denuclearization lead North Korea away from tyranny and toward greater freedom? Can North Korea open and liberalize its economy without jeopardizing the legitimacy of the Kim family regime? Furthermore, will the rapid pace of diplomatic activity usher in a shift in the power balance and relations both on the peninsula and within Northeast Asia? Might North Korea move toward closer alignment with South Korea and the United States, or is China likely to gain greater strategic influence over the peninsula, reducing the power of America's post-World War II system of security and bilateral alliances?

This report is divided into two parts. The first delves into the diplomacy of the past 18 months. The latter examines economic issues and pressure, especially based on an empirical understanding of the North Korean economy. Each of these sections provides recommendations and concluding thoughts that attempt to put the dramatic recent shift from brinkmanship to summitry into perspective. Success will take time, but a long process does not guarantee success. Whatever the future holds, the recommendations in this report can serve as important policy footholds for U.S. and international officials scaling great heights and toiling at lower levels, often out of public view, working on the routine but indispensable business of implementation.

# **CHAPTER 1**

## **A Diplomatic Opening**



**F**ear, money, and fame can catalyze, propel, and sustain diplomacy. All can help explain the new diplomatic opening that emerged with North Korea by mid-2018. The strategy of maximum pressure and engagement helped lead to a dramatic shift in North Korea's stance on peace and denuclearization. But explaining Kim Jong-un's apparent change of heart in abruptly moving from provocative military activities to focusing on economic development and diplomacy requires looking at both his newfound military capabilities and the state of his economy and his strategic aims. Seizing the opening to secure durable peace and disarmament will require further dramatic concessions and tradeoffs by various leaders. The twin goals of simultaneously replacing the 1953 Korean Armistice with a permanent peace regime and striving for complete, verifiable, irreversible dismantlement (CVID) of North Korea's nuclear weapons program are inseparable. Peace without CVID is unacceptable to the United States, and CVID without meaningful security guarantees and economic rewards is probably of little interest to North Korea.

### The Road to Diplomacy

At the height of applying pressure on North Korea in 2017, controversy about possible military strikes stirred global concern and criticism of the Trump administration. While undeniably a riskier strategy than past approaches, Trump's unpredictability may have spurred the policy shift toward diplomacy that was always sought. In its approach, the Trump administration was adopting one of the core insights from the successful negotiations that produced the Armistice after the Korean War. In a 1955 reflection, Admiral Turner C. Joy, chief U.S. military delegate to the two-year negotiations, offered this cardinal lesson from those talks: "[I]t is only through the imminent threat of application of our military power that the Communists can be compelled to negotiate seriously for the alleviation of the basic issues between their world and ours."<sup>11</sup>

The last year of President Barack Obama's administration saw a heightening of tension and pressure, as North Korea conducted a fourth and fifth nuclear test and began to diversify its array of missiles. President Obama and then-South Korean President Park Geun-hye opted not for strategic patience but for enhanced diplomatic, economic, and military pressure. In the early months of the Trump administration, an interagency review of North Korea policy settled on an approach of "maximum pressure, followed by engagement." "Maximum" referred mostly to the limited pressure tactics of the



*President Donald Trump visits Beijing and meets with Chinese leader Xi Jinping on November 9, 2017. At the meeting, Trump used flattery and praise to appeal to Xi to take tougher measures on isolating North Korea. (Thomas Peter-Pool/Getty Images)*

past: Sanctions inconvenienced North Korea but lacked the hypothetical weight they might exact on the country's leadership if China fully joined in. Since North Korea's economy depends on China for up to 90 percent of its foreign trade, sanctions and enforcement without China's cooperation were more symbolic than painful.

Given that reality, the Trump administration elevated North Korea to the top of the bilateral policy agenda with China. President Trump cultivated good personal relations with Chinese leader Xi Jinping.<sup>12</sup> Even so, warm relations did not prevent the Trump administration from applying pressure on China in the form of measured secondary sanctions on Chinese entities doing business with North Korea.

Penalties and threats of penalties for noncompliance were meted out strategically and with sufficient warning to give China time to save face and gain merit with Washington by cracking down on Pyongyang. It helped that North Korea's accelerated pace of missile and nuclear testing unsettled regional stability. By the fall of 2017, the Trump administration was regularly thanking China for its cooperation in applying economic pressure on North Korea. At the same time, however, U.S.-China relations entered a contentious period. Beijing took umbrage with being called out repeatedly in national security documents as a strategic competitor rather than as a strategic partner; a trade war loomed over threats of tariffs and investment restrictions; and geopolitical hotspots such as the South China Sea and especially Taiwan, threatened to flare up. This downturn in

## Increasing Pressure and Diplomacy



Sources: “Chronology of U.S.-North Korean Nuclear and Missile Diplomacy,” fact sheet, Arms Control Association, June 2018, <https://www.armscontrol.org/factsheets/dprkchron>; and Kanga Kong, “North Korea’s Nukes,” Bloomberg, March 27, 2018, <https://www.bloomberg.com/quicktake/north-korea>.

Sino-U.S. relations threatened to undermine cooperation over North Korea precisely at a time when North Korea’s peace offensive could test unity among the outside powers.<sup>13</sup>

Although pressure was the focus of the United States’ North Korea policy throughout 2017, the door to engagement remained open. United Nations Security Council Resolutions, U.S. and ROK military shows of force, and various threatening statements emanating from Washington ensured pressure was constantly being ramped up. All the while, quiet attempts at engagement never stopped, but they were mostly intended to keep the door open in the event Kim decided to embrace diplomacy. The new policy started after the election of Donald Trump in November 2016. Although President Barack Obama had hewed to a policy of strategic patience, he instructed Special Envoy Ambassador Joseph Yun to encourage North Korea to provide the incoming U.S. administration with a gesture of goodwill that might establish a basis for more concerted diplomacy going forward. Ambassador Yun’s North Korean counterpart rebuffed the effort, arguing that Pyongyang could not negotiate with an administration seeking regime change. The hyperbolic rejection may have been for effect, but it also could have been an allusion to the fear that the Obama administration was secretly pursuing a disruptive cyber strategy, especially after the 2014 hack on the Sony Corporation.<sup>14</sup> (President Obama’s response to North Korea’s cyberattacks remained unclear, but they might be gleaned from a 2015 interview in which Obama said cyber would eventually produce regime change in North Korea.<sup>15</sup>) Unfortunately, in the face of such a different and unknown U.S. president about to take power, Pyongyang apparently instructed its foreign ministry not to take up the advice of a goodwill gesture to greet the incoming administration.

Shortly after his inauguration in January 2017, President Trump authorized establishing contact with North Korea through the “New York channel” at the United Nations. Choe Son Hui, the Director of the North American Department of the DPRK’s Ministry of Foreign Affairs at the time, was invited to New York for talks. But as Choe and her delegation were leaving Pyongyang for Beijing to acquire the pre-approved visas, Kim’s elder half-brother, Kim Jong-nam, was killed in Kuala Lumpur airport in Malaysia, likely as part of a North Korean assassination plot. The brutal murder—which involved a VX nerve agent, classified as a weapon of mass destruction—prevented the visit from moving forward.

A few months later, in May, Ambassador Yun and Director Choe met in Oslo to negotiate the release of

three Americans held in North Korea, as a humanitarian gesture. At the meeting, North Korea seemed willing, and a week later, the Foreign Ministry indicated that one detainee, a young American named Otto Warmbier, was gravely ill. The 22-year-old had been convicted for the theft and destruction of a propaganda poster in January 2016 and was sentenced to 15 years' hard labor. Subsequent talks resulted in Warmbier's release. However, upon finding the young man in a coma and on life support when he arrived back in the United States in June 2017, the notion of a win-win diplomatic gesture turned into sharp recrimination against the Kim regime that continues even now.<sup>16</sup> (Warmbier died on June 19, 2017.)

August and September 2017 were important turning points in ramping up pressure and inflaming crises that would eventually give way to diplomacy. In mid-August, then-National Security Advisor Lt. General H.R. McMaster spoke on the record about the near-term potential of launching a preventive war against North Korea if it moved ahead with seeking to deploy long-range, nuclear-armed missiles. McMaster warned that the Trump administration was prepared, if necessary, to start a preventive war to stop "North Korea from threatening the United States with a nuclear weapon."<sup>17</sup> On September 3, North Korea conducted its sixth nuclear test, its largest by far, with what the Kim regime claimed was a hydrogen bomb.<sup>18</sup> On September 11, the United Nations Security Council passed resolution 2375, which included "the strongest sanctions ever imposed on North Korea." Resolution 2375 fully banned North Korea's \$800 million-a-year export of textiles, precluded overseas workers from providing \$500 million a year to the regime, and reduced the amount of oil provided to North Korea by 30 percent. Not only did China and Russia support the resolution, but they were susceptible to being coopted into greater enforcement via enhanced maritime provisions.<sup>19</sup> Four days later, North Korea tested an Intermediate Range Ballistic Missile (IRBM) over Japan. On September 19, President Trump used a speech before the U.N. General Assembly to warn North Korea: "The United States has great strength and patience, but if it is forced to defend itself or its allies, we will have no choice but to totally destroy North Korea," the president said. "Rocket Man is on a suicide mission for himself and for his regime," Trump continued, adding, "It is time for North Korea to realize that the denuclearization is its only acceptable future."<sup>20</sup>

As talk of a "bloody nose" option, or a surgical military strike, on North Korea ensued, Pyongyang indicated to all nations that it was no longer interested in diplomacy

because it was in the final stages of completing its nuclear missile program. On November 29, North Korea launched a successful ICBM missile test.<sup>21</sup> This launch of a Hwasong-15 ICBM capable of hitting the "whole mainland of the U.S." came with a statement from Kim Jong-un that North Korea had "finally realized the great historic cause of completing the state nuclear force."<sup>22</sup> While the launch demonstrated North Korea's missile prowess, this accompanying statement marked a potential change in focus. North Korea's declaration that it had met its nuclear goals suggested that it might next turn to its other major policy goal: economic development.

## **President Moon had made finding a path to peace with North Korea the centerpiece of his administration, and he and senior members of his team had relentlessly explored ways to reduce tensions in inter-Korean ties.**

The South Korean government hoped the new ICBM launch would not foil its attempt to use the Olympics to advance inter-Korean ties. Earlier in November, the United Nations General Assembly had passed an "Olympic Truce" resolution, which called for all parties to suspend any provocative acts in the period beginning a week before the Olympics in February until a week after the Paralympics ended in March.<sup>23</sup> Still, as Trump rushed to put North Korea back on the list of state sponsors of terrorism, talk of possible military options continued. But on January 1, Kim Jong-un surprised South Korea, the United States, and the world. While Kim's New Year's message called for the mass production of nuclear arms and claimed he had a "nuclear button" for striking the United States on his desk, Kim also alluded to "the harshest-ever challenges" pressuring North Korea. Most surprising was his unexpected overture for peace and reconciliation with South Korea.<sup>24</sup> President Moon had made finding a path to peace with North Korea the centerpiece of his administration, and he and senior members of his team had relentlessly explored ways to reduce tensions in inter-Korean ties. When Kim finally reached out to Seoul through his New Year's address, the Moon administration was well prepared to use the Winter Olympics to kick-start diplomacy and cast both inter-Korean ties and North Korea in a less hostile light. The new openness to cooperation from North Korea

raised a fundamental question: What were Kim's motives for seizing diplomacy in 2018?

### Motives Behind Kim's Diplomacy

Six years after assuming power and having not once left the country, the 34-year-old Kim embraced diplomacy and statecraft with a vengeance. From his shocking New Year's address to a visit by his sister, Kim Yo-jong, as special envoy to the Pyeongchang Olympics, where North and South Koreans paraded as one team; from a mystery train ride to see Xi Jinping in Beijing and a historic summit at the DMZ to the first-ever meeting with a sitting U.S. president, Kim has demonstrated his newfound belief in the power and utility of diplomacy.

Motivations can be difficult to discern in international relations. That challenge is even greater when a closed, outlier nation, such as North Korea, is involved. The United States and other nations have little, if any, experience or direct contact with Kim and his inner circle. Yet, Kim's basic motivations for turning to diplomacy can be discerned and are enumerated here. The harder, and arguably more important, question is whether this shift to diplomacy is merely tactical or if it will reveal a desire for a true strategic shakeup of the Northeast Asian landscape.

Five factors—newfound confidence, enhanced economic sanctions, international support for a pressure strategy, fear of a military attack, and a clear diplomatic opportunity—help explain why Kim opted to pivot away from weapons of mass destruction and toward diplomacy and development.

*Technical achievements* and the confidence that comes with them are good places to begin in identifying Kim's likely motives. Indeed, the policy U-turn can be dated to a successful missile launch on November 29, which demonstrated North Korea's technical ability to launch an ICBM capable of reaching the United States. Whether Kim had the means to strike the United States with a nuclear weapon appeared doubtful, but the rapid strides suggested demonstrating that ability was but a matter of time. In any event, the missile test gave Kim enough evidence to declare success at home and abroad. Domestically, his *Byungjin* policy line sought both guns and butter, or, more precisely, nuclear arms and economic development in tandem. To some degree, Kim's pivot was rooted in reaching a new threshold of military capability. The military feat capped rapid progress in both nuclear capacity and missile range. Kim had also demonstrated solid-fuel missiles that could be fired on short notice and mobile missiles that could be concealed in North Korea's mountainous terrain. What

Kim has not yet demonstrated to the world, however, is a successful long-range missile launch with a reentry vehicle holding a nuclear warhead. It is unclear if that development is likely: Such technology could already be in secret production; Kim could still require time and money to complete the step; or Kim could be using that latent threat as a bargaining chip.

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*Economic sanctions* may not have exacted truly "maximum" blows to North Korea as of 2018, but eventual financial and economic peril were in plain sight for the regime to see. Kim did not make expressions of military confidence free from coercion. Quite the opposite. The Trump administration's strategy of maximum pressure was gaining traction. What may have surprised Kim was the degree to which both a historical ally, China, and a progressive South Korean leader, Moon, supported the pressure strategy. Without China, unilateral and international sanctions lacked potency. As such, the Trump administration courted China to adopt a common North Korean strategy, using both incentives and negotiation, backed by the threat of secondary sanctions, and naming and shaming Chinese entities doing business with North Korea. At first, critics assailed Trump for believing China would ever share U.S. objectives and sacrifice stability on its border to advance denuclearization. But the Trump administration elevated North Korea policy on the bilateral agenda with China, and North Korea's mounting provocations nudged Beijing closer to a Washington-led pressure strategy. China took steps few imagined it would take, including drastically decreasing its exports of fuel to North Korea and enforcing new United Nations Security Council Resolutions banning the majority of trade with North Korea. In view of Kim's accelerated nuclear and missile programs, economic pressure became a more attractive option to serve Chinese interests.

*The internationalization of sanctions* breathed new life into a tool that has in the past lacked sufficient power to compel change in a bellicose state. China, Russia, and even South Korea preferred tightening economic pressure to potential military action by the United States.



With countries across the globe applying and enforcing sanctions, the economic noose around North Korea tightened. Kim may not have been feeling much pain from sanctions on January 1, but the trend was ominous and clear. In his new openness to diplomacy, therefore, Kim might have acted to stop the growing pressure and worked to reverse it. Kim's meeting with Xi in late March may have also won new assurances from China, possibly undoing some of the success of maximum pressure.

*Military pressure* under President Trump transcended the previous administration's shows of force. Sanctions alone seldom achieve major strategic effects. But in the case of North Korea in 2017, the Trump administration backed unprecedented economic sanctions with heightened military pressure. As part of the interagency review of North Korea policy, the White House had requested new-and-improved "flexible deterrence options" and "force enhancements."<sup>25</sup> Some of the pressure was a variation of previous themes: flying more strategic bombers and stealth fighters over the peninsula and conducting live-fire bombing runs; announcing submarine movements; or positioning three aircraft carriers within striking range of the peninsula at the same time. Smaller actions could also have intimidated Kim, such as a one-paragraph announcement stating that U.S. and South Korean elite special forces were operating on the peninsula. Cyber and psychological operations were undoubtedly another part of the arsenal.

What garnered more attention in Washington was then-National Security Advisor, Lt. General H.R. McMaster's suggestion, in August and September 2017, that a surgical military strike could be imminent. With its openness to a surgical military strike—often referred to as a "bloody nose"—the unpredictable Trump administration now appeared to be risking a catastrophic war. (Seoul had no effective defense against North Korean entrenched, long-range artillery and rockets.) Once conflict broke out, it would be impossible to predict where it would stop. Would nuclear weapons be used? Would the confrontation once again bring China and the United States face-to-face on a Korean battlefield? The newly-elected Moon Jae-in was horrified; as one Blue House official offered in private, "This keeps me up at night."<sup>26</sup> Some speculated that China was also motivated to apply more pressure to prevent possible military action. As for Kim, the combination of an unconventional American president and real planning for military action may have required quick and dramatic action on his part.

*Diplomatic opportunity* is a final factor and one for which much of the credit goes to South Korean President Moon Jae-in. Kim knew the Trump administration was



Vice President Mike Pence and Kim Yo-jong, North Korean leader Kim Jong-un's sister, attend the Pyeongchang 2018 Winter Olympics in South Korea. Kim Yo-jong flashed smiles at the crowds and the media to turn on North Korea's charm offensive, utilizing soft power to outflank Mike Pence in diplomacy and image-making. (Matthias Hangst/Getty Images)

open to talks at the right time. In South Korea, President Moon had floated dozens of diplomatic initiatives—all part of an updated version of the "Sunshine" policy—since coming to office in a special election in May 2017. Before that, Moon served as Chief of Staff to President Roh Moo-hyun, who held the second-ever inter-Korean summit in Pyongyang, in 2007. Moon tapped another veteran of inter-Korean diplomacy, Suh-hoon, to head the National Intelligence Service (the Korean CIA) and prepare for a third North-South summit. Suh was the most qualified person for the job, having previously organized both Roh's summit and Kim Dae-jung's meeting with Kim Jong-il in 2000.

In his push for an inter-Korean summit, Moon moved faster than his predecessors Kim and Roh, each of whom met with Kim Jong-il in the latter part of their single terms in office. Moon knew that to reach the summit with Kim Jong-un in his first year, he would need to make a gesture that would be hard to refuse. That South Korea was hosting the Winter Olympics and Paralympics in February and March 2018 offered an ideal opportunity. The Olympics also presented a strategic opening for Kim Jong-un, who could deploy soft power, led by his photogenic sister Kim Yo-jung, receive credit for "co-hosting" the Olympics, and create a positive global image at a time when the country was facing dire economic and political isolation. Kim Yo-jung—perhaps herself influenced by her success—is widely believed to have encouraged her brother to seek a diplomatic breakout through summitry.

In late March of 2018, a month before the Moon-Kim summit on April 27, at the Demilitarized Zone on the inter-Korean border, Kim left the country for the first time since taking control in December 2011. His visit to Beijing, where he met with Xi Jinping, at least superficially patched a rocky alliance, put China back into a leading role in diplomacy, and strengthened Kim's limited credentials as a statesman. By the time he stepped across the Demarcation Line, took President Moon by the hand, and invited him to step back onto the North Korean side of the dividing line, Kim appeared to understand summitry and public relations, perhaps bolstered by his childhood education in Switzerland. Moon beamed, recognizing that the day validated his life's work and his overriding policy priority. The subsequent weeks promised a Moon-Trump alliance summit, followed by a Kim-Trump summit. The web of summitry quickly thickened, paving the way for Five- or Six-Party talks, should a process be sustained. In May, for example, Tokyo hosted a trilateral meeting with leaders from Seoul and Beijing, and other regional summits were being discussed.

### A Peace Regime and Denuclearization

There are three basic models for denuclearization. The first, a conservative "Libyan" model, calls for maintaining pressure and holding off on all rewards until all nuclear programs are shut down, shipped out of country, or destroyed. The second, a liberal "Chinese" model, builds on step-by-step actions, performed gradually in phases and supported by multilateral diplomacy. The third, a "hybrid" model, remains theoretical but would combine the first two, seeking significant early denuclearization as part of a comprehensive deal while acknowledging the reality that international disarmament would take time to complete.

In the first of these three options, the Libyan model, rewards follow the eradication of its nuclear weapons program. Fifteen years ago, in 2003, Libya's then-leader Col. Muammar el-Qaddafi agreed to send his primitive nuclear technology to a facility in Tennessee.<sup>27</sup> Far from establishing closer relations with the United States after that nuclear surrender, Qaddafi was toppled eight years later in an effort supported by the United States and its allies. That precedent is one reason that experts are skeptical Kim would give up his most important insurance

policy—especially one that his father and grandfather developed.

The Libyan model is the preferred approach of the Trump administration, including new National Security Advisor John Bolton. Bolton, who served as Under Secretary of State for Arms Control and International Security Affairs under George W. Bush at the time that Qaddafi gave up Libya's nuclear weapons, hopes to avoid a phased process that would grant rewards early on and make it far more difficult to maintain pressure throughout. But the United States is virtually alone in staking out this demanding view, and the necessity of keeping in step with South Korea, China, and others may make some compromise necessary. For its part, North Korea has repeatedly made clear it is not Libya. There is no indication Kim Jong-un would agree to the total, nearly-instant and maximally verifiable dismantlement of his nuclear arsenal, past and future. Indeed, after Qaddafi was overthrown, when Kim's father was still in power, a North Korean foreign ministry official said Libya's nuclear agreement had been "an invasion tactic to disarm the country" that proved to be a "grave lesson."<sup>28</sup>

A second approach, or "Chinese" model, involves a step-by-step process in which action by one party is met by a reciprocal action by another. This process of incremental, simultaneous action is a process championed by China, which may be using its own summit meetings with Kim to persuade him to embrace reciprocity. Action-for-action could help convince Kim that he needs to take a chance by making bold concessions if he wants to receive significant benefits. But adopting this approach would mean conferring benefits in the form of sanctions relief on the Kim family regime before their nuclear arsenal could be locked down. Additionally, this model would create leverage for other regional actors, such as China, Russia, and Japan, who could play the role of a spoiler if they judge that a bilateral deal the United States strikes with North Korea disadvantages their own strategic interests. The key danger of an incremental approach is that it could allow the Kim family regime to wriggle out from the pressure that brought it to the bargaining table in the first place and wear down democratic administrations in South Korea and the United States.

A third "hybrid" approach would begin with a comprehensive agreement but then recognize the reality that

**The key danger of an incremental approach is that it could allow the Kim family regime to wriggle out from the pressure that brought it to the bargaining table in the first place and wear down democratic administrations in South Korea and the United States.**

implementation must occur gradually. It must happen gradually because of the vast scale of North Korea's nuclear program and the limits of existing institutions such as the International Atomic Energy Agency (IAEA). Not only missile experts but also, presumably, chemical and biological weapon experts might be needed to help verify the dismantlement of North Korea's weapons programs. The comprehensive agreement would take the form of a bold written declaration as part of a package deal involving both a peace regime and a denuclearization accord. Next would be progressive steps toward implementation. President Moon has put forth this general proposal, but the details may be far from fleshed out. The central question is what early harvest such an agreement can reap with respect to disarmament: e.g., a full disclosure of North Korea's nuclear inventory, closing North Korea's main nuclear testing facility, shipping nuclear weapons out of the country, and disclosing and locking up uranium-enrichment facilities, especially at any previously undisclosed sites. From an American perspective, this question is a crucial one because specific actions and programs locked down within the next year or two would be essential. U.S. interlocutors will likely prioritize obtaining complete access to all nuclear facilities and the dismantlement of all Hwasong-frame ballistic missiles. In Asia, a salient question concerns what incentives should be offered to Pyongyang: e.g., security guarantees from the United States, South Korea, and China, and perhaps tens of billions of dollars of investment in infrastructure and assistance from South Korea, China, and others. Beijing and Seoul prioritize sustaining a diplomatic and non-military approach to managing North Korea, and in the aftermath of the summits can be expected to press the United States to be more forthcoming than it would like with respect to incentives. North Korea will likely seek immediate and tangible economic wins, such as the announcement of key infrastructure projects and the resumption of activity at the inter-Korean Kaesong Industrial Complex. China and South Korea will undoubtedly pressure the United States to front-load benefits to the North. In short, the challenge will be to calibrate sanctions relief to permanent, verifiable denuclearization. Regardless of which type of negotiation model, competing definitions of and demands for denuclearization will be at the heart of any diplomatic process.

Denuclearization poses an early test for North Korea to pass: full disclosure of its nuclear inventory, stockpile, and fissile material, followed by a serious international verification regime. If Kim Jong-un is serious about denuclearization, he will offer to declare an inventory

of related weapons and facilities. If that declaration falls short of what U.S. officials know to exist outside of Yongbyon, talks could fail quickly. Likewise, Kim's willingness to commit to a relatively short timeline for action could propel talks forward, but if he is unwilling to do so, then negotiations could falter. North Korea is believed to have between 6,000 and 8,000 underground tunnels.<sup>29</sup> When it comes to dismantling North Korea's nuclear-weapons capabilities, uncertainties will remain regardless of what is written in an agreement, which is why verification is extremely difficult.

North Korea will make demands of the United States, too. Well before the current summit diplomacy, North Korea proffered five conditions as part of any deal on achieving a nuclear-free peninsula. Those five conditions are: (1) disclosure of nuclear weapons within the U.S. Forces Korea Command, even though all tactical nuclear weapons were removed in 1991; (2) elimination and verification of U.S. nuclear weapons in South Korea, which could justify intrusive inspections on military bases despite the absence of any nuclear weapons; (3) a cessation of U.S.-ROK military exercises mobilizing U.S. strategic assets such as nuclear-capable bombers and submarines; (4) a promise not to use or threaten to use nuclear weapons against North Korea; and (5) withdrawal of U.S. military forces from the Korean Peninsula, a condition that was dropped as part of pre-summit announcements made in the spring of 2018.<sup>30</sup> Still, North Korea has also added new conditions, including the sweeping demand of eliminating all military threats, security guarantees, normalization, and a peace treaty.



*North Korean leader Kim Jong-un meets with South Korean head of the presidential National Security Office, Chung Eul-Yong, in Pyongyang, North Korea, on March 5, 2018. A team of South Korean envoys in Pyongyang aims to get rid of the North's nuclear weapons and to restart dialogue between North Korea and the United States. (South Korean Presidential Blue House/Getty Images)*



Each of these broad conditions could hold up implementation of a deal on denuclearization. If that stalling is Pyongyang's real intent, then the apparent success of the summits will be quickly revealed as hollow. Conversely, Kim has backed off from some of these preconditions, as shown by when he was willing to allow the annual U.S.-ROK military exercises to proceed in April in advance of the summits.

The Panmunjom Declaration nodded in the direction of denuclearization but left the idea of complete, verifiable, irreversible dismantlement of North Korea's nuclear program for the United States to work out with North Korea. The April 27 declaration intimated one of the fundamental differences between the U.S. concept of denuclearizing North Korea and North Korea's concept of a "nuclear-free Korean peninsula." U.S. language of CVID, which has also been used in U.N. Security Council resolutions, could cover not just existing weapons but also the technologies that could build nuclear weapons and their means of delivery in the future. But North Korea has in the past used the nuclear-free formula to open the prospect of reductions in U.S. strategic assets on and off the peninsula, as well as to give North Korea reciprocal verification rights to those the United States and others sought of Pyongyang. North Korea managed to get South Korea to sign on to the latter, raising questions such as the potential impact on the U.S. extended deterrence over South Korea. If North Korea were to insist on rolling back U.S. strategic weapons not just on the peninsula but on other bases in the United States or abroad, South Koreans may harbor serious doubts about America's ability to defend Korea, and Americans may raise new objections about mobilizing for a distant fight. One senior Moon administration official exacerbated this fear when he raised the notion that the United States might have no need to keep troops on the peninsula should a peace regime replace the Armistice.<sup>31</sup>

The heavy lifting of finding a workable model and an effective implementation scheme will continue to take time. The recommendations below offer guidelines for how to proceed with diplomacy with North Korea, specifically with an aim toward CVID and replacing the Armistice with a peace regime.

## Diplomatic Policy Recommendations

### 1. MAINTAIN PRESSURE BUT RECOGNIZE REDUCED LEVERAGE ONCE THE PROCESS BEGINS.

Maximum pressure is, for the moment, to be set aside so long as talks make progress. But unless sufficient

pressure is applied throughout negotiations, North Korea will have every incentive to cheat and manipulate the process to buy time and leverage the particularities of its regime, such as power concentrated in one leader and an opaque system of governance. In the past, the temptation has always been for the United States and others to let up on pressure the moment a broad agreement is reached. Kim's complaints of pressure and his denial that it played a significant role in forcing him to embrace diplomacy would appear to contradict each other.<sup>32</sup> Pressure alone may be insufficient, but diplomacy without persistent pressure would likely repeat the mistakes of the past.

The Trump administration's strategy of maximum pressure followed by engagement is predicated on applying lessons of the past, including the lesson that the premature release of pressure will be exploited, ensuring the ultimate failure of diplomacy. Trump's national security team will need to be steadfast in maintaining pressure and dialing up that pressure when North Korea is not forthcoming or it reneges on a promise. Secretary of State Mike Pompeo and National Security Advisor John Bolton are right to insist on irreversible steps toward denuclearization before sanctions relief is granted to North Korea.<sup>33</sup>

**Trump's national security team will need to be steadfast in maintaining pressure and dialing up that pressure when North Korea is not forthcoming or it reneges on a promise.**

The United States should not underestimate the challenge of maintaining economic and military pressure through a protracted period of negotiations. Sanctions should be peeled away slowly and in proportion to the level of genuine cooperation from North Korea on denuclearization. Even assuming full cooperation, some sanctions should remain, and the ability to reverse sanctions should be a routine part of policy planning. Similarly, it should be possible to reduce military tensions without reserving the ability to swiftly mobilize a strong deterrent and response force, or to bring back the threat of military options should Pyongyang abandon its commitments. Although the Moon and Trump administrations successfully stuck to the same strategy prior to the summits, the expectations raised at the Panmunjom summit will put the onus on the United States to begin



releasing pressure on North Korea. President Moon will want U.S. approval to follow diplomacy with rapid investment, such as in special economic zones, transportation, and infrastructure. Sustaining China's current level of pressure will also become highly problematic. China's decision to strictly implement U.N. Security Council resolutions along the border appears to have been instrumental in convincing Kim that the economic sanctions would eventually cripple the North Korean economy. Secondary sanctions spurred China's cooperation in the lead-up to the summits, and secondary sanctions will be necessary should North Korea start dragging its feet with respect to implementation of accords. The Trump administration should have an ambitious list of Chinese entities to sanction should diplomacy collapse. But Xi's embrace of Kim in Beijing in late March and again in early May suggests that, if he has not already begun to do so, he will prioritize providing North Korea with carrots to continue engaging well before the United States would prefer.

## **2. MATCH CONCESSIONS AND SANCTIONS RELIEF TO THE IMPORTANCE OF SPECIFIC NORTH KOREAN ACTIONS.**

The pragmatic way forward would be to calibrate big concessions from North Korea with larger rewards, to include some relief from sanctions. Smaller concessions should receive smaller rewards in the form of confidence-building measures, exchanges, and investments that cannot be converted into support for North Korea's military programs, should the search for a sustainable diplomatic framework fail. For instance, there is a concern that some potential investments in North Korea could provide dual-use technologies that could enhance Pyongyang's clandestine military programs; investments should be vetted for such unintended consequences. Action-for-action is still a sensible principle on which to proceed. But as for its implementation, this means that only genuinely significant actions by North Korea deserve significant rewards. If North Korea does allow international verification of its full nuclear inventory, and move within the next two years or less to dismantle key elements of the nuclear and missile programs, then sanctions should remain in place and major investments should be held in abeyance.

The international community should expect that Pyongyang will try to sell various actions and disclosure as major concessions even when they are not. For instance, the Yongbyon reactor was "bought" several times over the past quarter-century, and the two years it took to destroy a cooling station at Yongbyon obscured

the reality that the tower was insignificant in North Korea's overall nuclear arsenal. To limit North Korea's ability to define what "successful denuclearization" looks like, the United States should clearly and publicly state what specific actions it is seeking North Korea to commit to.

## **3. DEMAND FULL DISCLOSURE OF NORTH KOREA'S NUCLEAR DOSSIER AND BE ASKED TO ACCEPT THE INTERNATIONAL ATOMIC ENERGY AGENCY (IAEA) ADDITIONAL PROTOCOL.**

Ensuring North Korean disclosure and maximum verification towards complete, verifiable, irreversible dismantlement (CVID) will be essential if a diplomatic breakthrough is to be sustained this time. While CVID will remain a long-term goal, the priority for sustainable diplomacy will require a timetable in which substantive steps for dismantlement occur within a relatively short window, probably by 2020, the final year of President Trump's first term in office. Early in the negotiations, North Korea must divulge the extent of its nuclear holdings, from weapons and fissile material production to other facilities scattered throughout the country. Half-hearted measures, like attempting to sell the Yongbyon nuclear facility outside of Pyongyang once again, or destroying a nuclear testing site that was apparently damaged during the mammoth September 2017 explosion, for example, would not constitute anything close to full disclosure.<sup>34</sup> U.S. intelligence is aware of fissile material production facilities beyond those at Yongbyon. A declaration from North Korea of its significant facilities and inventory would be a vital step toward testing Kim's commitment to CVID.

The international community has learned lessons about how to create a strong verification regime that reduces the margin of error. There is no foolproof system, and North Korea is not likely to allow 10,000 inspectors to travel freely throughout the country. To make matters more complicated, the cavernous terrain favors concealment of some technologies and weapons systems. The IAEA Additional Protocol provides the most rigorous means of detecting cheating and ensuring compliance. However, even then there is no such thing as "irreversible" dismantlement, as any country with a knowledge of nuclear weapons could eventually reverse course. The aim must therefore be relative irreversibility, which would reduce the chances that North Korea could pull out of a denuclearization accord without early indicators that it was breaching its commitments.

#### 4. ENSURE CONSTANT INTERNATIONAL COORDINATION TO KEEP KEY ACTORS WORKING ON A COMMON STRATEGY AND IMPLEMENTATION PLAN.

Among the many obstacles of implementation of what is agreed at a summit is that declarations must be the successful diplomatic orchestration of a common international strategy. That means that the more Kim can point to policy differences between outside powers, the more susceptible the process will be to failure. The North Korea problem intersects the important interests of several surrounding powers, including China, Japan, and Russia. To keep all of these powers committed to the same basic strategy, the Trump administration will need to enhance both bilateral and multilateral mechanisms while retaining control of the policy's overarching trajectory. Reviving Six-Party Talks would be a sensible starting point for a multilateral framework. Four- or Five-Party Talks are both problematic propositions. The United States could imagine leaving Russia out, but China would likely then object to including Japan, a U.S. ally that Washington will not allow to be sidelined. In addition, active diplomacy in Northeast Asia will also be required to ensure Washington is not excluded from important discussions, such as potential developments between China and Russia or among China, South Korea, and Japan.<sup>35</sup>

#### 5. BUILD UP EFFECTIVE CHANNELS OF COMMUNICATION WITH NORTH KOREA.

Channels of communication with North Korea have never been adequate or robust, and, if nothing else, the current period of rapprochement allows new opportunities for routinizing contacts. The current absence of reliable, authoritative channels of communication with Kim Jong-un hampers diplomacy and could lead to crisis instability. The hotline President Moon and Chairman Kim established was a useful gesture of goodwill, as was the idea of placing North Korea on the same time zone as South Korea. The United States must take advantage of the current momentum for diplomacy to build a resilient network of communications with the North Korean regime. Kim is able to use the openness of the United States and other countries to his advantage; narrowing the vast chasm between a dynastic dictatorship and democracies could make diplomacy more resilient. The intelligence agencies of North Korea, South Korea, and the United States were invaluable in establishing the summit diplomacy. Those channels should be maintained, given the sensitivity of many of the issues to be discussed and the location of people inside North Korea with knowledge about nuclear weapons. But if

the process gains further momentum, expert dialogues should expand to include more senior military officers, top party officials, and scientists, as well as special envoys and diplomats. Permanent liaison offices in Pyongyang and Washington could provide a platform for expanded contacts.

#### 6. PREPARE FOR CONTINGENCIES.

The Panmunjom Declaration emerging from the Moon-Kim summit was the loftiest by far among the three inter-Korean summit communiqués of 2000, 2007, and 2018. Unexpected success is a possibility that requires agile planning and diplomacy. Still, devastating failure remains more likely, and one means of enhancing the likelihood of this failure would be for a key actor such as South Korea to think that the diplomatic process, once begun, is more important than effective security outcomes. Both the ROK and China might find a flawed diplomatic agreement that diffuses tensions but leads to de facto acceptance of North Korea as a nuclear-weapon state, preferable to the military tension of the fall of 2017. This is one of the key dangers of the current haste to reach dramatic diplomatic breakthroughs. It is essential that both Presidents Moon and Trump are prepared to walk away from a flawed deal and seek new ways to increase pressure even further.

The volatility of the Korean Peninsula demands that the United States and the international community remain prepared for failure. Although there are no good military options, the collapse of negotiations and the deployment of North Korean nuclear-armed missiles are two of the scenarios most likely to make preventative war



North Korean leader Kim Jong-un shakes hands with South Korean President Moon Jae-in after signing the Panmunjom Declaration for Peace, Prosperity and Unification of the Korean Peninsula on April 27, 2018. (Korea Summit Press Pool/Getty Images)

more appealing for the United States. Thinking through ways to return to the less lethal but still effective strategy of maximum pressure would be a sensible diplomatic contingency plan.

Even if talks are successful, a radical shift from decades of hostility to peace will always be susceptible to a reversal of fortunes. The opening of North Korea could trigger domestic political upheaval in a manner not dissimilar from that which followed in Eastern Europe after the breakup of the Soviet Union. This comparison is not meant to suggest that the North Korean system is close to failure at this point, and no doubt Kim has closely studied the downfall of the USSR and its satellite states. But surely Kim is wary of the unintended consequences of *gaige kaifang*, the economic reform and opening of the Chinese system instituted by Deng Xiaoping in 1979. For instance, former North Korean diplomat Thae Yong-ho predicts Kim is only interested in old-style economic investments like the Kaesong Industrial Complex that bring lucrative rents to Pyongyang without the pressure of internal reform.<sup>36</sup> The Eastern Europe scenario in which economic reform catalyzed regime change is also one reason that the United States cannot provide absolute security guarantees about Kim's survival. Given its democracy-advancing agenda, the United States would be reluctant to allow repression of a democratic uprising against a dictatorship. This reality confines U.S. security assurances to the promise of nonaggression, rather than a positive security guarantee to protect the regime.

## **CHAPTER 2**

### **The Economic Dimensions of North Korean Diplomacy**



**N**orth Korea is a tough target for sanctions. While the current sanctions on all of its most important export goods are further depressing the economy from an already troubled state, its authoritarian system and repressive nature limits the domestic public's criticism of the regime. At the same time, Kim Jong-un has staked much of his domestic credibility on economic progress. In the national priorities laid out in his hallmark *Byungjin* strategy, launched in 2013, Kim placed economic development on par with achieving a nuclear deterrent. He has not introduced any sweeping overhaul of the economic system, but he has solidified the role of market mechanisms within it. On April 20 of this year, Kim declared to the Central Committee of the Worker's Party of Korea that because the nuclear deterrent is secure, the state will now adopt the so-called "New Strategic Line," a move that fully shifted focus to economic construction.

The North Korean economy, in other words, is a significant consideration in the Kim regime's diplomatic strategies toward the United States, South Korea, and the broader international community. While the nuclear issue is the main focal point for global attention, North Korea expects that economic rewards will be part of the process. It is crucial that the United States and its allies push for such economic rewards to be geared toward sustainable growth through institutional changes in the North Korean system. For the diplomatic process to succeed in the long run, it is in the interest of the international community as a whole that the North Korean economy become a well-functioning, prosperous part of the global economy.

To this end, the international community should offer capacity-building assistance in key areas of economic management to Pyongyang as part of the negotiations for denuclearization. In exchange for concessions on its nuclear program, the international community should also offer sanctions relief and membership in the World Trade Organization (WTO). Support for economic capacity building and integration into the global trade community will both be a carrot for Pyongyang and serve to strengthen peaceful development and prosperity in Northeast Asia.

As importantly, the countries involved in the negotiations should prioritize capacity assistance over cash transfers and direct financial transfers to Pyongyang. Economic cooperation with Pyongyang should be directly and explicitly aimed at facilitating changes to the current system, rather than propping it up and helping the regime avoid changes that are necessary but may be politically difficult. Although economic aid may be more

palatable to Pyongyang than assistance for systemic change, it could help uphold a repressive social structure and a highly inefficient economic system. A transition to a more market-based economic system is already taking place to some extent. In encouraging this transition, the international community would be supporting a development that began in North Korea several years ago. It is crucial that the United States and its partners coordinate closely on any assistance to North Korea, to ensure that support for broader economic transformation remains a consistent goal.

**Economic cooperation with Pyongyang should be directly and explicitly aimed at facilitating changes to the current system, rather than propping it up and helping the regime avoid changes that are necessary but may be politically difficult.**

### **From Stalinism to Grassroots Markets: The North Korean Economy**

Though still a nominally socialist economy, the decline and eventual downfall of the Soviet Union set North Korea on a trajectory of change toward a more market-based economic system, both among the grassroots population and in the management of the state sector. Markets for food and consumer goods were first largely illegal, but today, they provide for most of the population's sustenance. At times the government has fought marketization, the most prominent example being the botched currency reform in 2009 that wiped out the savings of many in the middle class who made their money through the market system.

But since Kim Jong-un took power in late 2011, the state has taken a much more conciliatory approach to the market system. Rather than suppressing the markets, North Korea under Kim has co-opted them and integrated them in the economic system to a greater degree than before, by strengthening practices such as tax collection and the permit regime for market trade.<sup>37</sup>

While some observers regard marketization as a subversive process, it is crucial to recognize that the markets bring an element of economic stability for the regime, since it cannot feed and provide for the population through its distribution system. Markets first grew

illegally and spontaneously, but have consistently grown both in space and in numbers over the past few years. Some estimate that North Korea's private sector accounts for between 30 and 50 percent of the country's gross domestic product.<sup>38</sup>

Kim Jong-un's policy choices on the markets have been consistent with his policy of *Byungjin*, or parallel development. The *Byungjin* line rejects the notion that North Koreans should have to sacrifice economic welfare in the pursuit of a nuclear deterrent. While making progress on the nuclear and missile programs, Kim has declared, the North Korean people should “never have to tighten [their] belts again.”<sup>39</sup> The state portrayed the so-called “arduous march” famine that took place under Kim's father's rule as a necessary price the population had to pay to defend itself against the threat of American imperialism. But under *Byungjin*, Kim claims, the country can have both. The North Korean regime has consistently chosen guns over butter, but Kim is eager to bolster his legitimacy by delivering on the long-standing promise to the people of a higher quality of life. With the information flow from South Korea and the rest of the world having increased over the past few years, improving the people's living standards is increasingly important for regime legitimacy. Markets help further economic development, and even though the regime has not officially recognized them, it sees markets as an integral and necessary part of the economic system. With the announcement of the “New Strategic Line” in April 2018, more pragmatic economic policies may be forthcoming regarding markets, enterprise management, and agriculture.

Historically, North Korea stood out among socialist countries for its rigid economic planning. In the 1950s, it went the opposite direction from economic and political relaxation in the Soviet Union under Khrushchev. Agriculture in North Korea was rapidly and fully collectivized between the mid- to late-1950s,<sup>40</sup> and the regime attempted to solve a food shortage that ensued by banning private trade in grain.<sup>41</sup> In 1957, the state formally instituted public distribution and rationing of virtually all goods, save for a few products that it allowed to be bought and sold at farmers' markets and in state shops.<sup>42</sup> From 1961, when the *Taean* Work System was introduced for enterprise management, even day-to-day operational decisions in industrial management fell under Party control.<sup>43</sup>

When the Soviet Union and China drastically decreased its economic support to North Korea, in the late 1980s and early 1990s respectively, Pyongyang could no longer rely on the subsidized imports of goods

such as food and fuel that had propped up its dysfunctional economic model. Its agriculture and industries, for example, were heavily dependent on oil imports on “friendship” terms.<sup>44</sup> As the two countries began demanding hard currency payments for North Korea's imports, the country's economy eventually collapsed, resulting in a famine that killed between 600,000 and one million people.<sup>45</sup>

Even as hundreds of thousands of its citizens starved to death, the regime refused to liberalize the economy. Markets first grew spontaneously, as the state's distribution system ceased to deliver food and other necessities. Over the years, the regime had little choice but to legally permit private economic activity.<sup>46</sup> Still, much of what goes on in the non-state sector remains technically illegal. The proliferation of private economic activity could theoretically be reversed overnight should the regime decide to do so. The country remains a nominally planned economy and lacks property rights and legal frameworks for domestic private business. Numbers are scarce and unreliable, but informed analysts estimate that about half of all economic transactions are still conducted within the planned economy.<sup>47</sup>

There is no financial sector to speak of in North Korea. The real estate market in the country's urban centers has experienced a boom of sorts over the past few years. One of the main reasons for this is the lack of other assets where the middle- and upper-classes can invest their surplus earnings. In addition, the regime essentially lacks the tools to control currency in the country. According to some estimates, the majority of transactions in North Korea occur in foreign currencies, mainly Chinese renminbi and U.S. dollars.<sup>48</sup>

The enterprise system has, much like the markets, become partially privatized through a bottom-up-process. All means of production are theoretically owned by the state, but since the early 2000s entrepreneurs have become an integral feature of the economic system. By partnering and contracting with state enterprises, they operate essentially as private companies, while the state collects taxes from them. The state has not officially recognized this so-called practice of private enterprises “wearing the red hat,” associating themselves with a state enterprise to be able to operate legitimately. But since taking power in late 2011, Kim Jong-un has allowed market mechanisms an increasingly more prominent place in the economic system, under the banner of “Our-Style Economic Management Methods,” a broad guideline giving state enterprises and other entities more autonomy in planning and production, launched in 2012.

Over time, the state has increasingly realized the financial benefits it can reap from becoming involved in—and even promoting—private economic activity. For example, there are now state-owned department stores selling consumer goods in an attempt to capture a greater share of the revenues in the market sector. The state has also taken an active hand in growing the real estate sector, allowing some private capital investments.<sup>49</sup> At the same time, however, the state sector has become more autonomous. In 2014, the government changed the enterprise act, expanding the autonomy of managers of state-owned enterprises to control both daily operations and long-term planning. The historically rigid Party control over management was abolished, and managers are now even allowed, at least on paper, to engage in foreign trade and joint ventures with foreign partners.<sup>50</sup>

**All means of production are theoretically owned by the state, but since the early 2000s entrepreneurs have become an integral feature of the economic system.**

In sum, while the North Korean economy is dysfunctional, it has improved significantly over the past few years, albeit with the catastrophic famine of the 1990s as a low baseline. The regime remains reluctant to undertake systemic reforms, fearing that such changes would threaten its grip on power. Ironically, sanctions may have spurred some of the necessary changes to the economic system, as the state scrambles to find new ways to make up for losses from lower export revenues.

### **The North Korean Economy Under Sanctions**

It remains much too soon to fully evaluate the impact of international sanctions on the North Korean economy. There is no doubt that the North Korean economy is experiencing severe pressure, but it is also not in a state of full crisis. The country has been under various international sanctions since its first nuclear test in 2006, but this time is different from previous sanctions rounds because China is complying with sanctions to a much greater degree than it has in the past. About 90 percent of North Korea's foreign trade is with China, making its other trade relationships almost negligible in comparison. From September 2017, the month after the U.N. Security Council passed a resolution banning imports of North Korean coal, iron ore, and other minerals, as well

as seafood products, North Korean exports to China fell steeply for several consecutive months as compared to the past year. The largest decline during the year came in December, when exports plunged by 83 percent compared with the same month in 2016.<sup>51</sup> As of late April 2018, trade remained at historically low levels, with North Korean exports to China having dropped by 89 percent compared to the year before.<sup>52</sup> After Kim Jong-un's meeting with Xi Jinping in late March this year, several signs suggested that Chinese sanctions enforcement has relaxed somewhat. In early April, for example, there were reports from the Sino-Korean border region that some 400 North Korean guest workers who were previously expelled due to sanctions had been allowed back into the country.<sup>53</sup> Still, as of now, there is no evidence to suggest that China's generally strict enforcement of sanctions has let up on a scale that would make significant difference to the North Korean economy. China and the United States have agreed to continue to enforce U.N. sanctions until North Korea takes tangible steps toward abolishing its nuclear weapons. Over time, however, if tensions around North Korea continue to de-escalate, China may relax its vigilance in sanctions enforcement, while claiming that its pressure policy has not changed.

Even so, sanctions would need to be in place for at least several months or even a year before their full potential impact can be gauged, as North Korea's supplies of crucial items such as fuel and foreign exchange would then begin to dwindle. Judging by market prices of rice<sup>54</sup> and the market exchange rate, as of late May of 2018, North Korea does not seem to be experiencing any major crisis hitting the economy in its entirety.<sup>55</sup> Market prices have not moved out of their ordinary span, despite North Korea's being under the most severe economic sanctions since its nuclear weapons and missiles development program came under international scrutiny and pressure in the 1990s.

This price stability is somewhat perplexing. If sanctions were devastating the North Korean economy as a whole, it would be reasonable to expect market prices to react. For example, public anticipation that future food imports will decrease could cause hoarding. For foreign currency, the chain of events is even more straightforward: When exports go down, less foreign currency flows into the economy, making it relatively scarcer and thus more expensive, causing a depreciation.

A number of factors could explain the price stability. One could be that smuggling and other trade that circumvents sanctions has grown since the economic pressure on North Korea began to increase.<sup>56</sup> But smuggling is



expensive and difficult, and it is unlikely to grow enough to make up for as devastating a decline in exports as that which North Korea saw in the latter half of 2017. Another possibility is that the market economy is separated enough from the state economy that sanctions target and that market prices do not reflect the economic impact of sanctions. This is likely true only to an extent, because boundaries are not so clear-cut between the state and market economies. Many nominal state enterprises also have a foot in the market economy, and it is therefore difficult to imagine a steep decline in foreign currency revenues that does not also affect the economy as a whole.

It may also be that domestic prices of fuel and energy—though they have increased quite drastically and often fluctuated through 2017 and 2018—are partially offset by the excess of coal available domestically due to the sanctions. Food prices may partly have seen a similar effect from the ban on importing North Korean seafood, making it comparatively cheaper for domestic consumers. Such effects will, however, not be able to offset the dire impacts on the North Korean economy in the long run from the lack of foreign currency inflows.

A final hypothetical possibility is that the North Korean state was better prepared than many analysts anticipated to cushion the blow of sanctions. It might, for example, be using a combination of tightening the supply of the won by decreasing credit to state enterprises and increasing the supply of foreign currency to stabilize the real exchange rate.<sup>57</sup> At the same time, it may be supplying enough cereal and grain to keep market prices stable. In January 2018, grain imports from China increased by 39 times compared to the same month in 2017.<sup>58</sup> Still, it is unlikely that the North Korean government could sustain such measures over a longer period of time, as its foreign currency reserves would quickly be depleted.

It is impossible to say with certainty why market prices appear stable despite sanctions, and whatever stability that currently exists is unlikely to endure in the long run. If the discrepancy between imports and exports continues to be as great as it currently is, North Korea will eventually run out of foreign currency. Particularly problematic for North Korea is its inability to import fuel under the sanctions; as the international community clamps down on illicit sales of fuel to the country with greater intensity, these imports will become increasingly expensive as the risk markup of sellers increases.<sup>59</sup> North Korea's foreign trade conditions are poor in normal years, but with sanctions the country will have to sell whatever goods it can export for sums far below market prices,



North Korea often deploys deceptive shipping practices, which are illegal under the United Nations Security Council. Depicted here, Korea Kumbyol Trading Company's vessel Rye Song Gang 1 conducts a ship-to-ship transfer of possibly oil with a Chinese ship to evade sanctions on October 19, 2017. China categorically denies engaging in any oil trade with North Korea. (United States Department of the Treasury)

because of the added risk to buyers of doing business with the country.

North Korea may not see starvation or major food shortages for some time thanks to increased productivity and larger harvests in the past few years, but eventually agriculture will begin to suffer from a lack of access to fertilizer and fuel to power the few machine tools available to farms. Perhaps most importantly, as foreign currency becomes increasingly scarcer, there will be a real and heightened risk of social instability as the population finds it more difficult to convert their savings into safer currencies than the North Korean won.

### Economic Policy Recommendations

The economy is an important consideration for North Korea in its dealings with the international community. It is one of several dimensions of security for any country, and Kim Jong-un has emphasized his promises to raise the living standards for the general population. Kim understands that military security may be Pyongyang's highest priority, but economic security is a crucial variable for the regime's legitimacy. Pressure from economic sanctions alone has not brought Pyongyang to its knees, but it is one of several factors in its calculations.

This report offers several policy recommendations for economic inducements that the United States and



its allies can pursue in negotiations over North Korea's nuclear program. These recommendations are not meant to form a holistic, full program. Rather, they represent policy avenues with potential. Other important areas to consider are, for example, support for both electricity infrastructure and a large-scale privatization program of state assets so that resources can be channeled into more productive uses than they are in their current, inefficient allocation.

These recommendations are explicitly designed to prioritize support that contributes to a systemic transformation of the North Korean economy. In several previous negotiations with North Korea, the international community has pledged aid donations in fuel, food, and other goods. Although humanitarian aid has reached and helped some vulnerable segments of the population, the inflow of aid has also likely prolonged the lifespan of the regime's repressive and inefficient distribution system for food and other resources. Different forms of implicit economic support, such as the Kaesong Industrial Complex (KIC), have helped the regime earn foreign currency while staving off broader economic policy reforms.

**Although humanitarian aid has reached and helped some vulnerable segments of the population, the inflow of aid has also likely prolonged the lifespan of the regime's repressive and inefficient distribution system for food and other resources.**

The regime is unlikely to ask for outright humanitarian aid in exchange for concessions on its nuclear and missiles programs, since the country's domestic food production is stable enough, for now, to sustain the population, albeit at an unacceptably low level. Furthermore, from the regime's point of view, asking for aid may be too great a loss of prestige to be worth the effort, particularly as North Korea's food situation has improved in the past few years.

That said, North Korea will very likely expect various forms of economic assistance, such as support for infrastructure, and participation in special economic zones where it can reap the benefits of foreign investments while keeping institutional change contained from the

rest of society. South Korea's President Moon has hinted that he wants not only to re-open but to expand projects such as the KIC.<sup>60</sup> Most of all, it is vital that the international community adopt a common, united approach to economic inducements in negotiations with North Korea. The economic measures within the diplomatic context should aim for systemic, long-term change of North Korea's economic system, rather than give the regime direct financial transfers, which would help the regime avoid pursuing necessary reform efforts.

#### **1. REWARD SUBSTANTIAL PROGRESS WITH SANCTIONS RELIEF AND INCORPORATE NORTH KOREA INTO THE GLOBAL TRADING SYSTEM BY SPONSORING IT TO SEEK MEMBERSHIP IN THE WORLD TRADE ORGANIZATION.**

China's enforcement of sanctions during the past few months has slashed North Korea's abilities to export any significant quantities of its most important goods. North Korea's leadership is hardly the only demographic suffering: The drastic decline in exports of coal, iron ore, and other minerals has probably put scores of mining workers out of jobs for the time being. Similarly, the labor-intensive textile industry is likely seeing many of its thousands of workers idle in the factories, since these exports have also dwindled.

But North Korea's foreign trade situation was neither sustainable nor secure even before the sanctions. Its trade levels in 2010 were on par with impoverished countries like Mali.<sup>61</sup> As sanctions have tightened over the past few years, its trade partners have decreased in number, leaving it highly dependent on trade with China, and at times, with South Korea.<sup>62</sup> The North Korean leadership is keenly aware of this vulnerability and has often recognized it publicly. For example, the plenary of the Worker's Party Central Committee on March 31, 2013, highlighted the need to diversify trade, given that almost 90 percent of it occurs with China in normal times.<sup>63</sup> North Korean regime publications, including speeches and state newspaper editorials, have stressed the same problem. Even more than twenty years ago, the country's leadership saw the dangers in economic reliance on other countries: In a 1995 speech, Kim Jong-il complained that the country's natural resources were being shipped off to other countries, where they were refined and sold for higher prices, warning that economic dependence easily translates into political dependence.<sup>64</sup>

Only removing economic sanctions, however, will not be enough. For North Korea to diversify its trade and make it more sustainable, it needs to be integrated into the international trading system. At the appropriate time, the international community should consider sponsoring

North Korea for World Trade Organization (WTO) membership as a form of inducement. This would be a lengthy process, but it would bring much positive with it along the way. WTO membership would be crucial to North Korea's aspiration to join the global economy and both increase and diversify its foreign trade. It would also require the country to strengthen its capacity for monitoring and gathering statistics on its economy, something that the United States, South Korea, and the U.N. should stand ready to assist it with. It would also require that North Korea undertake a wide range of economic reforms in both micro- and macroeconomic management, and free up its own system for foreign trade to allow freer competition for domestic actors. Here, too, the United States, South Korea, and other parties involved should stand ready to offer North Korea capacity building for such reforms.

## **WTO membership would be crucial to North Korea's aspiration to join the global economy and both increase and diversify its foreign trade.**

### **2. ASSIST NORTH KOREA'S AGRICULTURAL REFORMS.**

The North Korean regime has yet to announce any broad, sweeping agricultural reforms along the lines of what China did in the 1970s. However, under Kim Jong-un, the state has experimented with changes in agricultural management by decreasing the size of work units to increase production incentives. Work units have also reportedly been allowed to keep 60 percent of their production, giving 40 percent to the state.<sup>65</sup> The extent of these practices has not been confirmed, but they are likely widespread. More significant changes on a larger scale may come as the regime implements the so-called New Strategic Line in economic policy.

Agricultural yields have improved over the past few years, in large parts thanks to the prevalence of the markets and loosened government control over production conditions. But production still depends heavily on uncertain variables, including weather. In 2017, for example, production declined by an estimated two percent in large part because of dry weather conditions.<sup>66</sup>

Ensuring sustainable access to food is a key imperative for any government. For North Korea, it carries special weight after the devastating 1990s famine, which destabilized society to a degree not seen before or since the Korean War (1950–1953). Malnutrition has become

the new normal for segments of the population after the famine, and whatever stability of food provision exists remains at a low level. The international community has a clear interest in ensuring sustainable food supply in North Korea, both for humanitarian reasons and for economic ones, given the several-billion-dollar investments made in aid programs in North Korea that have operated for over two decades.<sup>67</sup> In the summer of 2017, for example, the U.N.'s Food and Agriculture Organization called for aid interventions to stave off a food shortage caused by the drought.<sup>68</sup> Though food supply may appear stable for now, it is highly volatile, and the government is likely well aware that it needs to make radical changes in the way agriculture is managed.

Historically, most food has been grown in the southern half of the Korean Peninsula, where arable land is much more plentiful. North Korea lacks a comparative advantage in agriculture and as such would do well to abandon its goal of self-sufficiency in food in favor of more imports. Still, the regime's changes in agricultural management should be encouraged.

Within the international community, China would likely be open to supporting North Korea with expertise in farming reform, having gone from a collectivist, socialist system similar to North Korea's in the late 1970s, to a more market-based system by the early 1980s. Possible material inducement could include a limited supply of machine tools and other equipment. If, for example, production units are divided into smaller groups to strengthen incentives—one possible component of agricultural reform in a planned economy like North Korea's—more agricultural machinery will be needed, since the number of production units will increase. Currently, North Korea's farming equipment is disastrously outdated, and estimated output per worker is only a fraction of that in South Korea.<sup>69</sup>

Such support must be tied to North Korean reforms of the ownership structure of land and agricultural production. In the long run, its farmers must be able to own privately the land they work, but in the more immediate term, any support for North Korean agriculture should be given only as the country takes tangible steps to letting farmers dispose of their full production, and levying taxes on them as regular producers in a market-based system.

### **3. ASSIST NORTH KOREAN AUTHORITIES IN CONSTRUCTING A FUNCTIONING MONETARY SYSTEM.**

North Korea's monetary system is deeply fragmented, fragile, and dysfunctional. Many North Koreans hold whatever savings they have in foreign currencies such

as the renminbi or U.S. dollar, rather than in North Korean won. In the past few years, the government has been able to keep the exchange rate relatively stable. It remains unclear precisely how. Ordinary monetary policy instruments, such as a central bank interest rate, for all intents and purposes do not exist in North Korea. As previously mentioned, it may be that the government has kept inflation at bay by tightening the supply of won, by lowering the credit it gives to state-owned enterprises, or by increasing the circulation of foreign currency through selling state assets for foreign currency, perhaps to Chinese-Korean investors or North Koreans with ample hard currency savings.<sup>70</sup>

None of these methods are viable in the long run. The general public's confidence in the won is already low, and should it fully collapse—say, if inflation begins to soar unexpectedly—the government would need to use foreign currency reserves in amounts it does not have to pay salaries for government employees, operate whatever limited public services continue to function, and, in general, conduct its daily business.

The United States, South Korea, and other parties involved should offer Pyongyang assistance for capacity-building—training to North Koreans on central bank management and macroeconomic data collection, for example—as a form of carrot in the diplomatic process. North Korean capacity might be more robust than many believe in implementing policy and monitoring the stability of its currency. But the country's economic system is still lacking in many respects, as evidenced by the relatively low credibility of the won, and the public's preference for saving in foreign currency.

#### **4. FACILITATE AND ENABLE NORTH KOREA'S SPECIAL ECONOMIC ZONES (SEZS) TO SEEK FOREIGN INVESTMENTS, BUT DO IT THE RIGHT WAY.**

The North Korean predilection for SEZs, or special economic zones, dates back to the late 1980s. Only in recent years, however, has the government adopted laws and regulations that hold up to international standards. Potential investors still face overwhelming political and commercial risks. North Korea lacks a judicial environment that investors can trust, and it also largely lacks the sort of infrastructure required to support commercial success for foreign investors. Above all, the tensions around North Korea's nuclear program make most investors shudder at the very thought of taking their factories to the country. That said, SEZs remain part of North Korea's economic strategy: Kim Jong-un designated over a dozen new areas as SEZs in 2013 and 2014.<sup>71</sup> The North Korean preference for SEZs is hardly surprising.

In theory, they allow the regime to reap the benefits of foreign investment without risking unwanted foreign social and political influences. Indeed, Thae Yong-ho, a former North Korean high-level diplomat, said in an interview in May 2018 that Kim Jong-un hopes to use the SEZ-model to gain revenue from tourism and foreign manufacturing while keeping economic reforms isolated from the rest of North Korean society.<sup>72</sup>

With the right form of engagement and incentives, this need not be the case. If done right, SEZs can provide a starting point for institutional change in the economy, allowing the government to experiment with economic policy changes on a smaller scale before implementing them on a broader, systemic scale. For example, through the SEZs, the government can experiment with practices such as unrestricted currency exchange, private ownership of capital, long-term lease of land and other property, and something as basic as freedom of movement for foreigners.<sup>73</sup> Several of North Korea's SEZs already operate under such laws, but they have scarcely been tried in practice since none of the SEZs have yet seen any large-scale investment.

**North Korea lacks a judicial environment that investors can trust, and it also largely lacks the sort of infrastructure required to support commercial success for foreign investors.**

The United States, South Korea, and other regional actors could leverage North Korea's preference for SEZs in several ways. Most importantly, defusing tensions around North Korea's nuclear program would alleviate one of the main stumbling blocks for the SEZs to gain traction, as international sanctions make foreign investments prohibitively difficult. Beyond that, the countries involved in negotiations around North Korea's nuclear program might consider supporting the infrastructure for a small number of promising SEZs, to make them viable for foreign investors, conditional on the regime's taking concrete steps to make the institutional environment functional for businesses—foreign investors and domestic actors alike. SEZs near the Russia and China border should not be the primary targets for international support, and instead, efforts should focus on SEZs further inland, to ensure that economic development does not get concentrated to the border region alone.

It is crucial, however, to ensure that the government does not turn its SEZs into mere income sources for the regime. Any international support for SEZ development, or condoning of foreign investment, should be premised on SEZs' generating positive externalities in the general economy. Any international lending partner to the SEZs should require, for example, that investors be able to input materials for manufacturing domestically through the country's market system and to pay workers directly rather than through the state. To ensure fair treatment of workers, any support for SEZs should come with a requirement that North Korea seek membership in the International Labour Organization.

##### **5. SUPPORT JUDICIAL REFORM FOR A SOUND INSTITUTIONAL ENVIRONMENT.**

In many realms, North Korea's judicial system only exists nominally, and no individuals or businesses are afforded the right of due process. North Korea's judicial system will eventually require a full-scale overhaul. But for the purposes of attracting foreign investments and spurring domestic economic activity, a few specific measures would go a long way. For foreign investments, the laws that exist on the books contain several key tenets for incentives and protections, such as land use and transfer rights, property rights for buildings, managerial discretion in production, hiring and wage setting, among other issues.<sup>74</sup> But for foreign investors to be able to trust that those laws will be enforced, North Korea would need to allow for international commercial arbitration, and it would need to be able to show that its courts rule impartially in cases between national entities and international investors. Chinese and other international businesspeople with experience in North Korea have often been cheated on contracts and deals; North Korea must take concrete measures to change this reputation. Domestically, the state must codify and formalize the market system to a greater extent, enact protections for private property, and create transparent laws to guide the increasingly vibrant market sector. Here, a wide range of actors within the international community should stand ready to help with broad reforms of the North Korean judiciary, to assist in the creation of organs for oversight and judicial independence.

##### **6. HELP CREATE A FUNCTIONING FINANCIAL SECTOR.**

North Korea largely lacks a financial sector in the conventional sense. In the past few years, the country has seen a modest growth of financial services, such as debit

cards and ATMs, but this has not translated into any significant or widely spread use by the public. Indeed, much of this growth is exclusively targeted at tourists and other foreigners in the country, rather than at North Korea's own population.

This dynamic is a major stumbling block for any economic progress. With the growth of the market economy, the so-called *Donju*—a nascent, urban, entrepreneurial middle class—has risen to become a relatively wealthy social class with a significant amount of funds to invest, but no real options for placing their money, since no commercial banking sector exists. One of the main reasons for the boom in construction in North Korea over the past few years is that it is one of few sectors where citizens can invest their money, and even real estate investment cannot be done in a judicially safe or transparent manner. For any substantial and sustainable economic growth to take hold, North Korea needs a financial sector that can mobilize both domestic and foreign resources to spur development in sectors such as industry, agriculture, and other parts of the real economy.

There are several ways in which the international community could use North Korea's dire need for a financial sector as a form of inducement. Technical assistance from institutions such as the IMF would

**For any substantial and sustainable economic growth to take hold, North Korea needs a financial sector that can mobilize both domestic and foreign resources to spur development in sectors such as industry, agriculture, and other parts of the real economy.**

be a natural starting point, as would capacity-building assistance from the international community overall. This would open the door for North Korea to potentially join and work with the World Bank and the Asia Development Bank as well. Technical assistance would be highly valuable to North Korea, and would come with requirements for transparency and monitoring that would have positive effects on the economic system as a whole. Planning for this technical assistance should consider what role electronic payment systems can play



in the development of North Korea's financial system. For the country to eventually become connected with the international financial system, measures for increased transparency are also crucial. In July 2014, North Korea joined the Asian affiliate of the Financial Action Task Force as an observer, and two years later, it passed a law on combating money laundering. While it remains unknown whether these moves translated into any concrete action, they show at least an interest in complying with international standards and norms in this realm.

## Conclusion: Safely Descending the Summit

While a new spirit of optimism may prevail in some quarters, the next several months offer little margin for error as President Trump and Chairman Kim descend from their summits. Even a successful climb can, with one misstep, end in sudden catastrophic failure. To avoid that, this report offers some essential guideposts. While conventional wisdom holds that a climber should not look down, negotiators engaged in the high politics of international security should remain aware of both diplomacy's peak potential and its perilous depths. This study explains the importance of diplomacy in the maximum pressure and engagement strategy employed by the United States, the Republic of Korea, and others as they prepared for the latest inter-Korean summits and the first-ever meeting between the president of the United States and North Korea's leader.

The world has witnessed a radical shift from the threat of greater nuclear weapons proliferation and the possibility of renewed conflict on the Korean Peninsula, to hopeful diplomatic spectacles. The hard part will be transforming diplomatic opportunity into reality. Even if war would be catastrophic, diplomatic success remains problematic. The U.S. has failed in previous attempts to remove nuclear weapons from North Korea, but neither the Agreed Framework's nor Six-Party Talks' collapse led to war. What is more, neither of these two other major attempts to eliminate nuclear weapons and advance peace was accompanied by a U.S. president personally committed to solving the North Korea problem. If President Trump's efforts go awry, falling back on defense, deterrence, and containment is also always an option. For now, however, the salient question is how to use diplomacy to push Kim toward converting swords into plowshares, should he be willing to do so at an acceptable cost.

Assuming the diplomatic process remains alive and well, the most sensible recommendation is to resist the temptation to draw definitive conclusions. A cold war has existed on the peninsula since the Armistice stopped regular combat. A series of possible diplomatic breakthroughs, especially since 1990, have all foundered—often over hurdles to implementation, verification, and inspections. A bold, front-loaded commitment to peace, and complete, verifiable, irreversible denuclearization must be achieved through many actions over time.

Last year witnessed an unparalleled campaign of maximum pressure, culminating in North Korea's taking

an abrupt about-face at the year's end. The first half of 2018 has seen the spirit of the Pyeongchang Olympics give way to brisk-paced diplomacy, including Kim's historic crossing of the DMZ to meet with President Moon at the Panmunjom Truce Village. The sweeping Joint Statement of April 27 was notable for its ambitious call for everlasting peace and a nuclear-free peninsula, and the pace and scale of activities agreed to be undertaken by the two Koreas. Replacing the Armistice with a peace treaty by the end of 2018 would be a remarkable achievement in the annals of the Korean Peninsula. Charting a course that could truly eliminate North Korea's nuclear weapons would be even more stunning. And it is almost unimaginable to think the former could be sustained without the latter.

A safe descent from the summit will require prudent diplomatic and economic initiatives: namely, ensuring timely and disciplined verification; calibrating pressure and release of pressure to substantial concessions by North Korea; and using economic development to foster lasting reform, rather than provide the leadership with cash rewards or otherwise give into rent-seeking among Pyongyang elite.

Finally, it is worth putting the Korean Peninsula into the important geographical and historical context of Northeast Asia, East Asia, and international security. The two Koreas were created in the aftermath of World War II, when Korea was liberated after 35 years of Japanese colonial rule. The peninsula was divided by the two occupying powers of the Soviet Union and the United States, and in 1948 the DPRK and ROK were established as independent governments. On June 25, 1950, Kim Il-sung launched an offensive war against South Korea. Although North Korea's attack had been sanctioned by Joseph Stalin and Mao Zedong, the United Nations Security Council passed Resolution 82 demanding North Korea stop hostilities and withdraw to the 38th parallel. Two days later, UNSC Resolution 83 invoked the use of the force for the first time—an authorization that would have been impossible had the Soviet Union not been boycotting the institution over Nationalist China's continuing participation. Resolution 83 provided the basis for the United Nations Command, which in 1950 comprised 17 countries providing combat troops and another five offering humanitarian assistance. The 1953 Korean Armistice was signed by a U.S. Army general, as Commander of the U.N., and representatives from the Korean People's Army and the Chinese People's Volunteer Army. A peace regime would be anchored by the United States, South Korea (even though it had not signed the Armistice), North Korea, and China. But

neighboring Japan would be instrumental in sustaining a process, and Russia would have a role as both a neighboring power and a member of the U.N. Security Council. As former South Korean Prime Minister Lee Hong Koo has noted, the question of a peaceful Korean Peninsula and a peaceful Northeast Asia are inextricably linked; this has been true throughout history and remains true today.<sup>75</sup> That truth appears alive and well today, as the nations of Northeast Asia and beyond hope that, this time, diplomacy can live up to its powerful legacy without the peril of nuclear war hanging over it.

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