

## **A Realistic Process towards Korean Unification and the Harmonized Privatization of Properties in the Unified Korea: Issues, Priorities, and Opinions of Key Stakeholders\***

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This article presents three prerequisites to a potential Korean unification, implying that South should make every effort to accommodate the wishes of the North Korean to achieve permanent unification of the Korean Peninsula. Removing the Demilitarized Zone that currently separates the Koreas would be a key aspect of unification efforts in order to satisfy the first prerequisite to long-lasting peace. Moreover, a unified Korea will still need to treat North Koreans under a separate system of social security at the onset of efforts, albeit including sufficient economic incentives to North Koreans for this to remain feasible. A contribution of this article to the existing literature is its proposed guiding principles for resource allocation to make an economic package persuasive, including the nationalization of North Korean properties by the unified Korean government to commence the unification process. Following this, the properties could be privatized in a harmonized way, in conjunction with other unification policies.

**Keywords:** Korean unification, prerequisites of realistic Korean unification, temporary separation of social security system, start-up assets, harmonized privatization of national properties

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## Introduction

The possibility of Korean unification became one of the primary concerns of the South Korean government<sup>1</sup> in the aftermath of the dissolution of the Soviet Union and the collapse of the North Korean economy in the early 1990's. The unforeseen death of Kim Il-Sung in July 1994 and ensuing economic crisis and famine within North Korea,<sup>2</sup> ignited numerous policy studies on the possibilities for Korean unification and its aftermath. At the time, both South Korean and American intelligence authorities predicted a sudden collapse of the North Korean regime within a few years. However, the regime of Kim Jong-Il, which followed that of his father, would survive, and coupled with the 1998 financial crisis in throughout East Asia, South Korean policymakers would turn their attention away from matters of unification. Economic anxiety had shifted their concerns towards the likely burdens that would follow reunification, and interest in Unification Studies decreased dramatically.

The historic North-South Korean Summit in mid-June 2000 created a completely different atmosphere in South Korean academia. A new term, "Inter-Korean Economic Exchanges and Cooperation" emerged to replace "Korean unification." Human and physical exchange between the two Koreas expanded very rapidly from that point until July 8, 2008, when a South Korean tourist was shot to death by North Korean soldiers just outside the Kumkang Mountain Tourist Area. The South Korean government has banned travel to the Kumkang Mountain tourism since then, and North-South Korean exchanges and cooperation started to waver. This was exacerbated by the North Korean sinking of the South Korean warship, the *Cheonanham*, and the deaths of 46 South Korean marines on March 26, 2010. South Korea reacted with strict bilateral sanctions on all exchange with

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1. Although the "Republic of Korea" (ROK) is the official country name, we use "South Korea" to emphasize that two Koreas will eventually be unified some time from now.
  2. Although the Democratic People's Republic (DPRK) is the official country name, we use North Korea.

North Korea. The following year, the North Korean Leader, Kim Jong-Il suddenly died on December 17, 2011 and his youngest son Kim Jong-Un inherited the regime's totalitarian power at the age of 28. The young North Korean leader has been regarded by many outside observers as unpredictable and immature, with some foreign observers asserting that the execution of his uncle, Jang Song-Taek is a signal towards the unstable nature of the Kim Jong-Un regime. Kim Jong-Un's decision to conduct a fourth nuclear test and launch a ballistic missile in early 2016 resulted in much stronger bilateral and multilateral sanctions on North Korea, leading some South Koreans to again mention probable Korean unification in recent years.

There has been significant study on how to integrate the two Koreas after unification. Privatization of national properties in the territory of what is today North Korea is one of the most popular proposals. Most scholars present the most "desirable" policy prescriptions on the issues, though very few of them discuss the implications of a "practical and realistic" process for Korean unification concerning the policies for nationalized properties in the newly-unified Korea. Moreover, unification itself is clearly not able to be completed piecemeal but instead demands an integrated synthesis of solutions. Policies for managing the national properties in the unified Korea thus need to be considered in harmony with other unification policies.

We start with examining the approximately year-and-a-half-long German unification process, lasting from 1989 till late-1990. Many critics at the time discussed failures in German policy at the time of unification, such as the sudden monetary unification of East Germany, which resulted in abrupt increases in East German wages and thereafter a sudden collapse of East German industry. Upon gleaned some new and practical insights from the case of German unification, we present realistic prerequisites for successful Korean unification, which will lead us to formulate the implications of practical and realistic processes for Korean unification. In the meantime, we can also rule out unification processes that are unrealistic and infeasible. Using this historical discussion as a foundation, we will note the importance of utilizing strategy in nationalizing certain properties in

a unified Korea. We will conclude with a proposal for a harmonized process of privatization of property in the unified Korea to permanently cement Korean unification.

## **Reexamining the Case of German Unification**

German unification was criticized a case of insufficient preparation by political critics, with their prevailing opinion being that monetary unification (July 1, 1990) in advance of political unification (October 3, 1990) was the most critical mistake in the process of German unification. Exchanges of the East German currency into the West German currency on too favorable terms for the East Germans were destined to result in wage increases in East Germany. East German firms with low productivity levels were unable to remain afloat in the pressures of the resulting sudden wage increases. The West German government had to allocate more resources than expected to help the newly-integrated East German states catch up with their West German counterparts. Nonetheless, political critics have overlooked some important aspects of German monetary unification. We need to examine the German unification process in greater detail to understand how.

### ***Was the German Monetary Unification of July 1990 a Policy Failure? A Reassessment***

The historic fall of the Berlin Wall on November 9, 1989 signified the everlasting will of East Germans who chose to migrate to West Germany in response to uncertainty over their future. From the opening of the border with East Germany in October 1989, almost 600,000 people migrated to West Germany in just a six-month period. East German demonstrators shouted that "If the Deutschmark [West German currency] does not come to us, we will go to it." West Germans did not want a mass migration of East Germans into the West. In this context, monetary unification was regarded as a big step towards preventing mass migration, thereby allowing East Germans to obtain

financial assets and salaries of sufficient quality and quantity without migrating to the West.<sup>3</sup> The West German Chancellor Helmut Kohl, thus, proposed in early February 1990 an early monetary unification, scheduled in July 1990, to lessen mass migration flows and permanently cement unification.<sup>4</sup>

In spite of this, in early 1990, the prospects for the first East German democratic multi-party election, scheduled to be held in mid-March of 1990, were not very optimistic for Helmut Kohl. Votes for rapid unification seemed not to decisively beat those for gradual unification. The West German administration did its best to garner the enthusiastic support of East Germans for a rapid and permanent unification. In so doing, early monetary unification, with favorable terms for East Germans, paved the way for successful German unification without mass migration into the West. Politics dominates economics in almost all cases. Thus, German monetary unification was regarded as a consensus policy, supported by both the majority of East and West Germans.

### ***Was German Unification a Case of Absorption or of Negotiation and Agreement?***

German unification was commonly regarded as unification through absorption. The fifteen East German regions (“Bezirk”) were re-grouped to become five new federal states and merged with already existing Federal Republic of Germany. Almost all political, economic, and social institutions from the Western regions would exercise control in the Eastern regions. East Germany became a part of West Germany; the former was absorbed by the latter. Nonetheless, as discussed above, West German and East German administrations negotiated over and agreed with each other on most of major issues before unification, such

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3. Further, East Germans could also get the same social security benefits as West Germans after political unification.

4. Bernhard Seliger, “Ten Years after German Economic Unification: Are There Any Lessons for Korean Unification?” *International Journal of Korean Unification Studies* 10, no. 1 (2011), p. 129.

as monetary unification and the establishment of a public agency for restructuring and privatizing state-owned properties in East Germany. Even Helmut Kohl promised East Germans, in the period before unification, to create a “flourishing landscape” in East Germany in order to attract East German votes.<sup>5</sup> German unification was definitely not a forced unification but rather a negotiated and agreed upon one.

Indeed, every peaceful unification process requires some kind of negotiation between the involved parties. Unification through absorption does not rule out unification through negotiation and agreements, and vice versa. The two concepts of unification are not mutually exclusive. Even the forceful and military unification case of Vietnam in 1975 included a kind of conciliation policy in favor of South Vietnam. The Socialist Republic of Vietnam has three top leaders, the General Secretary of the Communist Party, the President, and the Prime Minister of Vietnam. To ensure a sustained and permanent unification, the positions have traditionally been allocated to someone from the Southern, Central, and Northern regions of Vietnam. In the process of achieving peaceful Korean unification, the importance of negotiation and agreement between the South and the North cannot be underestimated.

### **Three Prerequisites for a Realistic Korean Unification Process and their Implications**

We present realistic prerequisites for Korean unification. The most important prerequisite is that the North Korean people themselves want unification with the South. Secondly, a North Korean Government representing the will of the people would need to be in power. Lastly the international community, including the US and China, would need to be cooperative (or at least, not an active hindrance).<sup>6</sup>

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5. Seliger, “Ten Years after German Economic Unification: Are There Any Lessons for Korean Unification?” p. 118.

6. Hyungsoo Zang, “A New Look on Korean Unification and Its Financing Issues” (in Korean), *Policy Studies [Jeongchaek Yeongu]*, Winter 2011 (2011), p. 135.

The German unification case clearly fulfilled these prerequisites. Firstly, East Germans wanted to unify with the West and chose their democratic government implementing their will through democratic multi-party elections. The elected East German government negotiated and agreed with the West to be absorbed into the Federal Republic of Germany. The USA, the UK, the USSR, and France did not interfere.<sup>7,8</sup> We discuss some novel implications of the above prerequisites of Korean unification next.

### ***Collapse of the North Korean Regime Would not be Enough for Korean Unification***

There have been a number of discussions on the scenarios of Korean unification. Some of them include the possibility of North Korean regime collapse.<sup>9</sup> Quite a few South Koreans believe that a North Korean collapse would be a sufficient precursor for Korean unification. Thus, they believe that the South Korean forces, in concert with the US, would have a genuine right to make an entry into the northern part of the Korean Peninsula, which they hold to be the genuine territory of South Korea which has been occupied unlawfully by the North Korean regime. Unfortunately, their belief would not be practically materialized today. A future collapse of the current North Korean regime, followed by South Korean and American intervention in North Korea, would almost surely invite Chinese intervention into North Korea as well.<sup>10</sup> China would likely claim that the alliance

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7. For the perceptions of the US, Japan, China and Russia (collectively called the Big Four) on Korean unification, see Kyuryoon KIm, et al., *The Attraction of Korean Unification*, Research on Unification Costs and Benefits 2013-2 (Seoul: Korea Institute for National Unification, 2013), pp. 159-308.
  8. For the perceptions of other countries than the Big Four on Korean unification, see Kyuryoon KIm, et al., *Global Expectations for Korean Unification*, Research on Unification Costs and Benefits 2014-1 (Seoul: Korea Institute for National Unification, 2014), pp. 7-360.
  9. Bruce W. Bennett, *Preparing for the Possibility of a North Korean Collapse*, National Security Research Division, Rand Corporation, 2013.
  10. For detailed discussions, see Bennett, *Preparing for the Possibility of a North*

treaty (Article 2) signed in 1961 with North Korea would oblige one party to intervene immediately on behalf of the other party once the latter is invaded.

China's possible military intervention in North Korea would affect the prospect of Korean unification in a number of ways. It is demonstrably not against Chinese national interests to support the presence of the state of North Korea in the northern part of the Korean Peninsula as a buffer state. Unification through military action without satisfying its prerequisites would be impossible or at least highly unlikely until Chinese national interests in the Korean Peninsula changed substantially.<sup>11</sup> Likewise, even without Chinese military intervention, a North Korean collapse would not naturally lead to Korean unification unless both the North Korean people and government agree with unification with the South. A North Korean collapse instead would most likely lead to establishment of a pro-China regime in North Korea. As of now, unfortunately, North Korean people do not know much about where they stand and how much they suffer. After the passage of time, they would be able to know it eventually. Korean unification will need some time to be realized.

### ***Korean Unification Requires Negotiated Agreements between Participating Parties***

The most significant implication of the realistic prerequisites of Korean unification discussed above is that all kinds of state unification require some kind of agreement between the two parties through a certain negotiation process. The negotiation power between the two states would vary in accordance with the situation at the time of an

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*Korean Collapse*, pp. 87-91.

11. China has clearly opposed the American proposal to ban China's petroleum exports to North Korea as a new UN Security Council Sanction to the North Korea's 4th nuclear test and a ballistic missile launch in early 2016. China has always maintained a "red line" that should not be crossed to maintain the peace and stability of the Korean Peninsula. To them, it is the presence of North Korea.



imminent unification. One of the states naturally would lead and the other would follow in the negotiation process. However, the leading state will not be able to wholly dominate the process; it should accommodate major concerns of the follower state as much as possible. Otherwise, the unification process itself may falter and move backwards. Successful unification itself requires the explicit and implicit consent of all (or most of) parties involved.

More specifically, in order to secure enough support for unification among the North Korean people, sufficient prearranged economic incentives would need to be offered to them during negotiations just as West Germany did for the East German people between November 1989 and July 1990. The South would need to offer a much better standard of living for the North Korean people after unification than their status quo. Moreover, it is much more important during the negotiation process to fulfill expectations of a majority of North Korean people that they will be better off after unification. We will discuss the principles and grand design of unification policies later. Here, we present a general principle: Except for the ranks of North Korean most powerful elites, most North Korean people including public officials and soldiers of low-to-mid-grades would need to be pardoned through a pre-announced general amnesty by a joint authoritative entity before establishing the unified Korean government.

### ***Is South Korea Financially Ready for Potential Korean Unification?***

Another important concern for the sustainability of Korean unification is the size of the compensation package for the North Korean people, beyond what a simple calculation of unification costs would show. The experiences of Yemen in accidentally reverting to their old divided status and the ensuing civil war in the early 1990s should not be replicated by Koreans. A complete, verifiable, irrevocable, and sustainable Korean unification requires the credible alleviation of uncertainties regarding unification process. People who will live in the unified Korea need clear assurance for better life after unification. Otherwise, they will not support it.

Thus, Korean unification will naturally accompany significant costs. Most important would be the economic strength and fiscal soundness of the South Korean government to pay for these so-called unification costs. West Germany was the 3rd largest economy in the world in 1990 and its currency, the Deutschmark, was the world's strongest. However, South Korea will not be able to match West Germany's might for decades. Fortunately, recent developments in financial mechanisms make resource mobilization towards infrastructure much more feasible than in the 1990s. West Germany mainly spent resources from its own fiscal coffers in the reconstruction of the Eastern region after unification. In contrast, the rehabilitation of the North Korean economy would be shared increasingly by the (international) private sector. Higher utilization of public-private partnerships (hereafter, PPP) would be possible as the political and commercial risks of PPP projects will certainly decrease after a successful Korean unification.

Nonetheless, the major portion of the unification costs would still be income transfers from the South to the North. South Korea will need to accommodate North Korean people's wishes as much as possible, and the most likely mechanism for doing so by the unified Korean government would remain through fiscal measures. Substantial issuance of government bonds and a greater amount of levied taxes will be inevitable to accommodate these fiscal needs. After German unification, West Germany has dedicated about 5 percent of its GDP annually towards various kinds of economic and income subsidies to East Germany. For the sake of comparison, the population of East Germany was roughly one-quarter that of West Germany, but their income level was roughly one-tenth its Western neighbor in 1990. On the contrary, the population of North Korea is roughly one-half that of South Korea, but the income required to maintain their population's standard of living is roughly one-thirtieth of their Southern counterpart. The relative burden placed upon the average South Korean will be six times greater than what was placed upon the average West German. That is to say, South Korea will need to dedicate 30 percent of its GDP annually towards North Korean relief efforts,

which simply represents an infeasible unification scenario. Due to these harsh economic realities, the so-called “unification costs argument” has prevailed widely in South Korea. More than a few South Koreans believe that Korean unification will result in definite intolerable damage to the South Korean economy and thus a “Plan B” will merit serious consideration.

***Forceful and Physical Separation of the North from the South after Political Unification will not be Practical***

The idea of temporarily maintaining the Demilitarized Zone (hereafter, DMZ) under the ruling of the unified Korean government and forceful separation of the southern and northern parts of the Korean peninsula has recently been discussed as an alternative for reducing the enormous financial burden of Korean unification. This idea however could not satisfy the first prerequisite of Korean unification: North Korean people should want unification and its outcomes with the South. The North Korean people would likely voice fierce opposition to physical separation of the North from the South after political unification. We can rule out that kind of unification method simply because it cannot achieve unification of two Koreas.

And yet, while we have noted that a forcefully maintained physical separation of the North from the South after Korean unification would not constitute a “Plan B,” we need to understand what exactly makes it so infeasible. South Koreans have worried about a possibility of an immediate mass-migration of North Korean residents into the South, which would certainly result in many negative consequences, including downward pressures on the wages of unskilled labor, enormous demands for social welfare services, and inevitable but avoidable turmoil in the South.<sup>12</sup> The temporary maintenance of the DMZ and prohibition of unsolicited migration from the North to the South

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12. Holger Wolf, “Korean Unification: Lesson from Germany,” in *Economic Integration of the Korean Peninsula*, Marcus Noland (ed.) (Washington, D.C.: Peterson Institute for International Economics, 1998), pp. 174-175.

would keep the wages of unskilled labor stable in the South, make fiscal transfers from the South to the North as small as possible, and thus could hopefully result in a gradual and not-as-expensive integration of the two Korean economies. The idea is unfortunately based on the impractical belief that South Koreans would be able to determine the will of North Koreans at a time that Korean unification seems to be imminent. However, the idea would not be realized as the North Korean people would never support unification of that kind to begin with. South Koreans yearning for Korean unification will encounter grave challenges in tending to the hearts of the North Korean people while minding their own purse strings.

### ***Let North Koreans decide to stay or migrate***

Every feasible solution to South Korean reintegration challenges would need to comprise the consent of both North and South Korean residents. The North would not accept a forced physical separation with their Southern neighbor, while the South remains unwilling to bear too high a fiscal burden arising from Korean unification. A newly-unified Korean government would certainly face enormous challenges to tackle before completing Korean political unification. Macroeconomic stabilization policies will be a necessity to cope with these challenges. Providing North Koreans with essential consumer goods for a sufficient period of time after unification to prevent humanitarian crises will also be required.

As we gleaned from careful examination of the German unification case, fiscal transfers from the South to the North to prevent a sudden mass immigration would be a key issue again in the Korean unification case as well. The South Korean economy, however, would simply not be able to replicate the achievement of West Germany.<sup>13</sup>

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13. Soogil Young, Chang-Jae Lee, and Hyungsoo Zang, "Preparing for the Economic Integration of Two Koreas: Policy Challenges to South Korea," in *Economic Integration of the Korean Peninsula*, Marcus Noland (ed.) (Washington, D.C.: Peterson Institute for International Economics, 1998), p. 269.

To be precise, the major portion of fiscal needs after Korean political unification will come from income transfers from the South to the North. Further, most of fiscal resources will be dedicated towards a new social security system for North Korean. The new North Korean social security system in the post-unification period should in principle be in accordance with the South Korean system. However, in order to alleviate the financial burden this would entail and keep social discontent to a manageable level, we suggest the provision of a temporary social security system for North Koreans in the unified Korea.<sup>14</sup> The detailed design of the social security system for North Koreans residing in the North and those migrating to the South would need to be studied more deeply in the near future, though we will deliver some thoughts on the matter in a later section.

As emphasized before, the separation of social security systems will not require the mandatory and physical separation of the Northern region from the Southern. North Koreans will certainly get a genuine right to migrate freely within the Korean peninsula after political unification. However, North Koreans who decide to migrate to the South in a specified interim period after unification will not get the same social security benefits as South Koreans are due to receive at the time. Further, North Koreans who decide to stay in where they used to live will get different social security benefits from those who migrate to the South or from those given to South Koreans.<sup>15</sup>

To make the scheme more viable, we suggest that non-migrating North Koreans get additional economic benefits over North Koreans that choose to migrate. Non-migrating North Koreans will also be equipped with start-up assets, which will be additional to the benefits

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14. Zang, "A New Look on Korean Unification and It's Financing Issues," pp. 152-153; Sukjin Kim and Kyuchang Lee, *Designing a Separate Social Security System for North Koreans after Unification* (in Korean) (Seoul: Korea Institute for National Unification, 2015), pp. 115-119.

15. The separation of social security system after Korean political unification could be judicially lawful under the current Constitution of the Republic of Korea. Kim and Lee, *Designing a Separate Social Security System for North Koreans after Unification*, pp. 55-62.

from currency integration that will be bestowed to all North Korean residents. North Koreans at the time of unification will be able to choose one of two options, stay or migrate. Both options would certainly be designed to allow for much improved standards of living for North Koreans than they had before unification. In order to feasibly realize Korean political unification, North Koreans will need to be convinced from the outset that the upcoming political unification will absolutely offer a better political and economic opportunity than they had before.

### **Guiding Principles of the Harmonized Privatization of the Properties in North Korea**

Who will have the right to own the properties of North Korea after unification will be the key question for the unified Korean government, and the answer for the question will have significant implications for whether North Koreans will stay in the North or migrate to the South.<sup>16</sup> A temporary separation of social security systems for North Koreans in the unified Korea for “a specified interim period” would become viable and feasible by providing “adequate” economic incentives to non-migrating North Koreans. A contribution of this study would be that we propose guiding principles for resource mobilization for making the economic package feasible and sufficiently persuasive. We need a deeper discussion on how to privatize the properties of the Northern part of the unified Korea in a harmonized fashion.

#### ***Current Situation of Property Rights in North Korea***

The Socialist Constitution of North Korea<sup>17</sup> does not allow private property rights except for income from labor, agricultural production

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16. Bennett, *Preparing for the Possibility of a North Korean Collapse*, p. 247.

17. It was first adopted in December 1972 and amended several times. The most recent amendments were made in April 2016.

from a small family house garden, and inherited goods. Thus, the State owns virtually all of houses, factories, businesses, mines, buildings, forests, lands, and all methods of production. In contrast, about 90 percent of farmlands are legally owned by socialist cooperatives, with the remaining 10 percent owned by the State. The farmlands owned by the State are basically set aside for seeds, breeding stock, and specialty crops. Almost all of North Korea's agricultural products come from collective farms. The social cooperatives are comprised of individual farmers that own these collective farms. This is an interesting consequence of the North Korean land reform. Kim Il-Sung, Kim Jong-Un's grandfather, after assuming power, plundered landlords' farmlands and distributed them to tenants for free. But, for some years following redistribution, the tenants were forced to put their farmlands "spontaneously" into socialist collective farms. That is, farmers in North Korea are supposed to have *de jure* collective shares in the collective farms, although they cannot exert their claims individually.

North Korea's property rights exist in quite a different situation than those that existed in East Germany. About half of East Germany's houses, small-scale businesses and lands were already privately owned in 1990. Thus, the concept of swift privatization could be a natural cause for the unified German government. Another significant difference between North Korea and East Germany lies in property registration systems. North Korean authorities had already completely abolished the property register system and nationalized virtually all of North Korea's properties. Certified copies of the land register were destroyed because there was no longer a need for private ownership registration.

North Korean authorities have provided the North Korean people, through their comprehensive public distribution system, with foodstuffs and almost all daily necessities, including consumer goods, health services, education, employment, and even houses. However, since the early-1990s when the former Soviet Union dissolved, the North Korean economy began to rapidly deteriorate. The state could not provide its people with enough food and necessities, and the peo-

ple responded desperately to the crisis by rushing out of the official economy to participate in the unofficial economy. The planned economy contracted and marketization began to spread. After the North Korean authorities have officially approved most of the marketization activities already prevalent in July 2002, even the official economy came to encompass both planned and market economies.<sup>18</sup> Some new houses and shops have been constructed, not by the State but by “donju” (private money lenders) and sold to somebody else, which is considered illegal.<sup>19</sup> “Donju” have been involved in other economic activities, even in the official economy, such as with state-owned enterprises.<sup>20</sup> North Korean authorities have noticed these illegal activities, but most of them were more interested in receiving bribes from those that partook in those activities.<sup>21</sup> Home buyers would likely to regard their houses as their own private properties. Although the emergence of the private sector is still in its early stage, this trend will be more likely to expand in the future.

***North Korean Residents’ Intrinsic Property Rights Need to be Safeguarded and even Bolstered to Establish Startup Assets for North Koreans in the Early Stage of Korean Unification***

After the political unification of Korea, most properties in the Northern region of the unified Korea would be under the control of the unified Korean government. The unified Korean government could nationalize

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18. Mun-su Yang, *North Korea’s Planned Economy and Marketization* (Seoul: Ministry of Unification Institute for Unification Education, 2015), p. 83.
  19. Seog-ki Lee, Mun-su Lee, and Eunlee Joung, *Analysis of Markets of North Korea* (in Korean) (Sejong: Korea Institute for Industrial Economics and Trade, 2014), pp. 215-218.
  20. Ministry of Unification Institute for Unification Education, *2014 Understanding North Korea* (Seoul: Ministry of Unification Institute for Unification Education, 2014), p. 261.
  21. Yang, *North Korea’s Planned Economy and Marketization*, pp. 99-100; Lim, Kang-Taeg, et al., *Study of the Status of North Korea’s Official Economy for the Estimation of Unification Costs/Benefits* (in Korean) (Seoul: Korea Institute for National Unification, 2011).



most of the properties in North Korea as the State owned them. At the very early stage of Korean unification, how to privatize them would certainly be one of the most important issues.

At the time of unification, privately occupied properties of North Koreans should be recognized and protected. *De facto* private houses, apartments, and small shops should be transferred to their current tenants and privatized immediately. These will become a part of the startup assets for North Koreans living in the non-farm areas. In addition, North Korea's state-owned enterprises in the official economy would be privatized in due course and the net proceeds from privatization would also be utilized for building up start-up assets for North Koreans. Further, North Korean farmers have *de jure* collective shares in collective farms, which should be respected. As to how to privatize collective farms in North Korea, the majority opinion would be that the unified Korean government should allow the members of collective farms to decide the way of privatization. In any case, all North Korean farmers will own the houses they currently reside in and be allowed to exercise their property rights in collective farms and thus be equipped with some startup assets. Likewise, urban workers in North Korea will own the houses they currently reside in and continue to work in the businesses.

The recognition of "vested interests" of most North Korean people<sup>22</sup> would potentially cause some equity issues. For instance, houses in Pyongyang will become much more expensive than those in remote rural areas. Collective farms in the western sedimentary plains will be appraised at much higher values than those in the eastern hilly regions. A major portion of the equity issue could be resolved by providing initial capital to everybody remaining in North Korea. Considering that the size of the North Korean economy that is less than one thirtieth of the South, the unified Korean government should do as much as possible to expand startup assets for North Koreans who are much poorer than South Koreans. Without supporting North Koreans

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22. Exceptions will be applied to the so-called "core elite group" of North Korea, which is estimated to be around 50,000 people.

financially in the early stage of Korean unification, North Koreans will not be able to compete with others in the privatization of major state-owned enterprises or investing in new businesses in North Korea. Some of them would have to sell to entrepreneurs their houses, farmlands, shops and businesses for cash. With startup assets, North Koreans could participate in taking over privatized businesses.

A likely way of injecting initial startup assets to North Koreans would be currency integration with a favorable exchange rate applied to the North Korean won.<sup>23</sup> West Germany indeed utilized this method in 1990. South Korea would need to do or promise to do similar injections during the presumed “unification negotiation period.” The injection would need to be distributed as equally as possible to average North Koreans. For instance, instead of agonizing over how to find the optimal exchange rate, the South Korean government could just give (practically) the same amount of South Korean currency to every North Korean adult. Other methods of injecting startup assets to only non-migrating North Koreans will be discussed later.

***The Separation of Social Security Systems between North and South Korea for a Specified Interim Period needs to Coincide with the Establishment of a “North Korea Privatization Trust Fund”***

As mentioned above, South Korea cannot replicate the West German case with regards to East Germany. Most importantly, South Korea will need to offer a separate social security system for North Koreans for an interim period, most likely ranging from five to ten years. North Koreans migrating to the South after political unification would not receive the same level of social security benefits as South Koreans. North Koreans that remain would receive only local social

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23. The injection of initial startup assets through setting a favorable exchange rate for North Koreans would naturally raise a concern for inflation as a monetary expansion would result. The financial resources needed to cover the monetary expansion would need to be mobilized by issuing government bonds, which would absorb the monetary overhang in the country and thus reduce inflationary pressures.

security services, which in most cases would be inferior than those bestowed upon South Koreans.<sup>24</sup> To compensate for the lower levels of social security services for North Koreans remaining in North Korea, a certain scheme of economic incentives would be required. For this purpose, this study proposes to establish a special-purpose Trust Fund titled "The North Korea Privatization Trust Fund" (henceforth known as the "Trust Fund").

This Trust Fund will be filled with proceeds from selling privatized national properties in the Northern region of the unified Korea. Although most of North Korea's state-owned enterprises may not attract external investment, some major strategic industries such as military equipment, metals, coals, and other mines producing mineral resources would still be competitive. Operation and management of the Trust Fund would be entrusted to the unified Korean government or an independent party. Resources of the Trust Fund should be devoted to providing economic incentives to only North Korean residents, the provision of which would need to be legally guaranteed. The Trust Fund will help North Koreans to stay where they were pre-unification. Other incentives could include a public distribution of essential consumer goods, health and education services, and unemployment benefits for the specified interim period. The allotment of residence rights in newly constructed apartments will be included as well.<sup>25</sup> Conversely, North Koreans migrating to the South after unification will not be able to receive those incentives,<sup>26</sup> but they would probably

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24. Zang, "A New Look on Korean Unification and It's Financing Issues," p. 153; Kim and Lee, *Designing a Separate Social Security System for North Koreans after Unification*, pp. 115-119.

25. Most houses in North Korea are dilapidated in the eyes of South Koreans. There will be a wave of construction of new apartments in almost all of major cities in North Korea after political unification.

26. This scheme is similar to the Hukou system of China. See Chun-Chung Au and Vernon Henderson, "How Migration Restriction Limit Agglomeration and Productivity in China," (NBER Working Paper Series 8707, National Bureau of Economic Research, January 2002), pp. 3-6; Zang, "A New Look on Korean Unification and It's Financing Issues," p. 153; Kim and Lee, *Designing a Separate Social Security System for North Koreans after Unification*, p. 106.

have access to opportunities for better education and health insurance regardless. The Trust Fund will act as a deterrent to migration, if managed properly and successfully. North and South Korean authorities will negotiate and discuss the package of the Trust Fund as well as the separation of social security systems. Negotiations will continue until the general outline of the package would be acceptable to North Koreans.

Potential problems with the management of the Trust Fund would be the possibility of obtaining insufficient proceeds from privatization, especially from dilapidated North Korean manufacturing facilities, as well as the intrinsic mismatch between revenue and expenditure flows. In the German case, the proceeds from selling East German firms did not satisfy initial overly-optimistic expectations. In contrast, we have reason to believe that the development of North Korean mines would be able to contribute non-trivial proceeds to the Trust Fund. Further, different from East Germany, where about half of lands were already privately owned, the unified Korean government will be able to nationalize most of lands (excluding farmlands) in North Korea and anticipate proportionally bigger privatization proceeds. Since privatizing the properties in North Korea would take some time due to the scope of the process, the first installments brought into the Trust Fund would need to come from the unified Korean government's budget through the issue of long-term government bonds or raising taxes. The overt guarantee by the newly-unified Korean government on maintaining the sustainability of the Trust Fund will reinforce the feasibility of the Trust Fund. As proceeds from privatization accumulate and the most urgent needs for supporting North Korean residents subside, the Trust Fund may sometime in the future buy back the previously-issued government bonds. Swift determination of property rights is the key to swift privatization, which is the key to building up the Trust Fund.

### **Restitution Claims, if Legally Proved, should be Properly Compensated**

To reconstruct and develop North Korea efficiently, public-private partnership (PPP) investment projects would need to be widely applied to infrastructure development of North Korea.<sup>27</sup> For the success of PPP projects, the unified Korean government and public sectors will need to set up an incentive scheme for the private sector to actively participate in infrastructure development projects that will need a long time to come to fruition. The first step toward this would be to finalize the property rights of land. Without ascertaining the proper ownership of property, privatization cannot start. The unified Korean government would be able to nationalize all the properties in North Korea, except for legally-recognized private properties of North Korean residents, *de facto* private properties, and farmlands *de jure* collectively owned by farmers.

For the nationalization of properties in North Korea, a group of people would be in the way who had claimed to own some lands in North Korea. However, there are no certified copies of the land register remained in North Korea. Furthermore, more than sixty years of depletion, displacement, sedimentation, and erosion would make exact matching of plots impossible, which is essential to ownership verification. Furthermore, as both North and South Korean authorities have executed farmland reforms, restitution claims on farmlands in North Korea would be more or less rendered null and void. Nonetheless, we could not completely rule out the possibility that certain South Koreans would present a legally non-disputable proof of ownership for lands in North Korea. The majority of North Korea specialists in South Korea support the use of compensation rather than allowing for restitution. German experiences reinforce the specialists' views. The unified German

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27. For a detailed discussion of PPP, see Hyungsoo Zang, *Haesik Park and Choonwon Park, External Financing in the Process of Korean Unification: Major Issues and Policy Recommendations* (in Korean) (Sejong: Korea Institute for International Economic Policy, 2015), pp. 251-274.

government in fact first opted for restitution; however, due to extreme complications and delays in the determination of property rights within East Germany, a shift in policy emphasis from restitution to compensation was necessary.<sup>28</sup> German privatization authorities could sell properties without waiting for the final determination of their ownership, with compensation paid at a later time to owners if needed, which contributed significantly to the speedy privatization and attraction of investments into East Germany.<sup>29</sup>

## Concluding Remarks

We started our discussion on the privatization of the properties in a harmonized fashion in the unified Korea by presenting three prerequisites for potential Korean unification. Firstly, the North Korean people should whole-heartedly desire unification with the South. Secondly, a North Korean government representing the will of the North Korean people should be in power, and lastly, the international community, including the US and China, would need to be cooperative. The implication of these prerequisites would be that the South Korean government should accommodate North Korean people's wishes as much as possible during a "unification negotiation period" in order to achieve permanent Korean unification.<sup>30</sup> During the initial negotiation period, among other matters, the swift introduction of a new land registration map for North Korea should be agreed upon by both North and South Korea. New measurements of all lands in North Korea would be required to establish this new land registration map, which would take about two years and need to be done cooperatively. Without the map, the process of finalizing property rights after unification would be hindered and thus privatization would stall. Further, during the

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28. Wolf, "Korean Unification: Lesson from Germany," p. 183.

29. Wolf, "Korean Unification: Lesson from Germany," p. 183.

30. The unification negotiation period was less than one year for Germans who wanted a rapid economic integration.

negotiation period, major issues and priorities for after unification should be discussed, negotiated, and agreed upon as Germans did some 27 years ago.

The unified Korean government would be able to nationalize most of the properties in North Korea. After that, their macroeconomic policies, including currency integration, a temporary separation of social security systems, privatizing the properties in North Korea according to certain guiding principles, and the provision of economic incentives towards remaining North Koreans would need to be done in a harmonized way towards a successful and permanent Korean unification. Here, the length of the specified interim period after unification would depend on when the migration pressures subside to a manageable level, which will be determined by the electorate of the unified Korea residing both in the South and the North. The North Korea Privatization Trust Fund will be the key contributor to a successful management of the interim period.

Probably the favorite opinion of the majority of South Koreans is that the best way to prepare for Korean unification is to maintain the fiscal soundness of the South Korean government. It is well-known that a key reason for the South Korean government's ability to overcome both the financial crises in 1998 and 2008 successfully was in fact South Korea's fiscal soundness at the time.<sup>31</sup> The South Korea's public debt-to-GDP ratio surpassed 40 percent, and is very likely to rise towards 50 percent. However, the Korean peninsula remains divided and any prospective future unification process will require substantial fiscal resources. West Germany's ratio of public debt-to-GDP was well below 40 percent at the time of their unification.<sup>32</sup>

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31. Zang, Park, and Park, *External Financing in the Process of Korean Unification: Major Issues and Policy Recommendations*, pp. 182-183.

32. Zang, Park, and Park, *External Financing in the Process of Korean Unification: Major Issues and Policy Recommendations*, p. 212.

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