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DIRECTORATE OF INTELLIGENCE

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North Korea's Approach to the West [Redacted]

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Summary

Difficulties in increasing exports to pay for Western equipment, combined with a dismal credit repayment record, have hamstrung North Korea's efforts to increase economic contacts with the West. In the last three years, few new contracts have been signed, and even the number of negotiations for equipment purchases appear to have dwindled. Moreover, Western response to the North's joint venture law has been lackluster. [Redacted]

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We expect P'yongyang will fall far short of importing the more than \$1 billion in plant and equipment it wants from the West. P'yongyang has been seeking equipment for developing its energy and mineral resources as well as high-technology goods such as computers, integrated circuits, and telecommunications equipment. With help from the

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USSR and China unlikely to offset these poor prospects, we see little chance that the North will be able to boost economic growth much beyond 2 or 3 percent annually over the next several years. [redacted]

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### Turning to the West

In early 1984, North Korea renewed its drive for economic contacts with Western Europe and Japan--which have been limited since P'yongyang's buying spree in the West in the mid-1970s. The effort has focused on acquisition of equipment, technology, and financing. In addition, P'yongyang has introduced a joint venture law which allows foreign investment in North Korea. The North has tried to encourage a positive response by paying several overdue debts to West European creditors. [redacted]

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We believe several factors motivated P'yongyang's approach to the West:

- Perhaps most important were chronic shortages of energy, material inputs, and means of transportation which were a drag on industrial development and a constant reminder of the widening economic gap between North and South Korea. President Kim Il-song's trip to Eastern Europe in 1984 probably also highlighted how far the North's economy lagged those of other Communist nations.
- We expect the political importance of economic development also figured in P'yongyang's decision. Kim may view a stronger economy as necessary to help legitimize the succession of his son.
- A failure to obtain significantly increased economic support from Communist countries probably helped convince the North to look beyond traditional trading partners.
- Finally, the example supplied by China's open door policy may have encouraged P'yongyang to look West. [redacted]

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Serious weaknesses in high-technology areas essential to long-term growth have dictated much of the North's shopping list. Although P'yongyang has put out feelers for many types of plants, equipment, and technology (see inset 1), we believe it has attached particular importance to high-technology items such as computers, integrated circuits, and telecommunications equipment. North Korea has approached companies in several countries for fiber optics, semiconductor devices and production equipment, and computer equipment, including mainframes, microcomputers, and peripheral equipment. [redacted]

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[redacted]

Making better use of its natural resources is another goal that has helped define what the North wants from Western nations. Energy shortages loom as a major production bottleneck, while the country's abundant mineral reserves offer potential for enhanced export earnings. As a result, North Korea has expressed a strong interest in such items as pipes and equipment for offshore oil exploration and mining excavation equipment. P'yongyang has also negotiated for machinery for boosting its basic industries--such as steel and aluminum--and for increasing production of consumer goods, notably clothing and television sets, and agricultural products. [redacted]

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North Korea traditionally has been most active in approaching Japanese firms but has recently given increased attention to West European sources, particularly for computers and telecommunications equipment. It has used both legal and illegal means in trying to procure equipment. [redacted]

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[redacted] P'yongyang has actively sought denied US-origin aircraft, oil equipment, integrated circuits, computers, and microwave equipment through firms in Japan and Western Europe. [redacted]

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### Little Success

P'yongyang's new approach has met with little success. Few of the many contracts the North has negotiated with Western firms have been signed, discussions on new business deals have dropped off, and the joint venture law has attracted little interest. Nor has P'yongyang's effort to acquire proscribed Western technology yielded much--the acquisition of Hughes helicopters was one of the few successes. [redacted]

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The import tally is particularly telling. P'yongyang's imports from the West--which by 1983 were already 10 percent below the 1980 level--fell 26 percent in 1984-85 (see figure 1).

<sup>1</sup> Preliminary data for the first nine months of 1986 suggest this downward trend will continue with nominal imports 15 percent below the level of the same period in 1985. In constant dollar terms, imports during January-September 1986 were down 40 percent, and we estimate that imports from the West for all of 1986 may have been only about half the 1980 level. [redacted]

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<sup>1</sup> Because no North Korean data are available, all of the statistics on the North's trade with the West are based on Western reporting. [redacted]

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Most of the drop in imports from the West in 1981-85 came from a 34-percent decline in purchases from Japan, which constitute 73 percent of North Korea's total imports from the developed West and about 17 percent of imports overall. The North's other major trading partners in the developed West are Australia and West Germany, which in 1984-85 together accounted for 13 percent of the North's imports from the West, and Italy and France, which made up another 8 percent. [redacted]

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A major portion of the decline in imports during 1984-85 was a result of a drop in wheat imports--mainly from France--from an average of 310,000 metric tons a year in 1981-83 to only 17,000 tons a year in 1984-85. Of more significance, however, was the 17 percent decline in imports of machinery and equipment, major items on the North's shopping list. The sharpest drops in machinery purchases were in imports of trucks--down 61 percent on average--and machine tools--down 68 percent. Imports of iron and steel and pesticides also fell sharply. One bright spot was imports of construction and mining equipment, which reflect P'yongyang's emphasis on increasing its output of coal and ores. [redacted]

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The North's high hopes for the joint venture law also have not been realized. As far as we can determine, only seven deals--all involved with services rather than production--have been concluded with Western countries since the passage of the law in late 1984.<sup>2</sup> [redacted] Western participants are encountering a variety of difficulties, which will continue to discourage other foreign investment (see inset 2). [redacted]

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#### Weak Purchasing Power

The major stumbling block in North Korea's approach to the West has been its inability to pay for equipment and technology. Falling prices for precious metals, a major North Korean export to the West, have made the problem worse. Exports to the OECD declined about 20 percent in 1985 and were only about half the peak level of 1980. Gold and silver--which in most recent years have accounted for more than half of total exports to the OECD--have declined especially sharply. Sales of these

<sup>2</sup> The North Koreans have used the term "joint venture" rather loosely. For example, P'yongyang has cited an agreement with West German firms for the construction of a cement plant as a joint venture, but the arrangement may in fact be an outright equipment purchase from the Germans. Even if the West Germans agreed to take some of the product as partial payment, this would be a compensation rather than a joint venture arrangement. [redacted]

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items amounted to nearly \$220 million in 1980, but in the following years averaged less than three-fifths that level. Sales of silver dropped from a record \$107 million in 1980 to less than \$20 million a year. North Korea's earnings from gold sales--boosted by the doubling of the world market price in 1980--fell precipitately in 1981 as P'yongyang significantly reduced the volume of sales in the face of sharply declining prices (see figure 2). By boosting the quantities exported, North Korea brought gold earnings back up to over \$100 million a year in 1982-84, but they suffered another decline in 1985 as the price again fell. Most gold went to West Germany except in 1985, when two-fifths of sales went to Japan. [redacted]

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Sales of lead and zinc, which account for about 15 percent of P'yongyang's exports to the developed West, have plummeted since 1980, again because of declines in world prices, but also because of production shortfalls and attempts to meet export obligations to the USSR. Average yearly exports of lead and zinc in 1981-85 were down nearly 80 percent and 35 percent, respectively, compared with 1980 exports. [redacted]

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North Korea's trade deficits with the developed West highlight its weak export performance. The cumulative deficit with the West during 1981-85 was \$770 million and with Japan alone, \$835 million. The North has been able to use various means to cover the imbalance. Sales of gold to West Germany--which gave the North a cumulative surplus of \$370 million--offset the deficit with other West European countries. We believe funds from arms exports--mainly to Iran--have largely covered the deficit with Japan. In addition, P'yongyang may have covered part of the deficit by skipping payments on short-term credits, thus unilaterally rolling them over. Finally, gifts of plant and equipment from the General Association of Korean Residents in Japan have exceeded \$60 million since 1972. [redacted]

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North Korea's failure to expand purchases from the West also stems from its inability or unwillingness to cover its overdue debt payments, which has placed it near the bottom of the Western lenders' creditworthiness list. Despite P'yongyang's attempts to arrange financing, we know of no Western country that has extended new medium- or long-term credits to the North since the mid-1970s. We estimate North Korea's debt to the West at \$1.5 billion in current US dollars. Of this, P'yongyang owes:

- About \$455 million to Japan; the \$195 million paid by the Ministry of International Trade and Industry on insurance claims is now owed to MITI rather than to the Japanese companies involved.
- Roughly \$300 million on West European government and/or government-backed credits.

-- About \$750 million on West European commercial bank credits. [redacted]

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North Korea has few resources to offset its debt. According to Bank for International Settlements statistics, P'yongyang's assets in Western banks have averaged only about \$100 million in recent years. The amounts that less developed countries owe the North for local projects probably are relatively small and, in many cases, not readily collectible. [redacted]

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### Prospects

We believe North Korea will continue to have difficulty in procuring the equipment and technology it wants from the West. In the near term, P'yongyang is unlikely to meet with much success in boosting exports, which is the key to dealing with the debt problem and generating funds to buy equipment. Given the production shortfalls we expect to continue for some time, the North Koreans will remain hard pressed to fill their own needs, much less to raise exports to both Communist and non-Communist countries. [redacted]

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We estimate that the cost of the large-ticket Western equipment and technology in which P'yongyang has expressed an interest would exceed \$1 billion over several years--a sum well beyond the North's financial capabilities. In recent years, for example, North Korean imports of plant and equipment from the West have averaged about \$165 million, a figure that includes many small-ticket items. Moreover, joint ventures should remain unattractive to Western partners. [redacted]

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Economic ties to China and the USSR are unlikely to offset the North's poor prospects for trade with the West. Despite improved North Korean-Soviet political ties, we believe the USSR will continue its tightfisted approach to the North. Since the mid-1970s, Moscow has pressed P'yongyang to step up exports to pay off some of its debt obligations as well as to pay for imports. The 1986-90 trade agreement with the USSR sounds promising--it calls for a doubling of trade. But we believe the North cannot boost its exports much more than the 4 percent a year--in real terms--realized since 1974. The plan to double trade would require an increase of about 17 percent a year if--as the Soviets are insisting--trade is to be balanced. [redacted]

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The Chinese, like the Soviets, probably will continue to call for balanced trade and at best will provide only minimal credits. [redacted] Tao Bing Wei, head of the Asian and Pacific Studies Department of the Institute of International Studies in Beijing, has claimed Chinese leaders are upset about the North's efforts to repay its debt to the USSR when it has repeatedly failed to meet obligations to China. Beijing reportedly has formally rescheduled P'yongyang's debt

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many times over the past few decades. [REDACTED]

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With its approach to the West failing and Communist trading partners unlikely to offer much additional help, the North probably will continue to face severe shortages of energy and industrial inputs, as well as a lack of know-how. Poor economic planning, combined with micromanagement by Kim Il-song and his son, Kim Chong-il, is likely to continue, limiting even the effectiveness of plants equipped by the West (see inset 3). Micromanagement by the two Kim's takes the form of (1) ad hoc directives which set priorities for allocation of resources and (2) on-the-spot guidance at individual plants, farms, and construction sites. This often disrupts production and interferes with planning. The leadership appears unprepared, however to make the major changes in economic management needed for a true take-off of the economy. As a result, we expect P'yongyang will have to be content with the current sluggish pace of economic activity. The North probably can realize growth rates of 2 to 3 percent a year by continuing to make modest improvements in the infrastructure mainly electric power and transportation. [REDACTED]

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Inset 1

North Korea's Shopping List

Examples of items in which the North Koreans reportedly have expressed interest:

- Equipment for exploration and exploitation of offshore and onshore oil.
- Coal-fired power plants.
- Coal-liquefaction gas plant.
- Equipment for coal mining.
- Aluminum refinery.
- Lead and zinc refinery.
- Steel plant.
- Plant to produce magnesite, magnesia clinker, and firebricks.
- Integrated-circuit production plant.
- Microelectronics equipment.
- Computers.
- Telecommunications equipment.
- Fiber optics plant.
- Plant to produce telephone equipment.
- Equipment for production of clothing, toiletries, shoes, foodstuffs, furniture, and kitchen appliances.
- Color TV plant equipment.
- Equipment for the manufacture of agricultural machinery and for processing marine foods.

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## Inset 2

## Joint Venture Problems

The Nagwon Department Store. This joint venture between Asahi Sansa (formerly Asahi Shoji Company, Ltd) of Tokyo and the Mangyong Trade Corporation of North Korea was formed in January 1985. The main branch of the store is in P'yongyang, and 31 branches are planned for major North Korean cities. [redacted]

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[redacted] Asahi Sansa personnel are rather discouraged over this project. Among the problems are:

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- A constant lack of goods in the stores because of domestic shortages and the failure of the North Koreans to order expeditiously from Japan the imported goods needed.
- The joint venture has not been profitable. Very few people who visit the stores have the hard currency required to buy the goods.
- Communist practices--such as "serve the worker day," "study day," and ad hoc party meetings--take away from retail workers' hours in the store.
- Employees have not fully grasped the need to try to please prospective customers. [redacted]

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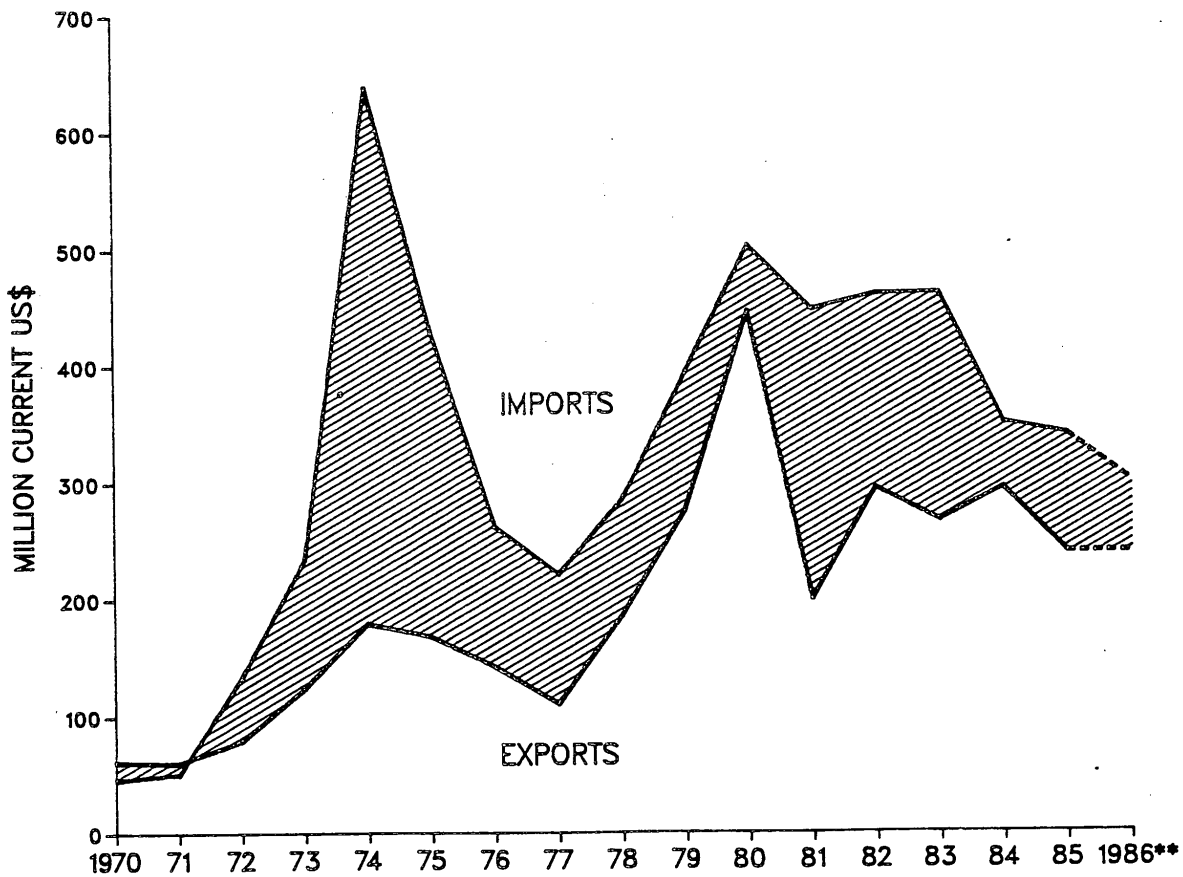
The Hotel in P'yongyang. Shortly after passing its joint venture law in September 1984, North Korea concluded an agreement with a French firm, Camenon Barnaul, to build a 45-story hotel in P'yongyang. In early 1985, the government announced that the foundation work on the hotel was complete and construction was progressing as scheduled. By December 1985, however, although ground had been broken, apparently no work was under way. It is possible that North Korea's failure to make good on debt repayments to France cast a pall on the French firm's willingness to continue with the hotel. [redacted]

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FIGURE 1

NORTH KOREA: TRENDS IN TRADE WITH OECD\*

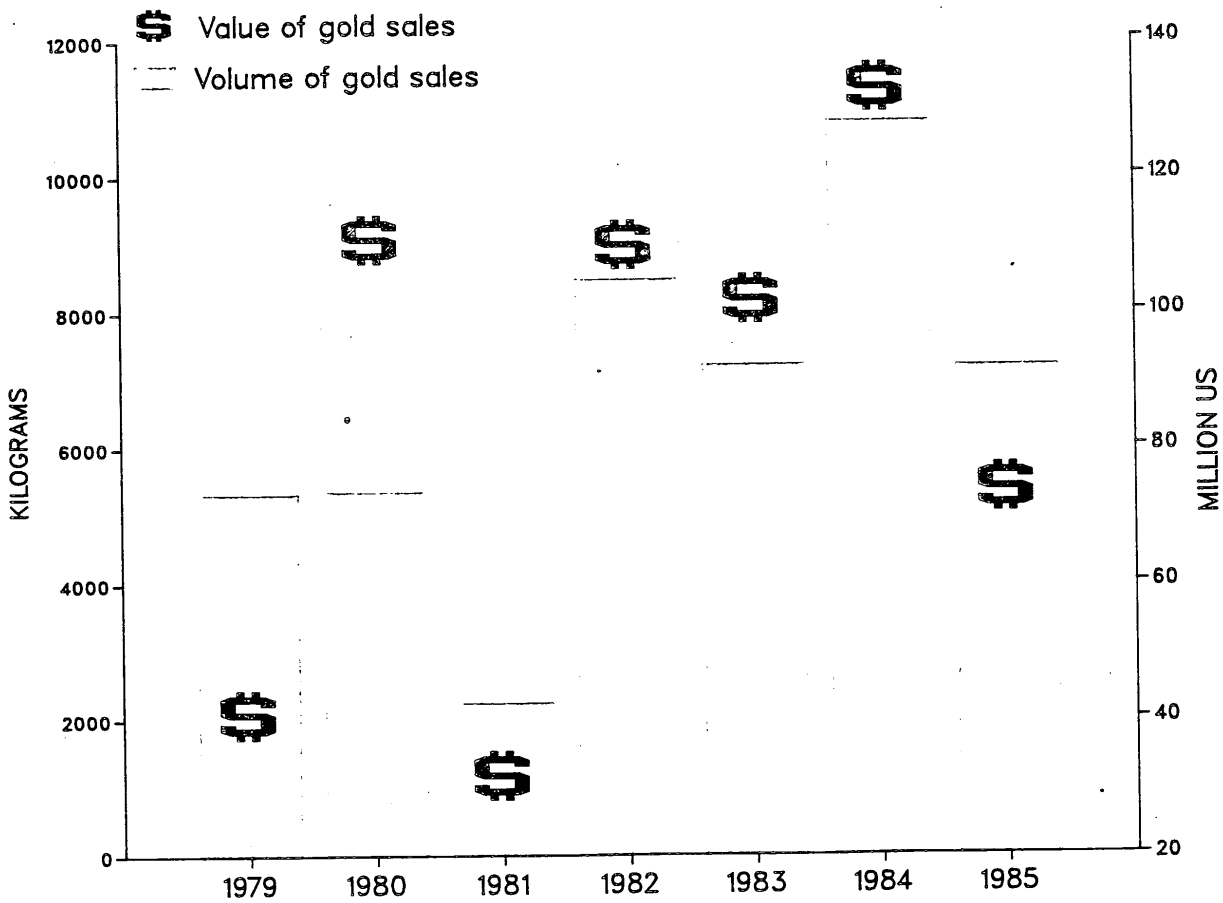


\*BOTH EXPORTS AND IMPORTS ARE ON AN F.O.B. BASIS.

\*\*BASED ON DATA FOR THE FIRST HALF OF THE YEAR.

FIGURE 2

### NORTH KOREA'S GOLD SALES 1979-1985



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28 January 1987

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