

Korea

Last month marked the 20th anniversary of the collapse of the Soviet Union. It also marked Russia's ascension to the World Trade Organization. Its recent aspirations had been frustrated largely by a single country in recent years—Georgia. There is a sense that a new era is at hand.

The end of the Cold War, the rise of China, and the collapse of the House of Finance and the deregulation and financial liberalization associated with the political success of both Thatcher and Reagan, have contributed to a sense of this new era. This is true even if the dimensions and contours of this new period have not yet ossified, making them unclear and still malleable.

Bump and Grind

As we have observed previously, change often comes in one of two varieties. Sometimes the change takes place over a long period of time. Typically, weather and demographics fall into this category. They are grinds. Alternatively, change can take place in a relative short period of time and yet have dramatic effects, like 9/11 or the collapse of the Soviet Union itself. These are bumps.

The death of North Korea's Kim Jong-il in the middle of December can be either a bump or grind. More likely, the change of leadership will mark a continuation of the status quo. Not only do North Korea's elite and military seem firmly in control, but the international focus is North Korea's acquisition of nuclear weapon capability.

Outside of weapons of mass destruction, there are more pressing problems than this vestige of the Cold War for most stakeholders. South Korea itself is somewhat ambivalent. It favors unification in principle, but in practice, it seems to be in no hurry. It is not exactly clear what Russia and Japan gain from the unification of the peninsula outside a larger rival and potentially some increase in trade.

China would be able to reduce its aid to North Korea, which the Chinese magazine Caixin estimates could be as much as 40% of China's foreign aid. However, the risk of that the united peninsula is dominated by U.S. interests may be of greater concern.

The U.S. would appear to have much to gain. It would allow it to reduce its 28,500 personnel and associated costs and could be part of a larger effort to restructure American forces and deployment. A united peninsula would create another potential check on the projection of Chinese power. Yet a discussion now on unification distracts from the WMD issue and a united Korea might pursue a more independent foreign policy over time.

Germany: Non-Example

Rarely does it seem that a discussion about the unification of Korea is not peppered with references to the unification of Germany. Of the numerous examples of the fracture of territorial sovereignty, including Ireland, Cyprus and China itself, Germany's experience was peaceful and successful.

However, the differences are more telling and Germany ultimately offers little guidance for Korea. West Germany never went to war with East Germany, avoiding the millions of casualties suffered in Korea and the subsequent animosity. Nor were there border skirmishes, as Korea has experienced.

East Germany was occupied by Soviet forces. North Korea, while a client state of alternatively Russia and China, has been free of Soviet troops since the late 1940s. Little is really known about North Korea but its economic institutions, government structure, and culture appears indigenous rather than imposed endogenously.

The gap between North and South Korea seems significantly larger than the gap between East and West Germany. Simply, if crudely put, North Korea's population is relatively larger and poorer. The East German population was about one-quarter of the West German population. In contrast, the North Korean population is closer to 50% of South Korea's. At around 24 mln, North Korea's population was a third larger than East Germany's in 1989.

East Germany's median income was estimated to be around 1/11 of West Germany's. North Korea's median income is estimated at about 1/20 of South Korea's. Assuming that the North Korean economy is stagnating or worse, the gap will grow in a compounded fashion.

Dollars and Sense

Confronting these facts, policy makers, academics and investors have tried estimating the cost of Korean unification. Some try to interpolate from the German experience, with notable caveats about the generous conversion of the Ostmark to the Deutschemark.

The German research institute IWH estimated that over the first twenty years of Germany's reunification there was a transfer of about 50% of Germany's 2008 GDP or about \$1.9 trillion). Over this period East Germany output rose from a third of West Germany's to 70%.

Estimates of the costs involved with the unification of the Korean peninsula vary sharply depending on assumptions, including about military savings. Using conventional economic models that link growth to investment, it could cost as much as \$1.7 trillion in 2010, according to Charles Wolf, a consultant at the RAND Corporation (<http://www.forbes.com/2010/03/15/north-south-korea-asia-reunite-opinions-contributors-charles-wolf-jr.html>) in order to achieve convergence of per capital GDP.

On the other hand, if the goal is more modest, say doubling of North Korea's per capita income over 5-6 years, Wolf estimates a more modest cost of \$69 bln. Such modest goal will likely have other social and political costs that ought to be taken into account.

Wolf says that North Korea's per capita income is around \$700 dollars and South Korea's is around \$20,000. Such modest improvement is unlikely to prove satisfactory to many and labor mobility would have to be restricted and strongly enforced. Massive flight from North into South Korea and the economic disruption is a real and significant fear of South Korea officials.

West Germany bore the costs of unification unilaterally. South Korea would most likely get foreign assistance, not only from the multilateral agencies, but also international investors. South Korea has also amassed much wealth. It has accumulated over \$300 bln in reserves and some large fraction of these can be used while still retaining more than enough to cover imports and short-term capital needs.

Ultimately the costs can be born. The real obstacle is will. There was a strong desire by both East and West Germans for reunification, even if other countries were skeptical and made strong demands, essentially monetary union. In Korea's case, unification has not strong advocate.

There are commissions, and occasional Six-Party Talks (US, China, Russia, Japan and North and South Korea) of course, but the transition of power in North Korea appears likely to simply reinforce the hereditary dictatorship. The South Korean formulae of peace, cooperation, confederation and unity, seems fanciful.

They want a grind. Everyone seems to prefer a grind. Yet an unpredictable bump is more likely and whenever it comes it will be a surprise.

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