

From the Desk of...

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Surprise! North Korea has the bomb. So what changes now? Anxiety levels for sure, but markedly higher the further from the Korean peninsular you are. Can it really be business as usual?

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North Korea is an issue which has an importance of inverse proportion to the distance from Pyongyang. It is more important in Tokyo than in Seoul or Beijing, and more important still in Washington and Brussels. This is because it becomes mixed up with other regional and global issues. The same law of inverse proportions applies to the level of person dealing with the issue. To Chris Hill, in charge of negotiations with North Korea, this is a less significant event than to John Bolton or to Dick Cheney. For most people on the ground, the probability that North Korea had a bomb was already factored-in. For those who rely on journalistic or neoconservative doomsday briefs and think that North Korea is a failed and 'whacky' state, then the issue is more serious.

It is therefore perhaps best to consider the North Korean issue from five different angles;

- The impact for regional security
- The impact for Iranian policy
- The future of non proliferation policies
- The risk of collateral damage to the South Korean economy from responses to the North Korean test
- Longer-term high-impact lower-probability issues

First, from their own perspective, the North Korean nuclear device is intended to create a nuclear and conventional *deterrent* to prevent an Iraq style attack by either Japan or the USA. It prevents the risk of an incident rather than makes it more likely. The bomb is not a threat to South Korea, China or Russia. It is at the same time, like much of North Korea's policy, a *provocation*.

The impact on regional security

The only country directly threatened by the nuclear test is Japan. We are in a new environment in Japan with a new neoconservative Prime Minister, Shinzo Abe, eager to build up Japan's power in the region, and with Japan's neighbours more worried about Japanese rearmament than about North Korea's ability to deter attack. Japan is bound to claim the need to spend more on its Self Defense Force and possibly claim the ability to conduct pre-emptive defense. This will create a dangerous situation.

North Korea on the other hand has its security greatly enhanced by having both missiles and nuclear weapons and could be able to consider reducing conventional forces. The neighbours are going to have to offer much more now to get anywhere in terms of a settlement with North Korea.

The impact for Iranian policy

Most of the world has been focused on preventing Iran from enriching uranium -- a far cry from making a bomb. On the other hand, Pakistan and India escaped sanctions for their past sins and India recently received a nuclear blessing from the US. There can be little doubt that the strength of UN Security Council resolution 1695 passed after the North Korean multiple missile launches was partly China's wish to pass a "do not go too far" message to Iran.

Even those who might be inclined to say "oh it is only North Korea" may want to take tougher action against Korea to warn Iran. The problem is that without invoking collateral damage in South Korea there is little action which can be taken.

The future of non proliferation policies

We have to say that non-proliferation regimes have failed and that a strong element of Solana/Powell diplomacy of the 1990s is now in disarray, as many warned it would be. Non-proliferation policies should now concentrate on prevention of weapons grade materials moving across national boundaries rather than preventing sovereign states from possessing weapons. A heightened inspection regime should be applied to all nations.

The risk of collateral damage to the South Korean economy from responses to the North Korean test

In the short term any stronger action taken against North Korea risks damaging the South Korean economy, without much risk of hurting North Korea. The short term risk of collateral damage is much higher than of any nuclear exchange.

What kind of damage is possible – albeit uncertain? It would be logical to expect;

- Withdrawal of a portion of foreign portfolio investment in the KSE
- Change in board room attitudes towards investment and production in Korea (see the inverse rule)
- A fall in Korean consumer confidence which would slow economic growth and damage business confidence as a knock on effect
- Collapse of the Kaesong Industrial Zone policy
- A slight weakening of the won
- Country risk insurance will rise. We would also expect a rise in insurance rates in northern Kyonggi province (where the LCD industry is located)
- Accidental damage due to confusion between the DPRK and ROK (South Koreans get discriminated against by mistake which has already happened)

It is inevitable that the costs of doing business will rise slightly in Korea and that the Korean discount rate will increase rather than decrease.

The real risks; fairly low probability but a big impact

The real damage would come if Japan and the US try to exert pressure on North Korea, including a naval blockade, which would invite North Korean resistance. Aggressive action against North Korea would invite an aggressive reaction, including exocet style shore-to-ship missiles. An alternative would be North Korean attacks against US targets in South Korea or in the region. The North Koreans will also chill towards South Korea if the South cuts off further aid.

So what if sanctions go too far?

There will clearly be a UN Security Resolution and the critical issue is whether there is a reference to Chapter 7 of the charter. If there is an attempt to impose global sanctions, there is a danger of economic collapse in the North. The North Korean economy is probably in worse shape now than for several years. If China and South Korea were to reduce aid, the situation in the North could become volatile. It has always been held in China and the South that propping up the regime was safer for regional security than facing the collapse. The on-going drama in Iraq makes this point more clearly.

What action should businesses take?

The consensus here in Seoul on 'day one' is that there is not much to do. Perhaps delay some investment decisions at least until the shape of the UN resolution is clear, take profits and delay reinvestment. And for the future, just price the risk accordingly.

About Anthony Michell

Dr. Michell is a highly respected Korea and NE Asia business strategist who writes and advises about the country's business and investment environment in this region. He has over 28 years' experience advising foreign companies on entry and operating strategies in Korea. He runs an executive programme in Seoul and presents regularly at business conferences in Asia, Europe and the USA.

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