

A NEW INTERNATIONAL ENGAGEMENT FRAMEWORK FOR NORTH KOREA?

Contending Perspectives

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The Structure of North Korea's Political Economy: Changes and Effects

Lee Young-sun and Yoon Deok-ryong

Socialist economic systems traditionally have been characterized by a centrally planned economy, in which a planning agency plans and organizes production as well as consumption to reach given objectives. The government carries out the plan while prohibiting unregulated economic activities. However, increasing difficulties in planning and severe shortages have resulted in a marked growth of unplanned economic activities in socialist countries. Activities outside the so-called plan have been termed the "second economy," the "unofficial economy," or the "private economy." This paper will focus on the private economy.

The private economy in socialist countries refers to all production or trade for private gain and is usually run by the market mechanism (Grossman 1977). Private economic activity has increased in every sector and has helped ease economic scarcity in socialist countries during the transition period. Another important contribution of the private economy is that it has allowed entrepreneurial people in transitional economies to make use of their abilities during the period of transition (Lee and Chun 2001, 199–226).

While numerous changes have impacted every sector of North Korea (the Democratic People's Republic of Korea, or DPRK), the military sector has not shown much change. It continues to take priority as far as receiving resources and investment. In fact, government military expenditures have remained stable while the rest of the economy has undergone a severe contraction. Kim Jong-il made the military his primary concern after his official takeover of power, and it takes only one visit to North Korea to recognize that the military is of the greatest importance. The military sector continues to be given priority in resources and investment, and government military expenditures have been stable even though the whole economy has under-

gone a severe contraction. North Korea's impoverishment since the 1990s has made the military relatively stronger.

The private economy in North Korea has also gained significance in terms of its increasing scale as well as in its role of easing material scarcity. North Korea introduced reform measures to facilitate market mechanisms in 2002; these reforms were regarded by many experts as approval of already existing market mechanisms within the society. Since then, however, North Korea has added to these reform measures by stimulating the private economy further. The increase in market mechanisms through these reforms will expand the unplanned portion of the North Korean economy more rapidly, which may then strengthen the private economy and market mechanisms.

The changes to North Korea's economic structure and economic capacity reflect changes in North Korean society. This paper attempts to show the changes to economic relations and draw implications from the political and economic points of view. This paper first explains changes to North Korea's economic structure and then analyzes the reform measures with regard to a possible economic transition. The final section summarizes the paper briefly and draws conclusions.

Structure of North Korean Economy and Changes Thereto

The North Korean economy is composed of three main economies: the official economy, the military economy, and the private economy.¹ The official economy refers to all economic activities occurring under central planning, and the private economy is defined as all activities outside the planning structure.² The military economy implies economic activities for the military sector. These three are only loosely related and do not appear to be closely integrated with each other. The absolute size and weight of each economy within the whole country's economy have changed greatly since the 1990s. The evolving differences have changed the daily lives of citizens and the significance of each economy. To comprehend the changes in the North Korean economy and the economy's influence on the sociopolitical environment, it is necessary to understand the internal dynamics of these three economies and how they interact.

Official economy. The official economy is the main body of North Korea's economy and is the formal economic system comprising state enterprises

1 Yoon and Babson (2002, 69–89) discuss the three economies in North Korea but do not include a fourth economy, the “party economy,” because it is not extensive. Sometimes, however, the party economy of North Korea's elites is counted as another important economy there. The party economy refers to the economic consumption by the small governing elite, who extract rent from the people's economy and own profitable enterprises such as gold and mining that earn foreign exchange.

2 This definition follows the classifications of first economy and second economy of Dennis O'Hearn (1980). There are numerous discussions of the definitions, each with a slightly different emphasis; see Grossman (1977), Kemény (1982, 349–66), Ericson (1984, 1–24), and Wellisz and Findlay (1986, 646–58).

Table 1: Weight of North Korea's Government Budget in Gross National Income (GNI), 1990–2001

Year	Budget (U.S. dollars, billions)	GNI (U.S. dollars, billions)	Weight (%)
1990	16.6	23.1	72
1991	17.2	22.9	75
1992	18.5	21.1	87
1993	18.7	20.5	91
1994	19.2	21.2	91
1995	n.a.	22.3	—
1996	n.a.	21.4	—
1997	9.1	17.7	52
1998	9.1	12.6	72
1999	9.2	15.8	58
2000	9.6	16.8	57
2001	9.8	15.7	65
2002	n.a.	17.0	—
2003	n.a.	18.4	—

Source: BOK, various years.

and agricultural collectives; it is a centrally planned and controlled monocratic system. The means of production are owned by the state or by cooperatives. Through its rationing system, the state distributes resources for production as well as consumption. In a command economy such as North Korea's, the social preference for production is decided through value judgments made by the ruling body. The North Korean economy is understood to have put great emphasis on social equity and welfare as the other socialist economies have done.

The State Planning Commission is supposed to drive the budget planning process by composing detailed plans; however, in reality, the annual budget is decided after compiling negotiated agreements on production for each enterprise and deriving an allocation of turnover and taxes on profits. Public finance plays an important role in carrying out planned capital accumulation as well as distribution. The budget and the public distribution system (PDS) serve as the core mechanisms of the people's economy for the allocation of resources. Similar to other centrally planned economies, North Korea manages its economy through a governmental budget, and the government uses a large share of the North Korean national income. The government share of total expenditures is normally above 70 percent, and it reached 90 percent in 1993 and 1994 (*Table 1*, above). Even if the government budget

uses approximately 60 percent of gross domestic product (GDP), as in recent years, the government still controls most of the national income.

The principal sources of revenue for the budget are turnover taxes,³ profits from state enterprises, and user fees for working capital. From 1994 to 1998, North Korea's budget declined almost 50 percent, from \$19.2 billion to \$9.1 billion.⁴ Subsequently, the total budget approved by the Supreme People's Assembly has increased slightly and has stabilized at approximately \$9.8 billion (Table 1). The collapse of the North Korean industry sector is the prime reason for the decline in total revenues.

In the financial system in North Korea, the central bank plays a major role. The state uses the central bank as another important instrument to realize its plan. The central bank provides funds from the national budget that are needed for business activities of government agencies and state enterprises; these include construction funds, maintenance funds, and operating funds. Loans are extended to meet additional demands for funds. In this system, financing is simply a measure to support the national budget system.

North Korea's central bank carries out the usual functions of any central bank, including issuance of banknotes, monetary control, payments and debt settlement, and the supply and receipt of national funds. It also functions as a commercial bank by offering loans and savings and insurance services. The central bank controls the supply of and demand for money, taking account of money in circulation in cash as well as in non-cash, based on the state's financial plan. North Korea controls resource allocation by controlling money to carry out the state plan. Prices in the people's economy are essentially accounting prices that are set to make supply meet demand. In other words, the monetary policy serves the national plan by controlling the money.

The official economy is run by the state, which plans, invests, produces, and distributes goods and services produced in society. The state manages all the production processes and consumption.

Military economy. North Korea has managed the military economy separately from its other economies (the military economy is called the second economy). The state established the Second Economy Committee in the early 1970s to manage the production of military goods. The Second Economy Committee decides independently on production and distribution and has first priority in allocation of necessary materials and resources. The committee is privileged to manage not only production organizations under the committee, but also the production institutions under the cabinet if necessary. The Second Economy Committee became affiliated with the National Defense Commission in 1993, shortly after its establishment in the constitution in 1992.

3 These are taxes on state enterprise production turnover.

4 Data from the Bank of Korea (BOK) are in U.S. dollars in order to make comparable assessments. For a discussion of problems contained in data from the BOK, see Noland (2000).

As the head organization of the defense industry, the Second Economy Committee oversees production activities under the control of the National Defense Commission. The committee manages the planning, production, distribution, and external trade of all military goods in North Korea. It directly controls about 130 munitions factories and about 60 facilities for weapons repair and parts production. In addition, the committee supervises about 100 civilian factories that can be converted to the production of military goods in contingencies such as war.

North Korea's armed forces operate an independent munitions manufacturing system that is a major player in the country's economy. The defense manufacturing industry is divided into two sectors: one producing weapons and technical equipment for combat such as guns, cannons, ammunition, tanks, warships, and aircraft; and the other producing military necessities such as uniforms, shoes, clothing, and food (Suh C. 2002, 28–36). To meet these demands, the military economy runs its own farms, mines, and even banks in addition to its factories.

Manpower in the second economy is estimated at more than 1 million, many of whom are employed in military-owned farms and factories. The North Korean military force includes 1 million troops on active duty and about 4.7 million reservists. The severe contraction of the economy has, however, weakened North Korea's conventional military capabilities, and the country cannot afford significant replacements or upgrades for its conventional military hardware. As a significant part of the labor force, the military economy includes activities or enterprises that meet the needs of the North Korean military establishment; this includes food production, military industries, and businesses that earn foreign exchange.

The military economy does not appear to be closely integrated with the official economy, although the national budget approved by the Supreme People's Assembly does specify allocation for military expenditures. This is probably best understood as "rent" paid by the people's economy to the military, and it supplements the resources mobilized within the military economy itself.

Private economy. A private economy implies one that exists outside the state plan and that operates according to market mechanisms. In North Korea, as in other socialist countries, informal markets seeking to make private profits have existed for many years. They developed from the farmers' markets, where farmers within cooperative farms can sell agricultural products from their private plots to consumers. The farmers' markets expanded gradually in the 1980s, and, since the sharp economic contraction of the early 1990s, these markets have grown in both number and variety. North Korean defectors report (Chun 1999, 179) that the markets, once open only every 10 days in rural areas, have proliferated and are now open daily. The farmers' markets deal not only with agricultural products but also with industrial

goods. The state finally accepted the markets and in March 2003 changed the name from farmers' market (*Nong-min Si-jang*) to market (*Si-jang*).

Several factors have caused the markets to grow rapidly (Chun 1999, 178–80). First, severe food shortages have driven people to the markets because the state has been unable to provide necessary food. Since the collapse of the PDS, the state has been forced to tolerate the markets' growth. Many North Koreans have been able to make a living thanks to the markets. Second, North Koreans have learned necessary market skills from Chinese peddlers (Korean-Chinese constitute the main group of Chinese tradespeople), and cross-border trade has become an important channel for learning and goods transfer. Third, the North Korean government has allowed its citizens to engage in the production of consumer goods. Workers and farmers were organized into auxiliary work units through the "August 3 Consumer Good Production Movement" in 1984 by order of Kim Jong-il. They were to produce consumer goods outside of state planning, using whatever materials were available. The economic crisis of the 1990s forced others to engage in similar activities on an individual basis.

Resources are now flowing into the markets from several sources (Yoon and Babson 2002, 76): agricultural surpluses that exceed state purchases that are produced by cooperatives and households; "leaked goods" from overseas food aid; commodities from cross-border trade with China; items stripped, pirated, and salvaged from state enterprises; commodities diverted from the PDS; goods from small family enterprises; and services offered in the markets.

Numerous reports indicate that the private economy has grown significantly since the early 1990s as households have responded to the food crisis and the failure of the PDS to supply basic human necessities. The PDS had been the mechanism for feeding the urban population, and, since its breakdown in the late 1990s, private markets have been stimulated by demand for basic consumption items. Prices in the markets are generally set in reference to border prices in China. A report by the South Korea Ministry of Unification estimated that 60–70 percent of urban households are now meeting their needs through the markets (Ahn 2002). Although there have been several crackdowns on the operations of informal markets, it seems clear that they will continue to expand. The informal market economy is not officially recognized, but it is accepted as a way of providing normal households with industrial goods as well as agricultural products.

Recent Changes in North Korea's Economic Structure

Drawing on data and estimates from the BOK, we venture a number of comments about structural changes in the DPRK's economy during the period since 1990. A number of these changes appear to be consequential—and, we argue, quite portentous.

First, the weight of government in the economy declined after 1994. The total expenditure of government started with an estimated \$16.66 billion and increased to \$19.22 billion in 1994. In 1994, the North Korean government absorbed almost 90 percent of the country's GDP, including the PDS, to preserve the socialist economic system. However, natural disasters—flood and drought—caused further deterioration in North Korea's economic situation. Industry was destroyed, and the government has lost its capability to manage the economy according to socialist principles. In addition, the government lost the greater portion of its income sources, causing government expenditures in the early 2000s to decrease to roughly half of what they were in the early 1990s. Although government expenditures increased a little in 2001, they have maintained a relatively constant level (\$9.6 billion in 2000 and \$9.8 billion in 2001.). Even though overall GDP has decreased dramatically, the decrease was seen mainly in the reduction of government income. The reason behind that loss is that state-owned enterprises became obsolete, and the government lost an important income source. The planning mechanism of the government was no longer able to function, and the PDS collapsed. Consequently North Koreans began to supply themselves with food and necessities from the farmers' markets (Park 2002).

Second, there are indications that the private economy is continuing to expand. At first, the government claimed a great portion of the household income, but by 1994 that income had dropped sharply—perhaps (we might surmise) even as low as one-third of the 1990 level. After the economic breakdown in the mid-1990s, household income rose above the level before the crisis. To make a good enough living to survive, households became active in the farmers' markets; at the same time, production in state-owned enterprises faltered and, in fact, never recovered. The government's ineffectiveness has led to the growing influence of the private economy. Total income might in fact have surpassed the governmental revenues since 2000. Because the private economy follows market mechanisms, the increasing weight of households in the economy reflects the growth of market mechanisms, indicating that more and more money is flowing into the private economy.

Third, government investments have decreased dramatically. The collapse of the official economy has led to this abrupt decrease because the government has no capital for economic rehabilitation. And, even though the private economy has the capacity for investment, there are no channels in place to facilitate it. In socialist countries, the government functions as the only investor; therefore, if the government does not have funds, investment cannot occur. North Korea finds itself in that double bind.

Fourth, the volume of contributions from foreign countries has declined markedly, especially in terms of total trade volume. Both imports and exports dropped because of the breakdown of the international cooperation network as well as internal industrial degradation. The trade deficit, how-

ever, remains at a level similar to the earlier level. More than one-third of North Korea's investment is being provided through foreign credit.

These changes confirm that:

- North Korea does not have the capacity for investment needed to escape poverty.
- The North Korean government is losing its influence over the economy.
- North Korea's economy runs in part through market mechanisms; both the private economy and market mechanisms are becoming more important.

All the above findings are interrelated. The government has neither the income nor sufficient capacity for investment. The expansion of household expenditures is a natural consequence of a helpless government: household income has now outstripped government income. Finally the government must find an alternative source of income and reinvigorate its investment scheme.

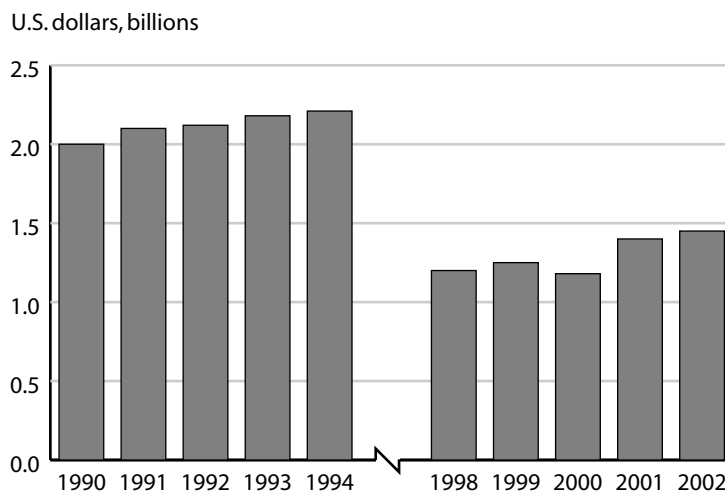
Changes in the Military Economy and the Military-First Strategy

North Korea appears to allocate about 15 percent of its total budget for defense; however, many experts suspect that the North conceals defense spending within other categories (*Figure 1*). The exorbitant military expenses and the huge volume of military spending have become severe burdens for the North Korean economy.⁵ However, North Korea regards military power as the foundation of its internal as well as external security, and the North cannot and will not reduce the military sector as expressed by the government's military-first strategy, even if the power of the military sector hampers economic recovery. The military-first strategy is a literal translation of a Korean term, *songun jongchi*, referring to the politics of giving first priority to the military. The term does not imply a single policy for a particular purpose; rather, it expresses the emphasis on the military throughout society (Suh D. 2002, 148–9).

The military-first strategy has dominated the management style of Kim Jong-il since 1995 even though it was not spelled out until 1998. The military-first strategy was a reaction to the economic crisis that stabilized after the floods of 1995 and 1996 and the drought of 1997 that severely aggravated food shortages. At the least, hundreds of thousands of people were killed by famine during these years.⁶ According to Koh Byung-chul (2004):

5 Some military experts argue that the North Korean defense industry makes up 30 percent of total national production and that the production volume of defense enterprises surpasses the production volume of civilian industries (Suh C. 2002, 28–30).

6 North Korea reported to the United Nations that the number of deaths resulting from famine was fewer than 300,000, but some workers in nongovernmental organizations estimated the figure to be greater than 2 million (FIDH 2003).

Figure 1: Military Expenditures in North Korea, 1990–2002

Source: BOK, various years.

A great number of people strayed everywhere to seek something to eat at that time. The traditional system of ruling by party faced limits in controlling society in those harsh times. It was inevitable that the military would take over the role of managing political, economic, and social stability. The army had to be strengthened to lead from a position of power both the socialist revolution and construction. That is Kim Jong-il's peculiar style of policy.

The weak economic power of the government threatened to destabilize the state itself. The North Korean government reacted to this situation by strengthening military power within society. The government has given priority to the military to stabilize the power system. The needs of the economy, therefore, were placed behind those of the military. North Korea's JoongAng Broadcasting reported on 18 February 2001 that Kim Jong-il had said: "If I would put the first priority on the economy, more fabric will be made and the quality of life of people may become a little better. However, for awhile yet, I can't endanger our socialist country, forged through blood and fire, for the goal of stuffing our mouths."

Despite its worsening economic conditions, North Korea gives priority to the military sector in distributing food and other available resources. Even if it has become a burden for economic recovery, the military has contributed to the economy by constructing roads, buildings, and dams on a large scale. The military sector guaranteed minimum production even at a time when most people left their places of employment to seek food, and a large num-

ber of North Korean soldiers are workers in army uniforms, spending the majority of their service periods at construction sites. The military sector has functioned as a stabilizer for industrial construction as well as for military objectives.

The defense industry has also earned foreign currency. This sector is the most economically competitive sector in North Korea because the country has exported military products continuously and gained international competitiveness. Even though the defense industry is relatively competitive in North Korea, it has too many problems to be relied upon to sustain the economy. But this situation has caused North Korea several problems. First, the defense industry expanded the country's heavy industry too much, causing an imbalance in the industrial structure. The industrial imbalance resulted in agriculture and light industries being underdeveloped relative to heavy industry. Second, the defense industry in North Korea became an important source of foreign exchange. This sector, however, uses much of this foreign exchange to catch up with new developments, and it becomes increasingly difficult for the munitions industries to find new external demand. Third, the defense industry in North Korea is isolated and is usually located close to military bases. This increases production costs and disturbs technology diffusion to other sectors.

Even though the military sector has been given priority in resource allocation, investment in the military sector has decreased significantly because of North Korea's absolute capital shortage. Government expenses for the military sector decreased abruptly in the 1990s, as shown in Figure 1. This implies that the defense industry may begin to fall behind.

Kim Jong-il has chosen the military as a principal tool to overcome a wide range of difficulties both inside and outside the country. The military has helped the state to stabilize economic and social conditions. North Korea is taking advantage of this strategy to strengthen its negotiating position in talks with neighboring countries, especially with the United States and South Korea. It seems clear that the North will stick to its military-first policy as long as Kim Jong-il is convinced of the lack of an external threat and of the necessity of the military to the country's economic recovery. As a result, the military sector will remain a burden in an economic sense and will not contribute significantly to economic improvement.

North Korea's Reform Measures and Their Implications

July 1 Reform Measures

North Korea introduced reform measures at the beginning of July 2002, raising wages and prices to bring the state sector into line with market valuations in the growing private sector. It has scrapped the system of rationing goods, and foreign currency currently can be exchanged for normal North Korean currency rather than coupons to be used in state-designated markets.

Table 2: July 2002 Reform Measures in North Korea and the Direction of Economic Changes

Direction of economic changes	Contents of reform	Policy measures for reform
Changes in economic management	Planned economy → monetary economy	Increase in prices and wages, abolition of rationing system
Reintegration with the international market	Isolation from international market → connection with international market	Readjustment of exchange rate, abolition of exchange coupons
Change in business management	Ethical, social motivation → material, individual motivation	Strengthening the self-supporting accounting system of corporations, material incentives, increase in the autonomous distribution of agricultural products

Price increases were expected to absorb the monetary overhang. Wage increases would provide the people with purchasing power to counter the increases in prices, securing a higher level of living and returning labor into the fold of government control. Scrapping the rationing system acknowledges the breakdown of the state planning and distribution systems. The abolition of rationing would, however, change the command economy into a monetary economy because money, not political power, would determine resource allocation. These changes would constitute the foundation of a market economy.

Moreover, allowing cash to be used for foreign currency exchange will allow foreign customers to approach North Korean markets directly. All these changes seem to be oriented toward monetization, reflecting the intention of the government to introduce market mechanisms.

According to these changes, money and cash will have a greater weight in the economy because the monetization will allow all the economic activities to be translated into monetary terms, thereby contributing to the reallocation of resources and the improvement of economic efficiency in North Korea. Monetization will ease the severe scarcity of consumer goods at first because family enterprises can decide what to produce.

The July 2002 reform measures included increases in prices and wages, a partial abolition of the rationing system, the abolition of exchange coupons, a realistic readjustment of exchange rates, the strengthening of the self-supporting accounting system of corporations, reinforcement of material incentives, and an increase in the autonomous distribution rate of agricultural products. Reform measures are summarized in *Table 2*, above.

This policy reform is expected to eventually increase the efficiency of the North Korean economy, and already there have been some positive outcomes.

However, it is likely that the reform measures will bring about some problems, especially high inflation and pressure on the budget. Budget pressures on the North Korean government will increase because the government will need to pay for government purchases and for higher wages and prices. Government budget revenue will decrease because the government has begun to strengthen the self-supporting accounting system of corporations and increase the portion of the agricultural sector engaged in autonomous distribution. North Korea will face inflationary pressure because economic activities will all be translated into money at an increased level of wages and prices but at the same production capacity. Even if the North experiences a small measure of success from the 1 July reforms, the country cannot fully enjoy the fruits of the reforms if there are no macroeconomic changes to increase government revenue and stabilize inflation pressures.

The North Korean government has also taken steps to control problems stemming from the reform measures. The main problems expected were decreased government revenue and higher inflationary pressure. In May 2003, North Korea began to issue government bonds. These bonds do not bear any interest; instead the government awards a prize to bondholders according to a lottery held every six months until the end of the bonds' validity. This bond issuance was an attempt to absorb private savings, increase government revenue, and reduce the pressures of inflation. The planned issuance period was extended from the end of August 2003 to the end of December 2003, implying that the government had difficulty meeting its fund-raising goals.

In early 2004, Yang Chang-yoon, vice director of North Korea's Ministry of Finance, confirmed that DPRK government revenue could not meet expenses after the economic crisis and that bonds were issued to finance the investment needed for economic recovery and improved living standards through the use of internal resources.⁷

Economic Changes and Sociopolitical Implications

The 1 July 2002 reforms were generally regarded as enforced reform, in other words, the approval of existing reality rather than active reform measures directed toward a specific goal. North Korea has reportedly had success since the reforms, even if there are no available data on actual outcome. *Chosun Shinbo*, the official newspaper of the Chosen Soren,⁸ has reported several times on economic and social changes after the reforms. According to *Chosun*

7 Yang was quoted in the January 2004 issue of *Monthly Fatherland*, a magazine for North Koreans published in Japan.

8 Chosen Soren are North Koreans who reside in Japan.

9 JoongAng Broadcasting also reported from 24 to 26 December on the economic achievements of 2003. It reported that the production of electricity, coal, consumption goods, and heavy industry increased and transport expanded. The report also stated that this economic achievement was a direct result of the new economic policy.

Table 3: Major Changes in North Korea's Economic Management System in 2003

Changes	Details of changes
Replacement of managers	Managers aged 30 to 40 named in major enterprises
Revaluation and enlargement of the market's role	Farmers' markets expanded into comprehensive consumers' markets Enhanced diversification of consumption goods Price ceilings set on essential index goods such as rice and oil; prices set every 10 days according to supply and demand Markets run under a government enterprise system Market fees and governmental payments imposed on vendors in the market
Enhanced autonomy of factories and enterprises	Government enterprises and cooperative bodies permitted to participate in market activity Factories and enterprises permitted to supply basic goods within a bound of 30 percent For the Pyongyang Tongil market, about 5 percent of returns allotted to factories and enterprises
Introduction of competition	Competition in soap and toothpaste encouraged via price equalization
Introduction of other economic innovations	Massive commercial ad placed in downtown Pyongyang Economic courses with reorganized emphasis on financial and monetary economics; emphasis on price control mechanisms Science and technology recognized as intellectual market goods Contracts between research labs and enterprises obligatory

Source: Material extracted and reorganized from various reports of *Chosun Shinbo* in 2003; cited in KDI (2004, 11).

Shinbo and other sources,⁹ North Korea's economy is showing improvement. The volume of production must have increased because the people are working more actively. North Korea's New Year's Common Editorial for 2004 stated that there were increases in production and modernization in light industry, even though no evidence was provided.

North Korea's continuing reform measures imply that economic reform has had some limited success. North Korea went on to complete a range of reform measures in 2003 (*Table 3*), and the New Year's Common Editorial for 2004 expressed the intention of the government to continue with reform.¹⁰ On 22 December 2003, *Chosun Shinbo* reported that a new way of thinking has prevailed in North Korea since the 1 July reforms. North Korean people no longer expect rationing of necessities from the government as they did in the past. The newspaper reported that the trial implementation of "practical socialism" is being established as an irreversible trend. North

¹⁰ Kim (2004, 12), referring to an article in the newspaper of Kim Il-sung University, analyzed the New Year's Common Editorial 2004, which explains the important tasks necessary to improve economic management.

Korea has expanded the farmers' markets into general consumers' markets and is trying to systemize the markets that appeared spontaneously in the period of economic crisis. The government revises prices for important goods every 10 days according to supply and demand. This seems to be a trial period for the introduction of price mechanisms into the market. Almost all products are traded in the market as long as the trading does not violate any laws. All this implies that reform measures in the North are much more than a just an approval of existing reality.

The private economy has grown rapidly, especially during the crises of the 1990s. The North Korean government has not been able to suppress the expansion of the private economy because the private economy has been combined with many positive effects.¹¹ North Korean households produce more agricultural products by cultivating private gardens or factory farms. North Koreans in the private economy produce necessities such as clothes and footwear, rice cakes, cookies, liquor, and so on. These activities do not reduce the products of the official economy because the labor or capital used in the private sector does not substitute for labor and capital in the official economy. Workers in the official economy are not fully employed, and they make use of surplus materials or recycled materials. Production in the private sector eases the shortage of goods.

The major question with regard to the reform measures in North Korea has been whether they will lead to a market-based free economy or whether they are simply a piecemeal collection within the framework of a socialist system. Most observers believe that North Korea might be reluctant to transform its system into a market system. This may be true. However, the choice will be made mainly by economic and political conditions. Therefore, it is important to enrich the supporters of transition in the North and improve the economic and political conditions for success. The expansion of the private economy provides good fundamentals for progressive marketization.

The expansion of the private economy has provided the expected positive effects for economic reform in the North (Chun 1999): First, the private economy can pressure the government for change by representing an alternative system. Second, as the private economy becomes larger, fewer people will lose their investments in the private sector. They will support economic reform. Third, the private economy can become a reservoir of entrepreneurship for transition.

The expansion of the private economy may weaken the spirit of socialism by spreading individualism and materialism and by increasing corruption. It can widen the gap between the rich and the poor. Even if there are some negative effects from the perspective of socialism, the state cannot suppress

11 At the beginning of the 1990s, the North Korean government tried to ban illegal private farming and unregulated farmers' markets and reduce the frequency of market opening. The government eased these regulations in 1993 (Chun 1999, 187).

the expansion of the private economy because of the private economy's dominant positive economic effects. The private economy in North Korea has grown rapidly, and the total expenditures (or revenues) of households now likely surpass those of the government.

Summary and Conclusion

The North Korean economy can be divided into three categories: the official economy; the military economy; and the private economy. Many changes have taken place in each economy over the years, especially after 1990. The official economy has fallen off because of the collapse of state-owned enterprises, while the private economy has grown because of people's efforts to survive. The military economy maintains itself at a level of relative fitness and still holds a large portion of North Korea's GDP despite a small contraction. The economic crisis has caused the official economy, in part, to transfer its role to the private economy. This will gradually lead the North toward becoming a market economy. The private sector will expand continuously at a much faster pace than before. Although the military economy requires some sacrifice in the economic sense, it has an important function for security as well as for external negotiations. The military economy also plays a role in crisis management in the country's economy. Above all, it cannot be expected that the military-first policy will change before reconciliation with the United States is achieved.

This study shows that the private economy will expand most rapidly while the military economy stagnates and the official economy is contracting. The private economy will pressure the official economy for change, and its expansion will hurt the society's socialist ideology. However, North Korea has continuously introduced diverse institutional changes since the 1 July reforms. The private sector will grow with the additional reform measures. North Korea began its institutional changes in the style of the Soviet Union, allowing only small changes within a tolerable range, but in the Soviet Union these acted as a catalyst to change and the system eventually collapsed. The reform measures in North Korea since the 1 July reforms, however, are similar to the Chinese style of reform, allowing a gradual but significant expansion of the private economy. To make sure that North Korea does not return to its past, more people must continue to show interest in the development of the market system in the North. Investment in various forms will help enlarge the basis for international cooperation as well.

International engagement toward a peaceful resolution with North Korea should begin with efforts to support growth in the private sector. If production in the private sector surpasses production in the official economy, North Korea may become a transition economy without making abrupt changes as China did.

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