

The Economic Future of North Korea: Will the Market Rule?

by Georgy Toloraya

More than two decades ago, when the USSR still existed and the concept of the world socialist system presumed that all socialist countries were developing as one, I argued (still in the framework of what was permitted in terms of Communist lingo) that in the case of North Korea (Democratic People's Republic of Korea, or DPRK) we have an example of how the civilizational specifics prevail over the general socialist principles of social-political formations. Country-specific factors behind that phenomenon at that time included:

- Small and isolated territory, historic traditions of "hermitage," and homogeneity of the population, which helped create a rigid system of control;
- Confucian governance system, which in fact was to a greater degree the basis for the political guidance structure than so-called "socialist democratic centralism";
- Collectivist traditions accumulated over the centuries of rice growing, which helped limit the reappearance of individualistic aspirations after national liberation (which was also the case of other socialist countries);
- Militarization of society and noneconomic leverage of mass mobilization under the pretext of external threats;
- Korean nationalism, which promoted the primacy of the nation over the individual.

Hence, there existed the stability and resilience of a rigid system "which can survive and even recreate themselves."¹ Over time, North Korea has succeeded in surprising the world by its resilience, regardless of dire external and internal circumstances.

The factors cited above are still at play. If we speak about North Korea's possible reforms and transformation, we cannot but wonder how much these national specifics matter. If North Korea would sooner or later move to a market economy (there is really no alternative), will the North Korean way again be a unique one? Anything would be progress in comparison with the traditional Stalinist inefficient economic system (conditionally acceptable only for the production of armaments), but where could this progress be stopped on the way to a fully market economy? Does marketization necessarily mean that the North Korean variant of the economic system would be similar to other, more internationally accepted ones? How should the world react to possible attempts to wrap economic reforms into *juche* clothing?

The spectacular advancement in the peace process during 2007 (the six-party talks and the U.S.-DPRK talks as well as the increasing North-South cooperation) leads to an analysis of these issues under the presumption of a politically stable DPRK, the sovereignty of which is challenged neither from

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the outside nor from the inside. Thus, for years to come we still will be dealing with the same—although gradually changing because of the generational shift—ruling elite.

Preservation of leadership means there would be no denial of prior policies, including economic policies. The *nomenklatura* was brought up in the “bosom of Great Leader” and the *juche* ideas (which have actually proved to provide quite an effective system of guidance for regime survival, and therefore many North Koreans might sincerely believe in them). After the total economic collapse killed hundreds of thousands but still the control of the economy was largely left in the hands of the same Pyongyang leaders, those leaders probably believe that economic change can be manipulated any way they wish. Pyongyang still regards the economic innovations under way since the 1990s to be an instrument for survival, not a development strategy. Therefore, obvious changes in the economy as yet are not bringing about transformation of the system. Could that happen and in what manner? That would depend on what would best serve the ruling class, and we should carefully separate the propaganda and ideological clichés from the real interests of that ruling class.

North Korea's Basic Economic Approaches and Their Results

The words “reforms” and “openness” still are not acceptable to Pyongyang, and *Choson Ilbo* on 4 October 2007 reported that Kim Jong-il himself stated as much during his talks with President Roh Moo-hyun of South Korea in October 2007. Under the present leadership, any economic reforms would most likely never be called such and would take place in an unpublicized manner without discussion.

How could such a process then be explained from the point of view of traditional North Korean theories, and to what extent would it be influenced by them? This is a crucial issue for the legitimization of the changes in the framework of North Korean ideology. Therefore, to prognosticate about the extent and direction of possible changes, it is necessary to remember some basics that are often overlooked and lead to distortions in perceptions of the framework in which DPRK leaders operate and in their real intentions.

In the eyes of the Pyongyang leadership, any economic policy should guarantee sovereign economic decision making and be independent of the outside world; it should also preserve political stability. That is stressed time and again even in recent propaganda materials (see *Rodong Shinmun*, 30 October 2007).

The DPRK rulers from the very start proclaimed reaching “economic independence” to be a key component of

protecting national sovereignty and the country's security.² Such thinking might have been initially prompted by an inferiority complex, as North Koreans themselves noted: “. . . the economy our people took over from Japanese imperialism after liberation was a very deformed, one-sided and backward one,”³ and only the economic aid of the USSR and China helped the country survive after the Korean War. Obvious enough in a postcolonial, war-torn economy, it was necessary to “overcome the one-sidedness,” but the actual course was soon altered to “concentrating all attention on guaranteeing self-sufficient development of the economy.”⁴

The economic rationale was abandoned by the 1950s and the goals were politicized—the aim of economic construction was proclaimed to be a “self-reliant, rich and strong, sovereign and independent state. . . .” Kim Il-sung's logic called for “building a diversified economy as to produce domestically most of the products of heavy and light industry and agricultural produce. . . .”⁵ and the economy was to be “equipped with modern technology and run by its own national cadres, using its own natural resources and raw materials. . . .”⁶ The system of workforce mobilization was established in accordance with Stalinist prescriptions: “. . . if we conduct political work properly, increase the political consciousness of the masses, their revolution are enthusiasm . . . regardless of the size of the economy there is plenty of room for its speedy development.”⁷

The fact that the economy would not act the way it had been instructed from above to act and could not survive in isolation troubled the “founding fathers,” who complained that “putting too much stress on others . . . leads the people to underestimate their strength and pay little thought to mobilizing internal resources. . . .”⁸ And these founders succeeded in closing the doors of the nation's economy to the extent that North Korea resembles some of the world's least developed countries, in which foreign trade equals about 10 percent of the gross national product (GNP).⁹

Since then the economic thinking has not changed much. The same theories are still taught at universities (although with a small addition of “bourgeois economic theories”) and remain the guidance for practical conceptualization. In the DPRK, the economy is still subordinate to the regime's political purposes to the extent that the economy has lost its own substantive function.¹⁰

Purely economically speaking, the lack of savings and investment was and remains the chief reason for North Korea's economic malaise: if at the beginning investment was funneled into industrial development at the expense of agriculture,¹¹ by the 1970–90s this source was exhausted while low-efficiency and overdiversified industries could

not generate enough savings. The sorry state of agriculture led to a lack of agricultural products, and no funds were available to import food.

The DPRK's economy entered a period of stagnation (and at times crises) after the initial industrialization phase was completed in the early 1970s. The economy degraded in the 1970s and 1980s to a state of conserving its technical backwardness; it was plagued by a lack of innovation, dependence on imported raw materials and fuel with no possibility of generating financial resources to pay for them, technical degradation of the capital stock (even compared with the USSR and Eastern European countries), high costs, and an unacceptable quality of its industrial products. In the 1970s and 1980s the country fell into a classic poverty trap when economic growth was insufficient to replace deteriorating capital stock or invest in new technologies to increase productivity.¹² For continued economic growth in North Korea, external investment was needed, but it dried up by the beginning of the 1990s with the breakup of the USSR. The North Korean centrally planned economy has entered a downward spiral from which it seems it will never recover.

Much of the country's industrial stock was lost in the 1990s.¹³ Floods in 1995–96 made worse by extensive soil degradation and deforestation not only caused damage (up to \$15 billion) but also resulted in a rapid decline in agricultural output.¹⁴ The famine that ensued resulted in the deaths of hundreds of thousands of people¹⁵ because no alternative to the state production and distribution system existed. Humanitarian catastrophe led to the breakup of the centralized planned command and distribution system—the blood vessel system of the economy. By the mid-1990s the epoch of the “command economy” actually came to an end.¹⁶

The reports on more recent microeconomic improvements do not testify to the corresponding trend in the macroeconomic situation. The structure of the GNP has changed because of the virtual termination of a large part of the industrial production while consumption has grown somewhat with the help of individual production and trade as well as foreign aid, but that does not really constitute economic growth in a usual sense of the word—at least not for internal production. Some positive figures for the (consumption) growth rate since the early 2000s are mostly attributable to economic aid, chiefly from China, South Korea, and international relief organizations. In 2000–04, as calculated by the Korea Institute for International Economic Policy (KIEP), foreign economic assistance to North Korea accounted for 90–100 percent of the volume of the yearly increase in GNP.¹⁷ The North Korean economy is still not working as an industrial economy should. Only macroeconomic reforms can take it out of its dead end.

Reforms or System Alterations? A Retrospective

Since the beginning of the acute economic crisis, North Korea tried at first to overcome the economic difficulties by relying on its own forces and limiting the changes to cosmetic ones. At first they attempted to restructure the economy by depending on internal resources, and they introduced potato crops as an alternative to rice and developed the production of electronics in order to introduce new technologies.

Could the Pyongyang government have deliberately resorted to market-oriented economic measures at that time? Beginning in the mid-1980s, the North Korean leadership toyed with market elements without changing the basics. These changes were prompted by the threat of a gradual change in the relationship between Eastern European countries and North Korea—from one of cooperation to one that was based purely on commerce—and the North needed to create a profit-oriented mechanism. Therefore, most of the North Korean experiments in the 1980s and early 1990s were related to the international sphere (joint ventures, export-processing plants, foreign trade self-accounting companies). Kim Il-sung was still alive when a number of liberal economic laws were adopted; these laws were aimed at attracting foreign capital without changing internal economic regulations and the North Korean system.¹⁸ Nevertheless inside the country both macroeconomics and microeconomics were supposed to remain of the socialist type, and any private activity and uncontrolled trade were prohibited until the beginning of the crisis, when the control system itself fell apart.

There has been an academic discussion about whether the economic changes that the DPRK witnessed in the 1990s and later were bottom-up changes or top-down changes. Depending on the answer, international aid might either conserve the centrally controlled system and delay the reforms or the aid might help the reformists speed up the reforms.

The economic history of the DPRK over the past two decades is the story of missed opportunities rooted in the reluctance and inability of the political leaders to change the rules of the economic game in accordance with new challenges. It is even more ironic that Marxist theory, which was the theoretical foundation of North Korea's economic system, found an unexpected confirmation in the DPRK in 1990s. Among other things, Marxist theory says that the “productive forces” determine the “relations of production.” The virtual disablement of North Korea's centralized industry made it necessary for the people to resort to market forms of economic activity for survival—first, the simplest forms of barter, then money-mediated chaotic exchange based not

on the former central distribution symbolic prices but on real cost proportions often measured in foreign currency.¹⁹ This process was given tremendous—overhyped—attention in the West, where it was largely seen as the introduction of market principles that would eventually lead to the breakup of the North’s centrally planned economic system and then (most interesting to observers) to the collapse of the political regime.

The uncontrolled breakup of the command economic system does not equal the automatic birth of a capitalist market system. The economic reality that started to emerge in the DPRK in the 1990s was a primitive quasi-market division of labor with mostly horizontal ties on a regional basis. No monetary system existed; no macroeconomic policy was set up. In the absence of leadership from above, it was unlikely that these processes could lead to a spontaneous emergence of a modern economic system. “Productive forces,” especially a modern industrial and postindustrial economy, cannot develop on such a narrow basis unless further conscious market-oriented policies are implemented by the political power. In the 1990s, however, Kim Jong-il was concerned more about his power than anything else, and it was not possible for him to risk contradicting the majority of hardliners in the country’s leadership as they tried to check and suppress the microeconomic changes.

By the time Kim Jong-il consolidated his power base, the economic processes under way could no longer be ignored or dealt with exclusively by bans and persecution, which were impossible because of the magnitude of these “deviations from socialism.” Kim Jong-il seemed to understand the need for internal economic reforms; according to a *Kyodo Tsushin* report of 19 December 1996, he spoke about it that month while visiting China, where microeconomic issues were high on the agenda. This experience was seen in Pyongyang as not quite relevant, however, owing to the different political situations in these countries and the different economic realities (for example, China started introducing market reforms in the agricultural sector with the “family contractual system,” but in North Korea agriculture has limited potential). Kim Jong-il also studied the Russian experience firsthand during his visits to Russia, but these comparisons were even less adequate because of a radical political power shift. Kim Jong-il took some notice, however, of several lessons of Russian bureaucratic privatization.

The North Korean constitution that was amended in 1998 made a reference to new realities of small private garden plots, the possibility of extracting profit “in the course of permitted economic activity” (Article 24 of the amended constitution), as well as “costs, prices, and profits.”²⁰ However, the steps to embrace the new market-influenced

economic reality turned out to be controversial, naive, and insufficient from the point of view of modern economic theories.

Take for example the much-lauded so-called government measures of July 2002. Both prices and wages were brought closer to the market levels that had formed spontaneously in previous years, which was a step forward for recognizing the realities of the market system.²¹ Pyongyang, whose positions vis-à-vis the West have considerably improved in 2000–02, probably hoped these changes would prompt its neighbors (especially Japan and South Korea) to increase economic and financial aid that would have helped increase consumer supply and reinvigorate production on a new, more realistic commodity exchange basis using the new flexible price and currency system. The goal, however, was not to change the principles but only the methods of economic control.

The official explanations were also totally antimarket. In interviews with the author, high-ranking North Korean economists made the point that, although the “previous price system” was molded according to the example of the USSR where costs for production of basic industrial goods—coal and iron—were taken as a scale for the whole price system, the new DPRK system took the price of rice as its basic equivalent. The increase in wages (which was much lower than the increase in prices) was based on the calculation of a “consumption basket” reflecting fixed official prices. Different categories of workers received increases on the basis of the importance of their work and their qualifications (with the military, miners, and scientists receiving larger increases than office workers), a change that in fact mimicked the differences constituted originally in the earlier Public Distribution System (PDS).

The changes in the agricultural sector were more significant: The area of farmland that an individual state farmer or a member of a production cooperative was allowed to cultivate individually was increased from 100–170 square meters to about 1,300 square meters in some parts of the country and teams in agriculture were reduced from about 100 members to about 10, which equaled two or three families. However, the agricultural population, unlike in China, is in the minority in the DPRK, and these changes had only limited effects on the broader introduction of a market economy.

It is true that microeconomic decision making was liberalized and in many cases directors of plants were given freedom to use state property in a way they considered most efficient. They were allowed to do this because central authorities relieved themselves of responsibility over “local industry” enterprises and let them solve their problems themselves. Most were not very successful. Enterprises received

access to foreign markets, mostly to get foreign currency in any form possible. But strategic items like electricity, coal, and products with direct relevance to defense are still centrally controlled, which limits the enterprises' abilities to be competitive.²²

The conclusion? The “measures” of 2002 were not perceived in Pyongyang as true reforms; nor were they even seen as a “first step” in reforming. They were not based on a long-term vision and in fact were not part of any master plan with an inner logic and sequencing of actions. Therefore the halfheartedness and controversial character of the measures became obvious very soon.

Some Consequences of Initial Marketization

The changes in recent years remained mostly spontaneous, and the 2002 reforms only opened the floodgates to liberate market forces. This is significant because, regardless of the intentions of the DPRK leaders, the logic of the process calls for more changes as they occur. As a result, the economy had actually changed from a centrally planned one to multisectoral economy, combining the state sector (largely inoperational), the capitalist sector (joint ventures and trading companies, free economic zones), the semiprivate sector (especially in agriculture and services), and the shadow (criminalized) sector.²³ The testimony to this is plentiful and visible. Beginning in the early 1990s, markets greatly increased in numbers and size and now number approximately 500 around the country and about 20 in Pyongyang alone. “Shuttle merchants” delivered merchandise from China (carrying back to China in exchange local minerals and natural products, much as in Russia at an earlier period). Foreign-currency shops, previously reserved for foreigners and repatriates, increased in numbers and became the major source of commodities for the middle class. People started small home-based production. The service sector flourished, including restaurants, billiard rooms, karaoke bars, rooms for rent carved out of personal living space, and repair services. Quasi-banking services emerged, and private lenders appeared.²⁴ All efforts by the authorities to check these developments through periodic campaigns turned out to be in vain.

Did the government intend to adapt its economic guidance system to these new realities? Probably not. Personal interviews indicate that even the most predictable negative by-products of the 2002 measures were quite unexpected to the reformers.

One of those results was spiraling inflation, with the won devaluing from the official 150 won to \$1.00 to more than 3,000 won to the dollar at market rates within five years.

This factor alone severely undermined the state sector and the material situation of those working for it.

Social stratification became a major factor of social tension. Among those able to work, 30 percent are now unemployed. Choson Ilbo of 2 September 2002 reported that although 70 percent of the population of North Korea receives 250–380 grams of food per day, a new class of affluent people has emerged. As in Russia, most members of the new, affluent class are connected with the shadow sector, with half-legal services, or they capitalize on their official bureaucratic positions to gain profits.²⁵ Unless checked, the criminalization of the economy could become a major concern not only internally but internationally (imagine North Korea becoming a safe haven for the Asian underworld).

Low-level corruption in North Korea is already widespread, and (as happened in South Korea) it might become a serious problem in the building of a modern transparent economy. Also, in Vietnam (where North Korea now seems to be looking for inspiration), the growth of the country is attributable mostly to the inflow of foreign capital, and one of the consequences has been rampant corruption.

The reaction of the North Korean authorities to these problems is controversial and has not been systematic. The attempt to reintroduce the PDS for food staples in September 2005 and the ban on the trade of these goods on the markets were not as antimarket as one might suppose. These measures were by and large egalitarian, designed to reduce social tensions by giving a guaranteed minimum to the most underprivileged layers of industrial workers and public servants, making state-sector workplaces more attractive, and aiming to strengthen control over the population. The attempt to bring more people into the state sector and limit corruption also is the rationale for banning younger housewives from selling on the markets. The regulations on the markets are said to have been tightened since Kim Jong-il's summit meeting with President Roh and the resulting assurances of more help from South Korea,²⁶ but that does not mean the clock can be turned back, as some would suggest. The markets themselves have been left intact and are being allowed to develop along with other forms of private initiative. In fact, some recent interviews show that currently it is actually much easier to get a license for opening a new restaurant in Pyongyang than it is in “capitalist” Moscow. The pragmatic part of the DPRK's leadership seems that it is starting to share (not openly, however) Deng Xiaoping's famous maxim that the color of the cat is irrelevant if it catches mice.

More important is that the introduction of market principles into what was supposed to become the international

market-oriented sector of the economy became one of the leadership's priorities. That process, which started in the mid-1990s, included attempts to create joint ventures and establish numerous free economic zones as testing grounds for new policies (the most significant was the attempt to start the Rajin-Sonbong special economic zone in 1997 through the "testament" of the late Kim Il-sung). Although many of these efforts were unsuccessful owing to North Korea's isolation, the closed character of its economy and the lack of trust in it, and the insufficient experience and poor decision-making capabilities of North Korean "businesspeople," cooperation with South Korea turned out to be a major channel through which to introduce capitalist management. The Kaesong free economic zone, the Mt. Kumgang tourist project, and the upcoming Mt. Paektu tourist project are examples. The recent agreements between the prime ministers of North Korea and South Korea on developing Haeju, cargo traffic, communications in the Kaesong zone, and shipbuilding facilities in the DPRK with the ROK's assistance are very encouraging as they broaden the scope of the South Korea-sponsored market sector in the DPRK's economy.

Does this mean that the ruling elite is ripe for embracing more radical changes? There is a window of opportunity that is determined by a multitude of factors: military, political, economic, and personal.

The Road Ahead?

To start meaningful economic changes, North Korea obviously needs comprehensive irreversible security guarantees. The main difference between the DPRK and, say, the People's Republic of China or Vietnam of the 1970s and 1980s is that when the PRC and Vietnam started reforms their security was not seriously threatened. Now is the crucial time as the international hostility to the DPRK and its isolation has been in recent years the most important single factor preventing the reforms. A diplomatic solution to guarantee North Korea's national security would enable that part of North Korea's elites who understand the need for a change to try modernization measures without fear for their future.

It seems like the core of this "new deal" would be Korean nationalism. In recent years the "interests of the nation" have been declared to be more important than the interests of class or ideology. Today a strong and powerful state—*kanson taeguk*—not a socialist utopia is more and more on the agenda. Although the DPRK boasts of its "invincible" military strength and improved international standing, economic development could well become the national priority, and Korean pragmatism might prompt the leaders to not be too selective about purity of ideological principles so

long as the new approaches do not contradict the interests of the nation.

The critical issue today still is: Will the leadership dare try real comprehensive reforms? It is not as monolithic on the subject as is usually supposed. Kim Jong-il seems to have to listen to both "pragmatists" and "conservatives," which makes formulating a coherent policy extremely difficult. So far the attempts to that end have been less than successful, not the least because people with economic knowledge have a very limited say in Pyongyang. Neither the ruling party functionaries, nor the military, nor party and security apparatchiks who constitute the major part of Kim Jong-il's retinue understand liberal economic concepts prevailing in international economic theory and practice; neither do they grasp how they could be applied to the reality of their country. They are probably correct in their assumption that liberalizing the economy would signal the start of the breakup of the governance system, but there is still no theory about the extent and the areas of DPRK state regulation that could be combined with the market and what the forms it might take could be. The top leaders, many of whom formed their personalities in guerrilla warfare, still try to have their cake and eat it, too, by limiting changes to an essential minimum. They might be afraid, however, that the logic of the changes would prompt more changes, which would eventually get out of control. Thus, the mission of the international academic efforts might well be explaining to North Koreans their options.

The possible solution to the nuclear issue by providing security and economic assistance to the DPRK could become a major factor as North Korea's leaders make up their minds on an economic model. What are the possible scenarios? We leave aside a possibility of a regime change and the absorption of the North by the South.

An immediate scenario that cannot be ignored is system conservation. A prolongation of the confrontational military-political status quo or halfhearted security guarantees (especially if the nuclear deal is not finalized under the current U.S. administration) could prompt the hard-liners to try to freeze the reforms and try to eliminate the most obvious "deviations from socialist principles." The system conservation experience during the 1990s could be repeated under more favorable conditions now that Pyongyang feels its immunity is guarded by its nuclear deterrent and it harbors hope for at least some economic aid.

In such a case, the DPRK authorities would try to increase their centralized control over the state sector of economy, try to revitalize it, and at the same time limit the spread of market relations. There are indications of such attempts already. An article in *Rodong Shinmun* on 26 September 2007

said: "If the ideological work is not carried on persistently, the revolutionary enthusiasm of the people gradually cools down and there appears among them the tendency of seeking an easy life. It is proven by historical facts that socialism collapses when the ideological work is let loose."

The larger part of the world community, taking into account the not fully resolved issue of weapons of mass destruction and military threats as well as the dangers that might be associated with a North Korean collapse, would in such a case be prepared to pay a comparatively small price for keeping the DPRK quiet and not causing problems. That would mean finding at least some fixes to the North Korean economic crisis by simply "feeding the beast" (even in the absence of meaningful changes in DPRK) to minimize political and security risks.

In such a case, economic assistance then would be based on the shopping lists provided by North Koreans and would not do much for modernizing the country. The decision to provide capital goods aid equivalent to 500,000 tons of heavy fuel oil on the basis of what the North Koreans say they need for renovation of the country's power industry and without considering the broader energy and economic consequences sets a dangerous trend. Russia has already had this experience; its economic assistance to North Korea in the 1960s and 1970s sucked the USSR into a downward spiral of increasing North Korean requests but could not help solve the long-term economic problems of the DPRK.

The above scenario really cannot be a long-term solution. Sooner or later the DPRK will have to transform its economic theory and practices or else it will collapse. Theoretically, the choice might be between the liberal (à la the Russian-style Gaidar liberal reforms of the early 1990s) and the dirigiste approaches. The second is more relevant to the North Korean situation.

It can be presumed that because of political considerations the role of the state in economic activities would still remain much bigger than in other classic transit countries at early stages of reform. Especially intriguing are Kim Jong-il's remarks, reported in the Korea Times of 28 October 2007, about his intention to follow the Vietnam-style doi moi economic reform and openness policy because of the supposition that the Vietnamese example is closer to the needs of the DPRK than the Chinese one. The doi moi reforms, because of the smaller size of the Vietnamese economy and its export orientation based on cheap labor, would be more suitable for North Korea from the point of view of the need for the regime to preserve stability. North Koreans have also been known to study the South Korean experience, in which state planning played an immense role in the export-oriented economic drive of the 1960s and 1970s.

The international community now has a unique opportunity to influence the DPRK's economic policy selection and implementation process. The long history of developed countries' aid to developing countries suggests that aid can be futile, even counterproductive, in the absence of complementary reforms.²⁷ Therefore, economic assistance to the DPRK, which would be part of the package for the solution of the nuclear problem, should be aimed at assisting system transformation, not at conservation of the outdated model by uncritically satisfying North Korean requests.

A program to that effect and based on a desirable prognosis for North Korean economic development should be prepared in the framework of the six-party talks jointly by the future donors on a coordinated basis. It should of course be agreeable to the DPRK authorities, but it should be made clear to them that the assistance will not be granted uncritically and automatically, but in accordance with the agreed strategy aimed at achieving the country's modernization and integration into global economic reality. Ideally the countries rendering assistance on a bilateral basis should correlate their efforts with the goals of such a program. South Korea, for example, is planning to supply energy for a shipyard and help reconstruct railways in the DPRK, which is to be coordinated with the other countries' efforts in the same direction.²⁸

In such a case is there a real possibility for an evolution of the economic system in North Korea? The critical issue, as the examples of other transit economies show, is creating a class of proprietors and owners. In the DPRK, creeping privatization is already happening—lots of foreign trade and production companies operate under every wing of the military, the party, local government organs, and security services in different areas of the country. In fact this process started in the 1980s when so-called self-accounting export and trading companies (like Ponghwa and Taesung) were created, and over the years it spread in width and depth. The party, military, and security bureaucracies benefit from this system. In some cases, they are already abusing their economic power by embezzling and conducting illegal business operations for their personal enrichment,²⁹ so obviously some new rules for entrepreneurship need to be set up. At the same time, this process must be tacitly guided from the top (unlike in Russia, where it was chaotic and controlled by rival factions and criminal circles).

Kim Jong-il might seek to give the right to use the country's economic potential and eventually property rights to the leaders of the military and security service, which in turn would guarantee the stability of the regime. This is crony capitalism, but it has worked in South Korea. According to a 1970s survey, 98 percent of business owners in the ROK

were the descendants of the colonial elite (children of landlords, merchants, industrialists, and officials).³⁰ The Korea Times of 15 October 2006 speculated that in the DPRK, it is the generals and leaders of military and political police who might be the best material for grooming to be local capitalists.

Privatizing state property entities “in bulk” could result in the creation of economic conglomerates resembling South Korea’s chaebol but with a greater role for the state. They could be the welcome partners for South Korean investors and the engines of an export drive and innovation. These new economic entities that would depend on the foreign markets for supply and sales would break the country’s isolation.

Structural Priorities and the Role of the Market

The structure of the DPRK economy could change tremendously. Russian researchers suggest that certain outdated industries—especially machine building and chemistry—should be simply liquidated, while other sectors (metallurgy) should be rebuilt on a selective basis. To solve the inevitable unemployment problem (which is already a fact of life), the workforce should be retrained and employed at new production facilities.³¹

A modern economic structure in North Korea will be established by foreign investors. And the nomenklatura money will melt into the foreign capital structure.

Although it denies its dependence on the international market, the DPRK is in reality a part of it—and will increasingly be in years to come. To integrate into the international and regional division of labor, North Korea will have to rely on the comparative advantages it possesses—cheap and comparatively well-educated labor, mineral resources, and the advantage of location. The development of corresponding economic sectors would then constitute the economic modernization of the country.

The modernization of the DPRK’s existing economic structure, with its heavy reliance on industry, cannot be achieved spontaneously, solely by the invisible hand of the market.³² Liberals might frown on the idea, but in North Korea’s modernization, government regulation of the industrial sector and a coherent structural policy, determining the priority industries and exercising support to them, would be necessary. Such a policy should prioritize those directions where the DPRK enjoys an internationally competitive position. Note that in the North Korean case the ideological reasons for protecting the nation’s sovereignty might result in placing a high priority on the inefficient branches (especially related to the country’s military-industrial complex).

A reasonable compromise with foreign donors should be found. A structural policy should take into consideration the following:

- Target markets of production (internal and external),
- Priority branches,
- Sources of investment,
- Role of state- and nonstate-sector actors, and
- Mechanisms of support.³³

Kim Jong-il himself seems to be looking at the so-called transit innovative model, where the bulk of growth and new investment is supposed to be concentrated in high-technology industries (like information technology [IT]). The country’s scientific potential and level of technical education feasible in the longer run need to be considered, but only after reforms are advanced and modern infrastructure has been created.

The most likely sectors destined to face exponential growth are the labor-intensive and export-oriented branches. Vietnam, with a comparable-sized economy and a similar history of development, could be taken as a reference for the DPRK’s possible road ahead: Currently Vietnam’s exports (which amount to \$293 per capita) account for 66 percent of Vietnam’s GNP; imports account for 67 percent of GNP. In fact, certain circles of the power elite in North Korea now advocate for developing foreign trade, so much so that Rodong Shinmun wrote on 30 October 2007: “We are stressing self-sufficiency, but that does not mean we are disregarding international economic relations while striving to build our economy.”

The export-orientation model of growth is already undergoing a test in the Kaesong foreign economic zone; it has had many difficulties, but they stem from the country’s continuing isolation, not the concept itself. With wages remaining much lower than in China, North Korea will be a future site for South Korean and even Chinese companies to relocate production of simple consumer goods, including textiles, footwear, simple electronics, and household goods, to the North. We are already witnessing the competition of Chinese and South Korean capital in the North Korean economy, and the ROK is very determined to take the lead. The agreement reached during the North-South summit in October 2007 to create a special economic “triangle” in the DPRK in the area adjacent to the demarcation line is the latest testimony, according to the *Korea Herald* on 4 October 2007.

Shipbuilding and other capital- and raw material-intensive industries could also become an area of specialization, as agreed also during the summit. Information technologies and outsourcing could also become a growing employment

sphere (provided that limitations on exports of dual-use technology would be lifted as normalization of the political situation proceeds). Another sector that could survive international competition is natural resources—mining of ferrous and nonferrous metal ores (including uranium); nonmetallic minerals; primary production of iron, steel, copper, zinc, lead, and building materials (cement, magnesite); fisheries and mariculture; and forestry. Traditional industries oriented toward the end user that have an immediate stimulating effect on the consumption market should also be modernized and helped out of stagnation; they include food processing, clothing, building materials, and similar activities.

To make use of the country's competitive transit potential and its capacity to become a recreational and tourist (especially ecotourist) destination, the systems of transportation and communication would have to be drastically rebuilt, including new roads and railroads, ports, airports, communication facilities, and hotels.

Infrastructure projects should be developed on a noncommercial basis, probably using official development assistance (ODA). The DPRK's inclusion in the international financial organizations will be important, although many difficulties will have to be overcome.³⁴

Detailed research on the basic parameters of such a model (Kim Jong-il's "new deal") should be undertaken. Before its realization, however, massive education and training programs for North Korea's economic managers should be put in place, which could start with distance education via the Internet: Those in training would not need to leave the country, making it cheaper and, in the eyes of the DPRK leadership, protecting the trainees from ideological contamination. Such training, which would be much more useful than the energy or food aid, could be the first joint action of multilateral economic assistance to the DPRK. Armed with this knowledge, North Koreans could formulate and implement the variant of the market economy most suitable for the specifics of the country and its geopolitical situation.

Georgy Toloraya is currently a visiting fellow at the Center for Northeast Asian Policy Studies (CNAPS) at the Brookings Institution. Dr. Toloraya is by training a diplomat specializing in East Asian affairs and has previously been posted in North Korea, in Seoul as deputy chief of mission, and in Sydney as Consul General. He works part-time for the Institute of World Economy and International Relations (MEMO) in Moscow. Dr. Toloraya holds a Ph.D. in Economics from the Graduate School of the Institute of the World Socialist System.

Endnotes

1. G. Bulychev, "Korean Variant—the Most Stable Model of Socialism?" In *Modern Socialism and Problems of Perestroika* (Moscow: Institute of World Socialist Economy, 1989), 90, 96.
2. Kim Il-sung's slogan was "Our party's line of building an independent national economy is the embodiment of the *juche* idea in economic construction"; see Kim Il-sung, "Answers to the Questions Raised by Foreign Correspondents" (Pyongyang [Russian edition], 1974), 179.
3. "Building of an Independent National Economy in Korea" (Pyongyang, 1977).
4. Hwang Do Young, *The Post-War Reconstruction and Development of People's Economy of DPRK-Moscow* (Pyongyang: Political Literature Publishing House, 1958), 9–10.
5. Kim Il-sung, *Selected Works* [English edition], vol. 3 (Pyongyang: Foreign Languages Publishing House), 399.
6. Kim Il-sung, *Selected Works* [English edition], vol. 4 (Pyongyang: Foreign Languages Publishing House), 558.
7. Genaro Cheka, *Rice and Steel* [Russian ed.] (Pyongyang: 1977), 117–118.
8. *Ibid.*, 221.
9. *Cooperation of Russia with East Asian Countries in the 90s* (Moscow: Institute of International Economic and Political Studies, 1999), 122–23.
10. Russian researchers argue that in the past the subordination of the economy was justified by military-political circumstances, but now actually it is inertia that rules; see I. Bogdan, "North Korean Economy in the Modern World," in *Korean Peninsula: Myths, Expectations and Reality*, vol. 1 (Moscow: IFES, 2001), 53.
11. Kim Il-sung, in *Selected Works*, vol. 4, page 40, argued: ". . . a formerly backward agrarian country like ours has no other way but to draw a certain amount of funds for socialist industrialization from the countryside."
12. Bradley O. Babson, "Economic Perspectives on Future Directions for Engagement with the DPRK in a Post-Test World," *The Stanley Foundation: Policy Analysis Brief* (December 2006), www.stanleyfoundation.org/publications/pab/BabsonPAB.pdf.
13. By early 1997, the average production of major plants in North Korea was, according to optimistic South Korean estimates, a mere 46 percent of capacity, while some Russian experts presumed in 1998 that it was only 20–25 percent of capacity; see *Cooperation of Russia with East Asian Countries in the 90s*, 122.
14. Database, Humanitarian Development Resource Center for DPR Korea (HDRC), 2004, www.humanitarianinfo.org/DPRK/default.asp.
15. Some say up to 2 million, potentially 10 percent of the 1995 population (see Marcus Noland, "Famine and Reform in North Korea" [working paper (WP 03-5), Institute for International Economics, Washington, D.C., 2003, 12–13], www.iie.com/publications/wp/03-5.pdf, Noland 2003); also see Sue Lautze, "The Famine in North Korea: Humanitarian Responses in Communist Nations" (Tufts University, School of Nutrition Science and Policy, Feinstein International Famine Center, June 1997), <http://famine.tufts.edu/pdf/nkorea.pdf>, Lautze.

16. William Brown, in “North Korea: How to Reform a Broken Economy,” in *North Korea: 2005 and Beyond*, ed. Philip Yun and Gi-Wook Shin (Stanford: Walter H. Shorenstein Asia-Pacific Research Center; Washington, D.C.: [distributed by] Brookings Institution Press, 2005), 64, observed:

By 1996 or 1997 North Korea’s economy, if not its political system, had indeed collapsed. An economy, by one definition, is a social system that allows the specialization of labor. By the late 1990s, specialization of labor had essentially ended for millions of farmers and industrial workers. Hungry coal miners abandoned their mines and scratched bark off trees to find something to eat while freezing farmers abandoned their fields and combed the hillsides for heating fuel. Without the “great leader” or a central plan to tell them what to do, and with markets and money strictly illegal, trade between coal miners and the farmers simply stopped.

17. According to KIEP data released in September 2007, in 2004, GNP in North Korea was estimated to have grown by the equivalent of \$458 million, while overall foreign aid was \$419 million.

18. Legal changes included the law on free economic zones (8 April 1990), foreign investment (10 December 1992), foreign enterprises (10 December 1992), contract joint ventures (10 December 1994), foreign investment and commercial enterprises and individual taxation of foreigners (8 April 1993), foreign currency regulations (8 April 1993), banks with foreign participation (10 December 1993), customs (10 December 1993), and foreign trade (March 1998).

19. M. Trigubenko, T. Neelova, and G. Levchenko, “Problems of Korean Peninsula,” in *Russian Diplomacy in Korea in 1990s* (Moscow: Institute of International Economic and Political Studies, 2000), 15.

20. Georgy Bulychev, *The Political Systems of the Korean Peninsula States* [in Russian] (Moscow: MGIMO Publishers, 2002), 95.

21. Prices for food, fuel, and electricity rose 26-fold, on average, and prices for rice rose 550-fold. Public transport fares increased by up to 20-fold. The new rate of exchange for the DPRK won—150 won to \$1.00—was introduced; the rate was based on the world market price for rice, in dollars.

22. “Recent Changes in North Korea” (Seoul: Ministry of Unification, 2005), www.unikorea.go.kr/data/eng0303/000158/attach/eng0303_158A.pdf.

23. T. Lezhenina, *East Asia: Tendencies, Contradictions, Conflicts* (Moscow: Institute of International Economic and Political Studies, 2001), 193–95.

24. Andrei Lankov, “North Korea: De-Stalinization from Below and the Advent of New Social Forces,” *Harvard Asia Quarterly* 9, no. 4 (Fall 2005), www.asiaquarterly.com/content/category/5/28/43/.

25. Some estimates say that approximately 150,000 state security service operatives use their education, knowledge of how the state operates, and privileged access to contacts and transportation to benefit from illegal operations, including smuggling, customs evasion, and assistance to those illegally entering China; see Hazel Smith, “Brownback Bill Will Not Solve North Korea’s Problems,” Jane’s Information Group, 21 January 2004, <http://www.janes.com>.

26. Kwon Jeong Hyun, “Inspecting Markets, the Hot-Beds for Anti-Socialist Activity,” *Daily NK*, 15 November 2007, www.dailynk.com/english/read.php?catald=nk01500&num=2914.

27. Stephan Haggard and Marcus Noland, “Economic Implications of Summit Agreement,” Policy Forum Online 07-082A (San Francisco: Nautilus Institute, 30 October 2007), www.nautilus.org/fora/security/07082HaggardNoland.html.

28. “South and North Korea to Tackle Railways,” United Press International, 17 November 2007.

29. In the most outrageous cases, some of the corrupt officials have been executed. An official of Kangsung Trade Company, which operated under the supervision of the People’s Armed Forces Bureau, was shot, as was a foreign-currency trader in Hamheung who accepted money from private business operators and used the company’s name to lend import and export quotas. Also executed was a foreign-currency director for the Chosun Fabric 88 Trade Company in Yunsu County, North Hamkyung Province, who built a private villa and purchased a Mercedes out of pocket; see “NK Brief,” Kyungnam University, Institute for Far Eastern Studies, 28 September 2007, <http://ifes.kyungnam.ac.kr/eng/m05/s10/default.asp>.

30. “Russian Koreans,” Moscow, no. 61, June 2004, 10.

31. *The Problems of Korean Peninsula and Russian Interests* (Moscow: Institute of International Economic and Political Studies, 1998), 21, 142.

32. Note the Russian example, where such expectations in the 1990s led to the severe crisis especially in the industrial sector, which has still not been overcome.

33. Ruslan Grinberg, “Structural Policy—A No-Alternative Lever to Modernize the Russian Economy” (roundtable, “The Strategy of Russia,” 26 June 2007).

34. At the fall 2007 meeting of the International Monetary Fund, South Korea promised to promote the North’s membership in the international financial institutions; see Kelly Olson, “South Korea Will Seek Inclusion of North Korea in Finance Organizations,” Associated Press, 18 October 2007, http://ca.news.yahoo.com/s/capress/071018/business/koreas_imf_world_bank_1.



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