

# **FRS - KF** KOREA PROGRAM ON SECURITY AND DIPLOMACY

**“It’s premature to say the market became the dominant mechanism in North Korea”**

**A conversation with Jo Dong-ho, March 2019**



Jo Dongho has been the president of the Institute for National Security Strategy since 2017. He is a professor at Ewha Womans University and was a director at Ewha Institute of Unification Studies. He had previously worked at Korea Development Institute for 16 years as director for North Korean Economic Studies. He is one of most renowned experts of the North Korean economy.

***Q1: Chairman Kim’s 2019 New Year Address was resolutely focused on economic issues. He declared that the country “faces the task of expanding the country’s capability of independent development” while being subject to “harsh economic blockade[s] and sanctions”. Meanwhile, over the last few years, international sanctions have been drastically reinforced. Could the North Korean economy successfully adapt to them and still grow, fulfilling the “new strategic line” announced during the 3<sup>rd</sup> Plenum of the Worker’s Party in April 2018?***

North Korea’s economy has continued to fall since 2017, when sanctions on North Korea began in earnest. According to the Bank of Korea, the economic growth rate of North Korea in 2017 was -3.5%. The main cause of the negative growth was the decrease in trade due to sanctions and the slump of export-related industries linked to this, especially the mining and manufacturing industries. In 2018, it is expected to have negatively grown by at least -4%.

If the current sanctions continue, the North Korean economy will fall further. Although North Korea is pursuing an import substitution policy, the actual replacement of imports is limited to certain consumer goods, such as food. Capital goods, such as machinery

and parts, still depend on imports. In this situation, import capacity is falling strongly due to a sharp decline in foreign currency inflows because of sanctions. In addition, import sanctions targeting machinery, transport equipment, and basic metals are being implemented since early 2018.

North Korea’s industries are vertically integrated and factories are highly deteriorated. Therefore, if one of the key factories in the up-stream, whose equipment has not been replaced due to the ongoing sanctions, is halted, the whole economy can be paralyzed at once.

This was the case of the ‘Arduous March’ in the mid-1990s. If the sanctions continue, the ‘Arduous March’ could reoccur. Recently, Rodong Sinmun, the official journal of North Korean ruling Party, reported that “it is harder now than during the Arduous March.”

The economic meaning of the ‘New Strategic Line’, adopted in April last year, is to reduce investments in the military sector and concentrate investments in the civilian sector. Although it is a desirable direction, it is a problem that investment resources themselves are depleted now. In the end, if the security environment, including U.S-DPRK relations, does not improve and if sanctions are not lifted in a process of denuclearization, the ‘New Strategic Line’ is difficult to implement.

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**Q2: In his first public speech in April 2012, Chairman Kim reassured that his people “will never have to tighten their belt again”. While we sometimes hear about “June 28 measures” or “May 30 measures”, what have been the main economic reforms undertaken by the young leader? Could we say the standard of living, in Pyongyang and in the rest of the country, has really improved since he came to power?**

Since the inauguration of the Kim Jung-Un regime, reforms pursued by North Korea can be roughly divided into three parts. First, it is a measure to reduce the trade rights of the party and the army and to expand the trade rights of the cabinet, which has jurisdiction over civilian economy. As a result, at least in the institutional setting, factories and enterprises have also been able to establish ‘Foreign Business Units’ and conduct trade independently.

The second part is the resource allocation mechanism reform, such as the ‘5.30 measure’. The centrally planned targets (mainly material targets) were reduced, and the operational autonomy of enterprises and cooperative farms was greatly expanded. Enterprises and cooperative farms also allowed to fund from markets or “Don-Ju” (North Korean or Foreign Financiers). In the case of enterprises, managers also began to have the authority to dismiss workers. In the case of cooperative farms, the unit of product distribution was greatly reduced to allow for the de facto family farming. It can be said that North Korea’s resource allocation mechanism reform has reached China’s 80s level.

The third part is the ‘New Strategic Line’ and the policy of ‘Concentrating All Powers into the Economic Development’, adopted in April last year. This is a resource allocation priority reform or developmental strategy reform, and thus can be categorized as an intensified reform than the resource allocation mechanism reform. China’s successful reforms in the 1970s and 1980s were due to the simultaneous promotion of resource allocation mechanism reforms and resource allocation priority reforms. But there is still no evidence that North Korea has reduced munitions investment and increased civilian investment. Though time is necessary, I think it will be implemented progressively in accordance with the denuclearization and the changes in the security environment.

Under Kim Jung-Un’s rule, the actual life of North Korean residents has improved until 2016. The market has been revitalized and, above all, prices and

exchange rates have stabilized since the second half of 2013. The food situation has been improved and industrial production increased, albeit at a slower pace. What made this possible was the great increase of trade with China as well as the impact of economic reform. Therefore, since 2017, the lives of residents seem to deteriorate as a result of a decline in trade volume reflecting the sanctions. Recently, North Korea has appealed to the UN for food shortages. This is the first time for the Kim Jung-un regime. The purchasing power of the residents is decreasing. There is no major chaos as prices and exchange rates are stable, but inflation and foreign exchange rates may become unstable if the foreign exchange inflows continue to decline.

**Q3: In his last book Unveiling the North Korean Economy published in 2017, Seoul National University Professor, Kim Byung-Yeon, presented on-the-spot guidance - advices given by the leader during field visits – as a reason for the inefficiency of the economic system under Kim Jong-il. What is their importance under Chairman Kim?**

Due to the nature of the North Korean system, factories, farms, and areas visited by Supreme Leader should typically achieve better results and improve the lives of residents than before the visit. Otherwise, the authority of the leader is impaired. Therefore, North Korean Supreme Leader direct funds, supplies, and manpower support for the unit immediately after the field visit. Some funds come from the leader’s private fund (Sooryong Fund), but for the most part, the funds which were planned to be invested elsewhere are redirected. The order of Supreme Leader is superior to the plan or the law. This kind of order makes the plan that was set up before distorted. This is the source of inefficiency. While planning is inefficient compared to the market, spot guidance makes planning more inefficient.

**Q4: Last October, the leading newspaper JoongAng Ilbo partnered with the INSS to analyze the development of market economy in North Korea via interviewing recent defectors. What were your main findings? It is said that there could be up to 500 markets, or so-called jangmadang, in the country. What are these markets and how do you assess the extent and the impact of marketization in the country?**

Jangmadang refers to the physical aspect of the market. More importantly, the market mechanism by which demand and supply are regulated by price signals is

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firmly established in North Korea. The consumer goods market has already existed as a semi-legal form since the 1990s and has been officially legalized since 2003. The capital goods market has also been partially legalized. The labor market is illegal, but it is being tolerated. There is no capital market. However, substituting for the role of banks, 'Don-Ju' (North Korean financier) plays as the lender. Don-Ju's investments are also being made in state-owned enterprises and cooperative farms. With the amendment of the corporate and farm laws in 2013, these investments have become legal.

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However, it's premature to say that the market became the dominant mechanism in North Korea. In the case of the defense and core heavy industries, which account for the largest portion in the North Korean economy, they are still operated according to the planning mechanism. Most North Korean refugees are those who have come from the DPRK-China border areas, that is, where the market is active. So, if you listen to North Korean defectors, the North Korean economy will be misunderstood that it is a market economy. Personally, I think the share of the market in North Korea is still well below 50% of the economy as a whole. However, it is clear that the market is growing qualitatively and quantitatively and has been incorporated into the category of official economy.

**Q5: Providing basic goods via a public distribution system was a source of legitimacy for the North Korean socialist system. It collapsed in the 1990s. Now, we see the emergence of Donju. Are growing economic inequalities a threat to the legitimacy of the regime? How can it survive marketization?**

In the past, the problem of economic inequality in North Korea was not serious. Of course, depending on the origins and positions, the economic benefits were different, but it was not a big problem. But now, economic inequality is a very serious social and political problem. While some people, like Don-Ju, have hundreds of thousands or millions of dollars, most citizens still live from hand to mouth. The gap between regions is also large. The residents of Pyongyang and metropolitan cities or those of areas where markets are active, such as the border areas of DPRK-China, are better off. The most poverty-stricken population in North Korea are the farmers. Basically, farmers can't participate in market business. Even if production yield is good, wealth is not accumulated among farmers because a large portion of production is extorted by the government.

In the past, economic benefits were given 'from top to bottom' within the national bureaucracy mechanism, so the loyalty of the residents and bureaucrats also went 'from bottom to top'. This was the basis of stability of the North Korean regime. Now, however, most of the economic benefits come from the market. Thus, the loyalty of the residents and the bureaucrats is not directed vertically to the top of the national bureaucracy mechanism but is distributed horizontally to the market. In fact, in North Korea, Don-Ju is the man who runs the money of elites. Some have accumulated wealth autonomously through business or trade, but most have by conspiring with power. Power is at the heart of the mechanism by which economic inequalities are reproduced on an enlarged scale. This is systematic corruption. Corruption promotes marketization to some extent. However, it impedes institutionalization and transparency of the market. I think the marketization of North Korea will soon reach this uppermost limit.

**Q6: In a recent interview, you mentioned "South Korea should intervene politically at an acceptable level so that the marketization of North Korea does not go backward". How would it be possible to make sure the country institutionalizes such a marketization?**

Basically, there is no way for South Korea to intervene directly in the marketization of North Korean economy. However, we can do it indirectly. For example, if the sanctions are lifted, the inter-Korean economic cooperation will resume. In the past, inter-Korean economic cooperation was carried out between the South Korean government and the North Korean government (G-G) and between South Korean companies and the North Korean government (B-G). In the future, however, it is necessary to ensure that the transactions between South Korean companies and North Korean companies, that is, B-B transactions, become the central way of economic cooperation. North Korea also allowed individual companies to autonomously attract foreign investment or do trade in the amendment of the corporate law in 2013. Therefore, a direct contract, between South Korean companies and North Korean companies, is not illegal in North Korea nowadays.

Next, it is worth considering promoting an FTA between the two Koreas. The South and the North Korea are not separate nations, but because they are separate customs territories, there is no problem to conclude an FTA. Although North Korea is not a WTO member,

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there are many examples of FTAs between member and non-member states of WTO. The North Korean trade barriers will be a sole issue which obstruct the concluding of FTA between the two Koreas, which can be resolved using the terms of the interim agreement of GATT/ WTO. According to this term, the two Koreas can conclude a low-level tentative FTA for a start, and then reach a normal level of openness gradually in the 10-year grace period. The South-North Korean FTA will also favor North Korea's accession to the international financial institution.

**Q7: In our last [Conversation with Professor Kim Ki-jung](#), he explained President Moon is developing a “market-centric perspective” towards inter-Korean relations. What would establishing a “One market Korea” mean for the two Koreas? Could resuming activities at the Gaeseong industrial complex and the Mt. Geumgang tourism project, and creating additional special economic zones, become an engine for South Korea’s growth?**

‘The New Economic Initiative for the Korean Peninsula’ (New Economic Initiative) of Moon Jae-in government is composed of two parts. One is the South-North Korean development cooperation project beyond the existing inter-Korean economic cooperation. It is a project to build three industrial belts on the axis of East Sea, West Sea and DMZ. It is basically a project to help North Korea's economic growth, but it also creates South Korea's new growth engine. Although North Korea has its own economic appeal, development cooperation with North Korea is also necessary for the South Korean economy to push to the front of the northern countries. In the longer term, it is also the basis for economic integration and political unification of the two Koreas. The other is market-oriented inter-Korean economic cooperation. As mentioned earlier, this is basically bringing the inter-Korean economic cooperation in the form of market cooperation, focusing on B-to-B transactions. Institutional reform of the inter-Korean economic cooperation including the FTA also needs to be pursued under these principles.

**Q8: International sanctions drastically reduced the DPRK’s sources of foreign currencies. For instance, UN Security Council resolution 2397, adopted in December 2017, required to repatriate all DPRK workers abroad within 24 months. In 2015, some North Korean officials declared they wanted tourism to become a “major industry” with an ambitious objective to reach 2 million tourists by 2020. Could tourism become an alternative source**

**of foreign currencies? If not, what are still the regime’s sources of foreign currencies?**

Prior to the comprehensive sanctions started in 2017, the main means of North Korea’s foreign currency earning was mineral exportation. While the exact amount earned from overseas workers or tourism is unknown, there are no doubts that they did not take up a large portion of total foreign currency earning. No matter how much tourism is increased, it can’t make up for the loss made by sanctions. The increase of tourists themselves is also limited. North Korea's tourism infrastructure remains poor. In this situation, the constant increase of tourists can’t be guaranteed.

Under current sanctions, there are only two ways for the North Korean regime to acquire foreign currency. The first is to acquire through smuggling or illegal trading. However, smuggling is smuggling and it can’t make up for the loss meaningfully. The second is to absorb the foreign currency held by the people. In fact, this kind of absorbing has been done through cell phone sales and so on. The problem is that the inflow of foreign currencies from outside has almost ceased, so the foreign currencies held by the residents are gradually being depleted. In addition, as foreign currency become precious in the market, the residents will try to put it deep in the wardrobe instead of using it. This will make foreign currency more precious in the market, making a dilemma for the government on whether to use forceful means, such as currency reform attempted and ended in disastrous failure in 2010, or not.

**Q9: In 1948, the newly founded DPRK chose a depiction of a large hydropower plant in its coat of arms. Yet, most of us have seen that satellite imagery of North Korea at night, a dark spot in Northeast Asia. Chairman Kim Jong-un mentioned in his Address that the country should “direct primary efforts to relieving the shortage of electricity”. How do you assess the current energy crisis in North Korea? Is providing energy or supporting capacity-building, what was part of the 1994 Agreed framework, an issue that could be discussed in the current negotiations?**

The power generation and supply of electricity was in its worst situation during 1990s. Since then, the electricity situation is getting improved gradually, though there is still no major improvement. Because hydroelectric power accounts for the largest portion, the annual output of power increases or decreases depending on the amount of precipitation. Since the

Kim Jong il's era, hydroelectric power plants have been renovated or newly built, but power generation has not been improved meaningfully due to the lack of core facilities such as turbines. The North Korean thermal power plants are anthracite coal-fired plants chelated by heavy oil. North Korea gets heavy oil by processing crude oil supplied by China. As Chinese crude oil support is limited to 500,000 ton per year, North Korea can't get enough heavy oil to use for chelating agent. The North Korean government is also encouraging the increase of anthracite coal production, but it seems that the increase has not done much except for export purposes. The export tunnel has been almost disused since the sanction.

It seems that building nuclear power plants for North Korea is not an agenda of U.S-DPRK nuclear negotiations yet. However, if negotiations for North Korea's denuclearization proceed well, North Korea will demand nuclear power plants. But this is after North Korea's denuclearization is complete and it returns to NPT. It is a very distant future. The transmission of electricity from South Korea, Russia, or China to North Korea and the improvement of North Korea's internal power grid are not an agenda yet either. Once the sanctions are lifted, we will be able to discuss them in terms of development cooperation with North Korea.

**Q10: China remains North Korea's most important economic partner. Chairman Kim recently visited China, the fourth time in 10 months. Could China, or another country, be used as a model of economic development for North Korea? International sanctions limit the country's imports of refined petroleum products and crude oil. Yet, oil prices have not substantially increased. Could China, or some Chinese smugglers, not fully implement sanctions?**

North Korea will prefer gradual and phased economic reforms rather than radical and full-fledged ones. Politically, it is highly likely to pursue economic change while maintaining the dictatorship system of the Workers Party. In this regard, China and Vietnam are the models North Korea can refer to. However, since North Korea will have a "North Korean model", it will not follow out the experiences of China and Vietnam.

A few days ago, the US Department of the Treasury further designated businesses and vessels related to North Korean illegal transshipment. The United Nations sanctions committee also

points out that illegal transshipment is not eradicated. The key of illegal transshipments is refined oil. But it may be difficult to obtain sufficient amounts of refined oil by smuggling, though I do not know the exact volume.

China does not seem to intervene in smuggling at the central government level. Rather, last year, the Chinese central government has been cracking down on illegal transshipment. It seems that individual companies are smuggling into and from North Korea. The Chinese central government can't stop all of smuggling. Some local authorities, in particular, those whose transactions with North Korean account for a large portion of the economy, tend to close their eyes to some smuggling.

**Q11: As a Professor, how to conduct research on North Korea, especially on its economy. What key indicators or key sources of information would you recommend to students and researchers interested in North Korean studies?**

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North Korea's economic statistics are all estimates except for trade statistics. Trade statistics also have several problems. So comparative research is important in studying the North Korean economy. Researching the countries that were socialist in the past and pursued reforms to open up, can offer insight in understanding the current situation of North Korea; some good examples may be Eastern European countries, China, and Vietnam. Interviewing North Korean defectors is also important. However, it is necessary to reinterpret the content of the interview because most of the defectors are locally concentrated and mostly engaged in market activities. It is also a good idea to interview North Korean defectors who were in the position of managing the North Korean economy. There is a magazine called "Economic Research" issued by North Korea that is very helpful in understanding the worries or the policy directions of the North Korean government.

**Interview conducted in March 2019  
by Antoine Bondaz.**

*The "FRS-KF Korea Program on security and diplomacy" is co-financed by the Korea Foundation.*