

North Korea's Economy in the Kim Jong Un era

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William B. Brown
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Pandemic or Not, North Korean Economy Under Great Strain

- **Expectations Matter.** With 2018 summits, Kim raised domestic expectations. But since Hanoi these have been dashed. Admits plan and management failures. Apologizes. Turns to Self reliance.
- **Weak productivity,** not lack of resources, makes North Korea poor.
- UN sanctions and pandemic closing are having a large impact, external trade near zero.
- Money stabilized but monetary, fiscal policy tight. Government is starving itself, privatizing a few assets. Little investment. Prices are volatile leading to speculation.
- Pandemic controls likely stifling emergent markets. Some in Pyongyang no doubt **approve.**
- Is there hope for reform under Kim Jong Un?
 - “Bottom Up” Marketization Underway
 - “Top Down” Macro / Micro Support Needed
- 2021 a lost year. Worst since “great famine”.

Impact of Pandemic

- Border Closing and Internal Restrictions must be impacting markets.
 - Fewer Chinese consumer products
 - Traders losing money
 - Private employment endangered
 - No investment
 - Decline in living standards
- Some Benefits for the State
 - Less outflow of foreign exchange
 - Less competition for state enterprises
 - Stronger controls, especially movement.
- But Economy now Depends on Markets
 - Plan Needs imports, capital goods.
 - Imports need exports
 - Financial instability
- Happy Party, Unhappy population

Marketization Underway, Incomplete

What is a Market?

- Many buyers
- Many sellers
- Rules, Structure
- Time, currency, behavior
- Compete for best price
- Market clears with flex price
- Usually most efficient outcome
- Decentralized, Unplanned
- **Law of One Price**

Marketization: Much more than “marketplaces”

- Goods Markets
- Services Markets
- **Labor Markets**
- Real Estate/Land Markets
- Capital/Finance Markets
- **Foreign Exchange Markets**

NK Command Economy: Broken, not gone.

What is a command economy?

- Marxist distrust of market prices and wages.
- Public ownership of “means of production,” capital.
- No private trade in capital. No real money, no private savings.
- Central Plan dictates decisions made by state enterprises and farms
- Complex input-output matrices attempt to rationalize production
- Plan determines prices. Distribution.
- Wages are rations or other in-kind benefits.
- Plans emphasize capital goods production, not consumer goods, to foster investment and growth.
- Intensive growth based on build-up of capital stock.
- Living standards weak since production goes to investment and to the state.

Problems

- W/O prices, weak efficiency and work incentives.
- Quickly becomes too complex.
- Inflexible, subject to disasters.
- Weak consumption leads to famine/revolts.
- Too much investment reduces returns.
- Foreign trade with other planned economies needs to be synced in comprehensive trade agreements.
- Foreign trade with market economies needs to flow through the plan due to irrational prices.

- Mixed economy is worst outcome. Two prices for everything. Arbitrage, corruption, speculation, diversion.

- Kim Il Sung, 1969: “Farmers markets are the death knell of socialism. Someday they will be eliminated.”

Kim Jong Un's Inheritance

Kim Il Sung era. By 1956, NK had fully transitioned to a command economy system with no real money. Won circulated but was secondary to rations and state plan allocations and thus not a store of value or a required medium of exchange. Prices were set by state and designed to promote investment, not consumption.

Kim Jong Il era. Without Soviet and EE aid, by mid-1990s KIS's command system had broken down. With resulting famine, ration distributions were not met and won came to be used as medium of exchange in illegal but pervasive markets. There was too much Won in circulation and hyperinflation ensued. Dollars and Yuan started seeping in. Nuclear program induced global sanctions.

2009 Currency Fiasco. With market and ration prices and wages differing by 50 times, and corruption endemic, state tried to suck up foreign money and unify prices at state-set levels, by redenominating won. People panicked as their won savings disappeared and the government relented, too late--a big lesson in finance for the young leader-in-waiting.



Kim Il Sung's Economy

"Farmers' markets are the death-knell of socialism. Someday they will be eliminated." 1969

Chapter 2 in new book on NK Economy, 2022 release.

- Draws on Wilson Center Cold War Project.

Main Points

- KIS inherited relatively industrialized economy in 1945. With much help, he takes it on bumpy downhill trend until he dies in 1994, on verge of great famine.
- Initial socialism brought in by Stalin's red army. Korean War led to KIS buy --in to attempted strong central planning.
- Constant and large-scale aid from outside. Aid was largely political, Cold War, and not aimed at true development needs. Case study in "immiserating" aid.
- Conflict between socialism and "self reliance" at national and personal levels.
- Big problems, to this day, central plan's "ration" prices versus "market" prices and state or collective ownership of all "means of production", including farms.



Kim Jong Il's Economy

The Arduous March

Faced with collapse of Soviet Socialism and its preferential trade with NK and with China's turn to markets, he fails to respond.

- Massive famine. The command economy breaks, industry collapses, PDS fails, won notes replace rations. Foreign commodity aid pours in.
- NK won inflates and US dollars and RMB seep in creating mixed economy. Markets expand at expense of state-owned enterprises. Corruption rampant.
- Despite famine, no reform of collective farming.
- Nuclear developments, including collapse of Agreed Framework, create severe international sanctions. China is only real partner. Dominates NK trade.

Kim Jong Un

2011-Present



Third son

- competitive
- well trained, Swiss schooling
- Chonan sinking?
- liberal leaning ?
- See Jung Pak's book.

Likely learned from father's bout with financial panic, inflation.



Kim Jong Un's Half-Step Financial Reforms

Allowed foreign currency to circulate at will.

- As in other dollarized economies, this dampened inflation.
- Creates new “good” for citizens to use their won to purchase.
- First time NK people had a financial savings vehicle—US dollars. Private savings must have soared, stopping inflation.

Encouraged factory autonomy, gave them pricing and production authority. How much is open to question.

- Market pricing would increase productivity, dampen inflation by creating new products. Especially in tech sector.

New Central Bank law in 2015 gave CB authority for exchange rate and loan activity, not Finance Ministry.

But reform not
extended to
farmers and state
employees—most
of the population

Pilot program aimed to decentralize farms stalled out.

Many state enterprises excluded, required to support Plan.

State set prices for key goods, like electricity, remained far too low.

Most importantly, without property rights, private savings flowed to US dollars and yuan cash and not to productive investments. Exception was small scale entrepreneurs, donju, and housing.

Macro-economy thus shifted from (state) investment-led to (private) consumption-led. No increase in aggregate demand so no inflation.

And dual wages system exploded, leading to massive state corruption.

Most critically, state wages remained at fixed low rates while market, productivity related wages, soared.

State wages set at 3-5,000 won per month, with declining value of ration perquisites.

Private wages soared to 300,000 won per month with no ration privilege. Investors could make much more.

Whatever they did, It worked to stabilize the won.

North Korea won per US dollar: 2012-2018





How might the Central Bank control the Won?

- Dollarized economy creates huge constraints on monetary policy, much like currency board system.
- In order to stabilize won, CB may have set an extremely tight monetary policy, restricting new loans to state enterprises and not printing new currency.
- And the Finance Ministry thus may have required a very tight fiscal policy since CB would not finance new debt.
- This would have shoved the economy into recession by 2017.
- Evidence is observed shortage of won cash in markets, money “cleaning”, attempts to issue bonds, and fee increases by state organs.
- State budget shows only a tiny increase in 2021 government budgeted expenditures, despite ambitious plan goals.

Then came sanctions and coronavirus

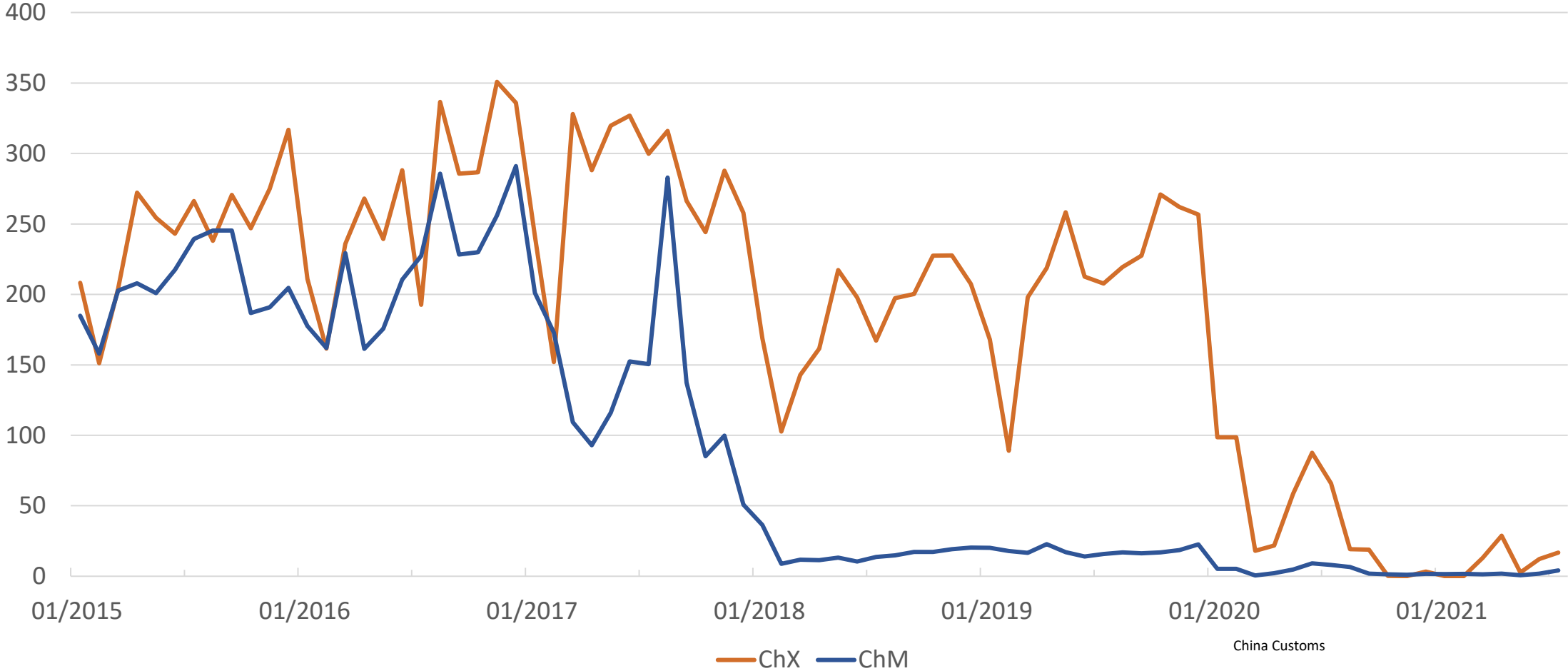
North Korea normally runs \$500 million per-year in observable goods trade deficit that is probably offset by an equivalent services/transfers surplus. So current account is normally balanced.

But in 2017, collapse in exports to China led to \$2 bn/ year goods deficits and thus a large current account deficit financed by an outflow of dollars and yuan. Tight money policy would have required CB to reduce circulation of won to compensate, keeping won rate even.

By 2020 imports also collapsed, due to border closure and likely lack of hard currency funds or credit. So current account was again in balance. Continued tight monetary policy, however, caused won to reverse course and rise in value as economy fell into deep recession.

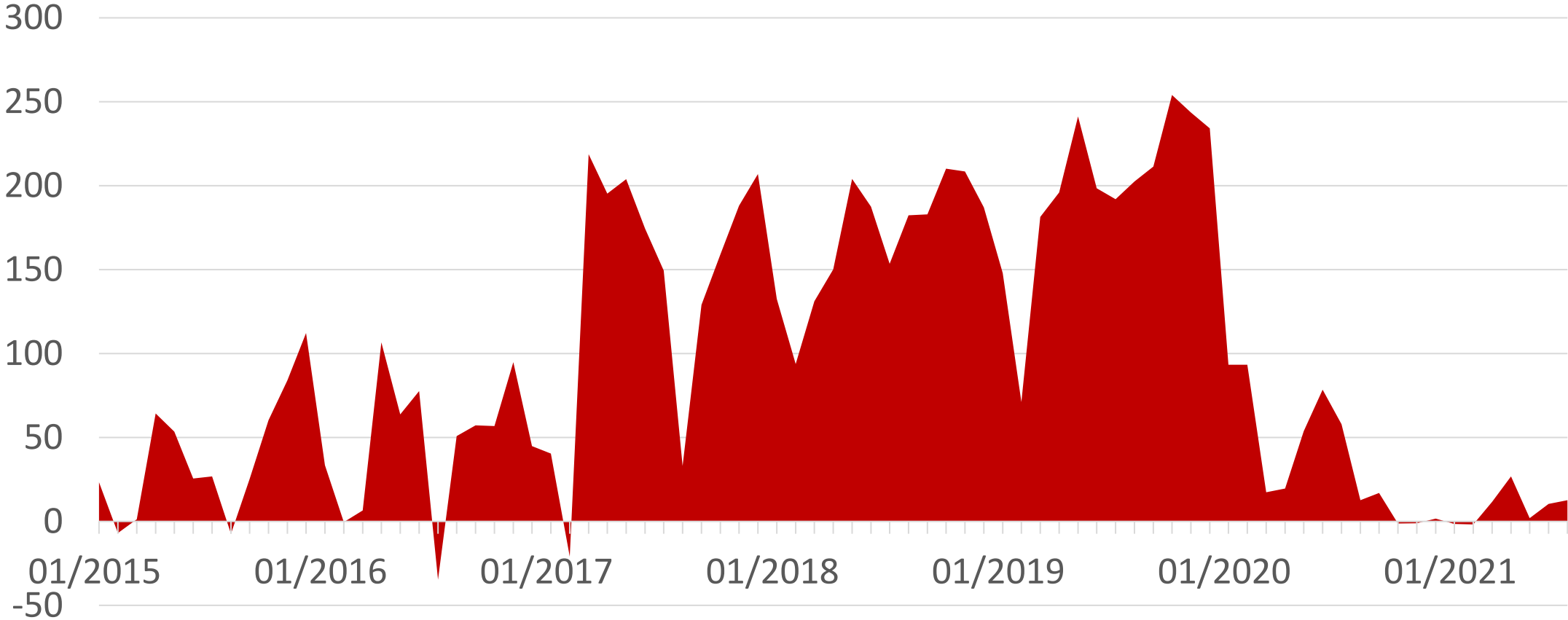
China-North Korea Trade

Jan 2015-July 2021
Million US\$



China-North Korea Trade Balance

Jan 2015-July 2021
Million US \$



North Korea Won/ US Dollar Sep 2019 Sep 2021



Source: Asia Press

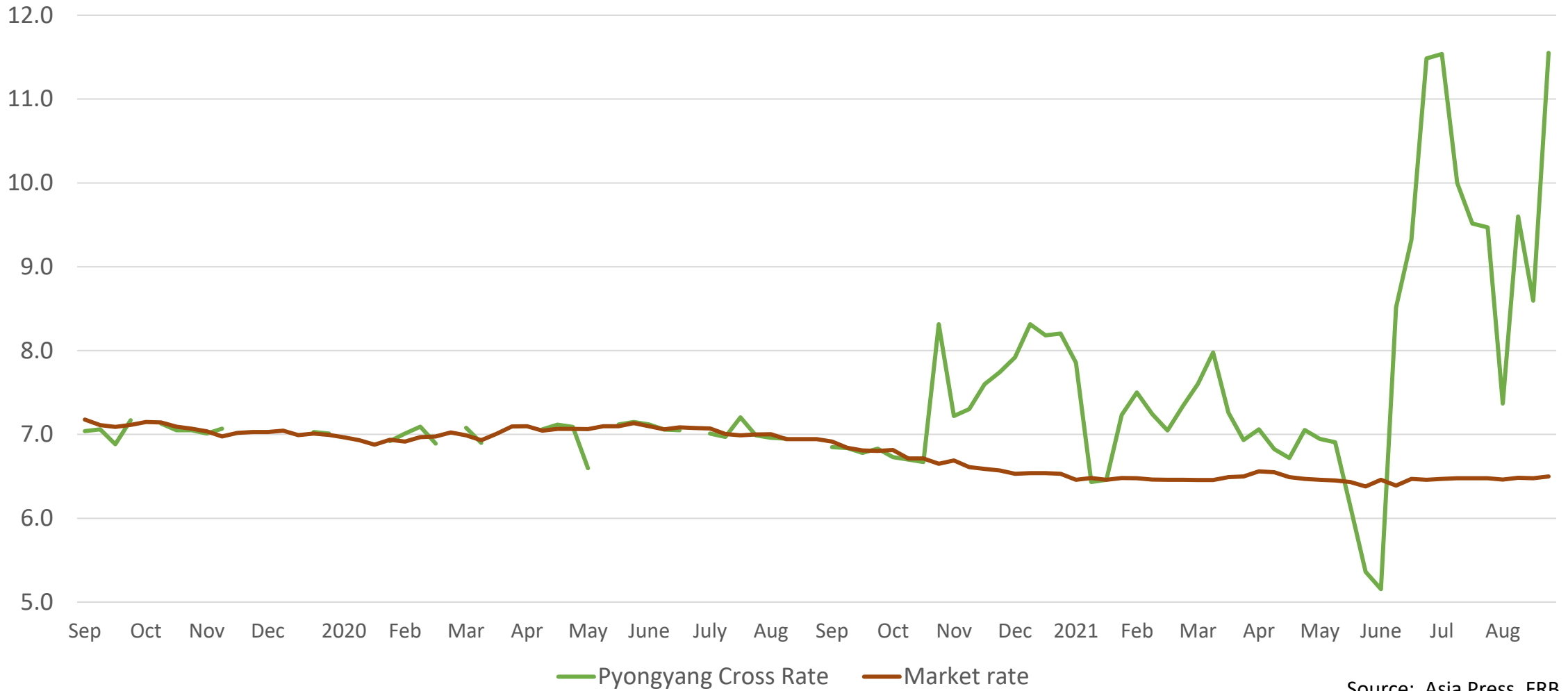
North Korea Won / China Yuan Sep 2019-Sep 2021



Source: Asia Press

China Yuan / US Dollar

Sep 2020-Sep 2021



Source: Asia Press, FRB

Experimenting with new money?

Chosun Banknote



Chosun Bank "Money Ticket"



Conclusion: Kim's singular achievement is in danger.

Kim's singular economic achievement, exchange rate and price stability, is in big danger with potential to disrupt the political and economic system. Inflation and money theft does that.

Tight monetary policy has pushed economy into severe recession.

Public has much more power than in previous regimes given their private holdings of foreign exchange, yuan and dollars. State has less control.

State budgets and wages are severely constrained due to need to protect won against circulating dollars and yuan.

Textbook solution is to sell state assets to private sector thus easing budget constraint, while raising state salaries, increasing prices of state supplied goods, and allowing property rights to encourage private sector productivity.

This could be done even in UN Sanctions environment.

Reform then Open

Chinese Construct, the order is important.

Reform in NK context means:

- Unify price and wage system
- Establish some private property rights
- Decollectivize agriculture
- Create new money and banking system, using interest rate to encourage private savings and direct investment to best uses. (SK model)
- Raise pay but shrink size of huge bureaucracy and military
- Privatize significant state assets including major factories.
- Establish tax system and transparent budget.

This could put economy on moderate growth track, without foreign opening.

Reform then leads to Opening, and massive engagement with rest of world. Breakout economic growth would ensue.