North Korea’s Foreign Exchange Rate Pressures[[1]](#footnote-1)

# “Control by Money?”

**Summary**

*North Korea has been experimenting, even moving, toward much more financial sector reform than many have appreciated. The dollarized economy has helped greatly to reduce inflation and use of money by the population is now widespread, the socialist ration system possibly on its last legs. In fact, one might argue that the central planning system has been replaced by a very rough, poorly regulated, capitalist system, or “control by money” as a 2015 letter by Kim Jong Un puts it. This ultimately may allow much better integration with the global economy, but not yet. The state still controls and owns most property and capital, and its huge workforce is still paid ration-like wages. And like all such systems, productivity of labor and especially of capital is exceedingly low creating dire poverty for the bulk of the population.*

*While the benefits of a stable money to the country are great, the dangers to the regime of maintaining this stability may be even greater and Kim seems to be pulling back in fear of what could happen. Dollarization forces the state to be very careful with fiscal and monetary policy—it can’t freely run deficits without causing a run on the won since the alternative US and Chinese money is widely available. It badly needs exports to provide the dollars needed even inside the country, yet sanctions cripple those efforts. So the state has apparently radically cut back on investment spending while the population takes advantage of real money to increase private savings and its own consumption. The combination of a richer public and a poorer state spells potential trouble for Kim. Outside, Western and South Korean policies need to be aimed at encouraging this trend and the use of real money. Internal financial reform, especially sturdier banks, rather than opening to the outside, should be North Koreas’ immediate focus of policy. Once reformed, with sound banks and growing private savings, the economy can take great advantage of opening. The experience of South Korea in the early 1960s in making that transition to modern finance is constructive.*

Kim Jong Un’s one economic success, and it is a large one, has been to stabilize the won currency and halt inflation, problems that may have nearly brought down his father’s regime. This is remarkable given the strong UN and US trade sanctions since 2016, and the coronavirus border closings since 2020, that easily might have lowered confidence in the won, even causing it to collapse in panic. The public, in practice if not in theory, can dump won and buy dollars or yuan from money changers in this unusual, partially dollarized economy. This has not happened and the won currently trades internally at about the same rate as it did a decade ago, and prices for key staples, such as rice and corn, are volatile but generally not higher. (See graphics 1 - 4).

Monetary stabilization has come at a cost, however, as it does everywhere; troubled state finances, a likely downturn in state and probable private investment, and frustrating, even embarrassing, circulation of Chinese yuan and US dollars in Kim’s so-called self-reliant society. All this is evident in a speech prepared by Kim for his financial sector functionaries in 2015.[[2]](#footnote-2) And despite promises of a new day in the long moribund economy, GDP growth has been flat or negative over Kim’s ten-year rule, this in a country whose income levels already were just above subsistence. A shift in the economy away from investment and towards consumption may have somewhat improved living standards while diminishing long-term growth prospects, at least without major reforms.

It is pretty clear that the regime would like to get rid of the circulating dollars, and yuan[[3]](#footnote-3), absorbing them into its own foreign exchange reserves, but it can’t for the simple reason they have been essential elements in the bigger need for won stabilization. Like a currency board economy, dollarization forces the authorities to be exceedingly prudent in avoiding deficit spending or expanding won credit, even in printing money. Noticed by the public, this conservatism provides a little and perhaps growing confidence in the monetary system. People complain about worn out and dirty cash—the last notes were printed in 2012 according to Radio Free Asia reports—but they would be more unhappy to see bright shiny new ones with more zeros. Won money expansion, either by extending credit or printing notes, has been avoided 

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lest the public trade newly created won for the safer and ubiquitous foreign cash, or use credit to buy, even speculate, in the ever-present dollars. Most interestingly though, in a virtuous circle, the stabilization of won is reinforced by the existence of this new financial vehicle for household savings, North Korea’s first, even if it is only non-interest-bearing US cash. One-hundred-dollar bills kept under the mattress. And as won stabilizes, it also slowly becomes a savings vehicle itself with a significant interest pay-off if deposited in a bank. That is the good news. Authorities seem to understand well, however, that the virtuous circle could again turn to panic, and wholesale selling of won, with only a few missteps by the monetary authorities. Hence, as would any government, it would like to ease dependence on the US currency.

The dollarization is unusual, even ironic in this supposed socialist economy and arch rival of the US, but it is not really unusual for Korea in historical terms or in its culture. While ancient kingdoms had sophisticated, Chinese-like monetary systems, for at least the past 150 years, Koreans have mingled Chinese, Japanese, Russian, and Mexican coins and paper with locally minted copper coins. Like the communists, latter day Confucian authorities prior to Japanese colonization, did not like public access to money so foreign money filled the vacuum, coming in from the country’s powerful neighbors. Kim Il Sung inherited an economy in 1945 using Japanese yen and Soviet military script, fairly quickly turning it to a ration-based system coupled with meaningless paper won that failed, eventually leading to famine. Useless ration coupons and distrust of the won paper led to reabsorption of foreign cash by small traders across the long border with China. Now it is the US paper currency that is most trusted, entering the country equally unencumbered via small trades, and likely large volumes of family remittances and aid.

Data is scarce but the public has likely responded to more stable prices and money by building private cash reserves--protection against vile but easily corrupted and poorly paid security services--denominated in won, dollars, and yuan, but with a strong preference for dollars, sending the economy into pause if not recession. Dollars, given their relatively high denominations, are better for savings and large purchases while yuan is better for imported products especially in border areas, and won is used for small denomination change in markets and for paying government fees. Government salaries are paid in won but are exceedingly low, forcing all workers to have some links to the dollarized market economy. Government industrial procurements, and enterprise to enterprise transactions, moreover, are reported to generally use dollars.

Rising private savings of dollars helps to slow inflation but is a problem as well. The government rails against this “idle money” and low circulation since it is not productively invested and there is no real tax system to reabsorb them. Savings institutions, including newly formed local “commercial banks” are not trusted to return deposits on demand. They can pay perhaps 5 percent per year interest but are forced to lend freely or very cheaply only to state owned enterprises, likely losing money on every transaction. Even high priority state projects, such as a new hospital in Pyongyang and tourist resorts near Wonsan and in the northern regions, have apparently run out of funds and are left uncompleted. Some private housing ventures, on the other hand, may receive private investments as owners test the limits of private property ownership. Attempts to sell won denominated bonds go nowhere; dollar denominated accounts probably do a little better, surprisingly offering competitive interest rates—10 percent per year on dangerous ten-year state bond-like instruments according to RFA reports. Few new factories have been built in a decade and infrastructure, especially electric power, has deteriorated.

Privatization has expanded during Kim’s tenure but except in speculative and dangerous black or grey markets, credit is not available for households or small entrepreneurs to take advantage of the savings to make investments. Electronic money is taking over using smart phones, but it is less progressive than meets the eye, generally a non-bank debit card used for convenience given the low denomination won cash. A switch to bank credit cards may be beginning, however, a game changer for private investments. All in all, a very money driven economy, not at all like Kim’s fathers and grandfathers, but still one that cannot take advantage of private savings directed into productive investments.

Overall, a very money driven economy, not at all like the past, but still one that cannot take advantage of private savings and investments.

An important question is whether this half-turn toward capitalism—the private ownership and trade of financial capital—was a planned move by Kim at the outset of his regime or whether it was dictated by the situation, an imperative to get control of the won and foreign cash no matter the cost to the socialist system. I had thought the latter; that is that they didn’t have much choice as foreign money was replacing won as an aftershock of a disastrous currency revaluation attempt in 2009, just as Kim was preparing to take over the government. I am now less sure, thinking that Kim may be more of a frustrated reformer than we have thought. But as the costs of tight money rose, halting his favorite projects, and as benefits of a more solid money accrued more to rich rivals and to the markets than to the state or party, he may have backed off. If so, we in the West and in South Korea may have made crucial mistakes, offering opening of the economy to the outside world and external investments when what they really needed was internal reforms to utilize their own savings, not just store them in dollar bills. This had been the genius of the South Korean reforms in the early 1960s which presaged their historic takeoff, and Kim might have wanted something similar.

Let me quote from a letter Kim wrote to the assembled state and party finance workers in late 2015, three years after he took power.

Let me quote from the letter Kim wrote to assembled state and party functionaries in late 2015, three years after he took power. It is one of the most important pieces of information we have on his economic philosophy and, though dated, offers a vision of where he wanted to go then, perhaps not now. I’ll give you a hint. It was not towards more socialism or self-reliance. I’m indebted to Rachel Lee and 38 North for her translation and analysis and to a related article on banking by Lee and Bob Carlin.[[4]](#footnote-4)

Writing in December 2015, but reflecting a reality that had already set in, Kim says to this closed but important audience:

• “A lot of funds are circulating outside the control of financial and banking institutions. Financial and banking institutions work in a fire brigade style without a smart methodology just because the country’s money situation is strained and there are many bottlenecks. As a result, **serious problems are raised in national budgeting** and budget execution, and the stability of the currency cannot be guaranteed, causing great inconvenience to the people’s livelihoods.”

• ‘’ The sovereignty of the country is being violated as currencies of other countries are publicly circulating at home, but the financial and banking sector has not taken decisive measures.

• Businesses should properly utilize their financial management rights and carry out financial management work on their own initiative and with creativity. Businesses’ financial management right is the right of businesses to raise on their own the funds necessary for business activities and rationally distribute and use them under the state’s unified guidance.”

**Then, a key order:**

* “[The Central Bank] needs to creatively apply the currency control methods that are widely in use worldwide to suit the actual conditions of our country and submit and direct all aspects of financial management to guarantee monetary stability. [The Central Bank] should stabilize the value of the national currency by establishing a unified exchange rate management system and fixing and adjusting exchange rates scientifically and flexibly.”

Creative business finance and a flexible and a rational exchange rate do not sound much like the old North Korea, when the dollar rate was set by Kim Il Sung’s birthday and was meaningless in a ration-bound fixed-price Marxist economy. In fact, while giving lip service to state ownership of capital, this letter is all about rational real money, not central planning, meeting quotas, and distributing rations. The theme, even the title of the letter, could be “Control by Won,” the title of one subsection. It doesn’t exaggerate or sugar coat. Kim says he aims to reform the money and banking system to encourage private savings, making the funds and thus the real resources, available to the state and to what he calls “businesses,” for investment. He understands that the public has good reason not to trust banks since they have a tough time withdrawing deposits, and that this needs to be corrected. Businesses are allowed to raise their own funds and invest and produce for profit. It is as if they, separate from the state, can own property, and their managers can likely get rich if they raise internal profits and distribute them to the state and to their staff, but not necessarily to ordinary people. There is a little of Deng Xiao Ping here, just not quite enough. Perhaps making people rich is just a bit too revolutionary a thought. Nonetheless, he condemns “armchair theorists,” probably in the Party, in asking his finance community to instead, act realistically.

* “Commercial banks should improve their savings organization work in line with the aspirations and demands of residents so that anyone can consciously participate in savings. … The basic reason savings work is not going well now is precisely that banking institutions do not keep up credit in their transactions with residents (in other words they don’t give back the deposits!)
* Banking institutions should raise the level of financial digitization by a notch, such as by actively embracing an electronic authentication system in financial services and perfecting a service system using electronic payment cards in credit and cash transactions.
* Financial and banking functionaries should not be armchair ideologists but should always go deep into reality….”

He ended the letter with a promising idea, juxtaposing state property, socialism and private wealth, capitalism in an unusual way:

• “Financial and banking work is honorable and responsible work that deals with the country’s property and the people’s wealth.”

Can the latter be interpreted to mean private ownership of financial capital? [[5]](#footnote-5)

**What has happened since the letter?**

The armchair socialists and physical scientists may have gotten in the way. Nuclear and missile testing programs took off in 2016, leading to “fire and fury” and a huge tightening of UN trade restrictions, especially on North Korean exports and especially by China. This was followed by an opening to the US that achieved summitry but ultimately failed to either stop the nuclear development or stave off economic pressures. Covid border closures followed, and Kim abruptly turned inward, speaking more like his father and grandfather, and emphasizing self-reliance and military production rather than opening and trade. Budget problems likely escalated as the huge state workforce continued to be paid minimal ration wages even when the rations were not available. Military manpower was said to have been reduced as the nukes would ostensibly reduce the need for conventional forces, and as the state was having trouble supplying enough rice to feed the soldiers.

Through all of this, surprisingly, the two important guarantees – exchange rate and price stability – have held up while the dollarization, despite the “loss of sovereignty” has likely advanced further. Several half-hearted attempts to force foreign currency out of markets, but not out of bank accounts, occurred in September 2018[[6]](#footnote-6) and the latest in April 2023, possibly continuing today as border controls are lifted.[[7]](#footnote-7) But the larger question is whether Kim’s suggested banking system reforms have stuck. Have the central bank and the newly formed commercial banks really been allowed to use “worldwide currency control measures” as ordered by Kim? This inevitably would be the use of interest rates and private capital ownership and trade, anathema to socialist ideology. There is some evidence that they have but it is inconclusive. At least there is no sign of a countrywide pull back against capitalist style banking and interest rate activity.

The letter in many ways had simply recognized money and banking changes that were occurring organically since the 2009 crisis, most particularly allowing the use of interest to bring in deposits, but which obviously were not working in 2015. The public for good reason had no confidence banks would return their money. The “letter” suggests privacy issues also were important, saying banks need to protect identities, an unexpected comment from Kim Jong Un. Reports indicate that as early as 2010 individuals had been forced to open small accounts in the new localized “commercial banks”, but which were paying 10 percent annual interest on won accounts. The banks would likely have had trouble balancing their books, however, since they could only lend the funds to state enterprises, according to reports from Radio Free Asia and likely at zero interest. [[8]](#footnote-8) Grey market private lending could come in at much higher rates, as much as 5 percent per month, fostering the escape of money from the banking system, warned of by Kim. [[9]](#footnote-9)

**Research Requirements—Much is Needed**

Clearly more authoritative and continuous financial data is needed on North Korea to understand quite where the country is headed. The most consistent financial data available is exchange rate data from two sources, North Korea Daily and Asia Press in Japan, both of which use phone contacts in North Korea to provide bi-weekly dollar and rates, are included in graphics 1 and 2. They should give some hints at how the financial sector is evolving. They show:

* Very stable but not locked rates from 2012 to 2018, wavering rates in 2019, sharply rising won rates in 2020-21 and a decline to the longer-term average in 2023. This pattern can be associated with a likely current account balance until the steep UN sanctions—a visible trade deficit offset by an equivalent invisibles’ surplus; a current account surplus as imports where shut off during the border closures, and a renewed deficit in 2023 as imports resumed. Capital flows are thought to be near zero throughout as the country lacks international credit.
* Cross yuan-dollar rates that conform closely to the international rate except in 2022, suggesting with that important exception, well working FX markets.
* Current rates of just over 8,400 won per dollar and 1,240 won per yuan are back very close to what they were a decade ago, making the North Korean won one of the better performing currencies in the world.[[10]](#footnote-10) A Chinese might have done pretty well by holding won instead of yuan over this period. And the cross rate now slightly advantages yuan over dollar; possibly because imports from China are expected to open shortly.

Difficult to explain, however, is the stability of won in 2017 as the country’s exports plummeted and imports declined only slightly. The visables trade balance with China, according to Chinese data, fell to a $200 million monthly deficit. Invisibles--services trade, especially remittances and illicit exports—probably declined from a substantial surplus in earlier years and would not have been strong enough to counter the drop in goods trade.

* Explanations are speculative but likely include a sharp decline in investment spending due to the cut in imported machinery, and a tight government budget. This would have sent the economy into a deep recession, reducing demand for hard currency, and keeping the won stable.
* If Kim’s letter was strictly adhered to, the banking system may also have used “worldwide measures” to guarantee monetary stability to raise interest rates on won deposits to induce holders of dollar and yuan cash to buy and deposit won. There are some indications that dollar accounts were given about 4 percent returns while won accounts 9 percent. If won inflation was seen as having subsided, this would give some support for the won. But of course the high deposit rates could be crippling the banks if they could not lend the new deposits more profitably. [[11]](#footnote-11)

Another difficult to explain phenomena is the large drop in yuan relative to the dollar in 2022. If markets were working well, as they appeared to be in the decade earlier and this year, traders easily could have made fortunes arbitraging yuan for dollars, that is buying cheap yuan in North Korea and exchanging it for cheap dollars in China. Several explanations, all with issues, are:

* The data is corrupt. It is very thin and likely even thinner than normal trade due to the border closure, but it does come from two competing sources that generally show the same relationships and it persisted over about a year.
* More likely it shows a sharp differentiation in the characteristics and demand functions for cash dollars and cash yuan in a very thin market. If high denomination dollar cash ($100 bills) are used primarily for savings they would be less influenced by a drop in imports and exports. Yuan, with the highest denomination of only Y5,000 (or about $7.00) are much less convenient for savings but much more convenient for shopping.
* If this theory is correct, the rise in the dollar versus the yuan might be an indication of an increase in savings and a decline in economic activity (GDP). And the return to normal in 2023 would thus indicate a rise in imports or at least an anticipated rise by traders who need yuan to make their purchases.
* The slight increase in the cross rate in favor of the yuan in recent months might suggest a decline in savings and a rise in GDP.
* Or, for unknown reasons, monetary authorities may have been offering better rates on dollar deposits than yuan deposits. Chinese currency is still, after all, not supposed to be traded outside the country.
* Of course this still doesn’t completely explain why there would not have been large scale swaps for yuan using dollars by large players; it is possible there were, and some large fortunes were made. But such speculation could easily have been reversed with large losses and financial instability that would be hard not to notice, even in North Korea.

Perhaps North Korean won holders had a more pessimistic view of China than the US, an interesting observation should it be true.

[end]

1. William B. Brown, NAEIA.com, Sep 13, 2023 [↑](#footnote-ref-1)
2. [Kim Jong Un: Let Us Bring a Turnabout in Financial and Banking Work and Vigorously Accelerate Powerful State Construction - 38 North: Informed Analysis of North Korea](https://www.38north.org/kim-jong-un-let-us-bring-a-turnabout-in-financial-and-banking-work-and-vigorously-accelerate-powerful-state-construction/) [↑](#footnote-ref-2)
3. This is sometimes referred to as “yuanization” but that is not really needed. The term yuan is the Chinese character for the word “dollar” and is pronounced won in Korean and yen in Japanese. Here when I use dollars I mean US dollars. [↑](#footnote-ref-3)
4. Robert Carlin, Rachael Lee, 22 December 2021 [Understanding Kim Jong Un’s Economic Policymaking: Pyongyang’s Views on Banking - 38 North: Informed Analysis of North Korea](https://www.38north.org/2021/12/understanding-kim-jong-uns-economic-policymaking-pyongyangs-views-on-banking/), [↑](#footnote-ref-4)
5. [Kim Jong Un: Let Us Bring a Turnabout in Financial and Banking Work and Vigorously Accelerate Powerful State Construction - 38 North: Informed Analysis of North Korea](https://www.38north.org/kim-jong-un-let-us-bring-a-turnabout-in-financial-and-banking-work-and-vigorously-accelerate-powerful-state-construction/) [↑](#footnote-ref-5)
6. [Anger, Fear as North Korea Bans Use of Foreign Currency in Local Transactions — Radio Free Asia (rfa.org)](https://www.rfa.org/english/news/korea/kpw-05112020204733.html) [↑](#footnote-ref-6)
7. [North Korea confiscates dollars and yuan after declaring foreign currency illegal — Radio Free Asia (rfa.org)](https://www.rfa.org/english/news/korea/money-04072023102829.html) [↑](#footnote-ref-7)
8. [North Korean Local Government Forces Residents to Open Bank Accounts — Radio Free Asia (rfa.org)](https://www.rfa.org/english/news/korea/nk-mandatory-bank-account-01212020150146.html) [↑](#footnote-ref-8)
9. [North Korean Moneylenders Hire Gangsters as Muscle in Loan Sharking Schemes — Radio Free Asia (rfa.org)](https://www.rfa.org/english/news/korea/nk-loanshark-05082019131118.html) [↑](#footnote-ref-9)
10. [Latest Market Price Index Inside N.Korea (asiapress.org)](https://www.asiapress.org/rimjin-gang/north-k-korea-prices/) [↑](#footnote-ref-10)
11. [ANDRAY ABRAHAMIAN](https://www.38north.org/author/andray-abrahamian/), [Banking on North Korea’s Banks? (38north.org)](https://www.38north.org/2017/02/aabrahamian020317/) 3 Feb 2017. [↑](#footnote-ref-11)