**Comments on “Is the NK won pegged to RMB?”[[1]](#footnote-1)**

It is very helpful that we focus attention on North Korea’s monetary system and I applaud the authors, and NK 38, for looking at the exchange rate, as they do here. North Korea analysts for a long time have had the luxury of not looking at money issues, always among the more complex problems in economics and politics, since the Marxist-Leninist system long fought, and by now has lost, a battle to do away with real money. A good start, but I would say the analysis here is in need of “Occams Razor”[[2]](#endnote-1), economics jargon for making something more complex than is needed and thus missing the larger story. They assert that the NK won should logically be pegged to RMB and not the US dollar and when they find the data supports the alternative, they somehow find reason not to throw out their preconception. It seems rather obvious to me that Pyongyang has chosen the universally convertible dollar rather than yuan as its peg, but, given that the yuan moves very closely with the dollar anyway, at least until its latest “trade wars” dip, it really doesn’t matter much and the much bigger story is why it has chosen to peg in the first place, and what are the consequences?

Indeed, it seems to me there are more reasons for Pyongyang to choose the US dollar rather than RMB as the anchor. For starters, RMB, at least officially, is not yet a fully convertible currency which means its use in this way could be considered illegal by Chinese authorities. More importantly, pegging a currency is all about building confidence in the domestic unit and most everyone, the world over, see the US dollar as the safest money in existence. Even Hong Kong, an integral part of China, pegs its currency in a tight currency board arrangement to the US unit, not the Chinese. So, if you are a North Korean merchant, or apartment seller, you want dollars to put under their mattresses. And to see the 8,000 won per dollar rate holding tight for five years or more, gives you confidence that tomorrow the rate will be the same. I’d say its one of Kim’s greatest achievements, given the hyperinflation and massive devaluations of his father’s era. But the stability comes at a big price and this is where things get interesting.

As the authors begin to point out the implications of this peg are enormous and, I expect, poorly understood by our North Korea analysts and policymakers, alike. They say it shows North Korea’s resilience in the face of massive sanctions that must be impacting the country’s foreign exchange earnings and reserves yet have not touched the value of the currency. Possibly, but another, and in my view more likely answer, is that the authorities are scared to death that confidence in the won will begin to erode and that at some point the won will suddenly collapse in a death spiral. Should this happen, inflation will soar and people, their money evaporating, will be in the streets. Like price controls, the immediate solution is a peg but since the economy now depends on markets and real money, the peg has to be supported by fiscal and monetary policy. And pegs are very dangerous; they tend to break. Once people see it fall just a little, they can lose confidence and, in panic, try to sell their won and buy dollars forcing the won into a death spiral.

The textbook solution is to try to preserve the value of won by limiting its supply, either by not printing cash or by withholding credit. The monetary chore is thus to keep won as scarce as dollars, thus holding the rate of exchange, stable. If dollars flee the country, won is sucked back in to the central bank, either by calling in loans or raising taxes and fees, keeping the relative supplies of the different currencies constant. In a capitalist economy, such as Hong Kong, this occurs more or less automatically, with interest rates soaring to induce demand for the local currency. How the North Korean economy can function without new credit is a puzzle, but not one without possible answers. I suspect, for instance, that rather than funding state salaries and providing credit to state enterprises for needed investments, Pyongyang is raising cash, even dollars, by selling assets and licenses. Privatization, and the inevitable increase in productivity that it brings, is a result of this peg, but with obvious costs to the command economy system and with likely huge budget tensions on the government. It is no wonder that Premier Pak Pong Ju looks so grim.

I am curious about the apparent slight move of won off the dollar peg, from a round 8,000 won per dollar to 8,250, last month, as RMB was falling by much more. Moving the peg, as in a wall climber, is a dangerous proposition but may be designed to give authorities a little more leeway, building a public expectation that such moves are not a sign of loss of monetary control. But this is speculation.

North Korea’s economy is not a mystery, but rather a puzzle that we have to figure out, using our best efforts to obtain information and smartly apply the data to our theories. The authors here are making a good start. At this point I’m most curious to know what is happening internally to won interest rates, and to the state’s budget. These would provide hints as to how resilient or fragile the system really is and how best we can take advantage of it.

1. Bill Brown is a retired US government official, an adjunct professor at Georgetown School of Foreign Service, and principal of his consulting firm, Northeast Asia Economics and Intelligence Advisory, LLC (NAEIA.com). Please check his website for more discussion of these important issues. [↑](#footnote-ref-1)
2. From Wikipedia. “Occam's razor is a problem-solving principle attributed to William of Ockham (c. 1287–1347), who was an English Franciscan friar and scholastic philosopher and theologian. The principle can be interpreted as stating Among competing hypotheses, the one with the fewest assumptions should be selected.” [↑](#endnote-ref-1)