

North Korea's Trade Hits Bottom—Decision Time, and Tears, for the Young Chairman

Bill Brown, 10/23/2020

Aside from being compared to Adolf Hitler, there is a little good news for Chairman Kim as he shuffles through papers and spread sheets while his government prepares for the new 5-Year Economic Plan, coming up quickly in January. Against all odds, *Juche*, the impossible self-reliance dream of his father and grandfather, has been achieved. The country imported essentially nothing in September, and very little throughout 2020, yet it remains alive. ¹ Proof, to some, that sanctions and “maximum pressure” don’t work. Would Kim’s father and grandfather be proud? The exception, a small flow of crude petroleum, 500,000 tons a year, provided free from China since the 1970s and not included in the data, perhaps just enough for President Xi to hold sway over bothersome nuclear and ICBM tests. And plenty of costly smuggled items, including refined petroleum products, that come across the China border and by sea but at the high cost of the sanction cheapened exports needed to pay for them.



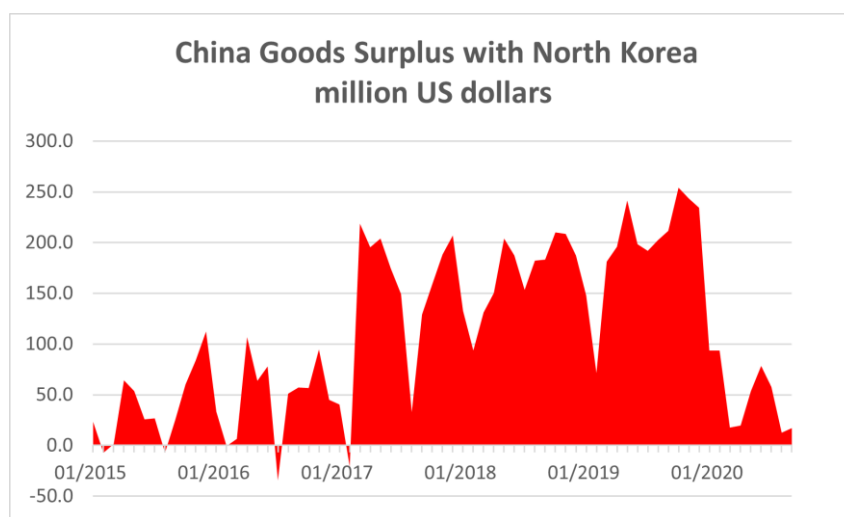
China Customs, 23 Oct. 2020

The other bit of *good* news is that for the first time since China began to close off its imports in mid-2017, Pyongyang is not hemorrhaging cash, at least according to the Chinese Customs data that Kim must rely on for his own foreign balance accounting. Smuggled goods and improper customs, after all, means undependable Chinese **and** Korean data. This Chinese data released on Friday shows its exports to North Korea were \$18.9 million in September and \$487 million for the first three quarters of 2020, stunning 92 and 73 percent drops from the same periods of 2019. And its reported imports from North

¹ <http://english.customs.gov.cn/Statics/43e4bf5a-94d5-489d-b0f8-698ec06bc67b.html>

Korea were only \$1.9 million in September and \$43.9 for the three quarters, 88 and 72 percent drops from same periods of 2019. This left a North Korean goods trade deficit of \$16.9 million in September and \$443 million for the year so far.

North Korea's exports had plummeted in 2018 and 2019 due to China's accession to tough UN Security Council sanctions, but imports had held up reasonably well, raising plenty of questions about how North Koreans were paying for them. The aggregate data hid a massive change in the composition of imports, however, a shift from investment goods, hundreds of millions of machinery and equipment, to consumer goods, especially food and clothing, essential items that the population demands. Now even those essentials have fallen to next to nothing. Kim blames the pandemic and the border closing but there may be also political reasons behind the shutdown—it fortifies *juche* and may strengthen control over the people in uncertain times.



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Goods are not all that is traded and other items in the country's current and capital accounts—overseas worker's remittances, foreign aid, net tourism receipts, illicit and thus unrecorded exports and imports, and a small amount of net foreign investment inflows—probably earn on the order of \$50 million a month, a guess based on the level that would have balanced the accounts prior to 2017. The steep drop in goods exports after 2017 was unlikely offset by a rise in such income; indeed, sanctions likely cut these receipts as well. This would mean that foreign exchange holdings, by the government and increasingly by North Korean civilians, would have been leaking out, as much as \$2 or \$3 billion cumulatively since 2017. Enterprising Koreans were paying US dollar or Chinese yuan cash for Chinese merchandise, selling it for a profit in local markets and sucking in household hard currency. Now this seems to be no longer the case and the Chairman, or at least his finance people and party stalwarts, might feel happy about that.

That is about where the good news ends. Poorly understood by outsiders, the North Korean economy is still a partially centrally planned economy, one where most property and capital is owned by the state, as dictated by its Marxist Constitution and its communist (Worker's) party. Prices and wages are set at whatever the Party wants and change little. Most people are employed by the government, its state-

owned firms, and collective farms. Consumption is discouraged to give priority in production to state requirements, including a huge military, and to building investment goods and buildings. That is the theory anyway. Money, in this part of the economy, is irrelevant and decisions are made according to a complex plan, an input-output matrix that allocates labor and resources and thousands of intermediate products which determine output and distribution. If the plan wants a hundred thousand one-ton trucks, it must order the production of a hundred thousand tons of steel and a half million or so tires. To make the steel it must require mines to haul in the right amount of iron ore and the coking coal and limestone. And the mines must be given the labor, fuel, and rolling stock the accountants figure they need. And so on. It gets very complicated very quickly and quickly devolves to barter or quasi money transactions where enterprises fill in gaps and pay their workers by trading between themselves, in the process creating more gaps since they don't supply their promised goods to other state firms. Since the goal of the plan is to maximize investment, it focuses on investment goods. Fewer private cars and more company trucks means more capital stock to build on next year. It produces export goods so that hard currency earned can be used to fill in for critical items that aren't produced domestically.

This system never worked well, and totally collapsed in the Soviet Union, Eastern Europe, and China; even faltering in North Korea during its famine of the 1990s. They all created plenty of capital equipment but the productivity of such capital, and associated labor, was abysmal. Unlike the other former centrally planned or Marxist states, the North Korean state, Mr. Kim and his regime, still owns the country's capital—all the factories and real estate and farms—and must figure out how to use it to make the economy grow while at least minimally keeping the people happy. So, it still has its Five-Year Plan and in 2021 its time for a new one. How many kilowatt hours are to be assigned to the Kangson steel mill this time around? It is important, even vital, to get this right if the mill is to survive. Pyongyang's bureaucracy is likely absorbed in developing the plan, with Kim and his elderly economy czar, Pak Pong Ju, at the helm, except that Kim has just ordered a nationwide 80-day "speed battle" to try to reach some of the goals of the failing current plan. Power plant operators are probably, again, pulling, with ropes, rail cars full of coal to burn in the giant Pukchang electric power plant, since no electricity is reaching the electrified tracks. Presumably, the thousands of planners are exempt from the speed battle and the pulling.

The speed battle is likely a national distraction. Kim no doubt is finding there is a much bigger problem with the spreadsheets he is looking at. A big input-output table invented by Soviet mathematicians, quite deserving of their Nobel Prizes. In the past, if there was a shortfall in a particular kind of machinery or intermediate input, it was imported, using hard currency earned by producing goods for export. After all, self-reliance, is hardly a socialist economy idea. Quite the opposite if you think about it. The socialist system depends on specialization and trade; it is just done by administrative fiat through the plan, not by profit driven price differences that reward risk-taking capitalists. North Korea used to export millions of tons of anthracite coal so to import equivalent volumes of bituminous coking coal needed for steel making. But as Kim must be seeing, for his new plan, there are no obvious export markets and, much more importantly, no imports. Where is the coking coal going to come from? Maybe Kangson Steel will use this as an excuse to miss its steel quotas and sell its then redundant kilowatt hour allotments to apartment buildings desperate for power to run their elevators. Who needs the trucks anyway if there isn't enough fuel? Taxis are much more profitable. Corruption, and the emerging money economy is making such efficiencies possible. But there is a limit. These industrially savvy people can figure out how to make a few 11-axle TELs, but can they do tens of millions of shirts

without any cotton or synthetic fibers? Or shoes without rubber, cookies without sugar? One can imagine Kim's spreadsheet has a lot of blanks and one big headache. How are they going to get filled?

Kim and even his father have been trying to solve the problem with a play on the *juche* concept, "figure it out yourself". Increasingly autonomous factories and service providers that are encouraged to be self-reliant, not depending on the plan for their inputs. They are even allowed to make profits based on cheap or free allocated input prices and near zero money wages—the workers are paid in ever declining rations and are expected to make money in sideline jobs. This has exploded over the years into a vibrant money and profit-led economy, existing side-by-side with the incompatible planned economy. Factories cheat on their plan quotas to leverage the cheap inputs, including labor. Nearly free plan-allocated kilowatt hours are sold at high prices for private uses, creating a whole class of rich arbiters. Some do even better, buying coal at ration prices and exporting it to China at market prices, easily a ten times difference. Easy money as they say. These people are called *donju*, literally "money rules" people, and if you want running water in your 20th floor bathroom, you better be nice to them. This growing money driven economy has kept the national economy alive over the past decade, even as the state economy has shrunk, giving the appearance of urban prosperity, and offering some hope for a reformed North Korea. Probably the best feature, with real money in circulation, people finally have a vehicle with which to save financial resources, freeing them from day to day dependence on the Party.

At risk today, however, is this private economy. The outflow of dollars and a likely coordinated decline in the amount of won in circulation—to keep the exchange rate on par—is driving down prices and profits in the market sector and is straining government spending as well, creating a recession like environment. An extremely tight monetary policy keeps won, and prices in general, stable but at the cost of the state being unable to create its own won credit, or even print much money. So, government enterprises and agencies can't get credit and investment spending and economic growth collapses. Kim seems to have thus done the Chicago School one step better; killed growth to protect the value of his money. With the large volume of US dollars circulating in the economy he inherited, he probably didn't have a choice.

So, now what will the new plan look like? Will Kim try to resurrect the past by tightening the plan, squeezing out the market wherever he can but risking the ire of the *donju* and the common citizens, or will he relax, giving up plan allocations, selling state factories to domestic investors, and letting the market do its job? Raising prices for electricity, installing an income tax, and paying state workers a reasonable wage would be a good start.

Kim, with his mammoth new shiny missile rolling around the dark streets of Pyongyang, can now boast he has a bigger button than Trump, and he has achieved a *juche* state, both dreams of his father and grandfather. Now maybe he can trade them off for something more useful, like a big settlement that allows him to sell his nice suits in the American market.