**Voice of America Interview with “Washington Talks” host, Ms. Cho Eunjung**

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**\*How bad is the current state of the N Korean economy?**

*1. N Korean leader KJU recently visited Samjiyon county and emphasized a ‘self-reliant’ economy. For KJU to travel all the way to the sacred mountain of Baekdu and make a symbolic announcement, how bad is the current state of the N Korean economy?*

It is in bad shape but then it has never really been strong. Relatively speaking, the country produces fewer goods per worker than any of about 200 other countries in the world, that is why they are so poor. And it’s a shame since they have excellent natural resources, good geography, and a pretty good stock of human and physical capital to work with. Their system, a mix of state planning and unregulated markets just makes extremely inefficient use of resources, especially of labor.

As 2019 draws to a close, I’m sure Kim and others in Pyongyang are reviewing the state of the economy. In fact, they are having a big set of unusual meetings this month probably geared to helping Kim with his policy speech on 1 January. Normally he would be speaking of the need to complete the five-year plan by the end of 2020 but instead he is promising something different, since I expect the plan is ending up in a complete disaster. We don’t know what his new approach will be. I expect their numbers for 2019 are looking pretty bad. In 2018 the large state planned part of the economy took a big hit from the drop in exports, I think, but rising private market activity offset some of that decline. This year, trouble with money caused by the sanctions, I think, is hurting the market side of the economy as well.

A little less than two years ago Kim promised he would focus on economic prosperity, amid much optimism regarding summit talks with China, South Korea, and the US. But now he is retrenching, talking again about self-reliance and “working harder” and traveling the country telling managers to do better work. This must be very disheartening for his countrymen to hear. “Self-reliance” in this context means they have to make everything they use, not an efficient way of production especially in the modern, high tech world. They would do much better by focusing on the many products they do well and importing what they don’t or can’t make so well--the law of comparative advantage. But UN sanctions, their own command price system, and their dismal record of reneging on debt obligations, makes that hard to do.

*2. The ‘International Trade Center’ data show N Korea’s exports dropped by 90% from 2015’s 3 billion dollars to 330 million dollars in 2018. N Korea’s trade deficit to China is at a record high. How is N Korea’s foreign currency reserve?*

I’ve seen estimates of $3 billion dollars or so, dropping every month, but truth is we don’t have a very good idea of the country’s foreign exchange reserves, and within that how much is controlled by the government and how much is in private pockets. It seems as there is a lot of US dollar cash floating around and used as domestic currency. But the government has trouble claiming that money without causing a revolt. Still, some is used for essential imports.

Many analysts are pointing to an uptick in exports and imports this year, based on monthly trade data out of China. But this entirely misses the point of the huge drop in 2018. It’s a mean analogy but Wall Street people like to talk about a “dead cat bounce” as when a stock price rises 10 percent after falling 90 percent. The bigger isue is, as you say, the rising trade deficit, a record $253 million just in October with China according to just released Chinese data. And this is with a non-sustainable level of imports—no imports of industrial or capital goods, just vital consumable goods.

A big problem analysts have is that whereas the goods trade is relatively well measured by foreign partner customs services, such as China’s Customs Bureau, the rest of the current and capital account transfers is poorly measured. If we estimate they have a monthly $200 million goods trade deficit, I expect at least half of that is offset by a surplus on services and transfers—money coming in from relatives abroad and from overseas workers, tourist receipts, aid funds that pay for some of the imports, and maybe a little bit of foreign investment, as perhaps Chinese-Koreans buying apartments in Pyongyang. So, the outflow may amount to a billion or so a year. As the reserves come down, there will be increased pressure on the exchange rate and imports will be cut even further, both activities damaging to the people’s standard of living.

*3. How can we compare with the ‘arduous march’ times in the 90s?*

Not much of a comparison. The growth in the private economy gives everyone a safety valve they didn’t have in the 1990s. Then, when the government’s food rations ran out, you went hungry, nothing much to do but starve. That is why all communist countries end in famine. Now in North Korea everyone can find some work and make a little money, buying and selling food and other goods and services in markets. So, while not great, its much better than a famine.

A big problem for the regime, however, is that it no longer can control everyone via the ration, and ironically the people, not the state, are more self-reliant. Moreover, expectations of prosperity have risen due to Kim’s own statements. So political and stability issues might be much greater for Pyongyang now than during the 1990s.

*4. It’s been 2 years since the UN adopted its strongest-ever sanctions on N Korea. How is the N Korean economy feeling the blow of the sanctions? What is most difficult about running the N Korean economy under the sanctions?*

The regime has done a good job of keeping he exchange rate steady, despite the drop in exports, and inflation is under control. But I’m pretty sure this is coming at the costs associated with having a very tight monetary policy, making it very difficult to borrow money and thus impossible to run deficits. Meanwhile many export markets are frozen tight. So, a recession is occurring, and managers must be having a tough time balancing their books. Investment spending seems to be at a standstill and layoffs, in the North Korean context, moving state workers to private jobs, must be happening quite a lot and people must be concerned. Meanwhile, government finance people must be working overtime trying to prevent a run on the currency that would spark instability. All in all, a very difficult time for everyone except maybe speculators.

*5. Is this UN’s strongest sanction ever to an individual country after Iraq and Haiti? Even though the sanctions are called sectoral and targeted, is it in effect comprehensive sanctions on N Korea?*

Well, we should remember, the UN fought North Korea in 1950, a much bigger sanction if you think about it. And there were tough sanctions on South Africa and Rhodesia to good effect. Still, arguably these are very tough. And by far the biggest culprit, from North Korea’s perspective, must be China.

China, clearly defensive, argues that we are not at war with North Korea and that the people’s livelihood should be protected, so it is doing some things to help Pyongyang. For instance, it still provides all the country’s crude oil, free. And it doesn’t seem to be enforcing many sanctions very carefully, perhaps deliberately so. Still, Beijing has to be considered the lynchpin of the sanctions and so far, is being pretty tough. Its not easy to stop so much trade across a long and generally friendly land border, with vested interests on both sides wanting the trade to continue.

*6. KJU is focused on building resort towns, including Samjiyeon, Wonsan-kalma and Mt. Kumgang. Under the current sanctions regime, how important is the tourism industry for KJU?*

I agree with Kim that tourism should be a big focus of his new economy. In the longer run it may pay off and right now, except for Americans, it isn’t sanctioned. I’ve seen reports of a million or so Chinese visitors every year providing a few hundred dollars each, which adds up to real money--still, no-where near enough to counter the trade imbalance. And it costs North Korea plenty as well. The industry is labor intensive and in order to be sustained, must require a lot of infrastructure investment. I don’t think they can keep the Chinese coming without some big improvements, so Kim is working on that.

But what he really needs is South Korean and Japanese visitors, who will spend thousands, not hundreds. So far, almost none of them are coming.

In my view a good approach by the US government would be relax our travel restrictions and help promote a market driven tourism economy. Safety for tourists could be provided by an official US tourist office in Pyongyang, a big step in undoing the “hostile policy” Kim likes to talk about. But it would be essential for tourist money to avoid the state command economy and work with the growing private economy—in other words dollars would be exchanged at the market, not official exchange rates. And pay for North Korea’s tourist workforce would be in money, not state rations. This would have a great impact of helping open the economy, both internally—the money would circulate—and externally, with hopefully a positive interaction between American visitors and North Koreans.

*7. Some experts find parallel’s to Cuba in blunting the pain of sanctions by promoting tourism. Is N Korea in a better or worse position than Cuba in developing tourism?*

There are some important similarities. Cuba is a relatively advanced country compared to North Korea and tourism probably would not have as much an impact there. On the other hand, they would be aimed at free spending Americans against relatively parsimonious Chinese. In both cases, the host country would have the unenviable task of limiting the exposure of their own people to the freedoms and obvious wealth of the visitors.

*8. How is KJU able to construct these large-scale resorts when he is cut off from imports and hard-currency?*

Foreign currency requirements are probably relatively small for these projects, since North Korea is good at producing cement and bulldozing sites. And workers seem to be forced, either soldiers or conscripted, rather than professional construction people, paid in real money. I expect though they are having trouble furnishing the resorts with up to date and usually imported equipment and consumables—like coffee. Kim would do much better to get foreign franchises to put up some capital, but any investments are still sanctioned.

*9. What are the limits to KJU’s current economic policy direction?*

I think he is caught between the market economy’s need for “reform and opening” and the state economy’s preferred “self- reliance” and use of rations, not money. It’s not an easy choice and I hope that is what they are talking about in their meetings this month. Reform in this context, like in Deng Xiao Ping’s China, is in legalizing and encouraging private market activities, including labor and capital markets, not just the goods markets that already are allowed. And they would include, perhaps most importantly, a drastic change in the collective farming system, allowing, in effect, private farming. These would no doubt spark a huge boost in productivity that would generate much economic growth. And opening to the outside world will probably only come with sanctions reduction and denuclearization, allowing more specialization of labor and inflow of foreign capital. Such opening has been tried before, with bad results, and in my view requires domestic reforms first, so the reform **and then** opening, should be the mantra.

But the cost of taking this path is reducing the very tight, almost slave-like, controls the regime has over the population. Pyongyang has taken some good steps, for example allowing money to circulate and people thus can have some of their own financial reserves, probably held in US dollars, so it may be just a matter of time. But policy moves by Kim could shift the economy backwards to more state self-reliance, and central planning, or propel it toward private led prosperity. Hopefully he will chose the latter.

*10. UN says N Korea’s cyber-attack-generated revenue is estimated at 2 billion US dollars. Isn’t this enough money to prop-up its economy? What is the scale of N Korea’s illegal economic activities? How important is the illegal economy in terms of revenue generation?*

The widely cited UN numbers really are just guesses and don’t even give a very good time frame. It is nothing like $2 billion a year or so, for example, but over many years. Their illicit cyber income probably is significant but, like everything else, doesn’t come free. I expect some is stolen by fellow cyber thieves and I wonder how much control the North Korean government can really have over these people. I even wonder if the income is worth it to the country, given the bad reputation North Korea is developing that will is increases the costs of any legitimate transactions they have with the outside world.

*11. US Federal prosecutors have charged a cryptocurrency expert for presenting at a blockchain conference in Pyongyang. Can we find parallel in this action with ‘secondary sanctions’? How is the US increasingly using extra-judicial measures to clamp down on N Korea’s sanctions evasions?*

Since this is an American citizen, I don’t think it would be a secondary sanction issue. If South Korea, for instance, charged the American, that would be a secondary sanction on its part. It’s a very odd case and we will have to see how our legal system works itself out. Anyway, its hard to see they would get anything on hacking they can’t find on the internet. And, if I were the North Koreans, I’d be hesitant to take the free advice from such a person. Trust, or lack of it, is so much a part of doing business.

*12. The Trump administration has sanctioned over 250 individuals, entities and vessels that provided support to N Korea. The number takes up 50% of all US sanctions against N Korea. What is your take on Trump administration’s sanctions effort?*

The ability to blacklist a company, person, or a vessel is a pretty effective way of making it harder and more expensive for North Korea to do international business. But with the higher risks comes higher potential profits so some trade will continue. The administration thus must keep up the effort, mostly I think to keep other countries and the public from losing interest and resolve.

We should keep in mind that the main US, as opposed to UN, sanctions, relate all the way back to the Korean War, terrorist activities like KAL and Rangoon, maybe the Chonan, and to North Korea’s non-membership in important international institutions, like the WTO and the ILO. These have long prevented a normal trade and investment relationship with the US, and this will continue until Pyongyang decides to normalize itself and reform its economy. So, in that sense, the recent US sanctions are somewhat exaggerated. The UN sanctions are what are pressing North Korea right now.

*13. In the New Year, how badly will N Korea need a breakthrough in breathing life into its economy?*

One thing we can see from Chinese trade data is that North Korean industry is responding to sanctions in logical ways, such as switching from sanctioned textiles to unsanctioned footware, watches and wig exports. And Kim’s focus on tourism probably makes some sense. But these can’t provide the income needed to really boost investment and growth. I think Kim is playing a dangerous game by resisting the UN. He may feel he can muddle through by focusing on self-reliance, and limiting domestic spending, but he is inviting a disaster, such as a currency crisis, a food shortage or massive layoffs that could put people in the streets. I suppose the question for him is what is more dangerous to his security, trading off his nuclear weapons and welcoming private production, or courting an angry public. Maybe the new year will tell.

\***China’s behind-the-scenes economic support to N Korea**

*1. What is the extent of China’s economic support to N Korea? What are tools and avenues for China’s economic support to N Korea without directly breaching the sanctions?*

By far the main support is 500,000 tons of crude oil that it delivers by a short pipeline to a refinery near Sinuiju. That is provided under a long term aid agreement and Pyongyang doesn’t pay a cent for it. It provides most of the petroleum that North Korea uses. I rather expect Beijing holds that as a very large lever it could use should Pyongyang engage in really dangerous activities.

Also, it is clear that China is somewhat two-faced when it comes to enforcing the tight restrictions it has imposed on North Korea, via the UNSC. Some trade in sanctioned goods obviously occurred, perhaps more on the North Korean import side (refined products) than on exports. And despite voting to disallow North Korean workers in China, not all of them will be sent home by the December deadline; in fact, many will stay legally with temporary travel passes.

Like with the crude oil, many of us complain but we don’t know the extent of strings that come attached to these activities. Certainly the UN level sanctions give Chinese leverage against the North Koreans, leverage I hope they are using to good ends.

*2. How is US congress moving to cut off Chinese support to N Korea, sanctions-evasion efforts?*

I don’t think there is much Congress can do. Using so called secondary sanctions against Chinese companies is very problematic since our economies are so intertwined. Just look at the Huawei case and see how complex things can get. In the end we must depend on China to support the same changes in North Korean policy, especially with regard to nuclear weapons, that we are working towards. Given that last big nuclear test shook major cities in northeast China, I don’t think we have to worry too much about that.

*3. Why is Chinese ship-to-ship transfer frequently being pointed out? What can the Chinese govt do more?*

China’s government clearly could do more but it just isn’t so concerned about it. After all, North Koreans pay good money for the refined products, probably at much higher prices than could be sold normally, and the gasoline and diesel fuels taxis and trucks in North Korea. Why give Pyongyang crude oil and not allow sales of gasoline? A good question, I think, a Chinese taxpayer should ask his or her government?

*4. Is food aid also a big part of Chinese support to N Korea?*

China rarely gives much grain to North Korea, very little in fact compared to international aid agencies. This year its grain exports have increased but are still tiny compared to North Korean consumption. And some of those exports may be paid for by third party aid agencies that procure grain or milled products in China and ship them to North Korea. If North Korea had another really bad harvest that could change although even then, Beijing probably feels international aid should be the answer.

I know China has long thought North Korea should decollectivize its agriculture, like it did in the early 1980s, as a solution to the food problem. So it may be frustrated by Pyongyang’s lack of progress.

*5. Which other countries are holes to sanctions enforcement? How about S Korea?*

Most UN countries are abiding with the rules, actually, to a surprising extent. One worries mostly about politically driven gifts, cash, that entities in North Korea might be given as bribes. These can influence specific activities, even military related, but I don’t think impact the direction of the economy as a whole.

*6. Is China N Korea’s only lifeline? Does China have dominant influence over N Korean economy?*

Kim may feel he could absorb a complete break with China by reaching out to another country, like South Korea, Japan, Russia, or even the US. And to the degree Beijing recognizes that possibility, it is not likely to completely cut off Pyongyang, as with shutting down the crude oil. Actually, I’m surprised that Beijing is being as tough as it is. North Korea’s strategic territory will always make it a player between the big powers, for good or for ill.

In the longer run there is little doubt China will hold tremendous economic influence over North Korea, just as the US has such influence over Mexico and Canada, but that doesn’t necessarily translate into political power. Economics always works both ways. I’m sure there are plenty of people and companies in China that want to do business with Pyongyang and would resist efforts to completely shut off the lifeline. And if it isn’t careful, China will create a black hole in North Korea that invites all kinds of illegal activities that criminals can run to, out of reach of Chinese authorities.

William B. Brown

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