

# Policy Forum 09-092: Currency Reform and Orthodox Socialism in North Korea



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# Currency Reform and Orthodox Socialism in North Korea

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By Rudiger Frank

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## I. Introduction

Rudiger Frank, Professor of East Asian Economy and Society at the University of Vienna, writes, "In hindsight, we will realize that the currency reform of December 2009 might have been a short-term victory for the North Korean government, but that it was not able to root out private economic

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activities and in the long run contributed significantly to a dangerous loss of the system's legitimacy."

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## **II. Article by Rudiger Frank**

- "Currency Reform and Orthodox Socialism in North Korea"

By Rudiger Frank

On Nov. 30th, 2009, the North Korean government implemented a currency reform, exchanging old against new won in a relation of 100:1. Shops were closed to ensure a smooth transition to the new currency. Reportedly, the maximum amount of money that could be converted this way has been limited in the range between 100,000 and 300,000 won per person. This is not big money; according to the unofficial exchange rate, this would be between 50 and 150 Euros.

Such a major financial transaction is costly. New notes have to be designed, printed and distributed (probably with a new face?); old notes must be collected and destroyed. This involves expensive raw materials such as special paper and ink, hundreds of trucks and fuel for transportation and a high security effort. Accordingly, a currency reform rarely takes place without an expected gain. What could it be in the case of this 2009 reform?

One possible motivation would be to shed a few zeros, which is something that has been discussed in many countries including South Korea for many years. It is inconvenient for individuals to carry large bills. Globally, spending 10,000 units of one's currency on something as profane as a modest meal is usually associated with underdevelopment, or worse, with inflation. Fair enough, but would such considerations be sufficiently high on the agenda of the North Korean government to prompt it to go through the economic and administrative ordeals of a currency reform? This appears very unlikely.

Rather, it seems that we have to interpret this measure as part of the ongoing neoconservative trend in North Korea that has started around 2004/2005. The government in Pyongyang was shocked by the unexpected effects of economic liberalization after the July 2002 reforms. These were catalyzed by the new economic cooperation with South Korea and the exploding official and unofficial trade with China. North Korea's leaders were disappointed by the failed deal with Japan (exchange abductees against normalization and huge funds) and acted under the impression of the post-9-11 policy of the United States. Washington made it very clear how it was ready to deal with misbehaving members of the "axis of evil".

So since spring 2003, when People's Life Bonds were issued and the range of goods tradable on markets were expanded from food to industrial goods, no further reforms were implemented. Later, trading on the markets was curtailed step by step, and efforts were made to lure people back into the state-controlled economic system of production and distribution. As sharp differences in wealth became visible across the board and triggered growing discontent, successful trading was criminalized. In late 2008, Kim Jong-il resuscitated orthodox economic policies of the 1950s and 1960s when he started the second Cheollima movement, or the great revolutionary upsurge (hyeongmyeongjeok daegojo). Shortly thereafter, a 150 day battle started. As in the not so good old days, a 100 day battle followed suit, and the North Korean population gets ready for a few more such "final" charges. The economic utility of these measures is questionable as individuals learn quickly and respond by withholding performance. The true value of the "speed battles" is ideological.

The currency reforms are part of this campaign to return to the North Korean version of orthodox socialism and to eradicate the dangerous effects of the few years of reform that were so gravely misunderstood, overlooked or plainly ignored in the West. The most dangerous result of these reforms was the emergence of a new group of people who became wealthy enough to develop individual ambitions and to break out of the state-imposed collectivism (jibdanjueui). The number of mobile phone subscribers to the Orascom network, allegedly about 30,000 in Pyongyang alone, the burgeoning private restaurant business etc. are instructive. Academic literature is full of studies that show how necessary (though not sufficient) an emerging middle class is for political reform. Once North Koreans realized that they could progress in society by their own economic effort, this created an alternative to advancing only politically through the ranks of state organizations. To many, this new option seemed attractive, they used it and generated not only wealth but also power. The new middle class provided an example that led to envy, but also to many unanswered questions by the people around them.

Such a situation does not lead to an immediate collapse of the existing system, but it is nevertheless highly risky. Kim Jong-il's analysis of the case of Eastern Europe correctly states that the collapse of socialism begins with a collapse of ideology, i.e. the domestic order is being undermined when reality increasingly deviates from ideological claims to a degree that makes propaganda just ridiculous in the eyes of the population. People may still fear and obey their government, but they don't trust it anymore.

It is such a situation that the North Korean government wants to prevent by all means. However, the virus of individual economic activity and the paradigm shift deriving from this is hard to kill once society has been "infected". The North Korean leadership went from technical measures to ideological campaigns to eradicate the dangerous traces of individualism that had emerged in the past years. Not unexpectedly, success was limited. It is one thing to withhold economic freedom; it is much more difficult to take it away once it has been granted for a while and people developed a taste for it.

The currency reform primarily wants to destroy the newly emerged North Korean middle class. No money, no trading; that seems to be the logic. But will this measure be effective? The answer depends on the situation of the affected individuals. Many of them will have been smart enough to convert their earnings into safe foreign currencies such as Euros, Dollars, Chinese Yuan or Japanese Yen. These are the true professionals, those who engage in large-scale economic transactions. However, in lieu of a functioning domestic banking system, trading requires large reserves of cash to pre-finance wholesale transactions. Revenues are made in domestic currency and not always instantly converted. So most North Korean business people will lose at least some of their property.

Those who suffer the most are those who are at the lower end of the new middle class. They interact with intermediate dealers, their transactions are made exclusively in domestic currency, their information networks are not overly sophisticated, and their opportunities for converting money into hard currency are limited. With the price of one kilogram of rice being about 1,500 Won, a small-size trader makes a turnover of 1.5 million won by selling one metric ton of this staple food. If only 300,000 Won or less can be converted into new currency, this clearly is a drop in the bucket. Complaining will have serious consequences, as possession of too much money is suspicious in a system that regards individual wealth as a byproduct of exploitation and deception.

What will be the consequences of the currency reform? Those who were excluded from economic success will shrug their shoulders and probably be happy that their newly rich neighbor is brought back down to earth. The top level of society has in all likeliness been prepared. The lower end of the new middle class will suffer a serious blow to its ability to continue economic transactions at the previous scale. Many North Koreans will lose their savings. Even those who were able to avoid

expropriation by having shifted their holdings into hard currencies, gold or other valuable goods will be much more careful in the future. Certainly, non-state economic activities will be seriously curtailed by the new measure, although it is unlikely that it will be stamped out altogether. The state will regain a good share of control over the economy that it lost in the past years.

The political consequences, however, are less promising for Pyongyang. The experience of other formerly socialist societies has shown that frustration and discontent silently accumulate until they reach a level that Lenin would call a "revolutionary situation". It can prevail for quite a while, but a triggering event such as the death of a leader, a famine, an external impact or a small-scale domestic quarrel suffices to bring about a major reaction. On October 7th, 1989, tens of thousands of seemingly loyal citizens paraded in front of their ageing leaders to celebrate the 40th anniversary of East Germany's foundation. Two days later, almost two hundred thousand people demonstrated in Leipzig against their government, demanding free travel and Gorbachev-style reforms. Within less than one year, East Germany was no more.

It seems that security is tight and an instant uprising will be prevented, although one never knows. In hindsight, we will realize that the currency reform of December 2009 might have been a short-term victory for the North Korean government, but that it was not able to root out private economic activities and in the long run contributed significantly to a dangerous loss of the system's legitimacy.

### **III. Nautilus invites your responses**

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Nautilus Institute  
2342 Shattuck Ave. #300, Berkeley, CA 94704 | Phone: (510) 423-0372 | Email:  
[nautilus@nautilus.org](mailto:nautilus@nautilus.org)