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# Policy Forum 05-100A: International Aid for North Korea: Sustainable Effects or a Waste of Resources?



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Policy Forum Online 05-100A: December 15th, 2005

## "International Aid for North Korea: Sustainable Effects or a Waste of Resources?"

Essay by Ruediger Frank

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### I. Introduction

Ruediger Frank, Professor of East Asian Political Economy at the University of Vienna and Korea Foundation Distinguished Visiting Professor at Korea University, writes "International support will continue to be an important and effective policy, as it obviously was in the past, although its nature might change and the impact will not always be directly measurable. However, it works. The few millions spent on projects in North Korea are a low price for regional security and improved living conditions."

## **II. Essay by Ruediger Frank**

- International Aid for North Korea: Sustainable Effects or a Waste of Resources?  
by Ruediger Frank

The focus of international efforts in North Korea used to be on food aid. With the announcement of a policy change by the North Korean government this fall, sending home humanitarian NGO's and reinforcing the Public Distribution System for food, attention has shifted to developmental assistance. However, the basic question remains the same: Will international support improve the situation in North Korea, or will it just prop up the regime? It will probably do both, not only because "North Korea" and "the regime" are two categories that are not easily separable. But are there any visible developments that would justify taking the pain of further engagement?

Thinking that the last years went by without any significant economic change in North Korea would mean ignoring reality.

Walking through an extraordinary, festive Pyongyang in October 2005 - freely, without any guide, and left unmolested - I found a hand-written poster (in Korean) at a watch store reading "To celebrate the important holiday [60th anniversary of the foundation of the Korean Worker's Party, RF], we are selling many goods at a 10% discount from Oct. 10th until Oct. 31st."

In other words, there was a sale - in North Korea. Better than any official announcements, this tells a whole story. In an ordinary socialist shop, from the perspective of the employees, selling means the investment of time without any revenue. Neither their income nor job security are usually connected to sales figures. Those familiar with other socialist countries will recall the lack of staff enthusiasm and customer orientation in shops and restaurants. Selling more than the plan dictates could even invite trouble because of empty inventory. Prices are usually fixed by the state and not negotiable; a socialist store in fact does not sell, it distributes. In such an environment, attracting buyers by giving a discount makes no sense at all. Having a sale implies an interest in selling, as well as price flexibility. It implies an interest in the customers, and hence the readiness to respond to their needs. The motivation surely is money; at least the manager of the store has a vested interest in raising the sales figures. A sale in North Korea? Can this be a harbinger of the start of a paradigm shift? Despite all skepticism vis-à-vis the reforms, monetization and marketization seem to be no empty words.

A few steps later, I saw an advertisement offering coffee, tea, "fresh beer" and a cozy place to play Korean chess (again, in Korean - i.e., targeting domestic customers). So far, so good, but this was a clothing store. Obviously not allowed to turn into a restaurant, its staff was at least trying to extend its outreach. Near my hotel I found an advertisement for "the first debit card in our country", issued by the North East Asia Bank.

At present it can only be used in roughly a dozen shops and restaurants. Still, this is a beginning. Some traders were ready to bargain, which implies private economic activity or at least growing flexibility. In one small but nicely arranged shop, NOT in the vicinity of a hotel, I found "Chanel" handbags at a very reasonable price, tags written in Korean but prices given in US Dollars. The same currency, not the Euro, is required to purchase a ticket at the Air Koryo office in Beijing. A

North Korean official asked me to send him English-language economics textbooks for his daughter who studies at Kim Il-sung University, and would not mind if I sent him the books via ordinary mail. This list of examples can be continued.

Beyond this anecdotal but significant evidence, there are other developments. For the second year in a row, North Korean agriculture was able to increase its output significantly (Yonhap News, "USDA Estimates North Korea's Grain Output as Largest in 10 Years", 2005-11-28). Analysts were quick to discard the idea that the famine of 1995-1997 was mainly caused by natural disasters; so it would be unfair to associate the positive development this time only to good weather. The attempts to utilize market incentives to increase production have been effective, although not without unexpected side-effects.

In China and Vietnam, too, initially nobody wanted to change the whole economic system in the first place. Even in the 1990s, Chinese economists were talking about a secondary and supplementary role of the non-state sector. But successful experiments prompted new ones, leading to the stop-and-go piecemeal approach that we now, in hindsight, recognize to have been the beginnings of gradual transformation. The external situation was more favorable there, too. So there is room for optimism concerning North Korea.

A huge and important difference between the North Korean case and that of China and Vietnam is the weight of agriculture in the national economy and in society. About 80% of the population in Vietnam and 70% of the population in China worked in agriculture at the start of the reform process (see Naughton 1996), as opposed to only about 30% in North Korea. Liberalizing food trade in a non-saturated and isolated market implies rising food prices. This is good for food producers, but may signal rising prices for consumers. In China and Vietnam in 1979, a majority benefited, while only a minority was forced to bear heavier costs in exchange for diversified supplies, and hence could be supported by state subsidies. Because of its different socioeconomic structure, in North Korea it has been the other way round. The majority of the population had to use their few and mostly static resources to struggle for food in the market and this drove up prices as well as industrial wages. Accordingly, inflation in North Korea skyrocketed, while it was much more moderate in the early reform phase in the other two countries (see Du 1992).

"Skyrocketing inflation" is not just an empty phrase. Due to the lack of data, there is so far no reliable way to calculate a North Korean inflation rate based on the standard method of creating a basket of basic goods and services. But the development of wages should provide us with important clues, assuming that wages must at least cover subsistence. Otherwise, nobody would go to work. I asked a worker at a cable factory in Pyongyang in October 2005 about his monthly wage, and he answered it was 30,000 won. Would he tell a foreigner the truth?

The number he provided appears to be very high, if compared to the official wages that have been raised from about 100 won to roughly 3,000 won in 2002 and allegedly have only reluctantly been paid. However, in addition to a few private shops, I also entered several state-run department stores in Pyongyang, in which goods are displayed at official state prices. Some examples: A pair of very basic sports shoes cost 10,000 won, a bar of soap was 600 won, a wall clock cost 8,500 won. This suggests the possibility that the worker was telling the truth. Based on this evidence, if the wages increased tenfold in three years, we can estimate the annual rate of inflation in North Korea to have been roughly about 215% since 2002.

If this is roughly accurate, the situation is politically not sustainable. So in October, the government put on the brakes, hoping to curb inflation by taking its major source - food - out of the market cycle. Will it work? That remains to be seen. Are the reforms over? Is avoiding reform the surest survival strategy for the elite in Pyongyang? I would disagree with such a view. If the whole world around

North Korea moves - and it certainly does - riskiest course may be to remain static. So even if the preservation of the status quo is the objective of the elite, in the long run it must work actively to achieve that goal. Strange as it may sound, reform is the only way to avoid regime change. Kim Jong-il calls that "adjusting to the new environment".

This brings us back to the international community. Assuming that domestic agricultural production is still, despite the increases in the last years, insufficient - does North Korea now "rely" on food deliveries from China and South Korea? That would be something revolutionary in its own right. If true, it must mean that the North Koreans see no alternative to reliance on Chinese and South Korean food aid in the short run. But if history is a guide, they will hardly bet their future on it.

Rather, the intention seems to be to repeat what in principle has already been done after another major crisis. During the Korean War until around 1953/54, Kim Il-sung asked his "socialist brothers" mainly for conventional aid, such as food, clothing, etc. Then, the items on his wish list changed to support for reconstruction and the delivery of machinery, technology, and even turnkey factories (for more details, see Frank 1996). Today, we would call that developmental assistance. Of course, the current situation is in many ways different from the 1950s. Yet a similar pattern may be unfolding.

So, what is the plan? In perfect congruence with the spirit of Juche, the North Koreans now do what David Ricardo would and European experts including myself at economic seminars in Pyongyang have told them for years: Ensure self-sustainability in food by increasing industrial output, exporting it, and using the revenues to import food to supplement domestic production. Before 1990, the North Koreans had the opportunity to engage in "politically correct" trade with socialist partners, who, for strategic reasons, often could not avoid buying low-quality goods. Now, if they want to export, the North Koreans have few alternatives to dealing with capitalists. Even the highly cooperative partners in South Korea are private companies that will go bankrupt if they purchase worthless or overpriced goods. North Korea's industry has no choice but to become competitive.

The logical consequence is the urgent need for modernization, the introduction of advanced technology, securing a stable energy supply, the import of capital and the development of an institutional and human resource capability to interact on the international scene. This is behind Pyongyang's focus on intensified economic training measures for its officials, and the background of the recent news about eased regulations for direct investment in North Korea (Hankook Ilbo, 2005-11-30). This is even more so since normalization with Japan and the expected financial support related to that deal are not out of reach, but still too far away.

The reforms are not necessarily over; the leaders in Pyongyang might just have adjusted their strategy. Rome was not built in a day, and the risks are high from the perspective of the North Korean leadership. International support will continue to be an important and effective policy, as it obviously was in the past, although its nature might change and the impact will not always be directly measurable. However, it works. The few millions spent on projects in North Korea are a low price for regional security and improved living conditions.

### **III. Nautilus Invites Your Responses**

The Northeast Asia Peace and Security Network invites your responses to this essay. Please send responses to: [napsnet-reply@nautilus.org](mailto:napsnet-reply@nautilus.org) . Responses will be considered for redistribution to the network only if they include the author's name, affiliation, and explicit consent.

Produced by The Nautilus Institute for Security and Sustainable Development  
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