



Policy Forum 03-31A: North Korea: 'Gigantic Change' and a Gigantic Chance



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By Ruediger Frank

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I. Introduction

The essay below is by Ruediger Frank, Visiting Professor at the Weatherhead East Asian Institute of Columbia University. Based on research done on the DPRK's extraordinary 1998 ideological switch and quantitative analysis of its 2002 price reforms, Frank argues that the DPRK is on the brink of profound and meaningful economic reforms. Moreover, Frank concludes that by allowing the DPRK a fair chance to reform themselves would produce a much more sustainable result than a change induced from the outside.

This essay is an abridged version of a much longer and detailed academic paper which is to be submitted for publication in May 2003.

The views expressed in this article are those of the author and do not necessarily reflect the official policy or position of the Nautilus Institute. Readers should note that Nautilus seeks a diversity of views and opinions on contentious topics in order to identify common ground.

II. Essay by Ruediger Frank

North Korea: 'Gigantic Change' and a Gigantic Chance

by Ruediger Frank

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The situation around North Korea threatens to escalate after the talks in Beijing passed without visible progress. There is a great danger that the standoff between the DPRK and the United States might be just another case in the long history of international relations, in which a lack of knowledge of the other side creates misperceptions and results in undesirable policy outcomes. After detailed research on a truly outstanding ideological switch in the DPRK after 1998 and a quantitative analysis of the 2002 price reforms, I come to the conclusion that something remarkable is finally going on in terms of economic reforms in North Korea. This opens a narrow window of opportunity that shall not be missed. On January 4th, 2001, a prominent North Korean wrote in an article titled "The 21st Century is a Century of Gigantic Change and Creation":

"Things are not what they used to be in the 1960s. So no one should follow the way people used to do things in the past... We should make constant efforts to renew the landscape to replace the one which was formed in the past, to meet the requirements of a new era."

These words were published in capital letters in the Rodong Sinmun, the number one North Korean newspaper. The author's name is Kim Jong-il, also known as the son of late president Kim Il-sung and now leader of the Democratic People's Republic of Korea.

In 2001, a far-reaching reform policy finally entered into its implementation stage in North Korea after some years of preparation, discussion and formulation. The constitution, which was changed in 1998, already contained passages stressing the relevance of "costs, prices and profits" (article 33). Various official publications reiterate this, among the latest ones being the speech of DPRK Finance Minister Mun Il-bong on the 2003 state budget addressing the parliament on March 26th, 2003:

"In all institutions and enterprises a system of calculation based on money will have to be correctly installed, production and financial accounting systems be strengthened, production and management activities be carried out thoroughly by calculating the actual profits."

In a dramatic move, on July 1, 2002, a sweeping price reform was introduced in North Korea. It increased the retail prices for basic goods, which in the case of rice meant a nominal increase of

55,000%. It devalued the North Korean currency against the US Dollar by roughly 6,800%. It divided the North Korean society into earners of ordinary and special wages, with the latter being three times as high as the former. The procurement price of rice is now lower than the retail price, i.e. the state stopped subsidizing this basic grain.

The results of this price reform are manifold. They provide strong material incentives for producers to increase the output of rice; indicate a strong interest in international economic exchange; bring the price of rice to a level comparable with international rates (about 29 cents per kilogram); point at a flexible policy towards an increasingly heterogeneous domestic political scene; and, last but not least, show the resolve to carry out a responsible fiscal policy.

Westerners might take all this for granted, but for a country like North Korea, the importance of such events cannot be overemphasized. Allowing prices to matter in the national economy acknowledges their role as mediators between demand and supply - and indirectly admits that the state cannot play this role itself. After various attempts to increase the output by mass mobilization campaigns and the like, North Korea has finally embarked on a road toward market reforms, supported by an inward-oriented ideological and an outward-oriented diplomatic offensive. The dual, hybrid structure of the North Korean economy, unofficially introduced since the early 1990s when farmers were allowed to trade surplus production on so-called farmer's markets (Nongmin Sijang), has finally been officially embraced. In an article of February 2002 in the leading North Korean economic quarterly, the P'yongyang Kyongje Yon'gu (P'yongyang Economic Studies), an economist explains how that is supposed to work:

"In the socialist society, the domestic market is divided into two markets: the market, which is established based on the socialist economic forms, and the farmers market."

The author, Yi Chang-hUi, claims that the DPRK is in fact the first country in the world to understand the true nature of a socialist economy, hence it is the first country to adapt this dual structure, which is meant to be only temporary. The farmer's market is supposed to function as a supplement to state-controlled distribution, primarily for agricultural production - undoubtedly the major economic concern of the famine-stricken country. Reality has meanwhile overtaken these theoretical elaborations. In early April 2003, Ch'oe Hong-kyu, a Director General of the DPRK's State Planning Commission, gave an interview to the Japan-based ChosOn Sinbo. He announced that the farmers market is now called just "market," acknowledging that all kinds of industrial goods are traded there as well.

Moreover, there are even signs that the DPRK is preparing for an integration of successful entrepreneurs into the classless society of socialism. A remarkable, but easily overlooked passage of the aforementioned speech of Finance Minister Mun Il-bong recalls the Chinese concept of the Three Represents:

"Our people, holding high the Great Leader's ideology of nation-building (Konguksasang) after liberation, have built a new democratic Korea upon the rubbles, those with strength (Him) using strength, those with knowledge (Chisik) using knowledge, and those with money (Ton) using money."

"Strength" stands for the workers and peasants, "knowledge" stands for the intellectuals - all groups well known and represented in the emblem right on the Chuch'e-Tower in P'yongyang (hammer, sickle, brush). But "money" is a new component, it stands for those who excel in economic activities. They are of course only acceptable if serving the right purpose. Nevertheless, not yet even visible successful entrepreneurs are in the process of being integrated into the DPRK's social caucus. It is remarkable that the leveling of the ideological battlefield has begun so early. Kim Jong-il might be no Mikhail Gorbachev, nor a Deng Xiaoping, but the evidence makes it hard to believe he is a stubborn

opponent of reform.

The latest event in this line is the announcement at the budget session of the DPRK parliament of the issuance of so-called People's Life Bonds (Inmin Saenghwal Kongch'ae). Why would a state like North Korea care about collecting large quantities of its own currency? Is it to reduce the debt of the state at the state owned banks? Or to convert the nonconvertible North Korean Won into foreign exchange on international financial markets? Certainly not. The only place where one could use North Korean Won is in North Korea itself. But the 2003 state-budget is balanced; it actually carries an unmentioned large surplus thanks to the elimination of the rice subsidies, which I estimate at 12-14% of the 2002 state budget. This is about the percentage by which the 2003 expenditures are going to be expanded. It is very likely that the one time extra revenue created by issuing the bonds will be used to pay wages until the new price system functions, or until the producers start selling their products at the new prices and thereby create higher revenue to cover their production costs, including wages and investments. The same might also be true for the purchase of other production factors, such as domestic business-to-business (BTB) transactions, which, as we know, are to be conducted on the basis of "costs, prices and actual profits."

If the above is true, it means that the issuance of the People's Life Bonds is not only a sign of a desperate effort to prevent a failure of the reforms, but also another indicator of the strong determination of the North Korean leadership to stabilize their national economy after the 2002 price adjustments, with the goal of creating a domestically functioning and internationally compatible national economy in the future. The DPRK Central Bank could simply print money. The only reason not to do so is that the reforms are for real and North Korea has decided to explore risky new ways to create revenue, rather than letting the reforms be weakened. If so, how long will the reforms last? The resolve by North Korea's leaders for "gigantic change" is obviously very strong. However, time is crucial. In 2002, something has started which can hardly be stopped anymore, unless it either becomes a brilliant success or a miserable failure. The changes have to produce results in order to be sustainable. North Korea has adjusted its distorted price system and explicitly asks its domestic enterprises to bring all their transactions in line with very basic (market) economic principles. The single production units are supposed to pay higher wages, to create and negotiate new BTB relationships, to buy the raw materials for their production, etc. - all that based on nominally higher prices.

The problem is that the revenues created by these transactions will start flowing in AFTER some initial spending on production factors like labor, electricity, raw materials, and so forth. This creates a serious gap, which must be bridged by loans. If loans are not available, the enterprises will be technically bankrupt and not able to pay bills and wages. As a result, since bankruptcy and the resulting unemployment, etc., are not acceptable for a state like the DPRK, these enterprises will be brought back under the umbrella of the state-run distribution system, which will effectively mean a failure of the economic reforms and most likely their end. There are signals that North Korea is now indicating that exactly this is happening.

This is a historical chance that cannot be missed in the interest of the international community. A collapse of the DPRK attempts to reform could create yet another humanitarian catastrophe; it might result in increased and desperate attempts to make money by trading arms, drugs, falsified currency, and so forth. A failure of the proponents of an economic, i.e., civil attempt to ensure regime security and prosperity might result in effectively strengthening the role of the military in domestic politics and a greater likeliness of an armed conflict in the region. The latter would certainly mean the end of North Korea, but not one that anybody close to North East Asia favors since it contains too many incalculable risks.

The resulting policy implications are very simple: First, provide enough food to North Korea to

secure a basic supply for everybody, until the new incentives for a production increase in agriculture start to create a larger output. This could take two or three years. Distribution should be organized in a way that it is equitable, to ensure that everybody survives and thereby social stability is maintained. Second, provide sufficient loans to North Korean commercial banks to finance the shortages in cash-flow of its state owned enterprises, to help them to put their operations and business transactions on a solid footing. Third, support any North Korean request for technical training in the fields of accounting, fiscal policy, international finance, and so forth, since the concepts in question are new and untested in North Korea so far. There already are very concrete instances of such programs and new, detailed training requests by the DPRK have been submitted to the EU and other members of the international community.

The timing of events so far is highly interesting. The reforms went into their hot phase in July 2002. The two big North Korean attempts to generate the necessary cash flow have not been successful. This includes the hitherto unimaginable event of admitting the abductions of Japanese civilians and, even more dramatically, allowing five of them to return to Japan in early September 2002. Public outrage in Japan prevented the envisioned normalization and subsequent payments. Not too long after that became clear to the decision makers in P'yongyang, in early October 2002 they approached the remaining potential source of the needed huge funding, i.e. the USA. Since time was running - the reforms had already started - the form of dialogue was very straightforward: We have the bomb, and you better buy it. Unfortunately, it seems that Washington is ready to call Kim Jong-il's bluff. No tangible result has been achieved so far, nor have ways to transfer significant amounts of cash to the DPRK have been worked out. The clock continues to tick for North Korea. Now, about ten months after the price reforms, the air becomes thin and time threatens to run out.

North Korea may have played its last card in this game - which does not have to be its last - by indicating it is a nuclear power during the talks in Beijing in April 2003. Ignoring this means two things: (1) Missing a great chance to support reform in North Korea and everything that is connected to such a peaceful, gradual and indigenous scenario, and (2) forcing the country to indeed produce the A-bomb in lieu of any other bargaining chip. Neither option is desirable.

The upcoming summit meeting between Presidents Roh Moo-hyun of South Korea and George W. Bush of the United States next week might be the last chance to make a courageous decision: Showing the moral superiority we claim to possess and helping the DPRK to become more responsible and more internationally compatible. Giving them a fair chance to change themselves would produce a much more sustainable result than a change induced from the outside. Showing the necessary patience and supporting such a development would be truly worthy of a superpower and might give the United States a good part of its lost international reputation back. Seen from a business perspective, instead of hoping that American companies would make lots of money from rebuilding a country after a war, why not participating in reconstruction right away, before physical and political damage was done? And wouldn't a peacefully unified Korea be much more likely to welcome a continuation and deepening of the alliance with the United States than a war-devastated peninsula?

We are running out of time. Recent evidence like the March 21 and April 3 policy statements (https://nautilus.org/pub/ftp/napsnet/special_reports/MilitaryFirstDPRK.txt) as well as unofficial reports indicate that leaders in P'yongyang are ready to acknowledge the failure of the reforms. But the chance is real, and it will be gone very soon. The summit meeting in Washington next week might be the last opportunity to send the right signals to P'yongyang. Increasing the pressure on North Korea by more sanctions, or even by doing nothing, would run against our interests and those of the people in the region.

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 . Responses will be considered for redistribution to the network only if they include the author's name, affiliation, and explicit consent.

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