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The Evaluation of 2015 and Prospects for 2016: North Korean Economy



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IFES will publish four issues of Issues and Analysis with the theme of “The Evaluation of 2015 and the Prospects for 2016. These four issues include this week’s “North Korean Economy” and “Korean Peninsula Affairs” and “Inter-Korean relations” will be featured in the following weeks. Last week covered “North Korean Domestic Politics.”

In the recent years, there are two alternating views on the assessment of the North Korean economy. These two views diverge in terms of evaluating the North Korean economy: one view sees relative improvement, while the other still sees stagnation. This debate is also directly connected with the reliability of North Korea’s GNI (Gross National Income) estimates of the Bank of Korea, and North Korea’s marketization (or informal economy) stands in the middle of this dispute.

According to the Bank of Korea estimates, while North Korea has repeatedly experienced negative and positive growth since the late 2000s, it has demonstrated a positive growth for four consecutive years from 2011 to 2014. Even so, this growth rate is only about 0.8 to 1.3 percent.

However, some experts argue that Bank of Korea estimates fail to include informal market activities that have significantly increased over the recent years. Therefore, the North Korean economy is likely to be doing better than what the Bank of Korea estimates and the economic growth rate is likely to be 1 to 2 percentage points higher. On the other hand, experts that are passive on North Korean marketization generally accept the bank estimates and argue that it reflects economic stagnation.

The two main factors that are driving the North Korean economy in the recent years are Sino-DPRK trade and marketization. When these two factors move in the same direction most North Korea experts are generally in agreement. However, when they move in opposite directions, it raises disagreement as witnessed in the evaluation of 2015. The problem is while Sino-DPRK trade is captured by statistics, marketization is not and this asymmetric nature of the two components fails to narrow the gap between these conflicting views.

At this point, it may be helpful to take a look at the North Korean economy by sector. According to the FAO and WFP reports, North Korea’s food production increased from 4.5 million tons in 2010 to 5.03 million tons in 2014, a boost of 53 million tons or 11.8 percent. However, the food production of 2015 comes with warning signs. In the first half of this year, North Korea suffered from a severe drought, which is raising concerns about the negative impact on this year’s food crop. FAO estimates that North Korea’s food production is likely to be reduced by 14 percent against the previous year, and eminent domestic experts on North Korean agriculture expect to see a decrease by 10 percent.

According to the Korea Trade-Investment Promotion Agency (KOTRA) Sino-DPRK trade hit a record high in 2014 with 6.86 billion USD in trade volume. However the increase rate was only about 4.9 percent while North Korea’s exports to China decreased by 2.5 percent from last year. In addition, North Korea’s major export items, coal and iron ore, showed a decline of 17.7

percent and 25.7 percent, respectively, in 2014. Moreover, North Korea-China trade in the first half of 2015 declined sharply in both exports (10.6 percent) and imports (15.8 percent). While the exports of coal declined slightly by 1.6 percent, exports of iron ore fell a whopping 70.3 percent.

As North Korea is experiencing difficulties in generating foreign exchange earnings from dwindling exports to China, it is turning to expanding tourism to attract foreign visitors and sending workers overseas to China and Russia. However, whether these efforts have achieved desired results remains unknown.

Movements in market prices and the exchange rate are relatively stable. After three years of monetary revaluation was carried out in December 2009—from 2010 to 2012—North Korea has suffered a sharp rise in inflation and exchange rates. However, the price of rice from January 2013 to early December 2015 was under 6,000 KPW per kg, showing a stable trend, as well as the exchange rate at 9,000 KPW per USD.

To witness three years of stable prices and exchange rates is an unusual phenomenon. Furthermore, whether this is the result of policy change from the North Korean regime is a question being asked. North Korea experts are suggesting various interpretations for this outcome such as the decrease in circulation of North Korean currency from rapid progress of dollarization; rice production increase and release of reserved rice; advancement in marketization that improved storage and distribution system for rice; and North Korea's effort to suppress runaway inflation. Despite these explanations, there is no uniform view on the source of this change.

Meanwhile, since 2010, North Korea's market has been picking up speed once again. In fact, a difference can be seen from the end of the Kim Jong Il regime to right after the launch of the new Kim Jong Un regime. The North Korean authorities continue to intervene in the market in various forms and are attempting to incorporate the market within the formal institutions, which is driving the growth of the market at the same time. The mobile phone and real estate markets are key example of this.

Definitely, North Korea is not promoting marketization in the public dimension like China did with legal and systemic institutional support. However, one cannot claim that there are no legal or institutional framework, as this is not completely an unofficial policy. One prime example of this is private ownership of means of production, which is strictly forbidden by law, but is reportedly permitted under the condition that it is incorporated into state institutions or enterprises. The pertinent institutions and enterprises lend their names to allow private ownership of means of production, granting them partial legitimacy, and are in fact collecting tax from these companies. These policies reveal a “socialist hat”—also called a ‘grey zone’ policy—and this is a characteristic of North Korean marketization and North Korean reform.

An indication that Kim Jong Un's policy may be more than simply permissive is “our-style economic management methods.” This is also called the May 30 measure which refers to a measure that significantly permits illegal or semi-legal activities related to farm and factory operations in the market. This allows the North Korean regime to leverage the market more actively and is providing a positive environment for marketization to gain momentum.

Overall, after the launch of the Kim Jong Un regime in 2012, the North Korean economy maintained a slow growth trend until 2014. Therefore, those experts that positively evaluate marketization claim that the economy has demonstrated relative improvement during this period; experts passive toward North Korean marketization still evaluate the economy as having trouble despite the positive growth.

However, something somewhat different appeared in 2015. With time, negative factors are beginning to surface and have become more noticeable. First of all, there is a possibility that food production will be lower than last year. In addition, there is a greater factor of trade. The Sino-DPRK trade—the greatest means by which the North earns foreign currency—has declined sharply. In particular, prospects for mineral exports such as coal and iron ore look bleak with the

decrease in demand from the slowdown in the Chinese economy. In response to this, North Korea has expanded tourism to attract more foreign tourists and increased the number of overseas workers. Domestically, the variety in service facilities in dining, leisure, and entertainment is showing an increase. Moreover, new markets are being created domestically for the middle and wealthy classes in attempt to absorb their foreign exchange reserves -- also known as “domestic foreign exchange earnings.” However, there is no information available to determine how much these new foreign exchange earnings methods could make up for the declining earnings from natural mineral exports.

However, positive factors also exist. Market prices and exchange rates have stabilized. In particular, despite the speculation that this year’s food production will decrease compared with the previous year, this has not affected the price of rice (until early December 2015) even after the fall harvest has ended. The source of this phenomenon remains a mystery. Moreover, North Korean marketization has been more resilient in 2015. The decline in the trade sector is likely to have an adverse impact on the market, but this is yet to be observed.

Thus, positive and negative factors coexist and intersect in the North Korean economy in 2015. Unfortunately, there is no concrete basis to determine which factors are greater. However, experts that are passive on North Korean marketization are likely to emphasize the negative aspects while those that are positive on North Korean marketization are likely to emphasize the positive aspects.

In terms of negotiation and compromise, the North Korean economy in 2015 will not be significantly worse than 2014. Or North Korean economy in 2015 may or may not differ much from 2014. Some observers even suggest the possibility of North Korea to have entered a recession but this claim may be too hasty.

Suggesting prospects for the North Korean economy in 2016 is not an easy task. However, in terms of the direction of economic policy, North Korea is unlikely to officially announce opening up and reform like the Chinese case. It is likely that North Korea will continue to quietly pursue “North Korean-style reform and opening up” for the time being.

In the upcoming 7th Party Congress scheduled for May 2016, there is surely to be attention paid to the economic sector. However, it may be difficult to escape from the theoretical and abstract. Of course, there is a high possibility North Korea will include measures to improve the people's living standards; but at the same time, references to adhere to the principles of socialism will certainly appear. It is possible that the regime will present a new and original vision for the economic sector. However, specific strategies are not very likely to appear. On the other hand, it is still uncertain whether there will be new measures that go beyond the current measures, or announcement of a dramatic action, such as expansion, advancement, or complete enforcement of the “our style economic management method” that focuses on autonomy and incentives.

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