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NORTH KOREA ECONOMY RESTRUCTURING THE ECONOMY OF DPRK: UNAVOIDABLE RISKS

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The prospects for the North Korean economy meeting Kim's New Year's demand that "...we should bring about an upturn in improving the people's living standards"¹ looked dim at the start of 2015. The self-imposed Ebola tourism ban lasted until April, cutting off a major foreign exchange earner.² In the first quarter, there were reports that North Korea faced a severe drought that would cripple hydro-electricity production and agriculture in 2015.³ The former may have happened – no-one knows although power shortages appear to be as severe as ever, forcing

the conversion of a ten electric trains to diesel and providing incentives to develop renewable energy sources.^{4,5} To what extent sanctions imposed after the January 2016 nuclear test and the February rocket launch may affect coal production and oil, especially refined products, imports, remains unclear. China has announced that it intends to implement a ban on exports of jet fuel to the DPRK, for example.⁶ However, we are skeptical that this will be a stringent application.⁷ Conversely, agriculture appears to have had a bumper crop

¹ Kim Jong Un, "2015 New Year's Address," *op cit*.

² A. Fifield, "After four months, North Korea's Ebola quarantine comes to an end," *The Washington Post*, March 3, 2015, at: https://www.washingtonpost.com/world/after-four-months-north-koreas-ebola-quarantine-comes-to-an-end/2015/03/03/3ab34415-3b35-4159-b70b-321167635b73_story.html

³ "North Korea says it faces worst drought in a century, BBC, June 7, 2015, at: <http://www.bbc.com/news/world-asia-33160768> and Anna Fifield, "Dry winter sparks fears of another food crisis in North Korea," *The Washington Post*, December 23, 2014, at: http://www.washingtonpost.com/world/asia_pacific/dry-winter-sparks-fears-of-another-food-crisis-in-north-korea/2015/02/04/b1c218a0-a0e7-11e4-91fc-7dff95a14458_story.html

⁴ Radio Free Asia, "North Korea Resorts to Diesel Locomotives to Deal with Rail Power Shortage," April 9, 2015, at: <http://www.asiabulletin.com/index.php/sid/231776805>

⁵ D. Von Hippel, P. Hayes, "Private Purchases of Solar Photovoltaic Panels in the DPRK: Signs of Green Energy Growth on the Way?" *NAPSNET Policy Forum*, January 13, 2015.

⁶ M. Martina, D. Stanway, "China announces restrictions on trade with North Korea," Reuters, April 5, 2016, at: <http://www.reuters.com/article/us-china-northkorea-idUSKCN0X20U4>

⁷ P. Hayes, D. von Hippel, R. Cavazos, "SANCTIONING KEROSENE AND JET FUEL IN NORTH KOREA", *NAPSNet Policy Forum*, March 10, 2016, <http://nautilus.org/napsnet/napsnet-policy-forum/sanctioning-kerosene-and-jet-fuel-in-north-korea/>

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in 2015, largely due to Kim’s apparent encouragement of a dramatic increase in the private share of agricultural production (reportedly up to 30-70 percent),⁸ and the service sector appears to have grown quickly in the major cities, along with economic inequality and even conspicuous consumption at restaurants and other approved sites. Thus, Kim can fairly claim to be bringing about “an upturn in improving the people’s living standards.” Larger-scale formal markets have remained fairly consistent in size and operation over recent years, especially in port, southern, and northern border cities.⁹ Private home-based and street corner service and goods vendors are not captured in this data but are likely expanding rapidly and flexibly, according to supply and political conditions on a daily basis. Although Kim’s on-the-spot guidance focused on “economic construction *decreased* from 28 percent in 2014 to 22 percent in 2015, he highlighted food production or the service sector on these visits, such as terrapin, catfish, or vegetable producers.¹⁰

⁸ A. Lankov, *op cit.* .

⁹ See B. Katzeff Silberstein “Growth and Geography of Markets in North Korea: New Evidence from Satellite Imagery,” US-Korea Institute at SAIS, October 2015, at: <http://uskoreainstitute.org/wp-content/uploads/2015/10/USKI-NewVoices-BKS-Markets-Oct2015.pdf>

¹⁰ Data from January 1 to November 5, 2015 were compiled from 143 field visits reported by the KCNA website at: <http://kcna.kp> or at “Supreme Leader’s Activity” by Rodong Sinmun (which is accessible to those inside North Korea) at http://rodong.rep.kp/en/index.php?strPageID=SF01_01_02&iMenuID=1&iSubMenuID=1 Overall, Kim’s political (including meeting delegations and expanded party meetings) were up slightly at 30 events (15 per cent); national defense (including listening to KPA chorus groups or factory visits, 57 events or 27 per cent; economic construction (such as dams, power plants), 44 events or 22 per cent; and cultural construction (including visits to education, health, welfare sites), 75 events or 37 per cent (rounding errors sum to 101 per cent).

Table 1: Kim Jong Un’s On-the-Spot Guidance 2015

| Activity | 2015 through Nov. 5, 2015 | 2014 through Nov. 5, 2014 | Change from 2014 to 2015 |
|---|---------------------------------|--|--------------------------------|
| Total Activities & Appearances according to Rodong Sinmun as of 5 November of year | 143 | 141 (NOTE: Kim Jong-un absent for 40 days in 2014) | +2 |
| Total components of activities and appearances contributing to one or more categories | 203 | 197 | +6 |
| Economic Construction | 44 / ~22% | 55 / 28% | -11 |
| Cultural Construction | 75 / ~37% | 72 / 36% | -3 |
| National Defense | 57 / ~27% | 59 / 30% | +2 |
| Political | 30 / ~15 % | 11 / 6% | +19 |

Source: Authors’ estimate, compiled from 143 field visits reported by the KCNA website at: <http://kcna.kp> or at “Supreme Leader’s Activity” by Rodong Sinmun (which is accessible to those inside North Korea) at http://rodong.rep.kp/en/index.php?strPageID=SF01_01_02&iMenuID=1&iSubMenuID=1 Overall, Kim’s political (including meeting delegations and expanded party meetings) were up slightly at 30 events (15 percent); national defense (including listening to KPA chorus groups or factory visits, 57 events or 27 per cent; economic construction (such as dams, power plants), 44 events or 22 per cent; and cultural construction (including visits to education, health, welfare sites), 75 events or 37 per cent (rounding errors sum to 101 per cent).

The ROK’s Bank of Korea estimated growth in 2014 at 1 percent, but this seems low given reports from visitors to the DPRK.^{11,12} Some suggest that real growth may

¹¹ The Bank of Korea, “Gross Domestic Product Estimates for North Korea in 2014,” July 17, 2015, <http://www.bok.or.kr/contents/total/>

be as high as 4 percent although this rate may not be sustainable in the face of declining terms of trade with China for coal exports,¹³ and the continuing but limited implementation of unilateral and multilateral sanctions on North Korean trade financing and exports such as light arms.¹⁴ Moreover, the Special Economic Zones announced in 2014 remain more conceptual than real – it does not appear that any Party or Organisational Secretaries (sine qua non requirements for demonstrating true support - are in charge of the areas. Even the long-established zones such as Rason lack basic infrastructure needed to attract foreign investment.^{15,16}

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http://www.bok.or.kr/down.search?file_path=/attach/eng/1959/2015/07/1437100417996.pdf&file_name=GDP_of_North_Korea_in_2014_ff.pdf

¹² Yonhap News Agency, “North Korea Newsletter No. 372, July 23, 2015,” July 23, 2015, <http://english.yonhapnews.co.kr/full/2015/07/22/84/120000000AEN20150722006800325F.htm>

¹³ M. Noland, “North Korean Growth in 2014: Once More with Feeling!” North Korea: Witness to Transformation blog, July 27, 2015, at: <http://blogs.piie.com/nk/?p=14320> and “North Korean Coal Exports to China: Resurrected,” North Korea: Witness to Transformation blog, July 23, 2015, at: <http://blogs.piie.com/nk/?p=14306>

¹⁴ US General Accounting Office, *NORTH KOREA SANCTIONS United States Has Increased Flexibility to Impose Sanctions, but United Nations Is Impeded by a Lack of Member State Reports*, GAO-15-485, May 2015, at: <http://www.gao.gov/assets/680/670170.pdf>

¹⁵ T. Clément, “How Not to Invest in a DPRK Special Economic Zone: The Case of Rason,” *Sino NK*, July 15, 2015, at: <http://sinonk.com/2015/07/15/how-not-to-invest-in-a-dprk-special-economic-zone-the-case-of-rason/>

¹⁶ R. Cavazos, D. von Hippel, “Supplying Energy Needs for the DPRK’s Special Economic Zones and Special Administrative Regions: Electricity Infrastructure Requirements,” *NAPSNet Policy Forum*, August 19, 2014, <http://nautilus.org/napsnet/napsnet-policy-forum/supplying-energy-needs-for-the-dprks-special-economic-zones-and-special-administrative-regions-electricity-infrastructure-requirements/>

Also, Chinese trade is down in the first three quarters of 2015 by as much as 17 percent by one estimate (due as much to China’s economic downturn as to DPRK-specific factors affecting its exports).¹⁷ Chinese investment has cooled off although it remains important in the DPRK mining sector. Due to its unwillingness to share basic economic data, in February 2015 China rejected North Korean entreaties to admit the DPRK to the China-led Asian Infrastructure Investment Bank (AIIB)--a severe blow to the DPRK’s prospects to gain substantial institutional investment in the DPRK’s economy.¹⁸ Thus, negative external trends may have ensured that Kim’s New Year’s call to “get rid of the proclivity to import”¹⁹ was fulfilled without much domestic effort, albeit at a high social and economic cost. The decision in February 2016 by South Korea to terminate the Kaesong Industrial Complex will only intensify this inward turning dynamic in the North.²⁰

Future Prospects

The DPRK is positioned to exploit its location for rapid growth based on rapid construction of infrastructure that completes connection of Eurasian-Russian and Chinese telecom, rail, road, logistical, pipeline networks and power grids with the ROK and Japan.²¹ It should be

¹⁷ K. Gray, “China isn’t about to abandon North Korea,” *East Asia Forum*, September 29, 2015, at: <http://www.eastasiaforum.org/2015/09/29/china-isnt-about-to-abandon-north-korea/>

¹⁸ E. Shim, “China rejects North Korea request to join Asian Infrastructure Investment Bank, China said North Korea’s economic fundamentals and financial condition disqualify Pyongyang from membership in the new bank,” UPI, March 31, 2015 at: http://www.upi.com/Top_News/World-News/2015/03/31/China-rejects-North-Korea-request-to-join-Asian-Infrastructure-Investment-Bank/4481427814172/

¹⁹ Kim Jong Un, “2015 New Year’s Address,” *op cit*.

²⁰ J. McCurry, “Seoul shuts down joint North-South Korea industrial complex,” *The Guardian*, February 11, 2016, at: <http://www.theguardian.com/world/2016/feb/10/seoul-shuts-down-joint-north-south-korea-industrial-complex-kaesong>

²¹ Won-Bae Kim, “Design of Infrastructure Development in North Korea: A Practical Approach,” presentation, DPRK Energy Experts Working Group, Nautilus Institute, Beijing, March 2008, at: nautilus.org/wp-content/uploads/2011/12/WBKim.ppt



able to extract substantial rent from the avid desire of China's three northeastern provinces to transit the Peninsula and use eastern ports to ship goods to and from Japan and beyond, avoiding crowded ports in China itself. As a northeast extension of China's vast economic and maritime silk belt projects,²² the North could gain substantial income to offset its trade deficit with China. This might even induce China to invite the DPRK to join the AAIB.

However, until the DPRK decides to restructure its internal economy – really three separate but overlapping economies run by the military, the line agencies, and the

party respectively, all in service of the central leadership that then allocates goods and services to individuals based on a loyalty system – the requisite markets to support such integration will be absent and the economy will languish. Meanwhile, Kim Jong Un has to ride the domestic tiger in the DPRK's mountains by reconciling the limited market system that substituted for the failed central economy with the *de facto* emergence of alternate power centers within the Supreme Leader system based on wealth accumulation from these markets and the generation of revenues within control system itself.

²² National Development and Reform Commission (NDRC) of the People's Republic of China, "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road", March 28, 2015. http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html