

## North Korea's Unofficial Market Economy and its Implications

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### I. Introduction

Amidst the rigid command economy of North Korea, there exists an unofficial yet flourishing market economy, currently operated through *Jung Ma Dung*, or literally a market place. Of course, a market place is a common feature of even the poorest country in the world and does not require special scrutiny. Yet to North Koreans who have been hitherto completely accustomed to government rationing for all their economic necessities, an economic activity for personal *profit* is a completely new and almost revolutionary concept. More importantly, the market place in the north has been gradually developed, with strenuous public oppression at the beginning, by a dire need for physical survival of its ordinary people. Without precedence and knowledge, they established, purely through trial and error, every aspect of the market place best suited for the existing peculiarities and constraints of its economy. Now the market place is so widely and firmly established, with the participation of practically everybody in North Korea, ranging from high government officials to common soldiers, that no power, including the leadership itself, can completely shut it down without causing a major revolt, especially by starving and desperate soldiers with weapons to wield, reminiscent of the October Revolution in czarist Russia.

Currently, the market place is the only force which prevents total collapse of the North Korean economy, and it will continue to grow of its own momentum despite occasional feeble suppression by the government. Due to the complete lack of an official economic policy, the growth of the market place by its people will definitely set the future direction of North Korea's economy. Therefore, it is very important for us to monitor its progress, and if possible, render appropriate assistance for its acceleration. The existence of a reasonably well-functioning market economy in North Korea will greatly facilitate reunification of the two Koreas without an enormous cost, which is estimated to range between U.S.

\$200 billion and \$1 trillion, as well as a serious delay experienced in the German reunification.<sup>1</sup> With objectives in mind, this article attempts to analyze the current operation of the market place and the optimum external economic assistance necessary to expedite North Korea's progress toward a complete market economy.

## II. Failure of North Korea's official economy

The market place of North Korea is a direct by-product of a failure of its official economy, some of the fundamental defects of which are discussed in this section. Notwithstanding the ubiquitous official slogan of "*Juche*" or economic self-sufficiency, North Korea's economy from its inception heavily relied upon economic aid from its socialist allies, especially food from China and whole industrial plants from the former U.S.S.R. These two countries provided for the total crude oil needs of North Korea at a heavily subsidized price in exchange for its raw materials and crudely processed goods. The amount of aid significantly increased after the armistice of the Korean War when the country embarked upon reconstruction of its completely devastated economy. In addition, North Korea also managed to secure from industrialized countries a large amount of long terms loans, \$12 billion of which defaulted in 1998. Korean residents in Japan sympathetic to North Korea also transmitted about 60 billion *yen* annually to North Korea as an outright gift, although some sources contend that the actual amount was three times larger than that figure.<sup>2</sup>

As the infant industry syndrome attests, continual and substantial outside aid ruins the economy of a recipient country, mainly because the economy has to remain *under-developed* in order to receive aid. A modern example of this predicament is in southern Italy known as *Mezzogiorno*, to which the government of Italy channeled a huge and continuous economic aid after the Second World War, without any desired improvement in its economy. This dilemma coined a new word known as *Mezzogiornoism* in order to emphasize the futility of continuous economic aid.

In the case of North Korea, prolonged external aid ruined the economy principally by enabling its leadership to practice a totally irrational policy of "on the spot" economic guidance, solely on the basis of personal instinct or inspiration. That guidance is a command that must be immediately implemented even at the cost of

an interruption of other ongoing important projects. Even a slight hesitation or question on the guidance is viewed as a sign of the lack of absolute loyalty to the leadership, with grave consequences for the offender.

At the beginning of economic reconstruction with almost unlimited opportunities for worthwhile investment, any randomly selected project would have become a success, and some of the leadership's "on the spot" guidance did accomplish spectacular yet temporary economic successes. These successes reinforced a vision of the leadership's singular prowess to the people as well as to the leadership itself, and encouraged further applications of such guidance. On the other hand, if a project failed, the leadership could always appeal for more outside aid on the pretext of some natural calamities beyond its control. In fact, North Korea's reliance on external aid has become almost an integral national policy even today. During 1995 and 1998, North Korea received \$1 billion of humanitarian food aid from various non-government organizations around the world, in addition to \$200 million of annual food aid from China. The South Korean government also provided North Korea with a large quantity of food and fertilizer under terms of a 30 year loan with 1% annual interest, yet without any realistic expectation of repayment.<sup>3</sup>

We may cite two major economic blunders in North Korea. First, recent catastrophic food production in the north can be directly attributed to the leadership's earlier irrational policy. To increase the size of arable land, North Korea undertook mammoth projects known as the "Nature Remaking Projects" in 1976 and the "Four Great Nature Remaking" in 1981, which attempted to convert, through mass mobilization of the military and students, mountains and hills into arable land by cutting trees and bushes. As a consequence, almost 80% of the mountains in North Korea are now totally denuded of trees.<sup>4</sup>

Such terrace farming is a popular practice in countries with mild weather. In North Korea, however, rain falls most intensively during the two months of July and August, which coincide with the period of the final growth of crops. Without trees and bushes to retain water, even mild rain washed down crops, as well as dirt and even boulders, from the terraces and seriously damaged the growing crops in the farmlands below. Worse yet, after several decades of this predicament, debris from the terraces accumulated at bottoms

of rivers and agricultural reservoirs, which in turn significantly raised these bottoms and reduced their capacities to retain water. Now, even mild rain or drought causes severe flooding or a shortage of water for irrigation. As a consequence, agricultural production has steadily declined ever since the introduction of the Nature Remaking projects.<sup>5</sup>

The second example of a fundamental defect is the current acute shortage of electricity. For the beautification of major cities, all electric supply wires were ordered to be buried underground, as has been done in Paris. Such a major project requires a meticulous engineering plan, with comprehensive blueprints preserved for posterity. Yet in North Korea, always emphasizing speed to demonstrate maximum loyalty to the leadership, electric wires were covered simply by plastic casings and buried under the streets. Over the years, the plastic cracked and water seeped in, causing up to a 70% loss of electricity in traveling from a power plant to the final users.<sup>6</sup> Due to the hasty execution of the project, there does not exist any record for the exact location of the buried wires, and spot checks and repairs of damaged casings or wires are currently not possible.

This is a typical mode of operation of the North Korean bureaucracy. Once a project has been hastily completed and the person in charge is promoted and transferred to another duty, the person is no longer responsible for the earlier project and sees no need to make detailed records for posterity. On the other hand, a new person can claim innocence for any inherited errors. Thus, there is no accountability for any failure, except for failure to achieve an assigned production quota. Since the leadership, the originator of a failed policy, is presumed to be wholly infallible and cannot be held accountable, the country simply tries to mask, instead of rectifying, the existing economic defects, and over years, these defects with the resultant economic inefficiency and catastrophe simply multiply. For example, instead of replacing cracked wires and their casings, the major source of electricity loss, North Korea has simply built more power plants with aid from its allies, because replacing the buried wires attests to a failure of the leadership's policy, and no one dares to suggest that. Yet, with the current severe leakage in the supply system of electricity, building new power plants is literally the equivalent of pouring water in a bucket with a big hole.

These examples typify the general tenor of North Korea's totally uncoordinated and unscientific mode of operation from the highest to the lowest level of its economy, which the country tries to justify as "our own way of socialism." Until and unless the leadership honestly admits and corrects the fundamental defects of previous economic policies, there will be no genuine improvement or progress in the official economy, especially the current dire shortage in food production. As the official economy of North Korea continues to deteriorate and recedes from the main stream, the void will be filled by the unofficial economy of the market places, and it is important therefore to monitor the future development of North Korea's market economy.

### **III. Operation of the market economy.**

Throughout North Korea, there exist about 350 market places which currently carry out flourishing businesses devoid of government sanction yet with its tacit tolerance. With more than 500 different commodities available, it provides 90% of the daily necessities for the ordinary people, for whom the government stores have nothing but empty shelves. This predicament has coined a new phrase in North Korea that the government store is for the elite, and the market place is a true store for the ordinary.<sup>8</sup>

To appreciate how important the market place in North Korea's economy is, we may discuss the main sources of goods supplied to the market.

First, the largest commodity is farm products from farmers' private gardens and illicit mountain farms. To encourage food production, North Korea in 1998 permitted each farmer a private garden plot, officially known as "the land belonging to private residence," 30-40 *Pyong* in size, or about .03 acre. Outputs from these plots are the private property of individual farmers. Understandably, farmers exert major efforts, as well as part of the model seeds and fertilizer allocated to their collective farms, into their garden plots, and, consequently, outputs as well as the quality of products from these plots per given size are significantly higher than the outputs of their collective farms. In addition, the opportunity to grow food for personal *profits* has encouraged many farmers to cultivate secret farmlands hidden deep in the mountains, to which a large portion of the resources from their collective farms is diverted to grow food for personal gain. This practice is so

pervasive that still another new phrase has been coined in North Korea: "in our country, food comes from the mountains rather than from the farms."<sup>10</sup> Farmers sell in the market surplus food beyond their personal needs at prices 1,000 times higher than the official prices at *empty* government stores. For example, the official price of one kg of rice is 8 cents, whereas its market price is around 90 *won* (one *won* equals 100 cents), equivalent to almost the average monthly salary of a worker. This means that a worker can purchase about one kg of rice per month with his/her monthly salary alone and must therefore find other means to acquire the bare minimum amount of food for survival. Those without other means simply perish from starvation. In fact, old parents living with their offspring often voluntarily vanish in order to lighten their children's burden.

It is true that in July 2002, North Korea undertook major changes in its domestic price and wage structures to make them more realistic. The official price of rice increased from 8 cents to 44 *won*, and a workers' monthly salary was raised from 110 to 2,000 *won*." At first glance, these changes may seem to have represented a significant improvement in the welfare of the average worker. This would be true only if workers could purchase their basic needs at official prices. As mentioned, government stores for ordinary workers are bare of basic necessities due to the man-made catastrophe of food production, and consumers have had to resort to the market places. Without a significant increase in domestic food production, workers with more *paper* money will simply drive up the market prices, and the disparity between the new official and the actual market prices of rice, as well as other basic necessities, will quickly revert to previous levels within a matter of months. In fact, in the former socialist economies, an excess of paper money held by average workers due to shortage of available goods at a government store was a very common phenomenon, known as "money hangover," and it contributed to an enormous inflation in black market prices.

The second source of supply at the market is various household goods sold by city dwellers in order to purchase basic necessities. They sell used household goods such as sewing machines, bicycles, blankets, clothes, or even a whole house.

When the supply of these goods is exhausted, people simply steal any marketable goods from private or public sources.

For example, there are practically no glasses on passenger trains in North Korea, because all glasses are stolen to be sold in the market. If a car, even a military vehicle, is left unattended on the street even for a short period of time, any removable parts, such as mirrors, windshield wipers, the horn, even a steering wheel, are quickly removed to be sold in the market. Due to the complete lack of new replacement parts for vehicles and machines, there is a great demand for such stolen parts. Vehicles or machines with stolen parts need other stolen parts as replacements, thus creating an endless and vicious cycle. In fact, the streets of North Korea are the cleanest in the world, simply because anything thrown away with any value at all, such as cigarette butts or a piece of paper, is quickly retrieved for personal use or for sale.<sup>13</sup>

Major buyers of household goods from city dwellers are farmers with surplus food. The market place with enormously inflated food prices has significantly increased farmers' incomes in recent years, while the *real* income of the urban sector has plummeted due to the stoppage of government food rationing at substantially subsidized prices. There is irony in this development. At an early stage of North Korean economy, the standard of living of the rural sector was significantly lower than that of the urban sector. Its leadership designated as a priority the improvement of farmers' incomes to a near parity with the urban sector, and, for this purpose, introduced several large-scale farm projects through the mass mobilization of students and soldiers, yet all ended in failure, as would have been expected by rational analysis.<sup>14</sup> As a consequence, farmers became worse off than before. On the other hand, only the total failure of the leaders' economic policy accomplished his original intention *indirectly* through the current illicit market place. One could have hoped that the current leadership, realizing an enormous advantage of farming for profit rather than for quotas, would have introduced a major reform at least in the rural sector by abolishing most of the grossly-inefficient large co-ops. Instead, the leadership has simply tolerated the introduction of piecemeal private garden plot within the co-op system, basically a bandage approach for a major wound. The third source of supply for the markets has been civilian factories and their workers. Since payment of workers' salaries by the government has been very erratic in recent years, often with a long period of complete stoppage, factory supervisors are compelled to

fill the gaps by paying the workers with goods produced in their factories as wages. The workers in turn sell these goods in the market. More enterprising factories resort to making marketable household goods, which may be totally different from their officially designated products, from any available raw materials, including the government's meager rations. In fact, this clandestine operation has been inadvertently encouraged by an earlier economic policy. In 1980s, North Korea introduced the so-called "August Third People's Consumer Goods Program." Individual factories, large or small, were mandated to recycle their discarded scrap raw materials into any type of consumer goods for their workers. Understandably, this campaign provided a considerable work incentive and was one of the very few successful economic policies of North Korea.<sup>15</sup> Nowadays, factories simply treat most of their raw materials as scraps to be converted into consumer goods. For example, a bicycle factory makes from its *scrap* materials iron pots and pans to be sold in the market. This practice of wage payment by goods has encouraged widespread theft by workers of the raw materials, as well as small equipment and factory machinery, to be sold in the market. This form of theft has created a specialized international trade. There are vendors who buy only factory machinery of North Korea to export to Chinese factories near the border.

The fourth source of goods for the market has been provided by a horde of small merchants, mostly housewives known as "bundle merchants." They roam around the country with their rucksacks, carrying semi-manufactured household goods from cities to distant farm households in order to barter for food, which is in turn sold profitably in urban markets. Activities of the bundle merchants have become increasingly sophisticated. On each business trip, they attempt to ascertain *what* urban goods are most wanted by farm households in any *particular* location. The merchants then try to find out, often through word of mouth rather than hard facts, which cities can supply such goods at the lowest price, and they journey to the places often on foot for weeks, or through some totally unreliable mode of transportation. Whenever they see a truck, either civilian or military, going in the general direction of their destination, they simply wave goods to be offered as fares for a ride. Examples might be several packs of cigarettes or a bottle of alcohol. If a driver feels that the goods are adequate fare,

he takes the merchants where he is going. To reach their ultimate destination, the merchants, have to repeat these acts several times, or, if unlucky, they rely solely on their feet. For the return trip to their home towns, they have to repeat the same agonizing procedure in reverse. Practically all these merchants lack official travel permits, especially for those far distant destinations from their domiciles. So either they simply bribe security personnel at each check point en route to their final destinations, or clandestinely they go around the check points. Especially at these major check points, there are several security personnel from different branches of the government and the Party. Either the merchants have to pay very hefty bribes, or, if any of the personnel is not in a mood to accommodate the merchants, often due to erratic and random directives from above, the merchants may end up in jail for months with all their goods confiscated. Thus, the activity of the roaming merchants is a very risky business, and the price of food that they bring to urban markets must be high enough to cover these potential dangers. Yet, the contribution of these housewife merchants to the survival of their families is significantly greater than the salaries earned by their husbands. Without these merchants, the amount of starvation would definitely have increased above its current levels, and therefore, these merchants play a very important role for preventing the total collapse of North Korea's economy.

The fifth supply source involves market activities directly undertaken by individual factories for the following three objectives. First, pursuant to the government's recent decree that providing food to workers is now the direct responsibility of individual organizations, many factories have designated one of their workers as "director of rear supply of food" in order to distinguish the person from director of government supply of food, which is almost non-existent nowadays.<sup>16</sup> The responsibility of the rear director is to obtain food and other daily necessities from whatever sources and means his ingenuity allows within a very fluid legal boundary that the organizations prefer not to know about. All they require are the results. The means available for the director include the utilization of the organization's vehicle with its precious gasoline as well as a travel permit normally not sanctioned for such purposes. Many individual factories, especially successful ones, conceal part of their quality products, after satisfying their production quotas with poor quality products, to be used for their workers. The rear

director clandestinely sells these products and then purchases daily necessities for his organization, often each transaction occurring at distant and different market places where prices are better. Thus, a truck with an official permit for long distance travel is a prerequisite.

A more enterprising rear director may also expand his commercial activity to organizations other than his own. The director contacts, often with significant bribes because there are many competing rear directors, heads of other organizations, including the military, in order to ascertain what surplus products they can spare and what products they wish to obtain in exchange. With this knowledge as well as a verbal contract, the director undertakes multiple transactions, either through barter or the market place, until the desired goods are obtained and delivered to individual organizations. From each transaction, the director profits either in goods or cash, most of which are used to procure daily necessities for his own organization. Yet, the director retains part of the profits, most likely clandestinely, as his own reward. As a consequence, a successful director can accumulate significant personal wealth normally unheard of in North Korea. For example, one such director, forced to defect to South Korea because of jealousy for his enormous success by other directors in his district, had several color television sets, two houses, and a large cache of hard foreign currencies which he profitably used as bribes to escape from the north.<sup>17</sup>

The second objective of an individual organization in participating in the market place is that the government rationing of raw materials, even to essential factories such as for armaments has not only been unreliable in recent periods but has also been totally uncoordinated and irrational when it has occurred, so that individual factories may receive raw materials completely unrelated to their main products. To acquire the proper raw materials, individual factories must exchange between themselves, either through barter or in the market place. For example, an ammunition factory was supplied with industrial diamonds not required for its product, and the diamonds were simply kept in its warehouse. At the same time a ship repair factory urgently needed diamonds but was not supplied with them. Through a middleman, the ship factory learned about the existence of the diamonds at the ammunition factory, and an exchange was arranged between the dried fish of the ship factory and the diamonds. For smaller raw materials, direct market

transactions are more common forms of exchange.<sup>18</sup>

The third objective is small scale foreign trade directly engaged in individual organizations. The major imports of North Korea, such as motor vehicles or construction machinery, are directly, albeit extremely inefficiently, controlled by the central government.<sup>19</sup> The distribution of hard currencies must have the personal approval of its leadership, which is almost impossible to obtain for individual factories, especially those far away from the capital city. Urgently needed foreign repair parts or machinery, must be imported by the individual factories themselves, which requires them to raise a sufficient amount of hard currency through market activities. At major harbors throughout North Korea, there are merchants, often foreigners, who are ready to pay hard currencies for North Korean exportable commodities. With information obtained from these merchants about the currently most desirable export commodities, individual factories convert their products into such exportable commodities either through multiple barter or market transactions. Final products are brought to the export merchants for hard currency. For example, a tire factory needed foreign replacement parts. It identified cocoons for silk as the most valuable export good. The factory arranged a barter between its tractor tires and cocoons from an agricultural co-op. The cocoons were then sold to the export merchant for hard currency.<sup>20</sup> Most of these transactions are carried out without official records, and thus are liable to unintentional as well as intentional errors by the middlemen.

The sixth source of goods for the market place involves goods obtained as bribes which are, in turn, sold in the market, especially luxury imported goods such as cigarettes or alcohol, the most expensive being British *Dunhill* and *Couvoisier*. The fact that there are civilian demands for these expensive luxury goods in the midst of a wide-spread dire poverty and starvation points out two undisputable facts about North Korean society. Since foreigners in North Korea can directly purchase these goods at much lower prices at special stores for foreigners, market demands for these goods must have come from the elite of North Korea. This means that the elite actively participate in market places. More importantly, since the market price of imported cigarettes is almost equivalent to a monthly salary of the average worker, *real* income distribution between the elite and the average workers in North Korea is

extremely skewed, so that the elite can afford to smoke away in one day the whole monthly salary of an average worker.

Bribery is so rampant that it is almost an accepted norm of every day activity. For example, to move by train government rationed food from a distribution center even to a privileged armament factory, bribes must be given to practically all individuals involved with the train's movement, ranging from a station master to freight car wheel inspectors. Otherwise, a delay of several weeks could and would ensue.

Even professors at the most prestigious Kim III Sung University receive bribes from students for better grades. This practice is so pervasive that the head of the University purportedly stated, "it is much easier to count the number of professors who do not take bribes than the professors who take them."<sup>22</sup> This predicament has been caused by two recent developments. One is the totally unreliable government rationing of food, which has necessitated that professors purchase food in the market at exorbitantly high prices completely beyond their official salaries. The second is that students at even the most prestigious universities are selected, not because of their academic excellence but by loyal deeds to the leadership and the Party, or military heroism. These students are much older than the average college student, and many are totally unprepared for university study, yet they are fully accustomed to the system of bribery in their former positions. Since a university degree is an absolute prerequisite for their future careers, they resort to any means to get better grades, the easiest way being bribery. Ironically, this system discourages even bright students from excelling academically. After graduation, the first tier of students in terms of academic excellence is assigned to government research centers, where the possibility of bribery is minimal, and the rest are sent to universities for teaching assignments with the possibility of bribes.

Bribes are sometimes coerced by those in power from ordinary people with little money. For example, a district head of the Party approaches a person, often a merchant with limited means. The head simply invites the merchant to become an instant party member with a promise of privileges, especially for educational and occupational advantages for their children. Any blemish, even serious ones, on the merchant's personal record, which would normally disqualify him from becoming a Party member, is totally

irrelevant, because the record can be altered permanently with all negative items being expunged. If the merchant hesitates, the Party head accuses him of having insufficient confidence in the Party with possibly serious adverse effects, so the merchant acquiesces. Sometimes, the amount of bribe can be exorbitant. For example, the most desired domicile in North Korea is the capital city of Pyongyang, which is, in fact, an independent state within the state. Residence in the capital is strictly controlled by the government and is permitted only for the most elite segment of the population. Yet a bribe of U.S. \$1.5 million *hard* currency, affordable mostly by Korean expatriates from Japan whose relatives in Japan are able to transmit such an amount, can obtain an instant residency in the capital city.<sup>23</sup> Since the government maintains a constant number of residents in the capital city, one new resident means that an old resident will be expelled from the city when the city's residents are adjusted. Thus even the privileged elite residents live in constant fear of losing their residency status. They in turn try to maintain their rights with whatever bribes they can afford. It is a vicious game of musical chairs with always heart-broken losers.

The seventh source of supply in the market is household goods brought by 94,000 Korean expatriates in Japan. Refrigerators or color television sets are often involved. To encourage further importation of such goods, the North Korean government seeks to force relatives to visit the expatriates in North Korea, accompanied by an obligatory minimum amount of hard currency. At these visits, the relatives bring newer household goods or send them later in order to replace old household goods, which are then sold in the market as semi-luxury goods. In fact, this custom has become commercially much more sophisticated. The relatives are now asked to bring or send items with highest resale values, such as wrist watch, cameras, tape recorders, color televisions, and VCRs.

The eighth source of market goods is consumer goods resold by high government officials and the military. High government officials often purchase a large quantity of consumer goods at secret government stores available only to them at extremely low prices, and resell them in the market with prices more than one thousand times higher than their original purchase prices. Or hungry foot soldiers steal items and sell military supplies in order to feed themselves and their families. Batteries for military radios, gasoline and soldiers' underwear are widely available in the

market. In fact, almost 30 to 40% goods sold in the market involve various military goods.<sup>24</sup>

Finally, the ninth source of supply for the market place involves large scale smuggling from the area bordering China, especially of inexpensive Chinese consumer goods such as low quality cigarettes, clothes, and shoes. This smuggling is a rather well organized activity involving the connivance of border guards on both sides.

#### **IV. Conclusion.**

Fortunately for us, a further expansion of these prevalent market places may afford us an unique opportunity to effect a gradual economic reform toward a complete market economy in North Korea, *without* the active participation and acknowledgement by its leadership. South Korea, in conjunction with other interested countries, may assist this transition, as the *transparency* and trust of the North will be gradually enhanced through an expansion of personal exchanges between the two Koreas.<sup>25</sup>

Most important for this transition is the first stage in the voluntary evolution of the North toward a market economy. For this purpose, South Korea will directly provide to the market places of the north medium-quality consumer goods beyond basic food and medicine, either as grants-in-aid or long term, low interest loans. Currently, South Korea is attempting to establish direct rail links with the North; once completed, they will greatly facilitate the direct distribution of consumer goods even to remote market places in the North.<sup>26</sup> These grants are fundamentally different from the current humanitarian aid to the North, because the latter is intended basically for general consumption, whereas the former is an instrument of an economic policy. Even if North Korea obliterates all traces of the South Korean origin of the goods, residents from the North are now knowledgeable enough to realize that their own economy is not capable of producing such goods and that they must have come from a market economy elsewhere. Already many ordinary North Koreans endeavor to practice clandestinely their limited knowledge of capitalism in their daily activities, as has been evidenced in a proverb that "our day is socialism, but our night is capitalism."<sup>27</sup> In fact, the extreme injustice in the disparity of income distribution in the North has motivated many children of the *elite* to join the North Korean version of Robin Hood, an

underground gang known as the "committee to control daily life," which attempts to steal from the rich in order to distribute the spoils free to the poor.<sup>28</sup>

With a relatively abundant supply of consumer goods from South Korea, some residents of the North will soon realize that the market place can be more than a mere convenience for the exchange of goods, and more specialized activities producing the better quality goods like those from the South (i.e., import substitution) can generate significant *profits*. However, this requires a new system of production and distribution drastically different from the current stale system of North Korea's command economy as well as the current inefficient market place. Enough profit incentives will impel new entrepreneurs to create this new system, clandestinely at the beginning yet with the full connivance of local authorities with their own vested economic interests. Competition will propel these participants to probe one step beyond the currently tolerated level of a market economy, and eventually, the entire country will be operating under an officially unrecognized yet sanctioned market economic system. Throughout this transition, the leadership of North Korea will gradually realize that a hybrid system involving a market economy within a socialist political framework, a la Vietnam and China to a lesser degree, is much more preferable for its own survival than the rigid command economy, and will silently condone the slow progress of this market economy, as it tolerates the current market place because of its demonstrated benefits.<sup>29</sup>

There are several immediate benefits accruing to North Korea from these economic reforms. First of all, without minimal reforms, international humanitarian aid, which is critically important for the regime's survival, will cease because of donor fatigue. Already, the South Korean government is criticized for its aid to the North without any substantive reciprocation. The U.S. Congress in November 1999 enacted a bill to suspend further aid to North Korea unless Pyongyang actuates visible reforms. Even the non-government organizations of the world withdrew their humanitarian aid to North Korea between 1995 and 1998 because of donor fatigue. Second, North Korea wants an infusion of capital and technology from the world. Yet, on the desirability of international joint ventures, the country is currently ranked by the United Nations at the bottom third of the 178 countries, just above Somalia and Afghanistan. Even the current meager joint ventures in North Korea

are carried out in a most inefficient manner. They are located in remote areas, far away from population centers and are enclosed by three meter high walls.<sup>30</sup> As a consequence, there are no spill-over effects of higher technology and management to the rest of the economy. Although the workers engaged in these joint ventures are paid higher than average wages, there are insufficient consumer goods for them to buy; thus, higher wages do not provide work incentives. The work is simply treated as another form of production quota, which is the core of the inefficiency of their socialist system.<sup>31</sup> Minimal economic reforms, including the provision of work incentives to workers beyond meaningless official slogans or badges, are necessary prerequisites for attracting such ventures. The current leadership of North Korea is empiric, and the benefits of each step of a change must be demonstrated before it will acquiesce to it. Yet, once persuaded, the leadership will, as it has in the past, silently participate, as it permits the Party to procure urgently needed goods from the market place.

A long period of economic cooperation between the two Koreas will ideally lead to political collaboration and the eventual unification of Korea. This will bring a slow process of unification that carries reasonable costs in terms of human lives, material, and political disturbances. More importantly, this is the unification scenario, each step of which is accomplished through learning by doing on the part of both sides, and to which the current leadership of the North will have the least objection because its intermediate steps do not threaten the demise of its regime.

Any economic policy is a double-edged sword, and there are always dangers associated with it. Even simple humanitarian aid may contain a latent danger of enhancing the military strength of a potential foe. Therefore, aid, trade, and joint ventures between the two Koreas must be carefully screened to eliminate the possibility of inadvertently aiding North Korea's military. This may mean that any products with more than 50% potential of military use may be banned. Yet it is impossible to completely separate goods with dual uses. A bicycle, for example, may become a military vehicle. Therefore, the value of an economic policy should be based on its benefits and costs. If the expected benefits significantly exceed its costs or dangers, then it is worthwhile to undertake, even at a potential risk.<sup>32</sup> Transforming North Korea into a market economy, and eventually producing Korean unification, has its inherent risks,

yet the benefits would seem to outpace the dangers. As mentioned, Korean unification *without* adequate preparations may cost the South anywhere between \$200 billion and one trillion dollars. Transforming the North through an expansion of the market places will cost the South a fraction of those costs. The past policies towards North Korea, ranging from strict military adversary to the current policy of conciliation and accommodation, have not produced significant results. We may now initiate a new, bold policy of transforming North Korea into a market economy by strengthening its market places.

## Notes

1. On the costs of the Korean unification, see Seo, Byung-Chul, "Unification on the Korean Peninsula and Lesson from German Unification," *Vantage Point*, Vol. 25, Nov. 8, August 2002, pp. 44-52. For the lessons of the German unification, see Kim, Sungwoo, "Korean Unification and Economic Policy to Abate Southward Labor Migration," in Cho, Lee-Jay and Eric Im (eds.), *North Korean Labor and Its Prospects*, Seoul, Korea: Korea Labor Institute, 2001, pp. 263-288.
2. The defaulted loan figure is from Oh, Kongdan and Ralph C. Hassig, *North Korea, through the looking glass*, Washington, D.C.: Brookings Institution Press, 2000, p. 42. The Japanese gift figure is from Sekikawa, Natsuo, *North Korea's Campaign to Sustain Human Lives* (in Japanese), Tokyo, Japan: Bungei Shynju Lts., 2001, p. 258.
3. For the NGO aid to North Korea, see Oh, Kongdon and Ralph Hassig, "North Korea between Collapse and Reform," *Asian Survey*, Vol. XXXIX, No. 2, March/April, 1999, pp. 287-309. For South Korean aid to North Korea, see Kim, Samuel S., "North Korea in 2000, Surviving through High Hopes of Summit Diplomacy," *Asian Survey*, Vol. XLI, No.1. January/February 2001, pp. 12-29.
4. This official act of denudation is further aggravated by destruction of trees by starving people in their desperate attempts to extract any edible matters from trees. See on this point Koh, Chong Son, *Kim Jong IPs Secret Arms Factories* (in Japanese,) Tokyo, Japari:Yu Nakane, 2001, p. 266.
5. For further discussion on this point, see Kim, Sungwoo, "Agricultural Policy and Grain Production in North Korea," *Journal of Social, Political and Economic Studies*, Vol. 22, No. 1, Spring 1997, pp. 23-38.
6. See Sato, Katsu Mi, *A Book for Understanding the Current North Korea* (in Japanese,) Tokyo, Japan: San Sho Books, 1999, p.54.
7. Many anecdotal evidences on this point are compiled by a Japanese visiting professor of agriculture to North Korea. See Lee, Woo Hong, *North Korea, a Very Lowly Republic* (in Japanese,) Tokyo, Japan: Asian Book, 1989.
8. See Ahn, Chul and Park Dong Myung, *A Report on Hunger in North Korea*

- (in Japanese,) Tokyo, Japan: Shogakukan, Co., 2001, p.64.
9. Oh and Hassig (2000), *ibid*, p. 46.
  10. Sekikawa, *ibid*, p. 186.
  11. See Chong, Bong-uk, "Reforms toward a Market Economy?" *Vantage Point*, Vol. 25, No. 8, August 2002, p. 14.
  12. Ahn, *ibid*, p.88.
  13. Lee, Yung Hwa, *The Evening of a Secret Meeting in North Korea* (in Japanese,) Tokyo, Japan: Bungei Shynju, Ltd., 1996, p. 127.
  14. In fact, the current leader's graduation thesis at Kim III Sung University was "Equality between Rural and Urban Sectors in North Korea." See, Ahn, *ibid*, p. 88.
  15. For further discussion on this point, see Kim, Sungwoo, "Recent Economic Policies of North Korea, Analysis and Recommendations," *Asian Survey*, Vol. XXXIII, No. 9, September 1993, p. 869.
  16. Ko, *ibid*, p. 48.
  17. *ibid*, p. 17.
  18. *ibid*, p. 47.
  19. For the fundamental inefficiency of North Korea's foreign trade, see Kim, Sungwoo, "North Korea's Foreign Trade with the World between 1980 and 1994," *World Competition*, Vol. 19, No. 4, June 1996, pp. 69-80.
  20. Sekikawa, *ibid*, p. 49.
  21. For further discussion on this point, see Ko, *ibid*.
  22. Whang, Jung Hyup, *Declaration of War on Kim Jong II* (in Japanese,) Tokyo, Japan: Bungei Shynju, Ltd., 1999, p. 355.
  23. Sekikawa, *ibid*, p. 51.
  24. Ahn, *ibid*, p. 132.
  25. On this point, see Cho Han-beom, "The Influence over North Korean Society of Inter-Korean Exchanges after the Summit," *Vantage Point*, Vol. 25, No. 1, July 2002, pp. 44-53.
  26. For the current plans on direct rail links between the two Koreas, see Jong, Sung-im, "Reconnection of Transportation Networks between South and North Korea, and Its Effect on the North Korean Economy," *Vantage Point*, Vol. 25, No. 10, pp. 46-56.
  27. Pak, Yung Gil, *A Diary of a Hoodlum in North Korea* (in Japanese,) Tokyo, Japan: Bungei Shynju, Ltd., 1999, p. 18.
  28. *ibid*, p. 242.
  29. For further discussion on this point, see Lee, Seoung-bong, "North Korea's Survival Strategy and Changes in Inter-Korean Relations," *Vantage Point*, Vol 25, No. 9, September 2002, pp. 43-53.
  30. Sekikawa, *ibid*, p. 161.
  31. For further discussion on this point, see Kim, Sungwoo, "The Inefficiency of North Korea's Economic System," in Cho, Lee-Jay and Park, Myung-Kwang (eds.), *Korea and the Asia-Pacific Region*, Hawaii: East-West Center, 2001, pp. 296-319.
  32. For optimal economic cooperation between the two Koreas, see Kim, Sungwoo, "Three Stages of Economic Cooperation for Peaceful Unification of Korea," *Vantage Point*, Vol. 24, No. 5, May 2001, pp. 41-51.