

# **Downfall of the North Korean State Economy: Losing Political Authority and Gaining Military Frailty**

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## **Abstract**

North Korea operates its system based on a strict adherence to socialism and its "military-first" policy but its economy has failed. Without government subsidies, the ordinary people have no choice but indulge in illegal economic activities. Now, a portion of the economic shortages is fulfilled by private earnings in the markets. The appearance of the market is a bottom-up process rather than a top-down process engineered by the state. As the market grows, the harsh regime confronts the decreasing influence of its power. To restore the state economy, North Korea implemented currency reform. However, it failed, leading to far greater mistrust of the government by the North Korean people.

Though new leader Kim Jong-un inherited the "military-first" policy, the poor economy cannot support its military ambitions. The misallocation of resources aggravates its economy and the legitimacy of regime. The pressure from the bottom of society to provide reform measures will almost certainly increase. This will likely mark the beginning of genuine transition of North Korea.<sup>2</sup>

**Key Words:** Kim Jong-un, Hereditary succession, Military-First Policy, August 3<sup>rd</sup> Person, North Korean refugees, Arduous March, currency reform, illegal economic activities

In North Korea, survival is a crime.

- Comments by a former North Korean diplomat

## **I. Prologue**

After Kim Jong-il's sudden death, debates over the future of the North Korean regime have been given careful consideration. The world is focusing its attention on how his son, Kim Jong-un, is able to maintain direct control of North Korea in light of only a short preparation of power succession. However, North Korea's official newspaper, *Rodong Sinmun*, in a front-page editorial on December 22, 2011 called Kim

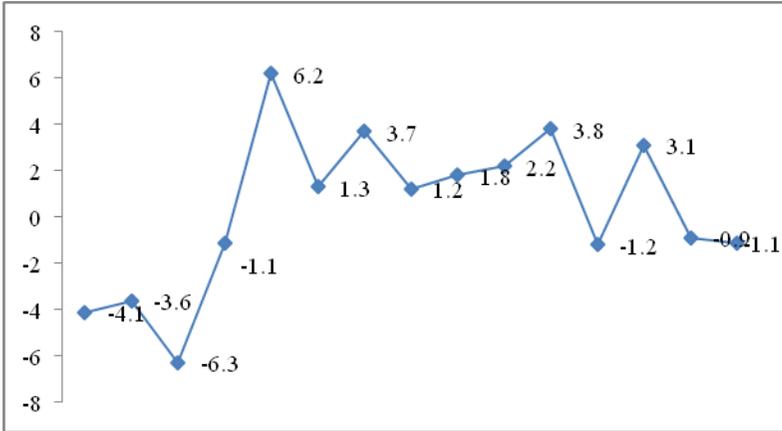
Jong-un the "leader of the people." Also, the editorial used the term "military-first" — the official ideology of Kim Jong-il — twenty-one times. Now the question is how the North Korean regime will overcome recurrent economic hardship and international pressure applied to abandon its nuclear development. Will the North Korean regime overcome recurrent economic hardship and international pressure for it to abandon its nuclear program? What internal governing structure will the new leadership implement? Can Kim Jong-un resolve the North Korean nuclear issue? In addition to these questions, interest in factors that will shape the future of North Korea is growing.

Despite changes in both the internal and external environments, North Korea has based its operations on strict adherence to socialism and their "military-first" policy. In the New Year's editorial of 2012, the official North Korean media repeatedly stressed the military-first policy. It urged its people and military to follow and defend its new leader, Kim Jong-un, "unto death," continue to uphold the instructions of the late leader, Kim Jong-il and strengthen defense capabilities.<sup>3</sup> The North Korean official newspaper also said "Let us defend with our very lives the Party Central Committee headed by the dear respected comrade Kim Jong-un."<sup>4</sup> In addition, the editorial emphasized that the United States should withdraw its troops from South Korea, calling those forces the main obstacle to peace on the divided Korean Peninsula.

The North Korean political system has long maintained stability but the economy has been under constant depression. <Figure 1> shows that momentarily the North Korean economy was able to display positive growth, on achievement based on external support and not internal growth.<sup>5</sup> Every year North Korea emphasized the top four priority categories of its planned economy: coal, electricity, metal and railroads. But the economic performance of the formal sector has had a dismal effect on the market forces. Unfortunately, there are no signs of improvement. It is only spiraling downwards. On the flip side of the coin, the dictatorial regime adamantly opposes reform, which results in re-enforcing the dictatorial way of governing its people.

As North Korea's economic situation continues to deteriorate, citizens are responsible for making their own living, truly self-reliance. The state economy hardly provides the goods needed to survive: there is no food, no salary, and no social security. People must obtain necessities elsewhere. As a result, the market system has emerged.<sup>6</sup> In the market, people can obtain goods if they can afford to pay for them. Despite such

**Figure 1: Economic Growth Rate of North Korea**



Data: Bank of Korea

a simple logic, even those that have money must be aware of the government's target inspections. This is an example of suppressing economic freedoms, which is one of the main factors evident in the private market.

In North Korea, the main impetus behind markets is a bottom-up process rather than a top-down process by the state. This means that the government is not eager to become too enmeshed in the market. The regime regards the market as supporting the means to provide necessities. The current trend in providing goods shows that Chinese products and household products are replacing products made by state companies.<sup>7</sup> In the absence of government subsidies or rations, citizens will have no other choice but to indulge in illegal economic activities. At this stage, legal or illegal use of state property depends on the household. As the private sector grows rapidly, the government collects separate taxes from private manufacturers. This phenomenon appeared in Russia and in eastern European countries during their economic transitions. Small private companies pay a bribe to the government. In return, the government provides unofficial protection.

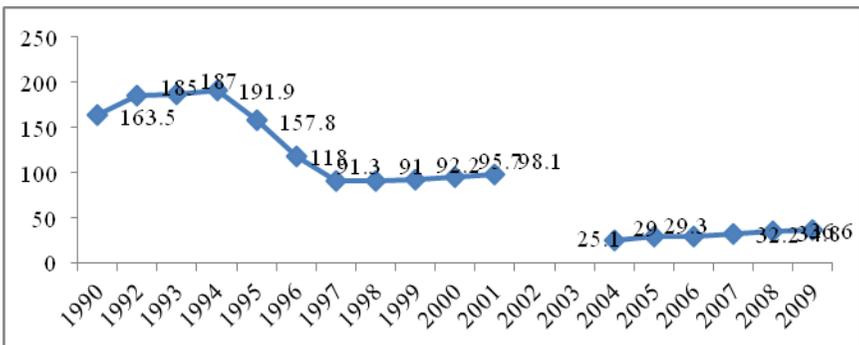
North Korea's only extrication from its desperate economic straits is to open its doors and to cooperate with other countries, especially with South Korea. The North should join the international community by implementing economic reforms and opening its markets. For example, the dynamic growth of Northeast Asia is a good example of

international cooperation. China, Japan and Korea have benefited greatly from the open and liberal international economic order. These three countries have expanded their trade volume in order to preserve the efficiency of the free trade system. In conjunction with the free flow of trade and investment, intra-regional cooperation has been strengthened with collaborative efforts in technology transfer and information gathering.<sup>8</sup> However, North Korea is losing its opportunity to benefit from the international division of labor and the high reserves of foreign currency assets held by the three countries.

The role of government and its intervention tendencies must be decreased to a minimum when considering the fact that socialism has failed because of an excessively corpulent state. <Figure 2> shows that the North Korean government is financially bankrupt. Within a ten year period, between 1994 and 2004, government expenditures decreased as much as 12.5%. This means that expanding public property, implementing social security, ensuring a decent standard of living, establishing economic order, and maintaining low unemployment have lacked financial initiative.<sup>9</sup> Moreover, stable unemployment and social conflict between the rich and the poor in North Korea are matters of urgent concern. A rapid economic transition with accompanying system change is absolutely necessary to resolve the economic problems incurred by North Korea's planned economy.

When North Korea suffered its biggest crisis during the period of the Arduous March, there were many predictions on whether the regime would survive or collapse. Speculators suggested that political instability

**Figure 2: North Korea's Finance Expenditure**



Data: Ministry of Unification

and economic hardship would cause defections of political elites and would ultimately bring about the collapse of the regime. However, Kim Jong-il's death brought some hope that North Korea might end its dictatorship and move toward Korean unification. Many, however, thought Pyongyang would simply muddle through one way or another, regardless of its difficulties. North Korea's countless hardships so endure, but, hereditary succession seems quite successful so far, a key factor supporting Kim Jong-un's legitimacy. To strengthen his power base, Kim Jong-un now needs to legitimize his rule. In short-run, the personality cult and violence might solidify his power. However, in the long-run, few expect that Kim Jong-un will remain in power.

Eventually, North Korea seems to be confronted with serious political challenges. The harsh regime faces the decreasing influence of its power in the face of sustained economic poverty. This economic distress seems likely to cause political weakness and military frailty in the long-run. This article will tackle the related issues. Section II describes the current economic situation in North Korea briefly. Section III investigates the fall of political authority due to the bad economy. Related military influence will be examined in Section IV. Concluding remarks will follow.

## **II. North Korea's Economic Downturn: From a Defector's Perspective**

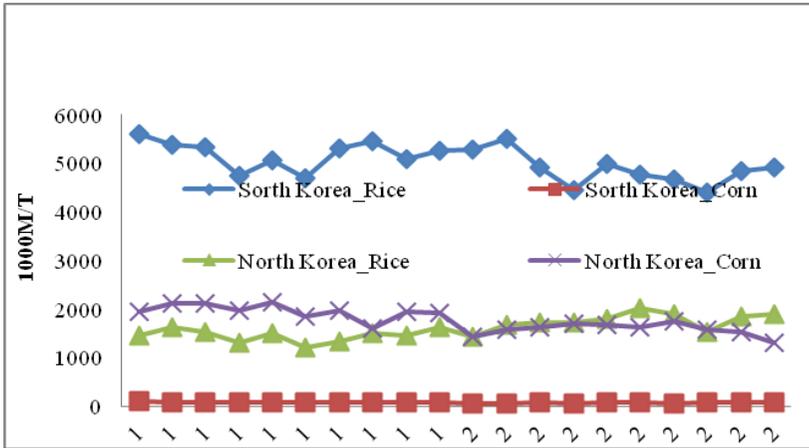
### **1. Economic refugees rather than political dissents**

Despite the efforts made by the North Korean regime to strengthen domestic control ahead of Kim Jong-un's hereditary succession, the recent number of defectors fleeing the North has increased. Interviews from these defectors, starting in August 2010, have revealed an overwhelming number of individuals citing economic reasons for defection. Even ten years ago, a significant portion of defectors claimed to have fled the North for political, ideological and religious freedom. Among these individuals, some had no choice but to defect, as illegal acts they had committed in North Korea had made their lives untenable. After the Arduous March, reasons to defect to the South have become more economic in nature, a change in focus.

The economic hardship that has prevailed since the famine in the early 1990s continues to provide incentives for corruption. Securing food remains one of the main topics on the agenda. North Korea steadily has expanded its cultivated land by slash-and-burn farming.<sup>10</sup> Though

North Korea's land under the plow is larger than that of South Korea, the production of rice and corn in North Korea is comparatively lower than South Korea due to a finite supply of fertilizer (see <Figure 3>).

**Figure 3: Rice and Corn Production.**



Data: Rural Development Administration

The evidence indicates that the North Korean government is incapable of providing food and daily necessities for its people. As such practices are far too common and widespread crimes committed for basic survival are punished with a certain degree of tolerance. The interview process has revealed a number of North Korean defectors who have stated that, although they could not eat fully on a daily basis, the situation had not deteriorated to the extreme level of people's starving in the streets. There have also been cases where North Koreans have refused to defect because of this economic deprivation.<sup>11</sup>

In the past, defectors who fled the North also had an indefinable longing for the South. Now, they seek to secure a stable life and better environment for their children. Another motive for defection is to provide economic assistance to families and relatives still in North Korea. The fact that previous defectors received huge sums of money (by North Korea standards) and have successfully settled in South Korea increases incentives for making the journey. Currently, a significant portion of defectors have arrived from border regions where they can easily receive assistance from previous defectors and where they can best

receive information about South Korea. Defectors have also increasingly begun to arrive from regions such as North and South Hwanghae and Kangwon provinces, which are not traditional areas of defector origin. Recent defectors no longer share the most prominent traits of past freedom fighters, seeking the values of freedom that the South provides but sharing significant similarities to illegal immigrants who primarily want a better economic life. The paradigm of defection is changing.

A North Korean defector who worked for a year at a cooperative farm in Onsong County of North Hamkyung Province stated that he received 30 kilograms of food for a year's work. According to his testimony, even during times of economic distress, workers received at least 20kg on a monthly basis. Workers and their families, however, were forced into illegal activities and maintained small plots of land for self subsistence as 30 kg of food only lasted for one month.

On cooperation farms, workers falsely reported agricultural output in order to sell what they can on the market. It has become the norm to manipulate the weight of rations by using water to add to the weight and taking turns stealing small portions from the food storage facility. Although such crimes can be overlooked by bribing officials, the government is not so forgiving in terms of taxing. Workers have come to fear the consequences of avoiding their obligations to the government and will take out loans to pay their taxes. Certain corporations such as the Kimchaek Iron Complex tend to provide rations and payment for their workers, but most North Korean companies do not provide the same privileges.

## **2. Deindustrialization of state companies**

In the past, factory workers participating in rural community support were provided with meals; now, not only do they have to bring their own lunch boxes, there is a prevalent tendency in rural societies to refuse assistance because of the financial burdens it entails. The difficult situation in North Korea is not only limited to food but has also expanded into the realm of other general merchandise.

Stores under government management lag behind their private market counterparts in terms of quality, diversity of products and overall customer service. Because of such inefficiencies, sales continue to decline, ultimately leading the government to lose revenue. The government is no longer capable of providing goods to the consumers. The burden has been laid upon the private markets to do so. Previously a

secondary economic tool of the country, these markets have increased in importance to become the primary venues. In market, the people come together for economic reasons; they are also the places where people exchange information about the outside world and general economic activities.

The declining production by state-owned companies emphasizes the systemic flaw of centrally planned economies and the universality of Janos Kornai's "shortage economy."<sup>12</sup> To supplement their inadequate supplies, ordinary people rely on the private market and the wealthy show a similar reliance in obtaining luxury goods. An increase in demand and an extra burden to offer bribes results in the continual increase in the price of goods and services. The government cannot neglect the tax revenue generated by the marketplace and continues to allow the police force and state security agents to take bribes. Thus, government permits the continued existence of the private market for the livelihood of the people, but, at the same time, utilizes it as a means of surveillance and a source of revenue.

With companies unable to function properly and with the expansion of the private industry, employees favor changing into an August 3 person. An "August 3rd Person" refers to someone who contributes a designated amount that far exceeds his or her wages to the company; the person then proceeds with private commerce. However, not all have the opportunity to become an "August 3rd person"; the individual must have a certain amount of capital and connections. Farmers and workers who have earned the title undergo high risks, and many commit illegal economic acts in order to maximize their profits. The practical application of the "August 3rd person" provides some positive effects such as the short term injection of capital and the utilization of idle manpower,<sup>13</sup> but in the long run it will have negative adverse effects on the working discipline and the overall state of the planned economy.

Before currency reforms, prior to any employment, males were obliged to contribute 30 to 50 thousand won and females 10 to 20 thousand won. After currency reform, the payment to be an "August 3 person" increased sharply in cities such as Chongjin. Currency reforms have eliminated many requirements as individuals can apply to become an "August 3 worker", but the exact amount needed to acquire such special privileges is difficult to determine. This is probably because of the uncertainty surrounding the currency exchange rate. For approved

“August 3 workers”, the most popular jobs are in the overseas trading and the service industry.

### **3. Expansion of service sector and small business**

Among defectors, only a small portion originates from Pyongyang. These individuals differ from other defectors in their thinking. They are sensitive to the drift of government authority and have a firm grasp of the international situation. People from Pyongyang have received payment for their services, but the amount has decreased as of late. A mid-level official from the Central Party normally receives one kg of rations per month, but the amount has decreased recently and individuals receiving an accumulated amount with their families have witnessed their rations decrease much more significantly.

However, many of these individuals do not rely solely on rations alone, shared by elites from regional cities. For example, a faculty member from a professional school receives 1,500 to 2,000 won on a monthly basis. Deducting various donations and obligations, the actual amount such individuals would expect to receive is around 500 won. Because faculty members cannot become an “August 3 worker”, they will normally teach privately for additional income. One teacher may teach the entire curriculum, encompassing such subjects as English, mathematics, and physics. A faculty member receives 10,000 won per subject and normally teaches four subjects, with each session comprised of ten students. Forty-thousand won per month is said to be an adequate income for comfortable living, but faculty members typically receive earnings between US\$50 and \$60. Meanwhile older faculty members and those responsible for politically-related courses find it hard to teach privately, and the wives of these individuals must work in the marketplace to earn a living.

The newly rich class of wealthy elites, the so-called moneyed, have secured support from the government in conducting various ventures. They borrow the names of state-managed enterprises to run their own company, engage in the service industry with high profitability, and even take part in the construction and sale of housing. A good example would be the operation of long-distance bus services. Another example is the private running of anthracite mines, hiring more than twenty workers with high payments.<sup>14</sup> In such lines of work, the wealthy elites understand the limitations in place that curtail their ability to earn high profits. This is because of government interference and endless

incidental expenses. Therefore, the elite must reinvest their earnings from the transportation industry to extract short-term profits. However, because such investments typically entail high risks, the wealthy tend to rely on illegal enterprises. Such tendencies are well noted by the secret police, and high economic growth is discouraged by the Anti-Socialist Inspection Group. Even though the wealthy are able to sidestep such barriers, they normally face other challenges.

### **III. Fall of Political Authority**

#### **1. Still solid control by government**

North Korea still aims towards maintaining national economic self-reliance based on the Juche ideology as its top priority. Not only is the economy still closed, but also the “military-first” ideology exists in combination with the violence of the dictatorship. So far, the durability of the North Korean regime is surprisingly robust. Even though the system of dictatorship and the military force remain strong, the ongoing economic crisis does not seem to threaten the stability of the regime. It is difficult to expect the sudden collapse of the North Korean regime. Any superficial similarity to East Germany is quite unlikely. Like East Germany, North Korea does not owe its existence to the Soviet Union, and has almost no experience in the free market economy or parliamentary democracy. Therefore, the possibility of sudden collapse due to internal factors, such as a civil uprising, is extremely low. Meanwhile, after observing the persistence of the North Korean regime, in the long run the impact of external and internal conflicts will eventually bring collapse of the regime.<sup>15</sup> But if North Korea improves its international standing by abandoning its nuclear program and normalizing its diplomatic relationship with the United States, it will be able to run a more relaxed political system and institute successful economic reform. However, it is premature to expect North Korea to act in this way at present.<sup>16</sup>

#### **2. Prevailing illegal economic activity**

In North Korea, illegal economic activities prevail. For example, housing sales, an official government responsibility, have been conducted much more publicly. The situation is similar to the embezzlement of government funds in Eastern European States and Russia. Housing can be privately traded when in possession of the right and in the absence of complaints. In the case of residential construction,

housing is built on land received from the government. The process typically involves a prosecutor or a high ranking official from the Organization Department of the Party with detailed knowledge of the law. A constructor may borrow the name of a state-run company to construct an apartment and sell it for profit.

Illegal construction and housing sales are seldom conducted on a nationwide level in cities such as Chongjin, Hamhung, Sinuiju and Hyesan. In the case of Chongjin, construction lags behind demand with the housing demand being relatively high. With both builders and tenants typically favoring seven-story buildings, the average housing price per lot is between \$7,000 and \$10,000. Buyers normally register somewhere in the region of \$3,000 to \$4,000 as a down payment. Housing sales are also subject to inspection by the Anti-Socialist Inspection Group and may be considered for confiscation.

Small enterprises may also have their property seized by relevant agencies. These firms may be falsely accused by the government for foreign exchange holdings or contact with South Korean officials. North Korean residents label such situations as "waiting for the baby pig to fatten." The exposure of illegal practices depends on the size of the firm as to the amount of the required bribe. But having a relative or family member in a government organization significantly decreases the necessary payment. Firms producing bread, clothing, tofu and other daily necessities do not have such restrictions but are obliged to pay small dues to relevant government organizations. Ultimately, the success of business enterprise in North Korea depends on the amount of bribes offered.

Unrelated to income, all members of North Korean society prefer South Korean products. This preference especially extends to food products and cosmetics. Culturally, North Koreans prefer South Korean soap operas, and several have confessed to have made money selling DVDs. This is why, despite the high risk of punishment, such videos are increasingly available. An interesting fact is that while North Koreans show interest in advertisements associated with their favorite shows, there is increased difficulty in understanding unfamiliar foreign words.

Wiring money to relatives in the past was a lengthy and expensive process that involved sending money to China and having someone personally cross the border with the funds. The process has been made much simpler, especially in the border regions, where Chinese expats come to retrieve the funds and deliver them to their final destination.

One may perceive the current trend as the establishment of an online credit loan and wire transfer system. There are cases where the funds have been received by the relatives of a defector within six hours of the initial request. The transfer of funds also allows for a confirmation phone call between sender and recipient to make sure that the service has been concluded.

### **3. Doubts over Government Policy**

Currency reforms in North Korea have absolutely obliterated any confidence in economic policy making and led to increasing political doubts over the Kim Jong-il regime in the past. The initial objectives behind currency reform were to eliminate accumulated private currency holdings and prevent future inflation, but they have endured severe public outcries. Though North Korea made some gains through this process, it lost authority. Since the currency reforms were announced, several regions in North Korea have replaced the North Korean currency with US dollars and the Chinese yuan. There are increasing cases in the market where payments are requested in foreign currencies and when the North Korean won is provided as the means for premium payments. There have been reports that most restaurants in the downtown district of Sinuiju request dollars or yuan. The depreciated North Korean won has been called the commoners' currency. The demand for foreign currencies increases as the value of the North Korean won decreases. Especially when it comes to purchasing expensive goods, foreign currencies are the medium of exchange. Consequentially, while the government has strictly adhered to the policy of self-reliance, the value depreciation of the North Korean won has resulted in an increasing economic dependence on foreign countries.

The North Korean regime has failed in its attempt to acquire additional resources through currency reform and to dominate the economy with monetary authority. Even if a state possesses seigniorage, inflation will persist if production is below par. Economic expansion as a result of a contradictory planned economy cannot easily be reversed and will result in economic contraction. In order to weaken the effects of the market and normalize companies and state run stores, the government must provide incentives in monthly pay and rations. However, the task is impossible, considering North Korea's inadequate productive capacity. Consequentially, North Korea's currency reforms have only induced a change in the nominal value of its currency. The North Korean

government has lost the peoples' trust as a result of this reform.<sup>17</sup> As a result of the learning effect, the North Korean people will always doubt government policy and favor foreign currencies. In terms of benefits, there is a high probability that North Korea will grow to depend heavily on foreign aid as the sunflower does with the sun.

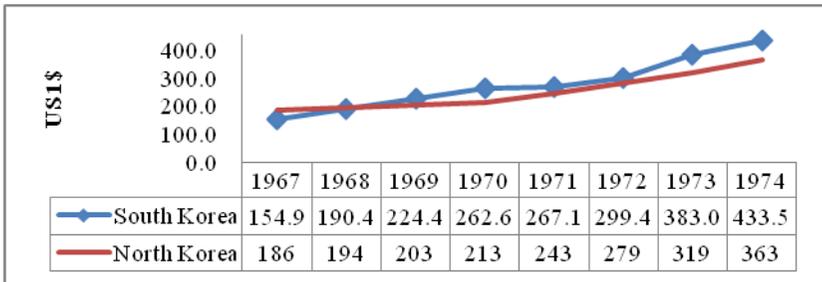
#### **IV. Military-First but Military-Frailty**

##### **1. Strict Adherence to the "military-first" policy**

The late Kim Jong-il utilized the military as the predominant organ of government and society. Military-first politics were reflected not only in the leadership positions, the National Defense Commission, but also in the relative elimination of many major KWP functions such as plenary meetings.<sup>18</sup> North Korea has a massive combat force that ranks fourth in the world, following China, the US, and India. As explained earlier in this article, the main reason behind North Korea's chronic recession is an inefficient planned economy. However, the new leader, Kim Jong-un, apparently continues to obsess with the military industry and to allocate resources favorably. The national objective of his regime is to establish "a strong and prosperous country". To achieve that goal, the "military-first" policy continues to be emphasized. North Korea's fundamental reason for adopting drastic reforms and open economic policies is that the "military-first" policy overwhelms all rational economic policies. In other words, the reason behind the diminishing momentum of economic policies is the fact that economics is strictly considered subordinate to politics. No matter how rational the economic policy, it will not be enforced if it challenges the authority of the supreme leader.

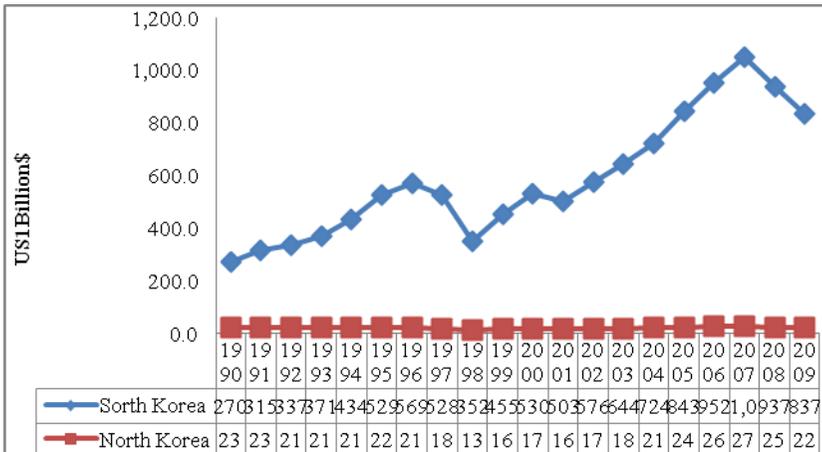
North Korea has overcome its political and economic frailty by bludgeoning its people into submission with extreme fear. However, the misallocation of natural resources will eventually aggravate economic hardship in North Korea and result in a worsening situation. This paranoid thinking makes the North Korean regime stick even closer to the "military-first" policy. The outcome of this military expansion results in false messages to South Korea. It will cause an arms race in the Korean peninsula. To date, in a severe trial of strength, the two Koreas have competed for more than half a century. In the late 1960s, per capita GNP of South Korea moved ahead of that of North Korea. <Figure 4> and <Figure 5> is a testimony to the fact.

**Figure 4: Per Capita GNP**



Data: Ministry of Unification

**Figure 5: GNI (1990-2009)**

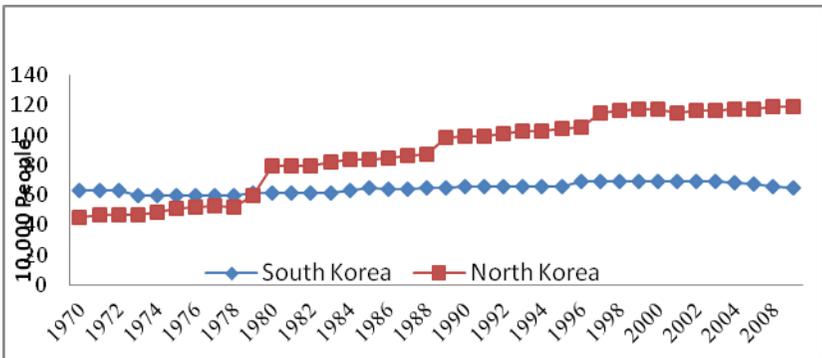


Data: Bank of Korea

In a normal economy, the labor force is an important factor of production. However, the misallocation of its labor force has hurt the North Korean economy. Since 1980, the number of North Korean soldiers has exceeded those of South Korea (See <Figure 6> and <Table 1>). However, the numbers alone do not determine military strength. Though North Korea pursued a “military-first” policy, its poor economy could not support its military ambitions. One of the important reasons behind this fact has been that the North Korean army acts both as a combatant and as a support engineering army. However, it cannot function efficiently in such a dual role. During periods such as the

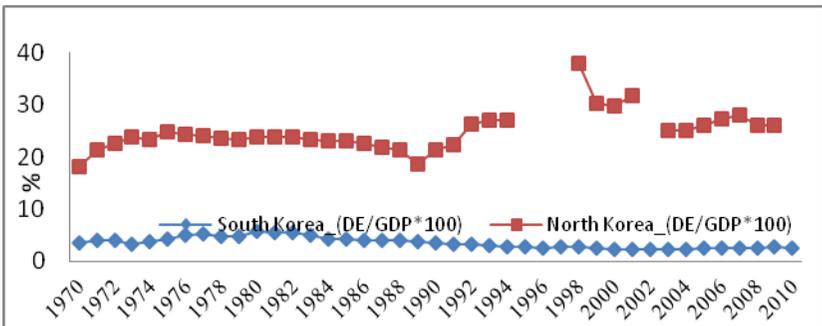
Arduous March, the only useful resource to support political, social and economic needs was the mobilization of a relatively well organized military.<sup>19</sup> In contrast to the robust economic performance of South Korea, North Korea's economy is in an extremely dire condition. Although <Figure 7> seems to indicate that North Korea's defense expenditure seems to far exceed South Korea's, the reality is quite opposite. South Korea's total military expenditure has a big lead over the North Korea's military expenditure.

**Figure 6: Total Military Force**



Data: Ministry of National Defense

**Figure 7: Defense Expenditure**



Data: Ministry of National Defense

**Table 1: Comparison of Two Koreas Military Forces**

(Unit: 10,000 People)

Year	Total Military Force		Army		Navy		Air Force		Marine Corps	
	S.K	N.K	S.K	N.K	S.K	N.K	S.K	N.K	S.K	N.K
1970	63	45	55	39	2	1.4	2.8	4.5	3.1	...
1971	63	47	55	41	1.9	1.4	2.8	4.5	3.2	...
1972	63	47	56	41	1.9	1.4	2.8	4.5	2.6	...
1973	60	47	53	41	1.9	1.7	2.8	4.5	2	...
1974	60	48	52	41	2.5	2	3	4.7	2.4	...
1975	60	51	52	44	2.2	2	3.1	4.7	2.4	...
1976	60	52	52	44	2.2	3	3.1	5.1	2.4	...
1977	60	53	52	45	2.4	3	3.3	5.1	2.4	...
1978	60	52	52	44	2.6	3.1	3.5	5.2	2.4	...
1979	61	60	52	52	2.7	3.2	4	5.2	2.4	...
1980	61	79	52	70	2.8	3.4	4	5.2	2.6	...
1981	61	79	52	70	2.8	3.6	4	5.6	2.6	...
1982	61	79	52	70	2.9	3.6	4	5.6	2.6	...
1983	61	82	52	73	2.9	3.7	4	5.6	2.6	...
1984	63	84	54	73	2.9	3.8	4	6.6	2.6	...
1985	65	84	54	73	4	4	4	6.7	2.6	...
1986	64	85	54	74	3	4	4	6.7	2.6	...
1987	64	86	54	75	3	4.1	4	6.7	2.6	...
1988	65	87	55	76	3.4	4	4	7	2.6	...
1989	65	98	55	85	3.4	5	4	8	2.6	...
1990	65.5	99	55	86.5	3.4	4.5	4.5	8	2.6	...
1991	65.5	99.5	54	86.8	3.4	4.5	5.5	8.2	2.6	...
1992	65.5	101	54	88.2	3.4	4.6	5.5	8.2	2.6	...
1993	65.5	103	54	90	3.4	4.6	5.5	8.4	2.6	...
1994	65.5	103	54	90	3.4	4.6	5.5	8.4	2.6	...
1995	65.5	104	54	91	3.4	4.6	5.5	8.4	2.6	...
1996	69	105.5	56	92	4	4.7	6.4	8.8	2.6	...
1997	69	114.7	56	99.6	4	4.8	6.3	10.3	2.7	...
1998	69	116	56	100.3	4	5.4	6.3	10.3	2.7	...
1999	69	117	56	100	4	6	6.3	11	2.7	...

2000	69	117	56	100	4	6	6.3	11	2.7	...
2001	69.1	115	56	98	4.1	5.7	6.3	11	2.7	...
2002	69.2	116	56	99	4.1	5.8	6.4	11	2.7	...
2003	69.3	116	56	99	4.1	5.8	6.5	11	2.7	...
2004	68.1	117	55	100		6	6.4	11	2.7	...
2006	67.4	117	54.1	100	4.3	6	6.5	11	2.5	...
2008	65.5	119	52.2	102	4.1	6	6.5	11	2.7	...
2010	65	119	52	102	4.1	6	6.5	11	2.7	...

Data: Ministry of National Defense

Historical evidence suggests that the Kim Jong-Il regime was seeking to secure its survival by developing and expanding its atomic bomb and missile capacity.<sup>20</sup> Today, North Korea is believed to have approximately 600 Scud missiles with a range of up to 700km and 100 Rodong missiles with a 2,000km range.<sup>21</sup> Overcoming the inferiority in numbers, South Korea has steadily reformed its national defense by building slim but strong military forces. It has also developed a pragmatic and advanced defense operational system.<sup>22</sup> In addition, the security of South Korea is guaranteed by a strong ROK-US military alliance which will enhance Seoul's capabilities for strategic planning, intelligence, and operational skill by a series of defense reform.<sup>23</sup>

## 2. Drifting Reform Policy

Under present circumstances in which the "military-first" policy constrains all other policies, North Korean economies potential growth is bleak. A half century of North Korea's history stands as evidence to this argument. Soonchun Vinylon Factory, Taean Work System, Ch'ollima Movement, Rajin-Sunbong Special Economic Zone, July 1<sup>st</sup> 7.1 economic measures, collective farming, and 2009 currency reform measures are all examples of failed economic policies. Following his father's doctrine, Kim Jong-un seems to strengthen planned economy by adjusting the people's economic plan. They have adjusted the plan by deleting the section that reads "delivering the opinions of the production unit to superior authority during the plan composition process." In light of past performance, the North Korean regime has displayed no desire to reform.

North Korean government propaganda claims the country will be able to become strong and prosperous by April of 2012 and live well, simply by disposing of its mineral resources. It is reported that the value of North Korean mineral deposits is estimated almost six trillion US dollars.<sup>24</sup> One hope for the “military-first” policy is to exploit these natural resources, mainly for military purpose. For example, Dancheon and Daeheung Youth Heroes Mine in Hamkyung Province are famous for their rich magnesite deposits; Daeheung Youth Heroes Mine is called White Gold Mountain. It is believed that more than 25% of the natural deposits of high-grade magnesite in the entire world are concentrated in the Daeheung Youth Heroes Mine. Other mineral deposits in North Korea are also impressive. It is estimated that mineral reserves in North Korea consist of 2,000 tons of gold, 500 billion tons of iron and 6 billion tons of magnesite, with a total value running into the trillions of US dollars.<sup>25</sup>

Despite these abundant mineral deposits, North Korea cannot escape a vicious circle. Most residents hear the regime’s propaganda lectures or summing-up lessons. They have great expectations, yet have become cynical once the reality of the false claims settles in. Especially after the currency reform, this kind of possibility or hope has gotten more of a negative reaction. People in their 20s and 30s complain the most, and as the living standards have been declining, the older generations have openly been saying that the nation is deceiving its residents and killing them without carrying out its responsibilities.

### **3. Refugees' views on the prospects of North Korean regime**

It is hard to guess what opinion North Korean people have in mind regarding its new regime. However, most North Korean refugees expect that Kim Jong-un will not be able to revive the North Korean economy or operate international relations in a harmonious way. Because of a lack of information, the North Korean refugees have lacked much to base their evaluations on and even those who are still in contact with their relatives have normally avoided discussing this topic. North Korean residents are very careful to say anything about Kim Jong-il’s successor because of strict surveillance and potential harsh punishment. Even with an understanding of the refugee status, not one refugee has had a positive perspective on the future of North Korea. In the past, through numerous interviews with the refugees, there were many statements that attributed the republic’s problems to US economic

sanctions. Many refugees anticipate that, even beyond economic hardship, social disorders like the spreading of drug use and the collapsing of the educational system will negatively impact North Korea in the future.

A few have predicted that North Korea might be able to develop positively if it were to improve its relationship with the United States and open up the country. But, after the currency reform, it seems that much of that hope has disappeared. With serious shortages of food and a steady stream of refugees, North Korea's future looks bleak. Most refugees have been pessimistic about North Korea's future, but they lack a clear vision. They were generally unhappy with Kim Jong-il's dictatorship, but none complained about North Korea as a state. Influenced by lingering nationalism, they hold a perception that they have existed and even grown as the product of their nation.<sup>26</sup>

Because of North Korean refugees holding differing views of North Korean and South Korean politics and ideas, most think that North Korean patriotism will prevent unification, either through military force or because of South Korea's initiative. They also believe that because of their limited national power and the United States hostility toward North Korea, North Korea's initiatives on unification will be impossible as well. They also tend to believe that the Korean Peninsula will ultimately become a competitive arena between the U.S. and China.

## V. Epilogue

It is difficult for North Korea to face major changes in the near future. Although there are attempts at economic reform in North Korea, the persistence of a planned economy combined with a military-first ideology is repressing its people. Looking at the economic policies of the past, North Korea has been hostile towards market-oriented reforms. Political freedom is still extremely restricted. However, with constant economic difficulties, the reigning force of the dictatorial regime is, in fact, gradually loosening. The number of North Korean defectors is increasing and corruption already seems to be out of control. In addition, the steady growth of private business will be an index to producing a new future.

The pressure from the bottom of society to provide reform measures continues to increase as the capacity of the North Korean regime decreases. With the slowly shifting paradigm of the North Korean

people and elites, the foundation for a market economy should gain strength in the near future. Without reforming its system, North Korea cannot achieve any positive outcomes. Contrary to its leader's expectation, North Korea's political and military power will become weaker. Changes in North Korea's economic policy will produce positive results when accompanied by a top down reform structure. In addition, the North should improve its international environment by abandoning its nuclear program. This means that a critical transition for North Korea may be beginning. In North Korea, any transition process will mean more practicality with gradual political reform, the implementation of the laws and the institution of capitalism, attracting foreign investment, and transforming North Korea into an export driven industrial structure. This will make possible a meaningful unification progress in the Korean peninsula.

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<sup>2</sup> This article is partly based on testimonies made by more than 60 North Korean refugees whom the author interviewed between August 2010 and July 2011. Opinions in this paper do not necessarily reflect those of the Sejong Institute. The author bears sole responsibility for the content of this paper.

<sup>3</sup> "N. Korea's New Year message urges allegiance to new leader," *The Korea Times*, January 2, 2012.

<sup>4</sup> "N. Korea's new leader visits tank division on New Year's Day," *The Korea Herald*, January 2, 2012.

New Year message urges allegiance to new leader," *The Korea Times*, January 2, 2012.

<sup>5</sup> The primary concern of the North Korean regime is to attain hard currency. North Korea normally sells natural resources to China. In 2010, the North reportedly resumed exports of anthracite coal to China, which had been suspended in August 2009 by Kim Jong-il's instructions.

<sup>6</sup> In North Korea, the farmers' markets, Jang Madang, have been allowed since the 1950s. The general market was permissible in 2003, in which people can buy most necessity goods including some intermediate products for state companies. For a detailed discussion of North Korean market, see Moonsoo Yang, *Marketization in the North Korean Economy* (Hanul Academy, 2010, in

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Korean).

<sup>7</sup> North Korea's trade dependency on China increased from 42.8% in 2003 to 83% in 2010. Korea Trade – Investment Promotion Agency (KOTRA), *Trend of North Korea's Foreign Trade in 2010*, p. 18.

<sup>8</sup> For a detailed discussion on this issue, see Lee-Jay Cho and Chang Jae Lee, eds., *Financing for Regional Economic Integration for Northeast Asia II*, Conference Proceedings 11-01 (KIEP, 2011).

<sup>9</sup> A portion of the financial shortages is fulfilled by private earnings in the "markets". Un-Chul Yang, "Structural Change of Market and Political Slacks in North Korea," in Haksoon Paik and Seong-Chang Cheong, eds., *North Korea in Distress: Confronting Domestic and External Challenges* (The Sejong Institute, 2008), p. 88.

<sup>10</sup> Comments by Dr. Kwon tae-jin at the 5<sup>th</sup> Policy Symposium, "The Truth about North Korea's Food Crisis," at the Sejong Institute. July 7, 2011.

<sup>11</sup> According to the testimony of a North Korean refugee, a lady wanted to invite her father to South Korea, but he rejected her request, based on his stable income in the market as a carpenter and his diligent nature. For Details, see his *Economics of Shortage*, (1953), and, *The Socialist System, the Political Economy of Communism*, (1988).

<sup>12</sup> Now, applicable targets for his theory mostly escaped from socialism. Kornai's theory needs certain conditions to apply to a remnant country such as North Korea or Cuba.

<sup>13</sup> The term "August 3<sup>rd</sup> worker" derives from the state's authorization of the "August 3 People's Consumption Products." On August 3, 1984, Kim Jong-il visited August 3 Products, the national exhibition of light industry. The new law allowed for workers to work independently from state organizations and personally pocket profits, while paying an initial fee to the relevant agency. "August 3rd Person" make payments to the companies in exchange for official permission to conduct external economic activities. Un-Chul Yang, "Structural Change of Market and Political Slacks in North Korea," p. 81.

<sup>14</sup> Comments by Ishimaru Jiro at the 7<sup>th</sup> Policy Symposium, "Reports by North Korean Journalists in North Korea," at the Sejong Institute. August 10, 2011.

<sup>15</sup> It has been reported that one of Kim Jong-il's close associates, Ryu Kyung, Vice Minister of the National Security Agency, may have been purged or killed. Ryu Kyung is a leading member of the NSA. Kim Jong-un needs to plant his own people in positions of power, and someone as powerful as Ryu Kyung is a danger to his future rule. Kim Jong-un may feel uneasy as Ryu Kyung's people had control of the whole NSA system. Kim Tae Hong, "Kim Jong-il Associate

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Purged from NSA,” *NK Daily*, May 20, 2011.

<sup>16</sup> According to Kornai, economic transformation combines several processes. First, change in the political domain occurs from single-party dictatorship to a multi-party democracy. Second, the change in the economic domain comes about when the predominance of state ownership is replaced by the predominance of private ownership. Janos Kornai, “Innovation and Dynamism: Interaction between Systems and Technical Progress,” *Economics of Transition*, Vol. 18(4), 2010. pp. 630-631.

<sup>17</sup> Former Secretary of Finance Park Nam-ki suffered because of the failure of currency reform and fell victim to the plot. He was reported to have been executed.

<sup>18</sup> Robert L. Worden, ed., *North Korea: a Country Study* (Federal research Division, Library of Congress, 2008), p. 184.

<sup>19</sup> Jihwan Hwang, “Getting Out of the Military-First Dilemmas: In Search of North Korea’s Coevolution Military Strategy,” *EAI Asia Security Initiative Working Paper*, June 2011, p. 9.

<sup>20</sup> The amount of money spent by the North in conducting nuclear tests and launching intercontinental and short-range missiles has been substantial. Launching an intercontinental missile is supposed to cost around three hundred million dollars, the second nuclear test around three hundred million dollars and each short-range missile more than forty-six million dollars. The money spent on the North Korea’s nuclear and missile development programs originates from fraudulent currency, drug smuggling, illegal trading in artificial cigarettes, etc. Lee Sung Roh, “Follow the Path to Save the Nation,” *NK Daily*, July 8, 2009.

<sup>21</sup> Kwang-ho Lee, “Countdown to North Korean Missile Launch,” *Vantage Point*, March 2009, p. 7.

<sup>22</sup> Ministry of National Defense, *2010 Defense White Paper*, p. 134.

<sup>23</sup> Hamm Taik-Young, “The Self-reliant National Defense of South Korea and the Future U.S.-ROK Alliance,” in *The 2006 Seoul-Washington Forum*. Organized and published by the Sejong Institute and the Brookings Institution, May 2, 2006.

<sup>24</sup> Statistics Korea, *North Korea’s Main Statistical Indicator*, 2010. p. 32 (in Korean).

<sup>25</sup> “Digging North Korea out of a Hole”, *Daily NK*, October 17, 2011.  
<http://www.dailynk.com/english/read.php?cataId=nk00400&num=8287>

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<sup>26</sup> Un-Chul Yang, “Glimpse of Current Economic Situation in North Korea Revealed by Refugees,” *Current Issues and Policies*, April 2011. p. 4 (in Korean).