

The Prospect of North Korean Economic Development

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완전자급자족을 지향하는 자립적 민족경제의 이념은 북한경제의 기본지도원리로서 오늘날의 세계경제 속에서 북한경제를 심각한 고립상태로 몰아넣는 결과를 초래하였다. 반면에 남한경제는 적극적으로 수출산업을 육성하면서 세계분업체계속에서 확고한 지위를 차지하는 수준으로 발전하였다. 비록 지금 당장 해외의 자본과 기술을 절실히 필요로 하는 처지에 처해 있지만 북한경제는 그 대가를 지불하는데 충분한 만큼의 외화를 획득할 능력을 갖추지 못한 상태이다. 북한경제가 세계분업시대에 적절한 역할을 수행하는 지위로 도약하려면 두가지의 난관을 극복하여야 한다. 첫째, 북한은 빈사상태의 경제를 회생하는데 절실히 필요한 외국의 협력을 유지하기 위하여 개방의 폭을 대폭 확대하여야 한다. 그러나 이 조치는 그간의 북한 통치 이념과 정면으로 배치되는 조치이기 때문에 북한 지도부에 큰 정치적 부담을 지울 것이다. 따라서 북한은 국토와 인구를 둘로 나누어 개방지역에는 절대 충성파들만 거주토록 하는 조치를 취할 가능성이 크다. 비개방지역은 철저히 폐쇄된 채 더욱 강한 통제를 받게 될 것이다. 둘째, 북한은 경제발전을 위한 방대한 규모의 외자를 유치하여야 한다. 북한은 외국인투자를 저해하는 모든 장벽을 제거하고, 여행자유치, 남북경제협력 장려, 그리고 기반구조 건설투자의 수익성을 높이는 계획 입안 시행등의 조치를 큰 폭으로 취해야 한다. 대만-중국의 관계는 남북 경제협력의 좋은 모델이 될 수 있다.

1. Background — Isolated Autarky

The World War II had brought forth division of Korean Peninsula into two Koreas, North occupied by USSR and South by USA. The Communist Regime in North Korea

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was established formally in 1948, after three years of Russian military control. But nationalization of production facilities had started as early as 1946, when all the Japanese-held assets were confiscated. North Korean economy headed for socialist planning system since then, although it is generally agreed that the framework of socialist planning economy had not been completed until 1958.¹⁾

Both of North- and South- Korean economies were heavily devastated by the Korean War. Physical inheritance from the Japanese colonial period was practically terminated as of July 27, 1953, when cease-fire became in effect. It is not too much to say that material accumulation in two economies of Korean Peninsula started from almost nothing as of cease-fire in mid-50's. Each Korea followed its own unique track of recovery from War to formulate present economic performance ultimately. It is well-known that North Korean economy has been and still is lead by the principle of Independent Nation Economy, and the present impasse of North Korean economy is closely related to this INE principle.

The INE principle was proposed by Kim Il-sung, and it dictates a self-contained economy where 1) agricultural products, light and heavy industrial products must be self-provided essentially, and 2) technology and raw materials must be made basically self-sufficient.²⁾ The most ideal INE carries a form of perfect autarky with advanced technology and self-provision of raw materials according to this definition. If an INE in a practical case falls short of this most ideal form, then it is not because the economy has intentionally given up self-sufficiency but because there is no other choice. North Korea, for instance, has to import petroleum because it has been endowed with no oil resources.

This nature of INE is again obvious in *Kim Il-sung's* definition of international trade. *Kim* defined the role of trade only as a residual balancing scheme except for several inevitable accounts.³⁾ Following *Kim's* ideal, North Korea has intended to produce by

1) Lee, Sang-Mahn (1996), *The Historical Background of North Korean Economy*, which is chapter 2 of <The North Korean Economy - Theory and Practice>, eds. by North Korean Economy Forum, Bummunsa, Seoul.

2) *The Collection of Kim Il-sung Writings*, Vol. 3. P.398 (in Korean). Interpreted by the author.

3) *The Collection of Kim Il-sung Writings*, Vol. 4, p.575 (in Korean).

herself 1) all the basic goods needed and 2) what is demanded on a large scale domestically. And it relied upon imports from foreign countries only in goods 1) which are needed in small amounts, or 2) whose domestic production falls by accident short of national demand, or 3) which cannot be produced domestically at all. That is, North Korea has been restricting international trade to an inevitable minimal extent. And even this minimal trade had been carried out mainly with Communist comrade countries under political, not economic, initiatives until the entire Communist block collapsed. Most trades were done in the form of barter, and the prices and other terms of trade were determined by inter-governmental negotiation, usually guided by political ideology of Communism.⁴⁾

As a war-torn undeveloped economy in 50's, North Korea lacked both of capital and technology to build and operate heavy industries. But heavy industries were understood to constitute the core of an INE, that provides equipment and machinery, which are essential to carry out all kinds of industrial and non-industrial economic activities. Furthermore, heavy industries enable to produce weaponry and North Korea needed it very badly as a country, either exposed to high risk or inspired by an intention of getting into another war. North Korean leaders then thought that it was most urgent for them to develop North Korea's own heavy industries in order to build up the economy into an INE as well as a strong military power. North Korea devoted her main efforts to promote development of heavy industries and finally attained international acknowledgement that North Korean heavy industry is just next to Japan in East Asia as of early 1970's. It cannot be argued that Russia and other communist allies supported this effort of North Korea substantially. Under the direction of INE principle and trade policy, North Korea succeeded in import substitutions on a wide spectrum of manufactured items to "streamline" an autarky with minimal volume of international trade.

In the mean time South Korea took a quite different procedure of industrialization. Post-war recovery started from resuming industrial activities, which processed raw

4) Holzman, F.D. (1976), *International Trade under Communism — Politics and Economics*, Basic Books.

(agricultural) materials, provided in the form of US aid, to produce basic light industrial goods for every day life. This direction was determined by US policy on post-war aid to Korea as a natural next step to emergency aid in the form of readily consumable food and clothing.⁵⁾ It is important to notice that South Korean industry was structured from the beginning, intentionally designed so or not, to process materials imported from foreign countries. As termination of US aid became imminent with negligible export in early 60's, South Korean industrial facilities were pushed to the brink of staying idle by force since there was no other way to obtain foreign raw materials. South Korean government was forced to design and implement vigorous export drive policy in 1960's in order to earn foreign exchanges, which are needed not only to pay for foreign loans and technologies but also to pay for imported raw materials just to keep established production facilities in operation. Eventually South Korea succeeded in developing export industries through 70's and 80's to build up a solid basis for earning foreign exchanges.

Evidently the choice of South Korea was set in the direction face-to-face against the North Korean principle of Independent Nation Economy. It was nothing, to North Korean view, but a road to dependency and annexation to imperialistic Western capitalism. While North Korea started with heavy industries, South began with light industries. North aimed at import substitution of every possible item, but South chose export-oriented stance. North idealized isolated self-sufficiency, when South preferred active participation into international division of labor. Two different tracks of economic development, each one followed by each Korea, are displaying an extremely drastic contrast between two Koreas both in past and present.

As the economy grew up, North Korean need for Western technology also became more and more evident in 1970's.⁶⁾ Without any knowledgeable export industries that

5) A report to US Senate in July, 1947 evaluated the prospect of Korean economy then as *desperate*. The Nathan Report of March, 1953 described the shortage of trained manpower, which was badly needed for economic recovery from the War, as a serious problem and no solution seemed to exist to solve this obstacle. The hope for post-War South Korean Economy was so dim that no ambitious design of South Korean economic development had ever been considered seriously in US aid policy.

can earn foreign exchanges, however, North Korea was not able to pay for any significant amount of goods and services from the Western countries. The collapse of Communist world in early 90's was really a devastating blow to North Korean economy, since it meant the end of cooperation from abroad, including petroleum supply under political initiatives. In a nutshell, the Independent Nation Economy of North Korea has pursued after "independence" for fifty years to end up with a disaster where it cannot procure even petroleum by itself! The autarky that North Korea has been aiming at is practically viable only when there are partners like USSR and China, who are willing to provide essential materials such as petroleum not in economic terms of trade but in political consideration. As of now, it is evident that North Korean Economy is in desperate need of economic cooperation from its former (and present (?)) enemies such as South Korea, Japan and USA.

2. Direction of Economic Development

There are many challenges for North Korea to face in order to join in and benefit from contemporary global division of labor so that her economy may operate smooth in the new world economic order. But the most urgent one seems to build up a stable mechanism to earn foreign exchanges. If North Korea had reliable means of foreign exchange earning, then she could still pursue after her own goal of INE whatever it is, keeping the level of her contact with rest of world to an inevitable minimum. Old friendship from Communist countries is no longer existent or not very helpful at best. It is beyond the dispute that North Korea needs foreign exchanges in order to acquire essential resources from foreign countries, which are by no means available domestically and used to be provided with by old Communist alliances on friendship basis so far.

North Korea has been alleged to rely upon foreign exchanges, which were earned

6) North Korea recorded 370 million US dollars in export and 440 million US dollar in import with the Western countries in 1970. Relevant data are available from Ministry of Unification.

from exporting weaponry to third world countries, sent home from abroad by Korean residents in Japan, or acquired by some other illegal means of drug smuggling and counterfeit US dollars. Diplomatic brinkmanship is also a well-known North Korean strategy to derive economic compensation from South Korea and her allies. However, none of these was as effective a means to earn foreign exchanges as the recent Kumgang Mountain tourism business. North Korea has enjoyed each year the revenue of foreign exchanges, which may be earned as net profit only when she exported as much as multi-billion US dollars.

However none of these means are to be accommodated any longer in current world order. Illegal activities and diplomatic tactics will not be allowed. There is limit on the size of pocket of North Korean residents in Japan, and Hyundai is suffering from heavy loss in Kumgang Mountain project. Reasonable and steady means must be developed for North Korea to earn foreign exchanges.

Exporting manufactured goods is a most stable way to earn foreign exchanges for resource-poor countries like North Korea. North Korea must foster the capability to produce commodities exportable with profit. The case of South Korea is a good example of success in this kind of effort. Export-drive policy has been the main force that propelled economic development of South Korea, which also lacked celebration of resource endowments exactly like North Korea. In the past, North Korea denounced heavy dependence on export as a clear-cut evidence for subordination of South Korean economy to Western capitalist countries. It is a real irony that this evidence for subordination is the key factor which enables South Korea to pay for whatever she wants from abroad, while INE principle has made North Korea absolutely incapable of paying for crucial foreign resources she needs. In this sense, South Korea has accumulated plenty of experiences and wisdom, which will prove useful to promote economic development of North Korea from now on.

An alternative way to earn foreign exchanges is to open the country to foreign tourists including South Koreans. Kumgang Mountain has been open to tourism for several years and it is so far a big success for North Korea, although it has created a serious financial crisis to Hyundai group. Observers think it is very likely that North Korea may expand

open sites for tourism further in order to attract more tourists from abroad. In order to make the projects viable, however, North Korean share must be set at a reasonable level so that her Southern partner may survive!

A third way is to open the land routes, that connect South Korea with many different places in continent. This connection is more than just a simple connection of continent with only South Korea, as South Korea is already well-equipped with infrastructure for marine transportation of large scale, which connects herself with rest of world. North Korea may seek to rent this route to collect toll fee in substantial amount.

All these three projects will become possible only after proper physical infrastructure is built to a satisfactory level in North Korea. It is, however, evident that North Korea alone is not capable of carrying out construction of requisite infrastructure. International cooperation is needed from the very incipient stage of North Korean economic development. Although North Korea is unable to pay for foreign contribution at this moment, she will become capable of repaying for loans once after she attains stable mechanism for earning foreign exchanges. In the mean time, North Korea must provide potential investors with credibility and legitimate incentives for this purpose.

3. Needs for International Cooperation

So far the performance of North Korean economy is simply a disaster. The practice of Communist economic planning has accumulated inefficiency, which foiled not only capital accumulation but also proper maintenance of existing infrastructure. Autarkic nature deprived North Korean economy of capability to earn foreign exchanges. Fundamental restructuring is necessary to reshape North Korean economy toward a viable one in contemporary global economy. It must become open to a substantial degree to outer world and linked properly to the system of global division of labor. Reconstruction and expansion of physical infrastructure is very crucial for this purpose.

In order to reconstruct economy, North Korea must resort to foreign capital and technology. International environment surrounding North Korea must be straightened

out, and appropriate arrangements must be made by North Korean government in order to induce market-oriented foreign investors into projects for economic development of North Korea. It is necessary for the Western world to lift various political and economic sanctions against North Korea, and North Korea must encourage it by some favorable and visible actions.

North Korea must be allowed some decent role in global division of labor, so that she may be convinced in possibility of her own security and prosperity in the new economic environment. It will be a worst outcome, if North Korea is forced to create troubles out of desperation without any stable link to global economy. There is a good reason for international community to encourage North Korean membership in new global economy. An imminent task is to provide an emergency outlet for North Korea from present crisis by supplying capital and technology. And North Korean government must be ready to accommodate cooperation from abroad by initiating proper restructuring her socio-economic system..

North Korean society is still most closed in present world. Only a very limited extent is exposed to the rest of world. In order to promote, or rather to initiate international cooperation, North Korea must expand substantially her exposure to outside world. International cooperation will naturally be limited by the degree of openness of North Korea.

It is most important for North Korea to prepare and promise safeguards for protection of foreign investments. There are plenty of risks for foreigners' investment in North Korea. The probability is very high for fruits of investment to be held up by host country. There are too many restrictions on foreigners' ventures and too many uncertainties concerning business environments. Foreign investors must negotiate with North Korean government agent to employ workers and are not free to choose their own employees. Government frequently interferes business practices of foreigners' ventures, demanding to pay higher wages or to use costly containers with poor quality produced in North Korea. Most of prospective investors in South Korea are worried about possible hold up after their investment is sunken in North Korean territory.

Of course this kind of risky environment is common to most developing economies. It

often happens in developing countries that local government raises up issue after issue demanding more of its share, once foreigners' investments are sunken in their territories. Foreign investors incur subsequent losses and decide to withdraw their investments and not to invest any further. These decisions of foreign investors give serious damage to the prospect of further economic development of host economy. It is not, however, properly conceived by most developing countries, since damage is done only to unrealized potential while offhand gain is a real one. As long as there is a real gain at hand, some governments of developing countries do not pay attention to any damage on development potential no matter how huge and serious it may be. North Korean government has accumulated plenty of infamous practices in international politics which may well make potential investors deeply worried about possible hold up against their investments. It seems absolutely necessary for North Korean government to provide with clear and credible business environment in order to offset its notorious past records.

4. Taiwan-China Relation — A Noteworthy Model

The relation between Taiwan and China indicates an interesting model for inter-Korean relation to promote and protect investment between politically hostile partners. Taiwan does not maintain diplomatic relationship with China, and Taiwanese enterprises are not allowed to invest directly into mainland. There is no inter-governmental agreement to protect Taiwanese investment into mainland, and so Taiwanese ventures in mainland are exposed helplessly to the risk of being confiscated any time by main land government. But no Taiwanese investors are alert to or worried about such risks and Taiwanese investment into main land China has been ever increasing.

Taiwanese investment has formulated a unique economic relationship between China and Taiwan. Taiwanese venture in main land processes parts and components imported from host firm in Taiwan to produce finished goods, which the host firm takes out to export to the United States. So the host firm in Taiwan is in charge of supplying parts and components, and exporting final goods, while its subsidiary in main land is in charge

of simple labor-intensive process of manufacturing. Traditionally Taiwan enjoyed the largest surplus in balance of trade account with USA. But now China is the trading partner who gives Taiwan the largest surplus.

If this chain of production-export is interrupted by some unexpected accident, say sudden decree from Chinese government, then the result will be a disaster to Taiwan. Main land China, however, also suffers deeply because the confiscated units are not capable of procuring material inputs and marketing their products overseas by themselves. The chain has been built up so tightly and interdependently that its destruction renders prohibitively huge losses to both sides. The per capita GDP of Taiwan was 23 times as great as that of China in 1990. But this number is reduced to 17 times in 2000. The remarkable growth of Chinese economy is indebted in a large extent to Taiwanese investment and Taiwan-China economic cooperation. As Chinese government is fully conscious of it, there is no worry about abrupt governmental interference, even though Taiwanese investments are not covered by inter-governmental protection agreement. Both sides are locked in a extremely tight chain of cooperation.

All this was possible because the leaders of main land China were fully aware of importance of long term benefit from Taiwan-China cooperation of this kind. If China had been tempted to hold up the small amount of short term gain, then there would emerge no such economic cooperation as it is now between Taiwan and China, and economic growth of China would have been much slower than it has been.

5. The North-Korean Dilemma

This mechanism may not work well at the incipient stage of inter-Korean cooperation. So far Chinese leaders succeeded in maintaining political stability throughout the entire transition period. Taiwan has been a hostile rival against main land China, but she is not to be compared with the mainland China in terms of size. Economic cooperation with Taiwan created little threat to political stability of the mainland China.

It is quite different in inter-Korean relation. Both Koreas stood against each other in

hostile rivalry for more than fifty years as Taiwan and China did. But South Korea is not Taiwan and North Korea is not the mainland China. South Korean population is twice as big as that of North Korea. The big size of South Korea alone is enough to be threatening North Korea. And what chokes off North Korea more is the miraculous economic performance of South Korea.

It has been the *raison-d'être* of North Korean government to save South Korean people from exploitation of capitalist enemies. All the political and economic hardships of North Korea have been understood as inevitable obstacles, which were deliberately created by enemies such as US and Japanese imperialists and their South Korean puppet government. This difficulties must be endured by people in order to unify the mother land, to complete the revolution, and to liberate South Korea. But all of a sudden, North Korea is given no choice other than to begin economic cooperation with South Korea, Japan and the United States.

It is not very difficult to understand serious dilemma imposed on North Korean leaders. How can they maintain their political consistency and legitimacy of leadership in transition from traditional autarky to international cooperation with former enemies? The cooperation is, to make it straight, nothing but asking for rescue. How will North Korean leaders explain the latest development and persuade their people? If present leaders of North Korea admit their failure and new leaders take over the power, then the dilemma will not arise at least. North Korea will really change then.

But such a development seems not very likely, and inter-Korean cooperation must be unfolded with such dilemma unsolved. This is why many observers are very suspicious of the real identity of North Korean leaders' mind: Have they really changed? I think that, if there is change in North Korean basic principle at all, then it will be only a gradual one at all. And this gradual change will take extremely lengthy period of time. Future development of inter-Korean cooperation will crucially be influenced by this factor.

6. Prospect of North-Korean Strategy

As inter-Korean cooperation escalates, the interactions between peoples of both sides will expand. More North Koreans will have to meet South Koreans and realize what is the real feature of inter-Korean economic cooperation. This will naturally confuse North Koreans to threaten their political stability. It is no doubt that North Korean leaders are prepared for this possibility. When they expect socio-political instability domestically because they must open up their door and expand North-South economic cooperation, the only strategy is to dichotomize strictly North Korean population and territory into two parts; the one open and the other tightly closed.

There is a significant portion of North Korean population who are diehard loyal to present leadership. The source of this no-matter-what loyalty is a very interesting subject of academic research and must be investigated in depth. But a superficial observation suggests that the principle of *juche* appeals to nationalistic minds and socialist ideology still attracts liberal minds of many North Koreans. North Korea will designate some areas as open district and relocate population so that those loyal people stay in open district and the remainders in tightly controlled closed district. Inter-Korean cooperation will occur only in open district.

South Korea and her Western allies must recognize this and prepare a master plan of cooperation. I think we must encourage North Korean leaders to proceed as they planned and positively accommodate their strategies.

However, it is also very likely that North Korean leaders, or their followers, may occasionally try to hold up unduly share from foreigners' investment for themselves. Kungang Mountain tourism, as everybody knows, is the biggest North-South cooperative project so far, which was agreed upon not by economic principle but by political consideration. They may claim that the project is a good precedent example and each future project must take models of Kungang Mountain project. In order to initiate a long lasting and mutually beneficial inter-Korean cooperation like the one between

Taiwan and China, it is utterly important to design each project of economic cooperation according to strict economic principle. While accommodating and supporting the North Korean strategy of strict dichotomy, South Korean and foreign investors must be very strict to impose market principle so that North Korean leaders may finally understand, like Chinese leaders, the benefit from cooperation based on market principle.

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The principle of Independent Nation Economy idealized perfect autarky and has led the North Korean economy to an extreme isolation from global economy. On the other hand the South Korean economy has aggressively fostered export industries to find a decent position in global division of labor. Although the North Korean economy needs desperately foreign capital and technology, she has no means of earning a sufficient amount of foreign exchanges to pay back for economic cooperations from abroad. There are two major obstacles for North Korea to overcome in order to adjust herself into a reliable partner in global economy. Firstly, North Korea must open up her country to a significant extent in order to induce economic cooperation from abroad on a massive scale, which is absolutely necessary to vitalize the already shrunken economy. But this action will generate too much a political burden as it contradicts directly to the past doctrine of North Korean leadership. North Korea is likely to dichotomize her population and territory and the open zone will be allowed for only those citizens who are die-hard loyal to present leadership. The other part will be tightly closed and subject to firm control. Secondly, North Korea must be able to induce substantial amount of foreign capital needed for economic development. North Korea must eliminate all the barriers against foreign investment, and implement reasonable strategies so as to promote tourism, to encourage inter-Korean cooperation in industrial activities,

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and to develop programs that improve profitability in investment for infrastructure. The Taiwan-China model of economic cooperation suggests a plausible direction for inter-Korean economic cooperation.