The First Ten Years of Kim Jong-Il's Economic Policy: Changes and Future Direction of North Korea's Economic Policy

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What will the North Korean economy look like a decade from now? Ever since North Korea's implementation of its Economic Management Improvement Measures in July 2002, a wide range of views have been voiced with regard to the future direction of the North Korean economy. This paper discusses what changed and what remained the same during the ten years since the death of Kim Il-Sung in July 1994, after which North Korea began trying to change its economy in accordance with its own version of socialism. The current state of the North Korean economy makes certain things clear. Difficult though it may be to predict how the quantitative aspects of the North Korean economy will change, there is general agreement that it will increasingly become market-oriented. However, there is no agreement on the pace of transition. Will it be a radical bang or a gradual transformation or a third-way. The future direction of the North Korean economy will become more evident over time.

Keywords: Inter-Korean Basic Agreement, Rajin-Sonbong Free Economic Trade Zone, Economic Management Improvement Measures, sunshine policy, six-party talks

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I. INTRODUCTION

In the aftermath of North Korea's implementation of its Economic Management Improvement Measures in July 2002, many opinions have emerged with regards to the future direction of the North Korean economy. On May 16 2004, *Ta Kung Pao*, one of the oldest dailies in China, carried a report in which it analyzed the possibility of North Korea adopting a market economy. The three main arguments contained in this report can be summarized as follows: 1) Given the timid nature of the North's reforms and opening to the outside world to date, a market economy system can hardly be expected 2) moreover, even if the North earnestly implements reforms, several significant obstacles will remain before a market economy can be introduced 3) the North's successful implementation of reforms will at the very least mean that a return to the ways of the past is impossible (KOTRA 2004). Various opinions on the future direction of the North Korean economy have emerged within Korea as well; with these opinions ranging from those who argue that the current changes will inevitably lead to the introduction of a market economy system, to those who maintain that the ongoing changes in North Korea will not bring about any long-term structural changes (Jeong 2004; Park 2004; Lim and Jeong 2004; Cho 2004). In which direction is North Korea's economy heading? Can North Korea follow China and Vietnam's lead and effectively introduce a market economy system? Or will the North follow the "Big Bang" approach adopted by the USSR and Eastern Europe as they tried to reform their planned economic systems? As the number of operational spaces in which a market economy can function has increased, the hope has grown in some quarters that North Korea will indeed proceed with the introduction of a market economy. However, the overarching problem with this line of thought is that it does not sufficiently take into account the economic system that has been in place in the North for the last 50 years. In other words, can the software used to manage the economic system, which has functioned alongside a planned economy system that has been in place for some 50 years, easily be changed? China, a country which had a planned economy system in place for some 30 years, was able, as a result of the reform and opening up policy it adopted at the end of the 1970s, to successfully move towards a market economy. On the other hand, the USSR, which functioned under a planned economy system for some 70 years, rapidly moved towards a market economy at the end of the 1980's as a result of its adoption of a "Big Bang" approach. This change, although very rapid, has not been accompanied by a concurrent understanding of the implications of a market economy among the general population of these countries.

The future direction of the North Korean economy will become more evident as time goes by. Nevertheless, it is clear that the current economic situation in North Korea and the changes in the external environment have led to these changes in the North's economic structure. Since the death of Kim Il-Sung in July 1994, North Korea has attempted to change its economy in accordance with "our-style of socialism."

How should the first 10 years of the Kim Jong-il regime be evaluated? What consistencies and changes have been recorded during this period? How will North Korea change in the future? While these are not easy questions to answer, this paper nevertheless attempts to do so in order to contribute to the understanding of the issues surrounding these questions.

II. DEVELOPMENT OF THE NORTH KOREAN ECONOMY UNDER KIM JONG-IL

1. Kim Il-Sung's Economic Legacy

Before any discussion or evaluation of the North Korean economy under Kim Jong-il can be carried out, the economic legacy left behind by Kim Il-Sung must first be addressed. Such an analysis is important because the economic legacy left behind by Kim Il-Sung became the basic foundation for Kim Jong-il's own economic policy, and has also acted as one of the most important factors complicating efforts to make certain changes to the North Korean economy.

Kim Il-Sung's style of economic construction, which picked up speed with the Chollima Movement launched at the conclusion of the Korean War in 1953, was at the outset quite successful. This can be ascertained by the fact that the goals of the 1st Five-year Economic Plan, from 1956 to 1960, were achieved a year early. However, with the abandonment of its Six-year Economic Plan for 1971 to 1976 in August 1975, North Korea found itself at a crucial juncture (Bae 2003). During this period, two changes in the regional landscape began to seriously threaten the North Korean economy, which had by this point become internationally bankrupt: First, the North's defeat in its economic competition with South Korea, which had been a very heated one during most of the 1970s, led to the establishment of a new relationship between the two Koreas, and to several economic problems for North Korea. Second, North Korea found itself increasingly pressured to prepare an adequate response to Deng Xiaoping's reform and opening policy launched at the end of the 1970s.

At this point, North Korea chose to move in three different directions. First, it decided to attract foreign investment, a move accompanied by the taking of such steps as increased emphasis on the development of international trade in the 2nd 7-year economic plan (1978-1984) and in the passing of the Joint Venture Law (September 8, 1984). Second, North Korea began to participate in inter-Korean economic talks (November 15, 1984), responded positively to President Chun Doo-Hwan's proposal for inter-Korean trade and economic cooperation, and accepted the South's offer to provide commodities and technologies to the North (August 20, 1984). Third, the North also reinforced the *Yonhap-Giupsa* – which combined companies engaged in similar industries in a larger unit (Nakagawa 2003) – and strengthened the self-account-

ing system (Kim 1990, 352-364, 426-483). However, as North Korea remained weary of launching reforms similar to those undertaken by China, the degree and scope of its reforms remained well below global standards. Moreover, the economic dialogue between North and South Korea broke down after the 5th round of talks (November 20, 1985). The North's policy of attracting foreign investment, which had been designed to acquire capital from the West, essentially became nothing more than a joint venture with Chochongryon – the General Association of Korean Residents in Japan – a denouement which left many North Korean economic managers frustrated.¹

This failure to reform the North Korean economy during the 1980s and the concurrent epochal changes in the external environment, namely the unification of Germany, and the collapse of the Soviet Union and the East European socialist block, had wide-ranging repercussions for the North Korean economy. These included, first and foremost, the loss of international markets. In fact, as a result of its conclusion of a new trade agreement with the Soviet Union in November 1990, which stated that from then on all payments had to be made in hard currency, and of a similar agreement with China in January 1992 that brought all barter-based trade to an end, agreements which were rendered necessary by the changes that had been wrought to the USSR and Eastern Europe's economic structure, North Korea lost about 70% of its international markets. Second, this period also witnessed the onset of North Korea's negative growth rates. In addition to this decrease in international trade, the near-curtailed of the Chinese and Russian shipments of crude oil and food aid also severely damaged the North Korean economy. This led to a growing lack of resources and raw materials essential to running the North Korean economy, which in turn led to a significantly lower output on the part of North Korean factories. Third, signs of a collapse of the food distribution system, one of the fundamental functions of a planned economy, also began to appear during this period. As a result of the growing problem of acquiring food from abroad, a two-meal a day campaign was launched from 1992 onwards. This situation was even worse in the northeast of the country where the food distribution system had already experienced paralysis on numerous occasions (Natsios 1999, 5).

Kim Il-Sung, recognizing the seriousness of the situation, adopted various measures: 1) Officially recognizing the failure of the 3rd 7-year economic plan, Kim Il-Sung declared an agriculture, light industry, and foreign trade-first policy as the economic strategy to be implemented during the buffer period (1994-1996) (December 8, 1993: The 21st Session of the 6th-term Party Central Committee) (Kim 1996, 272-290) 2) moreover, in order to normalize the North's relations with the South as well as with the international community, which had gone from being promising in the aftermath of the signing of the Inter-Korean Basic Agreement (February 19, 1992) and Additional Protocol (September 17, 1992) to being seriously strained by the North's withdrawal from the Non-Proliferation Treaty (NPT) (March 12, 1993), Kim Il-Sung agreed to restart talks with former U.S. President Jimmy Carter, (June 18-19,

1994) and to hold a North-South Korean Summit (June 28, 1994) 3) in addition, Kim Il-Sung also instructed that the Rajin-Sonbong Free Economic Trade Zone be rapidly developed (June 14, 1994) (Bae 2000; Kim 1996, 453-461).

2. The North Korean Economy Under Kim Jong-Il

If we accept the premise that the three main criteria used to evaluate the changes that have taken place within North Korea should be domestic, inter-Korean, and international developments, then the development of the North Korean economy in the aftermath of Kim Il-Sung's death (July 8, 1994) can be separated into three periods. The first of these periods spans from Kim Il-Sung's death in July 1994 to Kim Jong-Il's inauguration as the General Secretary of the Korean Workers' Party in October 1997 (1994-1997). This period can be referred to as the continuation of Kim Il-Sung's economic legacy. Meanwhile, the second period runs from Kim Jong-Il's inauguration as the General Secretary of the Korean Workers' Party to the implementation of the Economic Management Improvement Measures in July 2002 (1997-2002) and can be labeled as the preparatory stage of economic reform. Finally, the third period begins with the onset of the Economic Management Improvement Measures (2002-present), a period which will be referred to herein as the implementation stage of economic reform.

(1) The Continuation of Kim Il-Sung's Economic Legacy (July, 1994 - October, 1997)

In the aftermath of Kim Il-Sung's death Kim Jong-Il was faced with the arduous task of either upholding or abolishing his father's economic legacy. Unfortunately for Kim Jong-Il, in reality no such option was available to him as the North Korean economy was by this point for all intents and purposes bankrupt (O 1995, 47-48; Kim 1996, 474-490) and the collapse of the food distribution system that had started in the northeast began to spread (Natsios 1999, 14). As such, Kim Jong-Il's decision to leave all of his father's policies in place during this first period, officially explained away as due to the observance of a three-year mourning period by the younger Kim, was all but predetermined by external factors.

First, North Korea attempted to ease its energy and food problems, which were at this point the most urgent issues facing the North Korean economy, through the settlement of the first North Korean nuclear crisis. The Geneva Agreement (October 21, 1994) allowed North Korea to, from 1995 onwards, assure itself of 500,000 tons of crude oil and 1 million tons of grain annually from the U.S. and the international community (Natsios 1999, 8). Moreover, during this period Kim Jong-Il actively pursued the development of the Rajin-Sonbong Free Economic Trade Zone while keeping in place Kim Il-Sung's agriculture, light industry, and foreign trade-first policy (Kim 1994, 11-23). However, two limitations arose to hinder the development of the North Korean economy at this time: the socialist overtones of this agriculture,

light industry, and foreign trade-first policy (Kim 2000, 8-9), and the adoption of a strategy for attracting foreign investment that was based on cooperation with the Western world without any concurrent improvement in inter-Korean economic relations (Bae 1995, 22-27). In the end, this economic strategy proved to be a disaster as negative growth rates became the norm; a massive number of people died from starvation (Natsios 1999, 1); the government's control over population movements was paralyzed, and the collapse of the central distribution system caused a concurrent drop in industrial output as well as chronic inflation. Further compounding matters, the government's hoped-for foreign investment in the development of the Rajin-Sonbong zone never reached expectations (Bae 2000).

During this period, some signs of change began to appear on the horizon:

First, Kim Jong-Il's adoption of a military-first economic strategy resulted in strengthening his leadership over the military (Kim 2000). In reality, it was only natural that North Korea developed its heavy-chemical industry during its competition with the South, as this could be used to build munitions. This military economy, which accounted for 30% of the overall budget at the end of the 1960s, grew to account for in excess of 60% of total industrial production by the mid 1990's (Bae 2003, 157). Accordingly, the munitions industry became the last stronghold that North Korea could mobilize to rebuild its economy.

Second, experimental reforms, although limited to the Rajin-Sonbong Free Economic Zone, began to be implemented. In fact, new legal mechanisms were put into place and enforced from June 1, 1997 onwards that included the adjustment of the exchange rate (from 2.21 won to 210 won to the dollar), implementation of a flexible exchange rate system, application of market prices to certain products, and the granting of the permission for market economy activities to take place in certain specified sectors (food and accommodation industry, food processing industry, repair and maintenance services, handicrafts industry, as well as a few other industries) (Bae 2000, 348).

Third, as a result of the ongoing economic difficulties non-socialist economic phenomena, such as the emergence of farmers' and underground markets, began increasingly to pop up as an alternative to the moribund formal economy. Although estimates of the size of this informal economy vary greatly (Park 2002; Nam and Mun 2000)², all agree that its influence increased greatly from the middle of the 1990s onwards.

(2) Preparatory Stage of Economic Reform (October 1997- July 2002)

Upon being officially named to the post of General Secretary of the Korean Workers' Party on October 3, 1997, Kim Jong-Il immediately began to tackle economic issues (Kim 2000, 253-273, 274-287). Despite an overall continuation of Kim Il-Sung's economic policies, Kim Jong-Il also began to establish the foundation needed to gradually implement his own independent policies. In other words, although Kim Jong-Il's declaration of the need to independently construct the national economy while developing a strategy to reestablish socialism and re-launch the Chollima

Movement, which Kim Il-Sung had used to build the economy during the 1950s, can be regarded as a return to the past, Kim's inauguration as the Chairman of the National Defense Commission, the modification of the Constitution, the growth of independent economic development, and the adoption of a military-first policy by the Korean Workers' Party (KWP), should be seen as having sown the seeds of changes that were carried out in a gradual fashion.

The first task to which the newly elected General Secretary of the KWP turned his attention was the construction of a system that could be used to temporarily mobilize the military's economic resources for the rebuilding of the economy. The first signal of this strategy came during Kim's visit to the Jagangdo area in January 1998 (Bae 2003; Kim 2000, 393-411; Masao 2001). In this regards, Kim's reelection to the post of Chairman of the National Defense Commission, which came immediately after the North's first launch of the Daepodong missile (August 31, 1998), and the modification of the Constitution (September 5, 1998) were meant to announce to the international community that the North had adopted a military-first system in which the military's economic resources would be mobilized to rebuild the North's economy.

The next change occurred as a result of the changes that took place in Northeast Asia following the outbreak of the East Asian financial crisis in July 1997. Here, two streams directly related to the North Korean economy emerged in connection with these larger developments: One was the restoration of the North's traditional relations with China and Russia, relations which had been strained since the beginning of the 1990s. The other was the North's positive response to the Sunshine Policy launched by the Kim Dae-Jung government. This positive response was premised on Kim Jong-Il's belief that his participation in an Inter-Korean summit could help achieve a breakthrough for the North Korean economy, which proved to be quite astute as Kim Jong-Il's successful summit diplomacy with China (May 29-31, 2000), South Korea (June 13-15, 2000), and Russia (July 19, 2000) did in fact positively influence the North Korean economy. In particular, the inflow of economic resources such as energy, food, and hard currency from China and South Korea allowed the North to record positive growth rates from 1999 onwards, and to improve the industrial output of its main industries.

However, due to the contradictory results of the policies implemented during this period there has been much confusion as to how to evaluate the changes that took place at this time. This period saw the North's links with the global financial sector be severed as a result of the bankruptcy of Peregrine Investments Holdings Limited, the parent company of the Peregrine Daesong Development Bank, and of the ING Northeast Asian Bank's decision to withdraw from North Korea after the outbreak of the East Asian financial crisis (Bae 2000, 362). Moreover, the construction of the Rajin-Sonbong Free Economic Trade Zone actually ground to a halt during this period, all of which represent the red lights faced by the North in its efforts to gain access to international markets during this period.

However, the North's success in getting the U.S. to ease a second set of economic sanctions (September 17, 1999) (Korean Central News Agency 2000), and in establishing diplomatic relations with several European nations can be construed as some of the green lights that helped to further invigorate North Korea's reform and opening policy.

On the other hand, the constant debate over the North's weapons of mass destruction, a debate which was further exacerbated by the North's launch of a Daepodong missile as part of its military-first policy, emerged as another red light for the North's economic opening effort, with the Bush Administration's growing concern over the spread of weapons of mass destruction placing the North squarely at odds with the U.S. Conversely, the North's growing emphasis on scientific technologies, pragmatism, and on the need for new thinking based on the dual slogan of the drive to achieve reform & opening and practical socialism (Chosun Shinbo 2002), which was first announced during Kim Jong-Il's visit to Shanghai (January 15-20, 2001), represents another green light in terms of the North's opening up of its economy to the outside world.

Unlike the confusion that surrounded the North's international and domestic economic policies, the changes that occurred in inter-Korean economic relations during this period were evident. While economic relations between the two Koreas appeared to be strained at the beginning of this period, in large part because of the North's refusal to allow South Korean companies to enter the Rajin-Sonbong area (Bac 2000, 336-369; Bac 2003, 168-169), the donation of 500 heads of cattle to the North, which were transported over the heavily fortified DMZ (June 16-23, 1998), helped to facilitate the holding of a meeting between Kim Jong-Il and the honorary chairman of the Hyundai Group Chung Joo-Young, (October 30, 1998); a meeting which in turn helped to put North-South economic relations on track. However, the most significant development during this period was the signing of the June 15 Joint Declaration during the Inter-Korean Summit of June 2000. This agreement marked the onset of the North's strategy of using the gains made in inter-Korean cooperation to attract foreign investment; a strategy based on improving inter-Korean economic relations and ending the hostile relationship of the last 50 years in order to facilitate the North's opening up of its economy to the outside world.

(3) Implementation Stage of Economic Reform (July 2000 -)

Many of the difficulties faced by North Korea during the preparatory stage of economic reform were dealt with in the Economic Management Improvement Measures that were implemented in July 2002. Moreover, North Korea's new found notions of practical socialism were also evident in the announcement of the establishment of the Sinuiju Special Administrative District (September 19, 2002) and in the passing of a law making the Geumgangsán area a tourist district (November 13, 2002); which was followed by the passage of a law designating Gaeseong as a special economic zone (November 20, 2002). This practical socialist policy was designed to create diverse operational spaces where both the planned and the emerging market economy

could function, with the market's operational space restricted to certain areas. In other words, North Korea has adopted a policy of maintaining its socialist economy by bringing about a pragmatic reorganization of the system. Meanwhile, North Korea has decided to introduce a capitalist system in special economic areas such as the Sinuiju Special Administrative District.

Domestically, North Korea has also implemented significant changes in its policies on price, wage, and corporate management. These have included: 1) the readjustment of prices, 2) formation of pragmatic economic development plans, 3) expansion of material incentives, 4) increase in the number of items subjected to market prices, 5) and the decrease in the overall financial burden. All of these changes have been based on the normalization of the state's development plan (Cho 2004, 7; Kim 2004, 39-41). In particular, the massive increase in prices, which has sometimes reached as high as 25-fold, and this even when exchange rates are adjusted, has been the first such drastic price increase in the 50-year history of North Korea. In addition to the above-mentioned changes in long-standing socialist principles, another limited change that has taken place has been the primacy given to the development of the defense industry over the agricultural and light industries (Chosun Shinbo 2003). In other words, although the military's economic resources have been used to promote this so-called practical socialism, in the overall North Korean economic structure military indicators continue to play a larger role than public ones.

This period has also seen dramatic changes in the international environment. Although the plan to turn Sinuiju into a Special Administrative District along the same lines as Hong Kong was announced soon after the DPRK-Japan Pyongyang Declaration of September 17 2002, this announcement was met with disinterest from the West who by this point had lost faith in the potential of this project following the revelation of the North's pursuit of secret uranium-based nuclear program, which was made public after U.S. special envoy James Kelly's visit to North Korea (October 3-5, 2002), and the arrest of the man- Yang Bin- whom North Korea had designated as the First Minister of the Sinuiju Special Administrative District in China (October 8, 2002). Nevertheless, North Korea's willingness to reform and open up its markets during this period went well beyond most observers' expectations. North Korea's withdrawal from the Non-Proliferation Treaty (January 10, 2003) following KEDO's decision to stop providing crude oil (November 14, 2002) to the North relegated the construction of the Sinuiju Special Administrative District to the backburner, as the North increasingly focused its energies on the six-party talks designed to resolve the current nuclear crisis.

Despite the ebb in Japanese-North Korean economic relations, North Korea has managed to maintain positive growth rates throughout this implementation stage of economic reform. However, by far the most remarkable change that has emerged during this period has been the development of inter-Korean economic relations, with the amount of annual trade between the two Koreas now reaching in excess of 700 million dollars. As a result of the passing of the law making the Geumgangs

area a tourist district and the proclamation of the law designating Gaeseong as a special economic zone; the official announcement of a four-point economic cooperation pact (August 20, 2003); and the basic meeting of the minds on the need to reconnect railroads and roads that has been in place since November, 2002; the inter-Korean economic relationship has become more official and institutionalized. Furthermore the Gaeseong Industrial Complex has been established during this period, with several enterprises having already begun to move into the complex.

III. EVALUATION OF THE NORTH KOREA ECONOMY UNDER THE KIM JONG-IL REGIME AND FUTURE PROSPECTS

1. Signs of Change

(1) Quantitative Aspect: Continuation of economic difficulties and increased dependence on the outside world

A decade has passed since the launch of the Kim Jong-Il regime. How have Kim Jong-Il's policies affected the North Korean economy? Here, the economic indicators found in Table 1 clearly illustrate the achievements that Kim Jong-Il's government has been able to bring about over the last 10 years. The government's ability to steer the economy away from nine consecutive years of negative growth towards positive growth, which has been accrued ever since Kim Jong-Il assumed full control over the government, has been nothing short of remarkable. On the other hand, as most of these economic indicators demonstrate, Kim Jong-Il has been unable to bring the economy back to where it was prior to Kim Il-Sung's death. This point is clearly evidenced by a brief look at economic indicators such as the nominal GNI, GNI per capita, size of the overall budget, coal production, generation of electric power, fertilizer and steel production, and the size of international loans.

Despite all this, some changes have occurred that have for the most part gone under the radar. There are signs that North Korea has begun to increasingly participate in the international economy. As we can see from Table 1, North Korea's international trade, as well as inter-Korean trade, has increased since 1998, with the combined worth of such trade estimated at approximately 3 billion dollars. If the current trend continues unabated, it appears very likely that North Korea will be able to once again reach the 4 billion dollars in annual trade that it usually accrued before the collapse of the socialist bloc. Furthermore, the 300 million dollars in humanitarian support a year that North Korea has received from the international community since 1997 has served to further connect the North Korean economy, led by Kim Jong-Il, to the capitalist economy. In this regards, the growing links between the North Korean economy and its Chinese and South Korean counterparts have been by far the most salient development.

TABLE 1. NORTH KOREAN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Nominal GNI (100 million dollars)	231	229	211	205	212	223	214	177	126	158	168	157	170	184
GNI per capita	1,142	1,115	1,013	969	992	1,034	989	811	573	714	757	706	762	818
Economic Growth (%)	-3.7	-3.5	-6.0	-4.2	-2.1	-4.1	-3.6	-6.3	-1.1	6.2	1.3	3.7	1.2	1.8
Size of overall budget (100 million dollars)	166	172	185	187	192	N.A	N.A	91	91	92	96	98	N.A	N.A
Coal (ten thousand ton)	3,315	3,110	2,920	2,710	2,540	2,370	2,100	2,060	1,860	2,120	2,250	2,310	2,190	2,230
Electric power (100 million kWh)	277	263	247	221	231	230	213	193	170	186	194	202	190	196
Import of crude oil (ten thousand barrels)	1,847	1,385	1,114	997	667	806	686	371	369	233	285	424	438	421
Fertilizer (ten thousand ton)	88.9	80.4	77.5	90.1	73.8	67.6	53.6	43.1	39.2	57.2	53.9	54.6	50.3	41.6
Cement (ten thousand ton)	613	516.9	474.7	398	433	422	379	334	315	410	460	516	532	554.3
Steel (ten thousand ton)	336.4	316.8	179.3	185.9	172.8	153.4	120.8	101.6	94.5	124.3	108.6	106.2	103.8	109.3
Grain (ten thousand ton)	402	442.7	426.8	388.4	412.5	345.1	369	348.9	388.6	422.2	359	394.6	413	425
Traded amount (100 million dollars)	41.7	25.8	25.6	26.5	21.0	21.0	20.5	19.8	14.4	14.8	19.7	22.7	22.6	23.9
(export)	17.3	9.4	9.3	9.9	8.6	8.6	7.4	7.3	5.6	5.1	5.6	6.5	7.3	7.8
(import)	24.4	16.4	16.2	16.6	12.4	12.4	13.1	12.5	8.8	9.6	14.1	16.2	15.3	16.1
Exchange rate (won/dollar)	2.14	2.15	2.13	2.15	2.16	2.05	2.14	2.16	2.20	2.17	2.19	2.2	2.21	145.00
													1.53	
International Loans (100 million dollars)	78.6	92.8	97.2	103.2	106.6	118.3	120.0	119.0	121.0	122.9	124.6	N.A	N.A	N.A
Inter-Korean Trade (100 million dollars)	0.1	1.1	1.7	1.9	2.0	2.9	2.5	3.1	2.2	3.3	4.3	4.0	6.4	7.2
Trade with other major countries (100 million dollars)	China	4.8	6.1	7.0	9.0	6.2	5.5	5.7	6.6	4.1	3.7	4.9	7.4	10.2
	Japan	4.8	5.1	4.8	4.7	4.9	6.0	5.2	4.9	4.0	3.5	4.6	4.8	2.7
	Russia	22.2	3.7	3.4	2.3	1.4	0.8	0.7	0.5	0.5	0.7	0.8	1.2	
Humanitarian support (100 million dollars)						2.9	1.0	3.1	3.3	4.1	3.0	4.9	3.9	3.2
	(international community)					0.6	1.0	2.6	3.0	3.6	1.8	3.6	2.6	1.6
	(South Korea)					2.3	0.0	0.5	0.3	0.5	1.1	1.4	1.3	1.6

SOURCE: Ministry of Unification, Bank of Korea.

The message parlayed by these quantitative economic indicators is quite clear: The recent recovery experienced by the North Korean economy has not been the result

of internal factors but of external ones. Put differently, the main cause for the positive growth rates that the North Korean economy has posted over the last few years has been the increase in the amount of economic resources coming from abroad. As such, after ten years of Kim Jong-Il and his policies, the current state of the North Korean economy can be characterized as follows: While economic difficulties have continued, the growth rate appears to have gradually stabilized as a result of the increase in the North's dependence on foreign economic resources.

(2) Qualitative Aspect: Imbalance between military-first politics and the North's reform and opening policy

What have been the main factors behind the above-mentioned developments that have taken place within the North Korean economy over the last 10 years? Table 2 represents a summary of the North Korean economy prior to Kim Il-Sung's death, an analysis of which was carried out in section 2, and the main events that have emerged over the first 10 years of Kim Jong-Il's rule. In terms of the main factors that have remained largely unchanged from the Kim Il-Sung era, the following can be identified: U.S.-North Korea relations have continued to deteriorate as a result of the second nuclear crisis; Kim Il-Sung's military-oriented politics have given way to Kim Jong-Il's military-first politics; and the KWP's ruling principles have remained all but unchanged from what they were during the Kim Il-Sung era.

Then what has changed? First of all, the ruling system has changed from being one of direct KWP rule to one where the KWP now indirectly controls the country through the military. This change has in all likelihood been precipitated by Kim Jong-Il's perception that, given the growing paralysis of the North's planned economy system as a result of the ever-widening economic hardships faced by North Korea, and the widespread international belief during the period following Kim Il-Sung's death that North Korea was about to collapse; the only means of overcoming the domestic and international problems faced by the North was to rely on the military and the military's economic resources.

Second, the scope and intensity of the North's reform and opening policy has changed as well. What began to a certain degree as a domestic reform, the construction of special economic zones, has over time developed into a drive to build Hong Kong – style special administrative districts. Moreover, the North has sought to develop inter-Korean economic relations – a move which has already yielded such tangible results as the Geumgangsán tourism project and the Gaeseong Industrial Complex – as a means of increasing its participation in the global market. Even more encouraging for the North is the fact that the changes that have been wrought to the North Korean economy as a result of the implementation of the Economic Management Improvement Measures are expected to positively influence the construction of such special economic zones in the following manner:

TABLE 2. MAIN DEVELOPMENTS PERTAINING TO THE NORTH KOREAN ECONOMY DURING THE FIRST 10 YEARS OF THE KIM JONG-IL REGIME

	Kim Il-Sung's economic legacy	Main economic policies during the first decade of the Kim Jong-Il regime		
		The continuation of Kim Il-Sung's economic legacy (1994. 7-1997. 9)	Preparatory stage of economic reform (1997. 9-2002. 7)	Implementation stage of economic reform (2002. 7-)
Overall economic situation	<ul style="list-style-type: none"> • decrease in the amount of crude oil and food provided by China and the USSR (beginning of the 1990s) • onset of negative growth rates (after 1990) • loss of 70% of international markets (due to the collapse of the socialist bloc) • imminent signs of the collapse of the food distribution system in the northeast and the onset of the two-meal a day campaign (1992) • international relations strained further by the north's withdrawal from the NPT (1992) 	<ul style="list-style-type: none"> • securing of crude oil and food from the U.S. and the international community (Geneva Agreement: 1994) • removal of a first set of economic sanctions imposed on the North by the U.S. (1995) • continued period of negative growth • collapse of the food distribution system and the emergence of mass starvation, (1995-1997) as well as a marked increase in the number of North Korean defectors • outbreak of the East Asian financial crisis (1997) 	<ul style="list-style-type: none"> • implementation of summit diplomacy (the North also assures another source of crude oil and food by resuming the traditional relationship with China and Russia) • advent of positive growth rates • positive response to Kim Dae-Jung's Sunshine Policy (1998) • launch of a Daeguqing missile and amendment of the Constitution • U.S. eases a second set of economic sanctions against the North (1999) • The Bush administration singles out the North as a member of the "Axis of Evil" (2002) 	<ul style="list-style-type: none"> • North Korea-Japan Summit (2002: DPRK-Japan Pyongyang Declaration) • China arrests Yang Bui, the designated First Minister of Sinaju Special Economic Zone (2002) • the North is found to have developed a uranium based nuclear program (2002), which leads to subsequently withdraw from the NPT (2003) • the Ryongcheon Incident occurs (2004)
Domestic developments	<ul style="list-style-type: none"> • adoption of an agriculture, light industry, and foreign trade-first economic strategy (1993) 	<ul style="list-style-type: none"> • continuation of the agriculture, light industry, and foreign trade-first economic strategy • starts to mobilize the military to construct the economy 	<ul style="list-style-type: none"> • declaration of the onset of another independent economic development drive (1998) and the launch of the second Chollima Movement (to construct a strong country) • mobilizes the military to construct the economy (military-first politics) 	<ul style="list-style-type: none"> • implementation of the Economic Management Improvement Measures and related post-measures • places top priority on the building of the defense industry (2002: military-first politics)
International developments	<ul style="list-style-type: none"> • designation of the Rajin-Sonbong Free Economic Trade Zone (1991: UNDP participates in the Yumen River Area development Program) 	<ul style="list-style-type: none"> • acceleration of the speed of the development of the Rajin-Sonbong Free Economic Trade Zone • implementation of a capitalist experiment in the Rajin-Sonbong Free Economic Trade Zone (exchange rate changed from 2.21won/dollar to 210won/dollar) 	<ul style="list-style-type: none"> • designation of the Rajin-Sonbong Free Economic Trade Zone as a special economic zone 	<ul style="list-style-type: none"> • enactment of the basic law making Sinaju a Special Administrative District (2002)
Inter-Korean economic cooperation	<ul style="list-style-type: none"> • onset of indirect inter-Korean economic exchanges (1989) • conclusion of the Inter-Korean Basic Agreement and Additional Protocol (1992) • Agreement to hold a North-South Korean summit (1994) 	<ul style="list-style-type: none"> • continued indirect inter-Korean economic exchanges • Inter-Korean Basic Agreement and Additional Protocol rendered void • deferment of the North-South Korean summit 	<ul style="list-style-type: none"> • launch of the Geomgangsai tourism project (1998) • acceleration of working level inter-Korean economic cooperation in the aftermath of the June 15 Joint Declaration made during the Inter-Korean Summit (2000) • deferment of the return visit to Seoul by Kim Jong-Il 	<ul style="list-style-type: none"> • onset of the era of direct inter-Korean economic exchanges as a result of the promulgation of the law turning the Geomgangsai area into a tourist district and of the passing of the law creating the Gaecheon Industrial Complex (2003) • signing of a four-point economic cooperation pact (2003) • 700 million dollars in annual inter-Korean trade.

First, the North's ability to link its economy with the global one has been greatly increased by the easing of the inflation gap. As mentioned above, prior to the implementation of the improvement measures the North had religiously abided by a fixed price system that based all prices on the cost of industrial goods such as coal; meaning that no major readjustment of prices had been undertaken in 50 years. The same was true with regards to the exchange rate, which was manipulated to represent international prices. Therefore, inflation spread at a rapid pace as the gap between the regulated domestic prices and international market prices, and between the exchange rate and international rates, grew exponentially. This inflationary phenomenon created circumstances which made it difficult for foreign enterprises wishing to open joint venture companies with the North, or to enter the domestic market of North Korea through normal channels, to achieve their objectives. Following the implementation of the Economic Management Improvement Measures, price are now based on the food price index, which is much more sensitive to variations in supply and demand. Even though inflation has emerged once again, the gap has been narrowing compared with the inflation rate before the announcement of the EMIM (Kim 2003, 60).

Second, as North Korea has become further integrated into the market economy system, it has found it increasingly easier to introduce capitalist management methods. Although a partial market economy, in the form of government-authorized farmers' markets, did exist in some sectors of the economy before the implementation of the Economic Management Improvement Measures, a majority of the trade that went on during this period was carried out in underground markets, with the state increasingly encouraging the growth of these black markets as a means of partially overcoming the prevailing economic difficulties. However, since the implementation of the Economic Management Improvement Measures various steps have been taken to increase the role of the market economy in legal spaces. These steps have included the following: 1) The expansion of material inducements in the form of increased autonomy and incentives for the managers of organizations and enterprises 2) the legalization of the trade of industrial products in markets 3) the granting of permission for enterprises to participate, although only in specified sectors, in the market 4) and the granting of permission for cooperative farms to engage in small-scale trade with China. Since the implementation of the Economic Management Improvement Measures, North Korea has aggressively pursued the development of the Gaeseong Industrial Complex. Moreover, the advent of an internationalized wage system, the increased ability of corporations to autonomously hire and fire employees as they see fit, and the implementation of an incentive system, can all be linked back to the North's introduction of a capitalistic management system.

Third, the participation of North Korea's general population in the market economy has increased as well. As a result of the Economic Management Improvement Measures, Kim Jong-Il's order that the standard distribution system be done away with has officially become law. To date, the main problem has been that workers' wages have not been able to keep pace with the concurrent increase in prices that has been

brought about as a result of the Economic Management Improvement Measures. Consequently, although it had already become a serious problem by the time the issue of mass starvation emerged during the mid 1990s, the economic gap (Kim Woon-Keun 2003) has become even worse in the aftermath of the Economic Management Improvement Measures (Washington Post 2004). The polarization of economic classes has ironically heightened support for the introduction of a market economy in North Korea, in that the North increasingly finds itself having to expand the spaces in which the market economy can operate in order to maintain the power of the group that has gained most from the Economic Management Improvement Measures- i.e. the members of the Korean Workers' Party, military officials, and traders, who have monopolized the economic benefits of the EMIM – and to assure that those who have lost the most as a result of the implementation of the Economic Management Improvement Measures – workers – can make a living.

The problem is that the emphasis on military-first politics is reverberating throughout the North Korean economy like a boomerang in the aftermath of the Bush Administration's launch of the war on terror. Given the fact that the positive growth rates enjoyed by the North Korean economy have in large part been due to external factors, the ongoing conflict with the U.S. and the continued dogmatic emphasis on socialist principles have limited the efficiency of North Korea's reform and opening policy. As can be seen in Table 1, North Korea's growing laments about the drop in North Korean-Japanese economic relations and the whirlwind speed at which inter-Korean economic cooperation has developed since 2001 (Lee 2004) can also to some degree be interpreted as another offshoot of this emphasis on military-first politics. This dilemma caused by the instability between the North's military-first politics and its desire to more adamantly pursue a reform and opening policy, has been the main factor behind the North Korean economy's present state.

2. Future Prospects

(1) Kim Jong-Il's Economic Policy: The third way

Kim Jong-Il's economic policy, which has begun to increasingly take shape since the implementation of the Economic Management Improvement Measures, can be said to represent a third-style of socialist economy. In other words, it is neither a rapid transformation to a capitalist economy as was the case in Russia and in Eastern Europe, nor the gradually reformed socialism that China and Vietnam have adopted. Although North Korea's reform efforts date back over two decades, it is only recently that scholars have begun to pay attention to these efforts. Opinions on this reform movement have ranged from those who argue that the economic reforms undertaken by North Korea are similar to those carried out in Eastern Europe during the 1960-1970s (Cho 2004, 3; Kang 2003, 14-15; Lee 2003, 76-77), to those who maintain that although similar in spirit to the Chinese reforms carried out from 1979-1984, the

North's efforts to date have been too timid in nature (Park 2004, 25). In other words, they argue that while the change that has taken place in North Korea's economic policy is significant, the speed of these changes has been too slow.

In this regards, it should be noted that the capitalist experiment launched in the Rajin-Sonbong area has unfolded at a rapid rather than gradual pace. The capitalist experiment in the Rajin-Sonbong area has contributed to the construction of the Gaeseong Industrial Complex, the designation of the Geumgangsan area as a tourism district, and to the further development of the Sinuiju Special Administrative District. These second round development has been seen neither in Russia nor in China or Vietnam. Especially, the Sinuiju Special Administrative District is different from the special economic zones observed in China. The Special Central Administrative District is closer to the status of Hong Kong and is more independent from central administrative interventions or the KWP.

North Korea's reform and opening policy cannot be explained solely based on economic factors; rather, it has been derived from complicated political, military, socioeconomic and cultural factors, factors which include the resolution of the problems stemming from the division of the Korean peninsula; the reorganization of the Northeast Asian order; as well as several international and military issues, including the normalization of North Korean-U.S. relations. As such, depending on how the situation unfolds, the four special economic zones that have been set up in North Korea, especially the Sinuiju Special Administrative District, may very well wind up contributing to the advent of a "Big Bang" change in the North.

From a general standpoint, Kim Jong-Il has been able to weather the rampant economic problems faced by the North and successfully manage to achieve positive growth by using the growing amount of economic resources flowing in from abroad (Shambaugh 2003, 65; Cha 2004, 45). However, in order for the North to continue this juggling act, it has had to resolve the conflict between its military-first politics and its reform and opening policy. The direction that the reform and opening policy has taken since the implementation of the Economic Management Improvement Measures represents the alternative that the North has selected to resolve this conflict. In essence, this new approach has been one of separating special economic zones from regular areas. As such, while institutional changes have been made within these special zones, the overall focus has been on improving technological efficiency by reforming the system from within. This is why from the outside, Kim Jong-Il's economic policy, which is based on practical socialism, appears to be proceeding much more slowly than China's reform and opening policy. However, the reality is that this approach may very well bring about more rapid changes than China, or even, depending on how things develop, result in a "Big Bang," as mentioned earlier.

(2) The Future of the Third Way

The third round of six-party talks held in Beijing, which are aimed at resolving

the nuclear crisis, ended with the adoption of an eight-point chairman's statement (June 26, 2004). Although the U.S. and the two Koreas presented their positions in a clearer fashion during this round of talks than in the previous two such meetings, it is evident that this process will be a long and arduous one. At the international seminar held in South Korea to commemorate the fourth anniversary of the 6-15 North South Joint Announcement, the representatives of the North Korea, which has demonstrated a more cordial attitude toward the international community since the Ryongcheon incident, demanded that: 1) The already agreed-upon projects be implemented, 2) cooperation be expanded to the light industry, infrastructure, and high technology sectors, 3) inter-Korean cooperation be expanded to include improvements to the North's economic infrastructure, 4) the surrounding countries provide more support and adopt a cooperative attitude in order to assure that inter-Korean economic projects come to fruition (Min 2004).

Given that North Korea is known to have lobbied China to increase economic cooperation during Kim Jong-Il's visit to China in April 2004, the above-mentioned demands can be construed as the North reaching out to the other major powers surrounding the Korean peninsula, which as mentioned earlier have become the North's biggest sources of economic resources, and asking for their support in developing the North Korean economy in the aftermath of the Economic Management Improvement Measures. Will North Korea be successful in this endeavor? As it is still too early to carry out a comprehensive evaluation of Kim Jong-Il's economic policy, which is based on a 3rd way, any prediction of the future direction of his economic policy will by nature be inconclusive. Nevertheless, the following scenarios are the most likely:

The first such scenario is one in which although the normalization of U.S.-North Korea relations remains elusive, because of their inability to resolve the pending issues during the six-party talks, North Korea still manages to secure approximately the same amount of economic resources from South Korea and China as it is currently getting. In such a scenario, while the North Korean system would remain intact, Kim Jong-Il's socialist economic policy would have to resolve problems such as inflation, the loosening of the planned economy, a problem which has arisen as a result of the growing economic polarization, and the expansion of the economically marginalized group, including the urban poor (Cha 2004, 47). In order to resolve these problems, Kim Jong-Il may have to make a strategic choice between further strengthening the military-first politics and expanding the operational spaces of the market economy. However, under this scenario the possibility that the North Korean economy may undergo the same kind of "Big Bang" transformation that occurred in Russia and Eastern Europe cannot be ruled out.

The second scenario is one in which following the successful conclusion of the six-party talks, an agreement similar to the Geneva Agreement is reached. Should this come to pass, Kim Jong-Il's socialist third-way would in all likelihood, after many twists and turns, succeed. Under such a scenario, inter-Korean economic cooperation

is expected to accelerate, with an increasing amount of Japanese and other foreign capital being invested in the North Korean market. Moreover, North Korea could also gain increased access to international financial organizations. As far as the North's special economic zones are concerned, it is expected that under such a scenario, these would experience more rapid reform and opening than was the case in China by reaping the benefits of late development.

In the case of the North's regular areas, the speed of reform and opening would remain to some degree regulated. However, internationally such a denouement will depend on how the conflicts over the speed of the North's reform and opening policy are resolved, while domestically the issue of how smoothly the planned economy is run will loom large.

The third scenario is a Libyan-style one in which North Korea abandons its nuclear program and agrees to unconditional inspections of its suspected nuclear facilities. This scenario is based on the assumption that North Korea would gain concessions in secret negotiations with the U.S. However, given North Korea's mistrust of the current U.S. administration, and the North's emphasis on the primacy of the military, such a scenario is unlikely at this point.

IV. CONCLUSION

Although Kim Jong-Il has finally begun to implement his economic policy after a long preparation period, this economic policy has to date failed to meet expectations; an assertion supported by a simple look at North Korean economic indicators during this period. However, as economic reforms are ongoing, for example the development of the Sinuiju Special Administrative District has not yet begun; it is too early to evaluate Kim Jong-Il's economic policy. The characteristics of the North Korean economy in the aftermath of the Economic Management Improvement Measures can be summarized as follows: an increased number of operational spaces for the market economy have been introduced within the North Korean economy; the general perception of capitalism has been improved as such notions as the need to achieve a balance between supply and demand, efficiency, and production-based distribution have become more widely accepted. Although there remain many problems for North Korea to resolve, such as the construction of the infrastructure needed to assure the development of special economic zones such as the Geumgangsan tourism district, Gaeseong Industrial Complex, and Sinuiju Special Administrative District, it is evident that the North has gone to great lengths to assure that the mistakes that have been made in connection with the development of the Rajin-Sonbong Free Economic Trade Zone opened in 1991, are not repeated.

What will the North Korean economy look like a decade from now? The current state of the North Korean economy makes certain things clear. Although predictions of how the quantitative aspects of the North Korean economy will change are difficult

to form, there is general agreement that the North Korean economy will increasingly move towards a market-oriented one. In other words, regardless of whether Kim Jong-Il's socialist third way succeeds or not, the market economy has already begun to expand into the mainstream of the North Korean economy, an argument that is supported by the changes that have taken place in North Korea since the Economic Management Improvement Measures.

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ENDNOTES

- ¹ For example, the economic officials in charge of the formation of these *Yeonhap Giupso*, in keeping with the expansion of trade policy adopted by the Party and State Council, attempted to give them more rights to engage in trade. However, their efforts came to naught as a result of the objections of Kim Il-Sung. Masahiko Nakagawa, *Ibid*, p.70
- ² Nam, Song-wook and Mun Seong-min have estimated this amount to be a whopping 27.1% of the overall economy.