Prospects for Economic Reform in North Korea

Analysis by Nathan Beauchamp-Mustafaga based on:


As China’s lone treaty ally and unruly neighbour, North Korea is closely watched by Chinese officials and scholars for developments that may impact Sino-North Korean relations, the Korean Peninsula, and even the Northeast Asia region. While North Korea’s nuclear program has attracted the world’s attention since the first crisis erupted in 1994, Chinese academics remain attentive to the progress of economic reform in the North. Taking the long view, Chinese scholars are generally optimistic about the prospects for continued North Korean economic reform under favourable international conditions.

28 years of economic reform and counting

Over the last three decades, North Korea has initiated a series of largely unsuccessful economic reforms, but has recently renewed Chinese hopes with a series of new initiatives since January 2010. According to Zhu Liaoye and Xu Yonggen, the history of economic reform in the North can be traced back as far as 1984 with the introduction of the Joint Venture Law (heying 合营法) in an early attempt to attract foreign investment. (7) This was followed by the creation of two Free Economic Trade Zones in 1991, which failed to attract significant investment. (8) Most scholars trace the recent arc of reforms to 1 July 2002 (“7.1 Jingji gaige” 7.1 江吉改革 or “7.1 cuoshi” 7.1 切割), when Kim Jong-il’s government enacted a more liberalised economic policy that allowed a certain degree of private markets and more independent operation of farms and businesses, while raising wages and adjusting prices.

The December 2009 currency reform was officially intended to stop inflation and eliminate illegal black markets. (9) The reform allowed North Korean citizens seven days to convert their old currency to the new currency at variable rates and in limited quantities. (10) The 2009 currency reform caused unrest and forced the government to relax its strict limits, and to eventually offer subsidies as compensation. While most scholars view the reform as an unsuccessful attempt to stop inflation and eliminate inequality and corruption, Cui Yan sees it as an attempt by the state to reassert control over the economy. Cui Yan asserts that the reform most importantly was intended to “reclaim the personal capital that was circulating in the markets and to monitor the markets in order to once again bring the entire national economy back under the supervision of the traditional planned economy.”

The most recent surge of reform is generally dated to January 2010. In rapid succession, North Korea announced the Strategic 10 Year Plan (2011-
Economic reform is the only path to stability and prosperity

The North will continue to deepen its commitment to economic reform since it seems to be the only path towards economic prosperity and political stability. Zhu and Xu assert that economic reform in the North is “historically inevitable [and that] North Korea is at the point that it won’t survive without reform,” adding that it is also the trend of socialism. With earnest reform, the North can become self-sufficient for grain production and join the international community. Gong Yutao claims that “without economic reform there is no economic development” in the North, and that the North will adopt economic reform in order to accomplish the government’s goal of becoming a strong and prosperous country (qiangsheng daguo 强盛大国, gangseong daegug in Korean) by 2012, along with the need to maintain political control and a stable power transition. This also follows Kim Jong-un’s statement in November 2011 that food is now more important than bullets. Gong adds that the North has been responsive to the needs of its economy in the past, including the agricultural reforms since 2002 in response to food shortages, so the North will embrace reform again. More importantly, Gong believes that successful economic reform will reduce tensions in the peninsula by giving North Korea more confidence in its interactions with the South through non-military means. Furthermore, reform will pave the way for unification with improved leverage for the North, since the ultimate goal of both countries is eventual unification, and the country with the strongest economy will drive the process.

There are many promising signs that the North intends to pursue the necessary economic reforms. Gong Yutao and Zhang Huizhi highlight North Korea’s New Year’s editorials in 2010 and 2011 (yuandan shelun 元旦社论) as evidence for the renewed focus on economic reforms.12 Gong notes that North Korea’s increased marketisation after 2002 demonstrates that the North is making progress towards a Chinese-style “Reform and Opening” (gaike kaifang 改革开放). Zhang Huizhi views the North’s two Economic Development Zones with China, Rason and the Hwanggumpyong-Mirnwha Islands zone (huangjinpeng-weiuhuadao jingji qubie 牡平湾海达道经济特区), as a proof that the North is committed to economic reform.13 She believes that now that the North has started economic cooperation and stepped toward marketisation, the Democratic People’s Republic of Korea (DPRK) government is unable to stop the steady march of reform.

However, doubts remain over the impetus for reform and the likelihood of a true breakthrough towards a market economy. Zhang Liangui does not see any hope for true economic reform in the North and does not see the previous changes in economic policy as genuine efforts toward reform. He views the true goal of North Korea’s economic reform as supporting the military-first policy (xianjun zhengce 先军政策, Songun in Korean) by creating another revenue stream for the military’s nuclear and missile programs. The reforms of early 2010 were driven by the North Korean military’s need for foreign currency, since the sanctions enacted through UN Security Council Resolution 1874 cut off the traditional sources of money, including Japanese remittances, South Korean donations, and arms exports.118 Zhang Liangui cites the fact that the National Defence Council announced the January 2010 initiatives, not the Cabinet, which officially should run the economy. He believes Rason is intended to solve the North’s oil shortage by diversifying oil imports and earning foreign currency through transit fees.

Many elements still impede economic reforms in the North

Despite these positive prospects, there are many factors that continue to obstruct the forward progress of reform. Reflecting a common opinion, Zhu and Xu assert that the failure of North Korea’s past reforms was due to the superficiality of early reforms and the government’s lack of consistent effort in implementation. Furthermore, the current reforms are inhibited by the government’s fear of political instability, lack of public will for reform, lack of an overall design, and resistance by state-owned enterprises. Piao Yinzhe, Li Shenghua, and Yan Ying en cite international sanctions as the biggest factor limiting the North’s ability to enact far-reaching reforms, followed by the contradiction between the military-first policy and economic development, as well as a lack of public will. Zhang Huizhi also ties the difficulties affecting the North’s economic reform to international sanctions and the government’s fear of social instability, challenges to its authority, and problems for the power transition to Kim Jong-un.

While North Korea may embrace deeper economic reform, the government will pursue reform on its own accord. Both Zhang Liangui and Zhang Huizhi note that the DPRK’s state-run newspapers declared distrust of the term “reform and opening.” One North Korean article proclaimed: “The people of every country in the world who uphold self-determination must clearly recognise the reactivity and danger of the conspiracy of ‘reform’ and ‘opening’ advocated by the imperialists, and must confront it with a high level of vigilance.”

The path forward

While future progress on economic reforms will continue to be slow and cautious, there are opportunities to ensure their success through experimentation and international support. Zhang Huizhi believes reforms outside the system (‘tizhiwai’ 改革体制外) are the key to economic reform in the DPRK. She asserts that this style of reform is “outside of the planned economic system [and] is a basic force to develop new offices for managing markets and have them promote market reforms.” The independence from the system allows the reforms to proceed without presenting the typical problems of economic liberalisation, namely inflation, inequality, corruption,
materialism, and illegal markets. Zhang Huizhi believes the new investment company, national investment bank, and other initiatives are all part of this new style of reform, and that these reforms will eventually lead to the creation of a new economic system. In contrast with Zhang Liangui’s scepticism over Rason, Zhang Huizhi believes Rason allows the North Korean government to experiment with economic reforms without fear of political instability. Zhu and Xu believe the North Korean leaders will initiate the reforms, since the people lack the ability to initiate reforms themselves. They believe the reforms will start with the agricultural sector, namely agricultural privatisation, possibly based on China’s household responsibility system (baochan daohu 包产到户) from the late 1970s.

International support for reforms through increased economic cooperation between China, North Korea, and South Korea will be an important component to drive reform externally and integrate the North into the international economic system. Piao et al. see an opportunity to align China’s Chang-Ji-Tu project (changjitu kaifa kaifang xiandaoqu 长吉图开发开放先导区), North Korea’s strong and prosperous nation claim, and South Korea’s desire to become the economic hub of Northeast Asia. China and South Korea can guide the reforms by actively promoting reform through their economic cooperation with the North. Cooperation should first strive to improve the DPRK economy through focusing on agricultural, energy, and industrial policies and giving preferential tax rates to North Korean products sold in China and South Korea. Second, economic cooperation should focus on promoting reform by making the North end its military-first policy, designing aid to push reforms and not merely treat existing problems, as well as China advocating market economics with North Korean officials.

**China’s role and the international environment**

China can encourage economic reform through sharing its own experience as well as continuing to invest and trade with the North. While North Korea’s road to reform will undoubtedly be unique, Zhu and Xu, among others, frequently reference the experience of China and Vietnam for comparison. They suggest that the North can learn from China and Vietnam’s success as it makes a similar transition towards a market economy. Zhu and Xu state that “China and Vietnam’s Reform and Opening proves that only with Reform and Opening is there development, and only with development can one raise the ruling party’s authority and governing ability as well as raise the peoples’ quality of life and win the hearts of the people while strengthening the socialist system.” Zhang Huizhi views China-DPRK economic cooperation as a good opportunity for North Korea to deepen reform by allowing the North to see China’s successful integration of socialism and capitalism while also demonstrating to the world that the North is serious about reform. Following China’s experience, although Zhu and Xu, among others, noted that the transition to a market economy would possibly challenge the government’s hold on power, they did not link economic reform to progress on political reforms.

The North’s international environment will dictate the extent to which a reformed North Korea can thrive in the international community. The North needs to convince the international community to end sanctions, as those have an outsized impact on the North’s prospects for economic reform by isolating the country and depriving it of needed capital. Zhu and Xu assert that UN sanctions and the United States make other countries fearful of establishing trade and investment with the North. The United States looms large over discussions of the prospects for economic reform in the DPRK. All authors noted the need for improved US-DPRK relations before there can be genuine reform in the North. Piao et al. believe better relations are the biggest factor for economic reform, while Zhang Huizhi believes improved ties would allow the North to gain access to loans and aid from the International Monetary Fund, World Bank, and others. Zhu and Xu view US motives vis-à-vis North Korea with suspicion and claim that the US wants the North to be a member of the “free world,” namely to be controlled by South Korea. Similarly, Gong claims that the United States “has never abandoned its goal of toppling the current North Korean government.”

While the DPRK government has been hesitant to fully embrace economic reforms, the leadership will eventually be forced to enact fundamental changes to its economic system out of necessity for the continued survival of the country and as the only means to uphold and fulfil promises of economic development for the people of North Korea.

14. The Chang-Ji-Tu project was proposed in 2009 as an economic development plan for the cities of Changchun, Jilin, and Tumen in Jilin Province.
Tackling Economic Deceleration: A puzzle for Beijing

Analysis by Agatha Kratz based on:


The health of China’s economy has deteriorated these past months, and the quarterly statistics published in July have been the most critical since 2009. In the context of such market strains, will China’s leaders be able to take the necessary measures to re-boost their country’s economy?

A series of recently published articles shed light on China’s current economic conditions, the policies implemented by Beijing to contain economic decline, and the resulting drop in trust it has generated. Reactions by analysts have been mitigated, and several hope for China to accelerate reforms to complement the temporary containment strategies adopted by Beijing.

Disappointing economic indicators

In an article published in Caijing on 15 July, Yang Zhongxu gauges the state of China’s economy in the earlier months of the year. The statistics published in early July by Beijing for the second trimester of 2012 were disappointing. Between April and July, China’s GDP increased by only 7.6 percent. While this number would remain significant for any other country, it nonetheless challenged economic predictions, and came as a surprise following China’s three consecutive years of growth in excess of 8 percent. Furthermore, the numbers published in July 2012 suggest that the decline will be more than temporary. Indeed, China’s GDP growth in the first quarter also decelerated compared to the first quarter of 2011, with a growth rate of only 7.8 percent. This announcement was accompanied by the publication of alarming statistics on China’s inflation rate in June, which took the international economic community by surprise. According to these numbers, the Consumer Price Index (CPI) increased by only 2.2 percent during the first semester of 2012, compared with 3.3 percent in 2011. For the first time since 2009, China’s economy is experiencing deflationary trends. Some analysts have voiced concerns that such a trend could get worse in the future, and claim that enterprises are experiencing decline in the prices of their goods on a daily basis.

The early July numbers on international trade are similarly disappointing. Industrial investments are stagnating, the demand for industrial loans has gone down considerably, profit margins in several sectors have declined, numerous state-owned enterprises have reported losses, and the Producer Price Index (PPI) in July experienced a decrease for the fourth consecutive month as a result of low domestic demand, explains Yang Zhongxu.

While Yang Zhongxu claims that China’s economic deceleration is now an uncontested reality, the extent of such a decline is subject to debate. Some analysts predict a smooth landing, while others fear a dramatic crash. China’s economic situation nevertheless remains less critical than it was in 2009. During an interview with Yang Zhongxu, Liu Yuanchun, vice-president of Renmin University in Beijing, claims that while suggesting a decline in China’s economy, the statistics of July 2012 are in no way as alarming as the numbers that followed the global financial crisis. Unlike the latter, the July 2012 numbers suggest that the economy is still growing.

In addition to economic deceleration, the renewed dynamism of real estate development has generated significant concern. In a speech later transcribed by Chen Lu, Premier Wen Jiabao explains that one of the Chinese government’s main concerns is the real estate market. Indeed, following a notable slowdown in real estate transactions and the stabilisation of market prices due to regulatory policies, the price of property has increased again these last several months. Yang Zhongxu observes that real estate investments rose in May and increased by 9 percent compared to April. Moreover, numbers from the National Bureau of Statistics of China on 18 July, cited by Xinshiji in an editorial published on 23 July, confirm this trend. In July, China’s real estate market was once again overheated.
These inflationary trends could potentially constitute a significant threat to China’s economy. Beijing notably fears that prices may jump again and that speculation may resume. The latter scenario could nourish the country’s current real estate bubble, which is already close to bursting. Wen thus calls for great vigilance and encourages heightened surveillance of the real estate market.

As noted by the 23 July Xinshiji editorial, ensuring a healthy real estate market at the national level is one of the central government’s main priorities in years to come. Overcoming such a challenge will require making a choice between two potentially conflicting sets of interests: those of the central government, primarily concerned with macroeconomic stability and the socioeconomic well being of the population, and those of local governments and local enterprises, which directly benefit from the real estate market and its dynamism. These past years, local governments have indeed become significantly dependent upon revenues generated by real estate and land-related transactions. Such dependency has led to the making of risky decisions that have at times violated regulations established by Beijing. As such, the second challenge for the Centre will be to monitor the market closely with stricter regulatory policies, to ensure that its guidelines are enforced at the local level.

Finally, other concerns exacerbate these challenges. Yu Bin emphasises that local governments’ financial situations deteriorated during the first semester of 2012, as fiscal and land-related revenues decreased substantially. This raises the risk of economic instability in China, especially in light of the increasing relationships of dependency that has emerged between banks, provincial governments, real estate companies, and indebted property purchasers over the years. Moreover, according to Yu Bin, the significant decline in China’s domestic demand and the overall deterioration of the world economy have made some mainland industries worry about the threat of overproduction.

In light of such concerns, China’s leaders, including Wen Jiabao, have frequently intervened nationally to reassure the population, the finance sector, industries, and investors of China’s economic stability. According to Yang Zhongxu, Premier Wen organised a number of official meetings with representatives of all sectors of the economy to help gather opinions and suggestions on how to implement the most appropriate strategy to prevent instability.

The Chinese government finds itself in a delicate position insofar as it must accommodate two sets of conflicting interests, namely boosting the economy while discouraging overly risky transactions and preventing the collapse of the real estate bubble.

**Double drop in interest rates**

Yang Zhongxu and You Xi observe that the Chinese government has deployed a series of macroeconomic measures to boost the economy and avoid the bursting of the real estate bubble. The most important such measure was a decision to reduce interest rates in July. That decision was made twice within a single month. Hence, rates on deposits at up to one year went down from 3.25 to 3.00 percent, and rates on loans at up to one year decreased from 6.31 to 6.00 percent. This type of government decision is rare and attests to the unusualness of the situation. As Yang Zhongxu explains, it surprised financial markets and failed to eliminate their existing concerns. You Xi notes that this kind of measure usually aims to respond to low levels of microeconomic financing and to reduce the debts of enterprises, local governments, and individual borrowers. More generally, the central government hopes that it will boost economic transactions by facilitating access to credit and reducing the cost of liquidities. These measures have already proven to be effective, as a number of provincial governments announced the launch of new investment programs in years to come. Such investments could in turn stimulate economic activity at the local level.

However, the government is reluctant to rely directly on the real estate sector to boost the economy. Chinese leaders have thus decided to reduce interest rates unevenly. As noted by Lin Jinbing, real estate interest rates have not decreased. This will help the government ensure recovery in some key sectors of the economy, while also avoiding overheating the real estate market.

In conjunction with the lowering of interest rates, the government has expressed its willingness to launch a series of social programs. These will be implemented in the months to come and are considered fundamental reforms by Premier Wen Jiabao. Premier Wen maintains that in light of the current state of the economy, investment projects must be “reasonable” (合理). In the short-term, these investments will target infrastructure-related projects: transportation networks, energy, electricity, sanitation, education, etc. Premier Wen also mentioned the building of subsidised housing. The government announced the construction of 4.6 million housing units since January 2012, and as of today, 2.6 million of them have been built. Chen Lu adds that the government has emphasised quality over quantity in this process.

Finally, Premier Wen has committed to taking necessary measures to contain the real estate market. As such, a number of policies aimed at regulating the sector more closely have been implemented. Moreover, to prevent further instances of speculation, a number of measures meant to control access to real estate loans have been strengthened. These include requirements as to the differentiation and quality of loans. Reforms in the real estate taxation system will also be pursued. Premier Wen concludes that the objective of such strategies is to embark on a path towards the progressive reduction of real estate prices.

**Reactions to measures taken by Beijing**

These measures have generated a diverse set of reactions in the Chinese media. While some analysts such as You Xi have welcomed the government’s socially-oriented policies, many others do not hide their reservations. Most would nonetheless agree that the reduction of key interest rates can only be a short-term strategy and will not constitute a solution to some of the deeper imbalances characterising China’s economy.

You Xi maintains that if a decrease in rates can help stimulate the economy in the short-term, it can also send contradictory signals in the long run and bias investment decisions. Furthermore, the author claims that a reduction in such rates cannot guarantee the country’s economic redress. The latter would require cooperation from banks, which would be hard to obtain in a context of decline in economic trust. You Xi claims a reduction in banks’ regulatory deposit ratio would constitute a more effective solution by freeing up liquidity more rapidly. Moreover, while boosting investments constitutes a solution, Premier Wen contends that the most important objective today is to ensure that future investments are reasonable. A simple policy aiming to reduce rates would not guarantee this goal.

10. Cited by You Xi.
11. Cited by Chen Lu.
Lastly, You Xi adds that the government cannot keep on relying on banks when the country faces an economic slowdown, as this pattern feeds economic imbalance. Beijing’s long-term objective should be the development and stimulation of consumption to turn investments into drivers of economic growth. China should aspire to transforming the structure of its economy, which the author views as unviable, and begin a gradual transition process towards a more quality-oriented development path. According to You Xi, in the short-term, the country should prioritise cultural irrigation projects, the building of subsidised housing (already planned by the government), social development programs, a reduction in carbon gas emissions, and investment in other strategic sectors of the economy. In the medium-term, China ought to stimulate investment in infrastructure optimisation projects, while also placing limits on the development of over-invested heavy industries. In the long run, China must pursue its transition towards a market economy and reduce the tax burden on small and medium enterprises. You Xi concludes that China’s monetary policy should only be subsidiary and temporary, and should not constitute a substitute for a genuine long-term economic strategy.

Yang Zhongxu seconds You Xi on the importance of distinguishing short- and long-term strategies. According to Yang, China can no longer rely upon economic rate manipulations in the short-term. The government ought to demonstrate courage and implement reforms, especially in light of deteriorating international economic conditions in the medium-term. The author maintains that China must engage in a process of “creative destruction” to arrive at a new economic and development model. This creative process includes reforming the system of industrial monopolies, human and capital resources, the healthcare system, social security, the price system, state-owned enterprises, and the real estate sector. Yang Zhongxu adds that such policies may have short-term consequences insofar as they may distort the price system and financial incentives, and as a result lead to the overexploitation of natural resources and environmental destruction. Finally, the author notes that these policies have yet to bear fruit, as following the reduction in rates, China’s stock market reported a significant decline. Moreover, in the past several months, the renminbi has similarly lost value.

In general, the above authors all conclude by calling for deepened reforms and a transformation of China’s system towards a more sustainable economic structure, viable below the 8 percent growth rate threshold. This will require significant effort and constitute perhaps the greatest challenge for Beijing in the years to come.

Translated by Marie-Eve Reny.