

Case Study: North Korea

Economics 723, E. Osborn
Presented by J. Remington
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Many countries in Eastern Asia have enjoyed unprecedented growth over the past few decades. Most of these country's citizens have experienced significant gains in both their standard of living and wealth along with that growth. For many years since World War II, North Korea's economy has had double digit growth rates, while their citizens lived in poverty. Political policy along with a changing world economy has left this Stalinist Dictatorship country in the dark ages. This paper addresses the reasons for the current economic condition of North Korea, and addresses specific changes which the North Korean government needs to make in order to pull its people out of poverty and bring it's economy up to 'world class' speed.

North Korea is located in Eastern Asia, on the northern half of the Korea peninsula. The country's borders are South Korea, China, Russia, the Korean Bay, and the Sea of Japan. The country is slightly smaller than the state of Mississippi, has 1550 miles of coastline, a 880 mile border with China, a 150 mile border with South Korea, and a 12 mile border with Russia. It's population of 23.5 million is 99% literate, but only 15% have access to radio and only 1.5% have access to television. Telephone service primarily exists only for the government, with international connections through Moscow and Beijing. The nation's Gross Domestic Product is \$21.5 billion (\$920 per capita, 1994 est) and has a current growth rate of -7% to -9% (negative growth). Imports

(\$1.64 billion) outstrip exports (\$1.02 billion) by \$620 million U.S. Dollars. The local currency exchanged at 2.1 won to the U.S. Dollar in September, 1996.

Inland North Korea is mostly mountainous separated by narrow valleys. The west coast is mostly plains, with discontinuous plains on the east coast. Although the climate is temperate, only 18% of the land is arable. The nation's natural resources include coal, tungsten, zinc, copper, and gold, in addition to several other exportable resource. The 18,500 miles of roads are 94% unpaved, making travel by auto painfully slow. Rail transport covers 2650 miles, and is mostly electrified. North Korea does have high quality natural harbors giving this nation year round warm water ports for shipping.

North Korea's political climate has been a Stalinist Dictatorship since the country's independence in September, 1948. The Democratic People's Republic of Korea (DPRK) has been run by KIM Il-song for almost fifty years (until his recent death), and is now run by his son, KIM Chong-il. The state control of economic affairs is unusually tight for a communist nation.

Despite North Korea's natural resources, educated labor pool, and central proximity in Asia, the country is in serious economic crisis. The DPRK's primary trading partners were the Soviet trading bloc, with heavy industry (military output) comprising most of the its manufacturing capabilities, with light industry capacity lagging far behind. With the collapse of the Soviet bloc, North Korea has lost important technological links, and has had severe shortages of hard currency. The country's political differences with

South Korea, Japan, and The United States have left it practically alone in a new economic world.

In addition to the above economic conditions, North Korea has not been self supportive in food products. Compounding this has been several years of severe flooding, wiping out basically all of the country' s supply of foodstuffs. With idle factories and no trade to speak of, North Korea has literally no hard currency to purchase grains on the world market. Hence, the country' s people are literally starving to death, with current trends predicting widespread malnutrition in the upcoming months.

The government of North Korea has basically three paths it can take to change its current economic climate. North Korea could go to war with South Korea, which would basically amount to self destruction. The government could ' lay down' and die a slow political death, similar to what happened in Russia in the early nineties. North Korea' s third option is to change its political and legal structure to be more receptive to foreign investment, thereby growing its economy within the World market.

North Korea has made an attempt to entice foreign investments by creating a Free Economic and Trade Zone (FETZ) in a northeast area bordering Russia and China. The three types of allowed foreign direct investment in North Korea include a) contractual joint ventures, b) equity joint ventures, and c) foreign enterprises. However, due to the instability of the political system, only a few number of agreements have actually become reality.

North Korea does not permit private ownership of land by enterprises which make foreign direct investments. Instead, a prepaid long-term lease for up to 50 years can be acquired, excluding all rights to natural resources. Personal property is protected under the constitution, however, ' fair' compensation would be paid if unavoidable circumstances require seizure of property. The DPRK' s constitution also guarantees freedom of speech, however publishing, broadcasting, and telecommunications are viewed as vehicles which may undermine political stability. Basically, North Korea has one of the World' s worst track record for human rights. With these types of political standards, it is no wonder why the country is having a difficult time securing horizontal foreign direct investment.

One reason North Korea is having trouble securing foreign investment is because all foreign invested enterprises must conduct their banking business through accounts held with banks which are organized under the laws of the DPRK. Deposits at these banks are exchanged for foreign-exchange certificates. With the country' s trade imbalance (imports outpacing exports) and lack of hard currency, a foreign investor can expect their deposits to leave the country to pay for imports. This could make it difficult to withdrawal the funds from the bank if the depositor deems necessary.

Another reason for the lack of interest in foreign direct investment is North Korea' s formal (or lack of) legal system. Disputes in this country are typically resolved informally, instead of through judicial proceedings. This gives foreigners an uneasy feeling about entering contractual agreements with local business ventures.

On the positive note, South Korea' s constitution declares the entire Korean peninsula as its territory, and assesses no import duties on goods with North Korean origins. This potentially could pave a way for foreign investors to produce and/or add value to products in North Korea (maybe with content from neighboring China) and export those goods into the South Korean markets. One can only wonder for how long this scenario would continue before South Korea changes it' s trade policy.

With the current famine crisis at hand, one would expect investment to come second to consumption. Once the current crisis passes, investment should be in infrastructure and manufacturing technologies which produce outputs. North Korea needs to set industrial policy which targets certain industries with which the nation can expect to compete in World markets. Given the country's educated labor pool and existing heavy industry base, such industries might include shipbuilding or export based sub-assemblies such as metal castings or fabrications for large machines and equipment.

North Korea also has to make some decisions about it' s ability to acquire technology, whether it is through licensing or foreign direct investment. If the above industries were targeted for market entry, then the designs and know-how would need to be acquired. Licensing may be the best alternative, along with protectionist measures similar to the Japanese MITI treatment of computer technology. To compete on the world markets, the DPRK will also need to stabilize its currency's exchange rate against that of its predominant trading partner. Given the reservations the DPRK has with the United States, chances are slim that they will peg their currency against the dollar. A better

solution may be for North Korea to align their currency with their major trading partner, which potentially may be South Korea.

The North Korean government should also keep close links between business concerns and the government' s interest, without unnecessary over-regulation. One potential link could be state control of resource, whereas the government regulates the use of labor, minerals, electricity, oil, etc. This could minimize unwanted negative impacts from market ' rushes' on these types of commodities.

Given the current relationship which North Korea has with the United States, it doesn' t come as a surprise that North Korea is not interested in Western style capitalism and culture. North Korea' s best strategy is probably to iron out it' s political differences with South Korea, allowing the Republic of Korea' s (ROK) ' chaebols' (conglomerates) to make investments in the DPRK. This would free up hard currency which the citizens could consume and invest.

Unfortunately, current western political systems are trying to negotiate with North Korea to exchange foodstuffs for political concessions. With a predominantly Confucius and Buddhist religious order believing in a virtuous leader, this strategy may actually backfire on those instigating the policy. A better alternative may be for the U.S. to support the ROK, and funnel humanitarian relief through the South. This may give the impression that the South is serious about reuniting the Korean Peninsula, and could set precedent for future investment and trade between the two Korean nations. Also given the fact that most countries in Asia are some sort of dictatorship, it is probably

unwise for the U.S. to try and force its political reasoning on countries which are unwilling to accept western style culture. By allowing free trade which will increase the DPRK citizen's wealth, the people will eventually want greater freedoms as they are exposed to and desire to consume western style goods.

North Korea's initial development of a Free Economic and Trade Zone should be viewed by other countries as a positive step towards political and cultural change from within. However, the leaders of North Korea need to take further steps to ensure that this FETZ will indeed prove to be successful both politically and economically. By doing so, North Korea will enjoy growth in wealth through trade with their immediate neighbors, specifically China and South Korea. The DPRK needs to understand that the World economy is a give and take situation, and for North Korea to get ahead, they must view trade as win/win for all parties instead of viewing it as a zero sum game.

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