



# **Economic Reform and SEZ as Survival Strategy of DPRK**

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# 1. Is DPRK's Economy Sustainable?

: Can DPRK manage economic growth further?



## Outlook is not that bad

(Unit: \$100 million, \$, %)

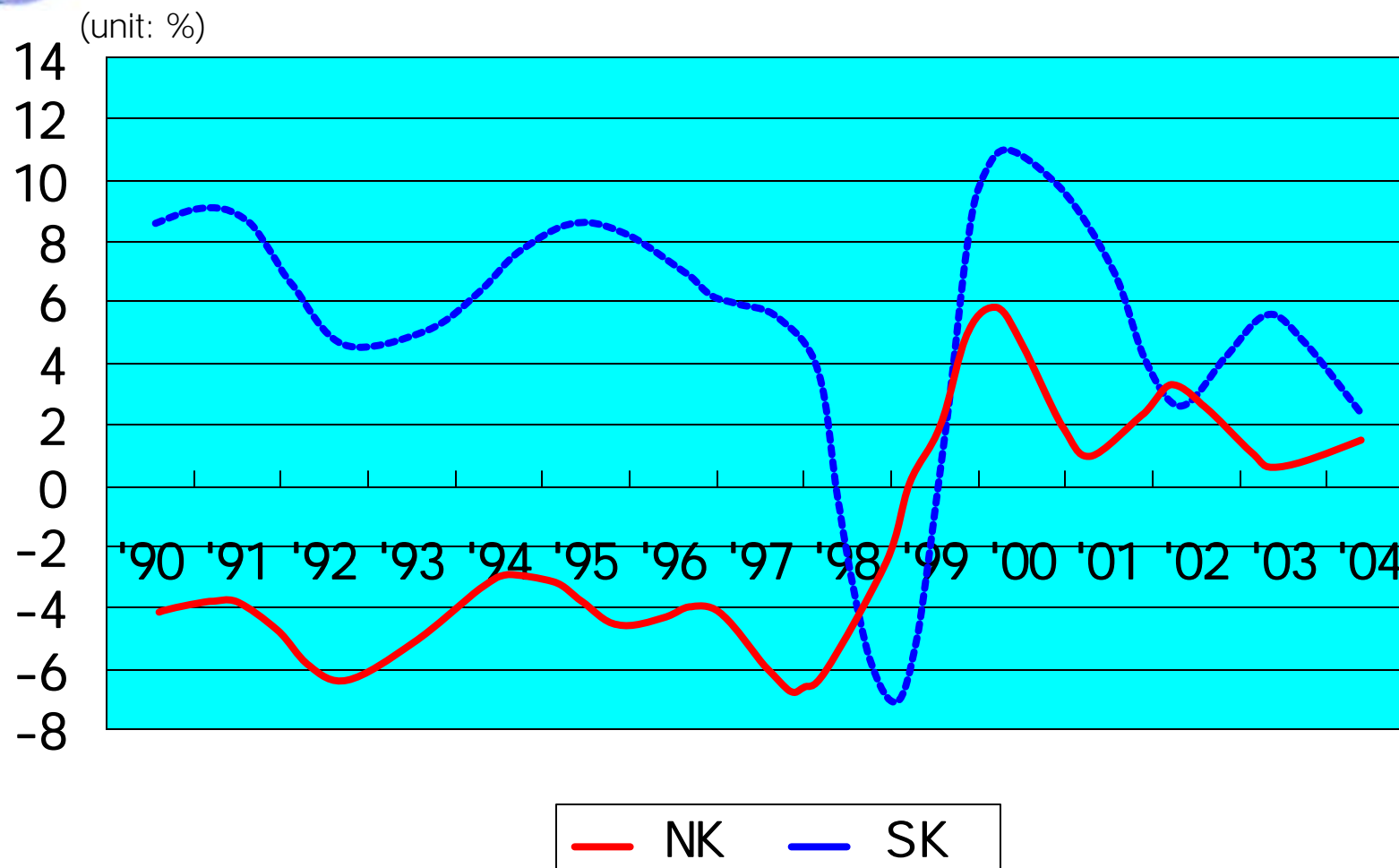
Indicator	1990	1992	1994	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>GNI(100M.\$)</b>												
N. Korea (A)	231	211	212	214	177	126	158	168	157	170	184	208
S. Korea (B)	2,523	3,143	4,017	5,183	4,740	3,168	4,021	4,552	4811	5475	6086	6,810
(B)/(A)	10.9	14.9	18.9	24.2	26.8	25.1	25.5	27.1	30.6	32.1	33.1	32.8
<b>GNI (\$) per capita</b>												
N. Korea (A)	1,142	1,013	992	989	811	573	714	757	706	762	818	914
S. Korea (B)	5,886	7,183	8,998	11,380	10,307	6,742	8,581	9,628	10160	11499	12720	14,162
(B)/(A)	5.2	7.1	9.1	11.5	12.7	11.9	12.0	12.7	14.4	15.1	15.6	15.5
<b>Growth rate</b>												
N. Korea	-3.7	-6.0	-2.1	-3.6	-6.3	-1.1	6.2	1.3	3.7	1.2	1.8	2.2
S. Korea	9.0	5.4	8.3	6.8	5.0	-6.7	10.7	8.8	3.8	7.0	3.2	4.6

- Positive growth rate since 1999 (Average growth rate 2.7%)

Source: the Korean National Statistical Office. *Comparison of Economic and Social Aspects of South and North Korea*.



## Growth rate of DPRK and ROK





## But, the economy is dependant on resources from outside

Indicator	1999	2000	2001	2002	2003	2004
GNI(100M.\$)	158	168	157	170	184	208
<b>Growth Rate</b>	6.2	1.3	3.7	1.2	1.8	2.2
<b>Growth Volume</b>	9.79	2.18	5.81	2.04	3.31	4.58
<b>Aid Volume</b>	4.01	2.96	4.93	3.93	2.97	4.19

- Without resource inflow as aid, DPRK's economy can hardly grow.
- The economy survives on special economic relation with PRC, ROK, Russia.
- Trade dependency on China(39.0%), ROK(19.6%), Russia (6%) increased.
- DPRK does not yet have the capacity for capital formation without help from the outside.



## 2. Is DPRK Changing?



## The Responses of DPRK

According to " Along the way toward improvement: Reality and prospects of DPRK's economy" (Chosun Shinbo, January 16~February 1, 2006)

- **Before 1998:** Economic deterioration due to disappearance of socialist market
- **1998~2000:** Arduous march. Preparing for economic recovery by establishing national policy measure
- **2001~2005:** Started construction of strong economy by implementing policy ideas and obtained good results esp. in 2005

Major economic policies:

- Modernization and reconstruction of People's economy;
- Reform of industrial structure;
- Agricultural revolution;
- Improvement of socialistic management
- 2006: Establishing 3-year planning for major sectors like energy, metal, transport and agriculture.





## Reform Measures of July 1, 2002

<b>Field of Changes</b>	<b>Objective of Reform</b>	<b>Policy Measures for Reform</b>
Economic operation	Command economy → Monetary economy	Increase in prices(x25) and wages(x18), Abolition of rationing system
International relation	Isolated domestic market → Link to international market	Readjustment of exchange rate(x70), Abolition of exchange coupon
Business management	Ethical, social motivation → Material, individual motivation	More autonomy of sub-units, Self-supporting accounting system, Strengthening material incentives, Higher capacity for autonomous distribution of agricultural products



## Introducing General Markets

- **General markets have been officially introduced instead of agricultural market. (2003)**

	Past	Present
Traded items:	Only agricultural goods	+ Manufacturing goods
Frequency:	Every 5 days	Every Day
Seller:	Only Individual	+ State Owned Enterprises

- **Big cities are experiencing a market**
- **Now consumption depends on market**
- **Money became the most important goal, and the people show eagerness to work more**
- **Results: higher production, economic mind of the people  
bigger gap between poor and rich, macroeconomic instability,,,**



# Macroeconomic Problems

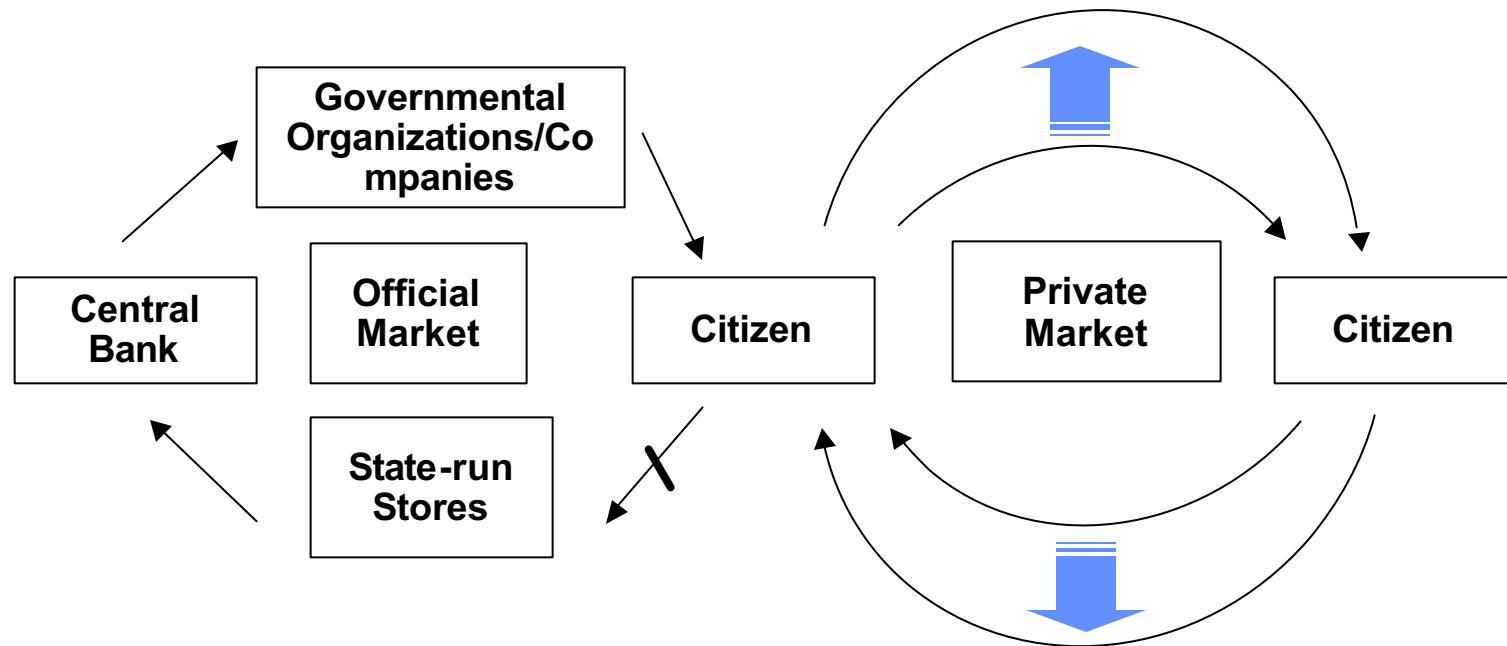
## 1. High Inflation and Soaring Exchange Rate

- High inflation pressure → Price & Wage increase
- Volatile Exchange Rate → Dollarization
- North Korea is suffering under macroeconomic instability due to the system mismatch.
  - Command & Control do not function on the market
  - Market appropriate policy instrument needed
  - Esp. New financial system needed



# High Inflation

## Process of Civil Accumulation of North Korean Currency





## Macroeconomic Problems

### **2. Inequality is expanding**

- Differences in accessibility to the market by region and sector has expanded the income gap
- Due to price increase, the increase in living standard inequality has lead to more dissatisfaction of people



# Reintroduction of Food Rationing

## Objectives:

- **Eliminate the inflation pressure and bring the price level under control**
  - **Price of rice is the standard for price policy in the North**
- **Reduce the dissatisfaction of poor people by providing food through PDS system**
- **Price cannot be stabilized due to the increasing money volume**



## Reform as Survival Strategy

- **Reform does not lead to the stage of transition or transformation**
- **New reform measures concentrate on efficiency improvement on the micro level**
- **Without financial reform, macroeconomic instability will hamper further reform measures**
- **The DPRK's reform measures are not market-oriented yet, but a way to normalize the economy by using market (? Reform follows market)**
- **DPRK regards reform as a survival strategy not as a development strategy**



### 3. Can SEZ Revive DPRK's Economy?





## Open-door Policy (1980s~2004)

- 1984: Joint venture law
- 1989: Beginning of inter-Korean trade
- 1991 : **Rajin-Sunbong Free Trade Zone**
- 1993: 1st Nuclear Crisis (Withdraw from NPT)
- 1994: Death of Kim Il-Sung, Geneva Agreement
- 1995: Establishing KEDO
- 1998: **Mt. Kumkang tourism project**
- 2000: Inter-Korean summit meeting and Open-door policies
- 2001: Chairman Kim, Jong-Il's visit to Shanghai (Jan.), Russia (July)
- 2002: **July 1st Reform, Shinuijoo Special Economic Zone** (Sept.)  
Japanese PM's visit to Pyongyang (Sept. 2002 / May 2004 )
- 2002: 2nd Nuclear Crisis (Oct.)
- 2004: **Gaeseong Industrial Complex**



## Special Economic Zones



1. **Rajin-Sunbong FTZ** : first special economic zone, but failed
2. **Mt. Kumkang** : open for tourists with SEZ potential
3. **Shinuijoo SEZ**: Hong Kong in DPRK with independent administration
4. **Gaeseong IC**: industry complex for ROK firms and others

# Gaeseong Project



- **Favorable condition for investment**

- 40 miles from downtown Seoul, 30 miles from Incheon Int'l Airport
- Hyundai has a plan to invest US\$ 1 billion annually

- **Expected impact**

- ROK's industrial restructuring
- Expand ROK's influence



## DPRK's Development Strategy using SEZ

- **“Island-Mainland Strategy”** : Test-confirm-expansion strategy
  - Develop SEZ (Special Economic Zone) and attract FDI
  - Experiment reformative measures in SEZ (island)
  - Adopt a slow transition in the overall economy (mainland)
  - Use the SEZ as a conduit of resource and technology to the overall economy
- **Assessment**
  - Gradual approach is good to minimize transition-costs.
  - However, to maximize the positive effect of SEZ, DPRK needs to make more aggressive economic transition
- **Future Task**
  - Maintain balance and find starting point for aggressive transition policy



## Three effects of FDI in SEZ

- According to Hirschman, foreign direct investment(FDI) in SEZ creates following three effects.



- The order of the impact:  
Linkage effect> Production capacity effect> Income creation effect
- The DPRK needs to create **linkage effect** between the SEZ and the rest of the economy



## To Activate the Linkage Effect

### **Link FDI firms to DPRK firms**

- First stage: supply of materials and laborers
- Second stage: labor-intensive intermediate goods
- Third stage: capital-intensive intermediate goods
- ? Diffuse the growth effect

### **Preconditions**

- DPRK firms need to understand the market economic principles  
e.g. importance of contracts, how the price is determined, labor management ...
- Success of SEZ depends on overall economic reform



## 4. What is the Chinese Role for DPRK's Economy?



# DPRK- PRC TRADE

Export  
Import  
Sum  
Balance (www.kita.net)  
RA





## Trend of DPRK- PRC Trade

- **Rapid increase since 2000 due to**
  - improvement of DPRK-PRC relation,
  - increase of Chinese demand for primary goods like mineral resources from DPRK
  - and others
- **Increase of DPRK-PRC trade holds 77% of the total DPRK's trade increase**



## Characteristics of DPRK- PRC Trade(I)

1. A big volume of deficit, however
  - provided partly as loan, partly as grant (total 100-200 \$mil)
  - bearable level
2. Export items are mainly primary goods
  - Fisheries are decreasing, but mineral resources like coal(+120.6%), iron ore(+46.9%) are increasing
3. Most important import items are energy, food, and machinery.
  - DPRK's economy depends on China



## Characteristics of DPRK- PRC Trade(II)

4. Border trade holds greatest weight but still underestimated.
  - Border trade held 80% of Chinese export to DPRK until 2001 because of special tariff and tax rate in the border region.
  - Chinese people in the border region can bring goods to DPRK without reporting up to the given amount.
  
5. Trade between DPRK and PRC is concentrated in Northeastern 3 regions (60~70%)



## Real Trade Deficit of DPRK

(unit : \$ mil)

	2000	2001	2002	2003	2004	2005
Crude Oil	75.6	108.8	76.5	121	139.3	197.7
Grant	27.6	69.1	16	10.9	14.6	38.1
Sum	103.2	177.9	92.5	131.9	153.9	235.8
Real Deficit	-310	-226	-104	-100	-60	-351

- A big volume of deficit, however
  - provided partly as loan, partly as grant (total 100-200 \$mil)
  - bearable level



## DPRK's Export to PRC by Industries

(unit : \$ mil)

	1998	1999	2000	2001	2002	2003	2004	2005
Primary Ind.	58.2	31.8	58.5	54.9	61.9	67.7	69.2	66.0
Heavy & Chemical Ind.	37.0	30.9	32.7	27.2	13.5	17.3	21.0	20.1
Light Industry	4.8	37.3	8.8	17.9	24.6	15.1	9.8	13.9

Source: China Customs Statistics  
KITA([www.kita.net](http://www.kita.net))

- DPRK exports mainly primary goods due to the shortage of manufacturing capacity.



## DPRK's Import by Use

(unit : %)

	1998	1999	2000	2001	2002	2003	2004	2005
Raw Material	67.2	63.6	64.7	64.7	62.5	56.0	53.3	70.8
Capital Good	10.5	15.0	21.0	15.7	17.6	14.9	16.7	13.1
Consumption Good	22.3	21.4	14.2	19.6	19.9	29.1	30.0	16.0

Source: China Customs Statistics;  
KITA([www.kita.net](http://www.kita.net))

- DPRK imports raw materials including crude oil and capital goods
- These goods are crucial to maintain DPRK's economy



## DPRK's Export by Kinds of Trade

(\$ mil, %)

	1999	2000	2001	2002	2003	2004(a)	2005(b)	(b-a)/a
Trade	1.3 (3.2)	0.9 (2.5)	9.7 (5.8)	8.8 (3.3)	20.9 (5.3)	75.0 (12.8)	147.9 (29.6)	97.3
Border Trade	32.1 (76.9)	29.5 (79.3)	40.0 (24.0)	55.0 (20.3)	81.3 (20.6)	156.4 (26.7)	181.9 (36.4)	16.3
Grant	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	-
CPT	5.4 (13.0)	5.0 (13.5)	21.2 (12.7)	11.0 (4.1)	10.3 (2.6)	21.7 (3.7)	20.9 (4.2)	-3.4
Bonded Trade	2.3 (5.5)	1.4 (3.6)	94.9 (56.9)	191.9 (70.9)	278.3 (70.4)	321.1 (54.8)	145.4 (29.1)	-54.7
Others	0.6 (1.4)	0.4 (1.1)	0.9 (0.6)	4.0 (1.5)	4.5 (1.1)	11.4 (2.0)	3.0 (0.6)	-62.5
Total	41.8 (100.0)	37.2 (100.0)	166.7 (100.0)	270.7 (100.0)	395.3 (100.0)	585.7 (100.0)	499.2 (100.0)	-14.3

Source: China Customs Statistics; KOTRA



## Weight of Export to NE China

(unit : %)

	1998	1999	2000	2001	2002	2003	2004	2005
Liaoning	43.1	42.9	40.5	67.7	80.4	81.6	66.8	48.9
Jilin	41.2	47.6	48.6	15.0	12.5	12.4	18.0	20.7
Heilongjiang	3.9	0	0	0.6	0.7	0	0.5	1.6
Others	11.8	9.5	10.9	16.7	6.4	6.0	14.7	28.8

Source: China Customs Statistics; KITA([www.kita.net](http://www.kita.net))

- Three Northeastern regions hold over 70% of DPRK's export to China





## Weight of Import from NE China

(unit : %)

	1998	1999	2000	2001	2002	2003	2004	2005
Liaoning	37.5	36.2	31.9	30.3	28.9	24.5	26.0	29.9
Jilin	19.3	17.0	20.8	24.2	23.8	25.5	25.7	22.6
Heilongjiang	12.9	15.2	16.0	16.1	17.6	15.6	11.9	12.7
Others	30.3	31.6	31.3	29.4	29.7	34.3	36.4	38.4

Source: China Customs Statistics; KITA([www.kita.net](http://www.kita.net))

- The three Northeastern regions are important as importers as well



## Chinese Investment into DPRK

### **1. Volume is still very small:**

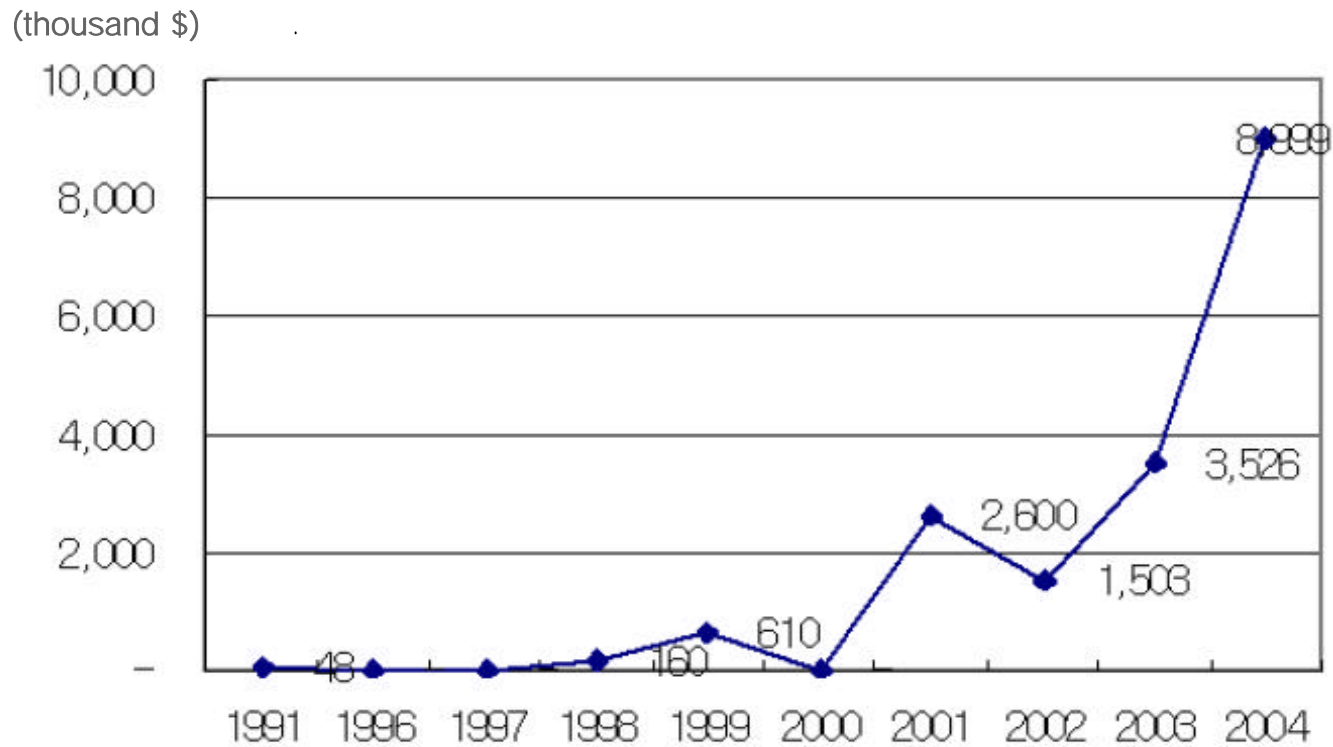
- less than 10 \$mil in 2004, less than 50 \$mil with unreported investment.

### **2. Chinese investment into DPRK is increasing:**

- China expands investment in abroad
- Political relation between DPRK-PRC is getting closer
- DPRK makes efforts to induce foreign investment providing favorable condition
  - Minimum wage level 30 Euro
  - Tax and other costs reduced ( Costs for electricity, water, gas...by 30%)



## Trend of Chinese Investment in DPRK



Source: KOTRA(2005)



## Characteristics of Chinese Investment

### 1. Related with trade

- Chinese investors provide ships and fishing implements
- Active investment focuses on mining sector
- Managing department store, import markets

### 2. Related with the development project of Northeastern 3 Regions : according to State Bureau Document No.36.

- China supports development of energy, natural resources, and mining
- China supports construction of infrastructure
- Joint project for Rajin port development, project to improve Bridges over Yallu, marine transportation route b/w DPRK and PRC etc.
- China suggested a plan to develop Dandong as SEZ linking with Shineuijoo.

? **Active Chinese investment is motivated by the development plan for Northeastern region rather than political intention**



## Reasons for DPRK's dependency on China

- **China provides favorable conditions for DPRK**
  - Competitive price of Chinese product
  - Chinese demand for DPRK's resources
  - Geographic adjacency
  - Special tariff and tax system for border region
  - Close political relationship between two countries
  - Expanding market as a result of rapid economic growth
  - Ethnic Koreans in Northeastern China
- ? **China-DPRK economic relation is based on historical and natural condition.**



## Implications

- China cannot rehabilitate DPRK's economy in a short period, but it can help/sustain DPRK's survival
- DPRK-China relation will lead to more active marketization in the DPRK
- Containment policy against DPRK cannot be so effective, it will rather strengthen DPRK's dependency on China



## 5. Conclusion



## Conclusion

- DPRK's reform and opening policy has been just a survival strategy not a development strategy
- China has functioned as a reliever for survival, but not as a developer
- SEZ may become a window for DPRK's economic development, but it is up to further reform utilizing linkage effect





**Thank you for your attention!**

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