
NORTH KOREA'S ECONOMIC DEVELOPMENT AND EXTERNAL RELATIONS

NORTH KOREA'S INTERNATIONAL ECONOMIC RELATIONS: TRENDS AND FUTURE PROSPECTS

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Overview

In 2004, despite various internal and external negative factors, North Korea's institutional foundation for external economic cooperation was established with the enactment and promulgation of regulations related to special economic zones. The four major economic cooperation agreements signed by the two Koreas have also taken effect.

Sino-North Korean economic cooperation has evolved from the past, when China was unilaterally providing economic support and aid to North Korea, and the cooperative bilateral economic relations of these two countries are gradually entering a new phase in which both sides seek to achieve mutual profits and benefits. In the midst of the newly forming cooperative economic relations between North Korea and China, North Korea is making active efforts to attract investment from Chinese corporations and individuals. China has also expressed its resolve to expand economic cooperation with North Korea in order to increase its influence on Pyongyang as well as capture the North Korean market ahead of other countries. As a result, Sino-North Korean economic cooperation is expected to expand further, and North Korea's economic dependence on China is expected to deepen.

Trade volume between North Korea and China has grown significantly to reach \$1.38 billion. Both North Korea and China have promoted the construction of the Pyongyang International Business Complex and the leasing of the Pyongyang First Department Store as well as other economic cooperation activities. To develop the designated special economic zones of Najin and Sonbong, an economic cooperation agreement was signed with Russia in January 2004. Discussions were also held in October 2004 about offering duty-free and tax-free zones in Najin and Sonbong.

In addition, North Korea is preparing actively for the opening of its economy: people are being trained overseas about market economies and improving investment conditions, for example. North Korean economic delegations have been sent to China, Vietnam, Australia, Southeast Asia, Europe, and other regions, and overseas training in market economies is ongoing. In addition, North Korea has:

- Allowed foreigners to establish independent companies in North Korea;
- Lowered the minimum wage to 30 euros; and
- Slashed charges for electricity, tap water, and other utilities and taxes so as to improve the investment environment for foreign investors.

To acquire much-needed hard currency, the North Korean government has set up centers for foreign exchange and is attempting to increase trade. Foreign-currency exchanges are conducted at market exchange rates at the centers in order to attract hard currency from local residents. Permission has been granted for individual factories, companies, cities, and counties to engage in trade; and companies that earn foreign currency can now use up to 40 percent of their total foreign-currency earnings on their own, including for reinvestment (previously they could use only 20 percent). Factories and companies have been granted the right to increase their import volume to reach up to three times their export volume. Permission has been granted for companies operating in the Kaesong industrial complex and in the Mt. Kumgang tourism district as well as foreign companies to sign individual labor contracts with North Korean laborers and pay them direct wages (in foreign currency).

In terms of inter-Korean relations, much was accomplished in the first half of 2004: inter-Korean coop-

erative projects were carried out smoothly, military cooperation was realized, and an atmosphere conducive to resolving the nuclear issue was created. After July 2004, however, when the South Korean government prohibited civilian organizations to visit Pyongyang to observe the 10th anniversary of Kim Il-sung's death and when hundreds of North Korean defectors arrived en masse in South Korea, government-level inter-Korean dialogue came to a halt. North Korea has pointed to the abovementioned issues as obstacles to improving inter-Korean relations. Meanwhile, consultations have continued about humanitarian aid for North Korea and the three major economic cooperation projects—construction of the Kaesong industrial complex, the Mt. Kumgang project, and the reconnection of roads and rail lines between the two Koreas. Private contacts were held intermittently.

Diversified Diplomacy for Actual Profits

After its hermetic existence since the July 1994 death of Kim Il-sung, North Korea held 13 summit meetings with China and Russia following the inter-Korean summit of 2000. North Korea is participating in summit talks with not only China and Russia but also with Japan and other nations in the European Union (EU) and Asia. North Korea normalized its diplomatic ties with only two Western nations in 1998 and 1999, but this has increased to 21 since 2000 as more EU nations and other advanced nations have normalized relations.

North Korea is attempting to abolish its negative image by participating in the international community. North Korea has normalized relations with 23 of the 25 EU nations (France and Estonia excepted). As a result, the North Korean embassy to the United Kingdom opened its doors in April 2003, and its embassy to the Czech Republic reopened in May 2004. North Korean representatives also participated in the annual conference of the Bank for International Settlements (Kim Wan-su, president of the Central Bank, attended 26–28 June 2004), the ASEAN Regional Forum (Paek Nam-sun, minister of foreign affairs, attended 1–2 July 2004), and the 59th United Nations General Assembly (Choi Su-heon, vice minister of foreign affairs, attended 27 September–5 October 2004).

Inter-Korean Economic Relations

Despite the stalling of inter-Korean government-level dialogues in the second half of 2004, the South and the North were engaged in active exchanges of visitors. Occasions for visitor exchange included the groundbreaking for the Kaesong industrial complex, two rounds of exchange visits of separated families, economic projects like overland trips to Mt. Kumgang and trips to Pyongyang, exchanges in the economic and socioeconomic fields, and assistance to North Korea.

Although the number of North Koreans who visited South Korea stood at 321 in 2004, a decrease of 69 percent from 1,023 people during 2003, the two Koreas were actively engaged in diverse areas, including sociocultural events and sporting events. In 2004, there were 353 round-trips to Mt. Kumgang, during which a total of 268,420 tourists—from South Korea as well as other countries—visited Mt. Kumgang.

The total volume of inter-Korean trade was \$697.04 million in 2004, decreasing 3.8 percent from \$724.22 million the previous year. North Korea's imports from South Korea in 2004 totaled \$258.00 million, decreasing 10.8 percent from \$289.25 million in 2003; and exports totaled \$439.00 million, increasing 0.9 percent from \$434.97 million the previous year. The decrease in total trade owes to a reduction from 2003 to 2004 in the trade of textiles, a commission-based processing that accounts for more than 80 percent of inter-Korean business trade. The contraction of the textile trade resulted from the bankruptcy of large textile manufacturers as well as reduced orders caused by a lack of consumption in South Korea.

In the area of economic cooperation, 28 projects gained approval for cooperative business partnerships and 26 projects for cooperative business projects. Some progress was made in investment in the already approved cooperative business projects. There were 26 projects involving companies like Andong Hemp Textile Company and KT, which gained approval for their business projects in 2004.

The total volume of inter-Korean trade (consisting of 317 items) during January 2005 was \$49.42 million,

a 35.4 percent decrease from \$76.50 million for 248 items during the previous month and a 34.7 percent increase from \$36.69 million in 172 items during January 2004. Of this, the total amount of commercial transaction imports was \$26.78 million. Commercial transaction imports comprised \$17.22 million of products in trade and \$9.56 million of economic cooperation project goods.

In 2004, the Kaesong industrial park was a hot spot of inter-Korean economic cooperation.¹ The institutional foundation for the project was an August 2000 agreement between the Hyundai Group (South Korea) and the Asia-Pacific Peace Committee (North Korea). North Korea has promulgated 11 subregulations related to taxes, labor, customs, real estate, insurance, and so forth since it unveiled its Kaesong Industrial District Act on 27 November 2002. The two Koreas reached agreement on four major inter-Korean economic cooperation programs—investment guarantees, prevention of double taxation, payment clearance and settlement, and dispute settlement. Full-scale development of the Kaesong complex commenced in earnest after the two sides reached a consensus and concluded an agreement on land rents on 13 April 2004. Land development for the pilot site of 28,000 *pyong* (approximately 85,000 square meters) was completed on 30 June 2004. Fifteen South Korean companies are expected to be operating in the pilot site by the end of 2005.

North Korea's External Economy

Trade

In 2003, North Korea's foreign trade approached the \$2.39 billion mark, up 5.8 percent from 2002 (*Table I*). Exports for the same year totaled \$777 million, thus posting a 5.5 percent rate of growth from one year earlier and representing five straight years of growth since 1999. Imports in 2003 topped \$1.61 billion, up 5.9 percent over the preceding year. North Korea's trade deficit for 2003 amounted to \$837 million, a slight increase from the \$790 million recorded in 2002. These figures clearly reflect the characteris-

Table 1: North Korea's Foreign Trade, 1994–2004

Year	Exports		Imports		Totals	
	Value (\$ mill.)	Change (%)	Value (\$ mill.)	Change (%)	Value (\$ mill.)	Change (%)
1994	858	-13.3	1,242	-25.0	2,100	-20.6
1995	736	-14.2	1,316	6.0	2,052	-2.3
1996	727	1.2	1,250	-5.0	1,977	-3.6
1997	905	24.5	1,272	1.8	2,177	10.1
1998	559	-38.2	883	-30.6	1,442	-33.8
1999	515	7.9	965	9.3	1,480	2.6
2000	556	8.0	1,413	46.4	1,969	33.0
2001	650	14.9	1,620	15.2	2,270	2.6
2002	736	13.1	1,524	-5.9	2,260	-0.4
2003	777	5.5	1,614	5.9	2,391	5.8
2004	1,020	31.3	1,837	13.6	2,857	19.5

Source: Reports from overseas trade offices (Seoul: Korea Trade-Investment Promotion Agency [KOTRA], various years).

tics of North Korea's foreign trade, in which imports sharply outweigh exports.

The major reasons for North Korea's export growth in 2003 include the increase in exports of nonmetal goods and marine products to China and the surge in the export of North Korean textile goods to major trade partners.

North Korea's increase in imports in 2003 is attributed to a sharp increase in imports of various energy resources from China and Russia and the hike in imports of nonmetal goods, machinery, and electric and

1. The area of the Kaesong industrial park totals 20 million *pyong* (65.7 square kilometers or 25.4 square miles)—8 million *pyong* for the industrial complex and 12 million *pyong* for the host cities.

electronic products. Meanwhile, North Korea's shipments of vegetable products, mineral products, chemicals, and plastics posted a slight decrease compared with 2002. Imports of textile products, vehicles, and chemical goods also declined a little.

In 2004, North Korea's trade with China and Japan reached the \$1.62 billion level, showing a 22.9 percent increase from the previous year. North Korea's exports to the two countries totaled \$740 million, up 30.9 percent compared with 2003; imports from the two countries totaled \$880 million, up 22.9 percent from 2003.

North Korea's trade with China. Sino-North Korea trade volume hit a new record in 2004, approaching \$1.38 billion. North Korea's exports to China topped \$582 million, up 47.2 percent compared with 2003. Imports totaled \$795 million, up 26.5 percent from the preceding year. North Korea's total trade volume for 2004 reached nearly \$2.9 billion.

The increase in North Korea's exports to China stems from the increase in exports of various blue crabs, fish, and shellfish; metal products; and textile goods. Meanwhile, the North's increase in imports from China is mainly attributed to the hike in the import of energy resources such as crude oil and coke and food such as frozen pork. In addition, imports of various grains like rice and wheat as well as nonferrous metals were conspicuous.

North Korea's trade with Japan. Despite the Japan-North Korea summit in 2002, the political tension between the two nations caused by the Japanese-abductees issue had a negative influence on Japan-North Korea bilateral economic trade. North Korea's major exports to Japan—shellfish, crabs, and textile products—drastically decreased in volume in 2004. North Korea's imports of machinery, textiles, and nonferrous metal products from Japan also decreased significantly.

Efforts to Import Information Technology

North Korea has been concentrating on developing its information technology (IT) industry since Kim

Jong-il stressed the imperative of "achieving leaping economic growth in the shortest possible time" after his two visits to Chinese cities where the IT industry is thriving.² North Korea has been aggressively pursuing exchanges and cooperation with external partners (on 41 IT projects with 21 countries) in an effort to adopt leading scientific and technological developments. North Korea's technological cooperation projects with foreign partners have been focused on the IT area.

While it maintains continued cooperation with its traditional allies, including Russia and China, North Korea is striving to expand exchanges with such Western countries as Germany and Switzerland. Moving away from its past strategy of passively maintaining relations with various African countries, North Korea is actively moving toward expanding the scope of exchanges and cooperation with European and Asian countries (31 projects with 20 countries in 2004). North Korea has also been making efforts to expand cooperation with international organizations, including the United Nations Development Program and the International Telecommunication Union (four projects in 2002, five projects in 2003, and six projects in 2004).

Since 2000, North Korea has been focusing strongly on building connections with scientists of Korean ancestry who live abroad—for example, in Japan and China—and expanding cooperation with South Korea in the area of science and technology. North Korea also is expanding programs for its scientists and engineers to study at and/or visit the world's leading institutes and sites. North Korea is increasingly relying on such programs not merely as a means to understand the way the capitalist economy works, but also as an effective way of adopting leading scientific developments and technologies from foreign countries.

On top of its traditional method of seeking cooperation with foreign countries by entering into agreements or protocols, North Korea is increasingly expanding opportunities for its homegrown experts to study abroad to become familiar with the latest scientific and technological developments. As it increases the number of countries where its experts can apply to study, North Korea is encouraging the use of such

2. Kim traveled to the Beijing Junggwanchon area in May 2000 and to the Shanghai Pudong area in January 2001.

programs to study in a variety of fields, such as IT, mining, and agriculture.

As part of the national initiative to adopt the latest technologies in various areas of the nation's economy, North Korea is eagerly endeavoring to set up joint ventures and businesses with foreign partner companies (17 projects in 2004). In 2004, North Korea urged stepping up efforts to win joint venture and business contracts with foreign companies as a means of importing leading technologies from abroad. It appears that North Korea is destined to face limitations in its efforts to obtain the latest technologies unless it resolves the pending nuclear issues and establishes cooperative relationships with Western countries first.

Humanitarian Aid from International Society

The Food and Agriculture Organization (FAO) of the United Nations and the World Food Program (WFP) forecast in November 2004 that North Korea's food shortages will worsen in the latter half of 2005. The FAO-WFP reported that food rations in North Korea fell early in 2005 to just half of the recommended daily amount.³ The WFP, the main channel for food aid into the hermetic North, added that a further cut in rations is inevitable after June 2005 if no new promises of aid from the international community are forthcoming. In January 2005, WFP monitors said North Korea's daily state rations were cut from 300 grams of cereal to 250. The minimum daily ration of cereal set by the agency is approximately 500 grams.

At the moment, the food situation in North Korea does not show any sign of improvement. Concern of and aid from international society to combat North Korea's food shortage are losing momentum, however, because of the nuclear problem and the large-scale tsunami disaster in South Asia. Despite the condition of inter-Korean relations, it is not expected that South Korea will stop its humanitarian support for North Korea (300,000 tons of fertilizer and 400,000–500,000 tons of grains per annum).

Major Trends and Prospects

In 2004, North Korea reinforced its political and economic cooperation with China (it established cooperative relations with the new Chinese leadership) and Russia, which form the core of the North's activities to diminish U.S. pressure on North Korea. Meanwhile, North Korea made efforts to break from international isolation and solidify its international economic cooperation activities through diversified diplomatic activities, which include accelerated contact with the EU, nonaligned nations, and international organizations. As for international economic cooperation, North Korea's trade with advanced Western nations decreased, while its trade with China, Russia, Thailand, and others increased. What is particularly noteworthy regarding North Korea's international economic cooperation in 2004 was that investments and trade with China have increased significantly.

For 2004, the volume of North Korea's trade with China is presumed to stand at \$1.38 billion, which is a 34.6 percent increase from 2003. Sino-North Korean trade currently accounts for more than one-half of the North's total international trade volume. By rapidly increasing the volume of exchanges with China, establishing cooperative and joint companies, and implementing various other measures, North Korea is actively searching for ways to promote cooperation with China in a range of economic fields. During the visit of Li Zhaoxing, China's minister of foreign affairs, to North Korea in March 2004, during Kim Jong-il's visit to China in April 2004, and on other occasions, discussions have taken place on expanding bilateral economic exchanges and cooperation. North Korea is actively seeking to:

- Introduce advanced Chinese industrial technology in its industrial facilities, machinery, and construction projects;
- Work jointly with China so that the supply of materials from Chinese corporations is increased; and
- Boost other aspects of cooperation.

3. "North Korea Has Bigger Harvest: But Millions Still Need Food Aid" (Pyongyang, Rome: FAO and WFP, 23 November 2004), www.fao.org/newsroom/en/news/2004/51607/index.html.

China, for example, decided to provide a glass factory to North Korea free of charge; China began construction on 1 July 2004.

The overall assessment for North Korea's international economic relations in 2004 is negative. It is generally believed that the market mechanism has a self-reinforcing mechanism: once market-oriented reform is introduced in a transitional economy, marketization will be given impetus by its own momentum. Thus, some observers of North Korea believe that the North's journey to a market economy is irreversible. This is not necessarily true, as described in the turnpike theories of optimal growth as developed by Radner.⁴ The turnpike terminology describes how a person taking a long trip will gain by incurring some initial cost (in economic terms: economic reforms) to get onto a turnpike, but it might not pay to go via the turnpike for a shorter trip. North Korea's political leader may well be a short-trip traveler.

For North Korea to bail itself out of inflationary pressures and poverty and break out of the vicious cycle of shortages, it must have financial resources and technology. Under current circumstances, however, neither domestic savings nor foreign direct investment is a viable option for the North. To narrow discrepancies between demand and supply and, thus, smooth the North's reform process, capital and technology inflow from the outside world—including South Korea—will be needed. Nevertheless, given the North's inefficient resource allocation system managed by the central government, cash inflow from outside will hardly be conducive to alleviating defects in the supply side. Some argue that the inflow of a large sum of cash (including Japanese reparations) will pull the North out from its low-level equilibrium. However, a cash inflow (or a positive trade gap) is only one of many necessary conditions for the country's sustainable economic growth. Without an efficient resource allocation mechanism, cash inflow for the North will be like pouring water into a bottomless pot.

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4. Roy Radner, "Paths of Economic Growth That Are Optimal with Regard Only to Final States," *Review of Economic Studies* 28:98–104.