

# **A Strategy for the Advancement of the North Korean Economy**

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### I. Introduction

The Kim Jong-il era of North Korea is an era of military-first politics. Military-first politics is a survival strategy of North Korea that directs every policy area. It was chosen while North Korea went through extreme difficulties derived from the collapse of the socialist bloc in the early 1990s and the “Arduous March” in the mid-1990s. No matter how dire the situation was, Kim Jong-il could not possibly abandon socialism and introduce an active opening and reform policy. Thus a military-first strategy was an inevitable choice for North Korea in the 1990s.

Necessarily this military-first strategy brought about changes in traditional economic strategy. In the Kim Il-sung era, economic strategy had made developing heavy industry and simultaneously developing light industry and agriculture a top priority. According to the military-first principle, however, the focus shifted from heavy industry to the military industry. The principle also implied that all economic fields had to be sacrificed save for the development of the military.

What were the reasons for adopting the economic strategy of the military-first era and what were the underlying motives? Can such an economic strategy succeed? If it is bound to fail, what kind of strategies could come next? What would be the role of South Korea and neighboring countries to expedite the economic development of North Korea?

This paper seeks to answer these questions. It concludes that North Korea's economic strategy in the military-first era was positive for handling economic difficulties in the short run but could not help producing negative effects on the economy in the long run and finally bringing about the collapse of the North Korean regime. Therefore, this paper



suggests that North Korea must abandon its existing economic strategy and adopt a new one if it wants to avoid collapse in the future.

## II. Economic Strategy in the Military-First Era

### 1. Concept and Contents

According to North Korea, the military-first era is defined as “the era where all problems occurred in the process of revolution and reconstruction should be solved by the military-first principle.”<sup>1</sup> Giving priority to the military means that “military affairs take precedence over others and strengthening the military industry should be treated preferentially.”<sup>2</sup> North Korea has been propagating the military-first principle as a “new and ingenious idea” created by Kim Jong-il. In this sense, North Korea is criticizing Karl Marx by implying that he overlooked the importance of the military industry. North Korea is also criticizing Vladimir Lenin and Joseph Stalin in their emphasis on heavy industry and lack of “the right view on the strategy of the economic development.”<sup>3</sup>

It was natural that North Korea’s economic strategy had started to focus on the military industry as the military-first era emerged. Such a strategy is called the economic strategy in the military-first era, which means putting the top priority on developing the heavy industry and simultaneously developing light industry and agriculture. According to the *Gyungje Yeongu* or *Economic Studies*, the most important North Korean quarterly economic journal, Jae-Seo Kim (1999) is the first article that emphasized the importance of the military industry and Seong-Hyeok Lee (2001) is the first one that connects the military-first principle and the military industry. The first article that includes “military-first” in the title is Dong-Nam Kim (2001), but it did not actually cover the military industry. The review of the articles in *Economic Studies* concludes that the discussions systematically analyzing the reciprocal relationship between the military-first principle and the military industry had not been initiated until the work of Lee (2003) and Park (2003).<sup>4</sup>

Although economic strategy in the military-first era purports to mean that light industry and agriculture are to be developed simultaneously, what it actually means is that light industry and agriculture should be sacrificed in order to develop the military industry.<sup>5</sup> In other words, the military industry is the “lifeline of building a strong and prosperous country” and it is the “fundamental economic principle in the military-first era” to



develop the military industry. Thus “the government expenditure must be invested in the military industry before any other industry”<sup>6</sup> and “the necessary inputs such as workers, facilities, raw materials, and electricity must be provided preferentially for the military industry.”<sup>7</sup> Furthermore, Cho (2005) explains that what economic strategy in the military-first era really means is that the advancement of light industry and agriculture is needed to reinforce the military industry and that the military sector is the top priority among all sectors of the economy.

North Korea is using the term “military industry” as the “munitions industry.” For instance, Kim (2005, 109) defines “the military industry” as an industry to supply modern arms. In fact, North Korea divides its production sectors into three categories: munitions production, producer goods production, and consumer goods production, and the munitions industry is defined as the industry that produces materials used for military purposes. Thus North Korea says that “the munitions industry is the same as the military industry since the munitions industry contributes to defending North Korea from military attacks by the imperialist countries.”<sup>8</sup>

## 2. Logic

What is the logic behind the economic strategy in the military-first era and how does North Korea justify such a strategy? According to North Korea, the goal of economic activities in a socialist society is to guarantee the independent and creative lives of workers just as it is to produce surplus value for the properties of the bourgeoisie in a capitalist society. The independent and creative lives of workers consist of two parts. First, people have to be independent as the owners of the society and their independence is secured by protecting socialism from the invasion of imperialism. Second, people must enjoy abundant and civilized lives that are guaranteed by fulfilling material needs.

North Korea explains that the first part is more important than the second part because it is impossible to improve people’s living standards unless socialism can be protected from the aggression of imperialism. In other words, people’s wealth is meaningless if they remain slavish. So any other industry cannot be more important than the military industry and without its development, national security cannot be ensured and economic improvement cannot be achieved. It is to say, “we can live without a lollipop but not without a bullet”<sup>9</sup> and “it is human nature to prefer living in an independent country even if food and clothes are much worse than living in a colonized country.”

Undoubtedly light industry and agriculture will decline if the military industry is regarded as the top priority, since the funds to invest are limited. As a result, they will influ-



ence people's living standards in a negative way. But North Korea is insisting that "the military-first principle is not sacrificing people's living standards by focusing on the military industry. It is not only to protect the nation and socialism but also to provide better lives for the people."<sup>10</sup> However, North Korea does not present the specific logic of how it is going to improve people's living standards.

Then how will economic strategy succeed in the military-first era? North Korea claims that the voluntary work of workers based on their revolutionary ideas is the basic means and that "revolutionary military spirit" makes them achieve a higher level of effort for their voluntary work.<sup>11</sup> To answer the question why "revolutionary military spirit" is required, North Korea explains that every era needs the spirit of the times and thus they need a revolutionary military spirit as North Korea enters the new era of the military-first principle.<sup>12</sup>

### 3. Economic Strategy in the Kim Il-sung Era

Economic strategy in the Kim Il-sung era can be summarized as putting top priority on developing heavy industry and simultaneously developing light industry and agriculture. So the difference of the economic strategies between the Kim Il-sung era and the military-first era is whether top priority is placed on heavy or military industry.

North Korean literature indicates that the economic strategy of the military-first era is not separate from that of the Kim Il-sung era and in fact inherits the latter. The reasons can be explained as follows. First, the military industry is closely related to heavy industry because heavy industry is the foundation of the military industry, and the military industry induces the rapid development of heavy industry. Second, the military and heavy industries share common factors in terms of physical and technological characteristics. For instance, the weapons industry, which is the core of the military industry, is the machine industry, which belongs to heavy industry. Third, the development of heavy industry is a precondition for the development of the military industry since the products of the heavy industry, such as fuel, electricity, equipment and facilities are the inputs of the military industry.

In addition, North Korea claims that Kim Il-sung did actually stress the importance of the military industry and endeavored to reinforce it. For example, he noted that that "the modern military industry is one of the most important areas in building self-reliant national economic foundation" and he accentuated the "importance of the military industry in his entire leadership period."<sup>13</sup> There also exist articles enumerating the cases of building factories for the military industry since 1945.<sup>14</sup> But the economic strategy in the military-first era is different from that of the Kim Il-sung era since it is clear that the top priority in each strategy is not the same. The reason why North Korea asserts two strate-



gies is basically identical, based on the realistic environment in which they cannot deny the legacy of Kim Il-sung.

### III. Evaluation of Economic Strategy in the Military-First Era

As mentioned above, the economic strategy in the military-first era was a product of North Korea's serious difficulties in the 1990s, both internal and external. The upsurge of crisis and tension from domestic and foreign sources caused the advent of the military-first strategy, as North Korea has conceded.

In the mid-1990s, the concern North Korea had about the collapse of their regime reached its climax. Kim Il-sung died suddenly, the so-called 'Arduous March' began, the socialist bloc had fallen, and the United States became a super-power. In addition, China, who had been in a tight alliance with North Korea, accelerated its efforts to improve its relationship with South Korea. Thus North Korea had no one to depend on. In this situation North Korea concluded that military power was the only answer for defending its regime by itself. This idea was realized in military-first politics.

Still, it was not the right choice and North Korea should have adopted an economy-first, not military-first, politics. As long as North Korea focuses on its military industry, its economic strategy is destined to fail. Furthermore, the economic strategy in the military-first era is nothing but a slogan and it does not mention any specific ways to proceed with the strategy.

In fact, the way to promote economic growth is the same both in a socialist planned economy and a capitalist market economy in the sense that economic growth requires inputs such as labor and capital or technical progress. But since North Korea is in a state of full employment, it is impossible to increase the workforce. The poor economic condition as well as the closed-door economic policy also limits technical progress. Thus, how to acquire capital is the key to economic growth and the needed economic strategy should provide a blueprint for inducing foreign capital.

But economic strategy in the military-first era has not mentioned ways to mobilize capital domestically and internationally. And the military sector cannot invite foreign investments by its nature. A limited budget, furthermore, focusing on the military sector should be followed by the shrinking of the other sectors in the economy.

Instead, the economic strategy in the military-first era suggests several other measures such as science and technology, trade, and production efficiency. But none of these



are likely to bring about positive outcomes under North Korea's present economic situation. For instance, the science and technology North Korea has been emphasizing is understood in practice as the modernization of facilities.<sup>15</sup> However, it is extremely difficult due to the lack of capital. Increasing trade volume enough to contribute to the economic growth is also almost impossible unless North Korea carries out active opening and reform programs. At last, North Korea introduced “the July 1st economic measures” in 2002 and permitted the establishment of “comprehensive markets” in 2003.

Some studies such as those of Kwon (2008) and Han (2009), apprehend that the economic strategy in the military-first era and “the July 1st economic measures” were carried out almost simultaneously as they noticed the timing that the economic strategy became known to the public. For example, Han says that “Kim Jong-il actually planned to relate the prioritizing [of] the military industry to the improvement of economic management in the civilian industries, and thus his plan was a mixture of reformative and conservative policies.”<sup>16</sup> But it seems unreasonable to think that one person would plan two policies which are contrary to each other at the same time. Therefore, it would be more likely that the economic strategy in the military-first era was initiated before “the July 1st economic measures” although its official announcement was delayed. In fact, Kim Jong-il ordered at the conference with officials of the central committee of the Party on January 1, 1997, that “even the economic projects should be related to strengthening the military” and also stressed at the same occasion on January 1, 1999, that “the economically strong country cannot be built without the military industry. Thus, it should be given top priority.”<sup>17</sup>

If we interpret that the economic strategy in the military-first era and “the July 1st economic measures” proceeded not simultaneously but consecutively, it is much easier to understand the intention of the economic policies of North Korea. To Kim Jong-il, the military-first politics cannot be discarded under any circumstances, because they represent the slogan of his era. As a result, the economic strategy in the military-first era cannot also be retracted. Thus “the July 1st economic measures” were executed to improve economic management by partially introducing several market-based functions within the economic strategy in the military-first era. In this sense, we can conclude that “the July 1st economic measures” were not to transform the North Korean planned economic system to the market-oriented one, but to complement shortcomings of its system. Such measures must be needed in order to build an economically strong country, because an economic strategy focusing only on the military industry cannot achieve the goal. Therefore, “the July 1st economic measures” and the establishment of “the comprehensive markets” were to guarantee the success of the economic strategy in the military-first era, and they have to be analyzed as the introduction of reformative policies for complementing





conservative ones, not the mixture of reformative and conservative policies.

“The July 1st economic measures” and “comprehensive markets” did bring about positive influences on the North Korean economy, since they provided firms and workers incentives to produce more and opportunities to be involved in economic activities through the markets. In fact, the setup of markets entails the creation of additional value. For instance, whereas in the past there was nothing more when the government produced and distributed 100 dollars worth of wheat, now people do not just simply consume the wheat but they produce and sell bread or noodles with that wheat at the price of 120 dollars in the market. Consequently, 20 dollars worth of value-added have been created, and the GDP and the economic growth rate rise that much.

However, they also resulted in negative effects. People came to prefer business in the markets over working in their firms because they could not be paid properly and regularly at their workplaces due to the reduction of operations caused by the insufficient supply of electricity and raw materials. Thus the attendance rate went down to 10%, the socialist education along with debate about work attitudes that used to take place every day was now held only once a month, and it became common knowledge that about 90% of workers performed their economic activities in the markets.<sup>18</sup> Even a class of merchants appeared and a spurt of industrial capital emerged.<sup>19</sup> Furthermore, various forms of illegal and private economic activities were on the rise. It is estimated that about 20% to 30% of agricultural production is produced on privately cultivated land, and that a portion of the production of firms for markets sales takes up about 20% to 30% for consumer goods and about 5% for producer goods. In addition, illegal economic activities such as private financing, smuggling, trading foreign currencies, real estate transactions, and private corporations are rising.

Although what North Korea intended by introducing the “July 1st economic measures” and “comprehensive markets” was to normalize and strengthen the socialist planned economic system, the negative effects such as expansion of market activities became too big to ignore and made the North Korean authorities worried about the possible collapse of the regime. As a result, North Korea started to control market activities and to withdraw the “July 1st economic measures.” For instance, North Korea tried to decrease market size by reviving the distribution system in 2005, and banned sales in the market by adult males over the age of 17 in 2006. In 2007, the age allowed to sell in the market was limited to over 40 years old, and several other policies were activated such as liquidation of unofficial trading companies, control of sales items and prices in the market, and prohibition of sales outside the marketplaces. Finally an announcement was made in 2008 that the market would be closed down from 2009 on.

However, reality could not change as the North Korean authority intended, because



people who had already experienced the efficiency of the market system and could no longer live without the market raged against these restrictions on a serious scale. Even if there was no reaction by the people, the North Korean government could not have arbitrarily coerced the closedown of markets because it would only have led to economic chaos and hardship as long as the North Korean government was incapable of restarting distribution.

After all, economic strategy in the military-first era, which mainly focused on political survival rather than on economic growth, was doomed to failure. From the beginning, in particular, it had a fatal limitation in the sense that it did not give answers to how to induce foreign capital that was the core for economic growth. As a result, since the introduction of the economic strategy in the military-first era, the North Korean economy has confronted a situation where legal and illegal activities exist together and where planned and market systems coexist as well. It is this situation that upholds the living of North Korean people and positively influences the North Korean economy. But it also means the start of the collapse of the socialist planned economic system. Thus we can conclude that the current situation of the North Korean economy is in the process of growing and collapsing simultaneously.

#### IV. Inevitable Decay and Groping for Escape

Starting around 2010, North Korea has shown series of changes in economic strategy in the military-first era. For instance, the New Year's Joint Editorial of North Korean newspapers in 2010 emphasized to the highest degree the importance of light industry and people's living standards. This was very unusual. However, such a stress on light industry has continued even today.

It seems that there have been debates and conflicts among the ruling elites in North Korea concerning the economic strategy in the military-first era as it failed to achieve the goals originally anticipated. Such a symptom can be found in the articles of *Economic Studies*. For instance, we can see the difference in policy priorities between the military industry and heavy industry even if it is slight so far. The original position is that heavy industry should serve a military industry as directed by the economic strategy in the military-first era. One of those examples is "it is the fundamental principle that every industry must provide any materials in any condition if they are required in the military industry."<sup>20</sup> However, the implication is different in the positions such as "the military and civilian industries are closely related and affect each other"<sup>21</sup> and "[a] bigger burden is laid on



the heavy industry strategy in the military-first era."<sup>22</sup> In addition, some articles emphasize less the importance of the military industry than the traditional ones. Those examples are that "the heavy industry should serve equally for the light industry, agriculture, and the military industry"<sup>23</sup> and that an "economic strategy in the military-first era means an exact balance among the light industry, agriculture, and the military industry."<sup>24</sup>

It is not clear that North Korea has really decided to change an economic strategy which focuses solely on the military industry. All we can say for sure is that North Korea has begun to emphasize the importance of light industry and people's living standards. It would be mainly because the year 2012 is coming, the year by which Kim Jong-il himself has declared North Korea will have built a strong and prosperous country. North Korea has insisted that it is competing by building an economically strong country because North Korea is already strong in military, politics, and ideology.

It implies that North Korea has now every incentive to focus on improving economic conditions. First, the North Korean people may not be persuaded by the announcement that they have become a strong and prosperous country without an improvement in their living standards that they can really feel in their daily lives. Second, building the strong and prosperous country is the last task of Kim Jong-il to finish his era magnificently. He will be remembered in history as the "great leader who has built the strong and prosperous country" as his father is remembered as "great leader who built the self-reliant country." Third, Kim Jong-eun himself also has an incentive to focus on the economy. Although he was appointed as a successor by his father, he is not well known to the people and thus has to show them his ability as a potential leader. Furthermore, helping with his father's last task will contribute to solidifying the power succession from his father.

In order to construct a solid foundation for economic growth, however, the fundamental change of the economic system and policies is an absolute prerequisite. The history of China and the Eastern European countries suggests that only active reform of the system and wide opening of the economy can bring about a self-sustaining foundation for economic growth. Nonetheless, in the era of Kim Jong-il such a change cannot be anticipated.

As a result, it seems that North Korea will have to rely only on the efforts to induce foreign supports and investment on order to achieve its goal in 2012. The recent announcement of raising the status of Naseon City, and the establishment of Chosun Daepoong International Investment Group probably are parts of such efforts. Nevertheless, in a situation where the nuclear issue is not solved, it would be impossible to invite foreign assistance as much as North Korea wants. Moreover, foreign firms will not launch big investment programs if North Korea does not initiate economic reform and liberalization. Even if some amount of investment is made, the effects of the induction of foreign capital



will hardly be seen as long as North Korea sticks to its current economic strategy.

Therefore, the North Korean economy cannot but help declining if military-first politics remain unchanged. Consequently, the abdication of military-first politics, the reform of the economic system, and the liberalization of the economy are the only ways to prevent the possible collapse of the regime and to develop the economy. Of course, such a change will be expected in the post-Kim Jong-il era since he cannot abandon the military-first politics which is the slogan of his era.

## V. The Strategy of Coevolution

### 1. Transition and Reform Stage

#### (1) North Korea

In order to keep North Korea alive, Kim Jong-eun or the next North Korean leadership has no other alternative but to make the decision to give up nuclear programs and military-first politics. In return, he will receive economic support and investment from the international community including South Korea, and these funds and goods will function as a driving force for rapid economic growth of North Korea.

However, an inflow of foreign capital alone cannot facilitate preparing a self-sustaining foundation for economic growth unless an environment that can effectively utilize the capital is fully furnished. Consequently, the next leadership needs to promote reform of the economic system as a new means of economic survival. On a contextual level this means North Korea has to initiate the transition from its traditional socialist planned economic system to the capitalist market-oriented one, and on an ideological level this means that military-first politics should be changed to economy-first or civilian-first politics.

How to proceed with the transition of the economic system is usually divided into a gradual approach and a big-bang approach, or shock therapy. For North Korea, a gradual approach is seen to be a better one. First, in the transitional period, serious side-effects and chaos are inevitable and the risks are much greater in the case of a big-bang approach. North Korea, which has been suffering economic difficulties during the last twenty years, is not likely to endure those negative impacts. Second, North Korea has never experienced the capitalist market system. Thus, the radical change of the economic system would be



too risky and lead to the collapse of the state itself. Third, there exists South Korea as an economic alternative to the North Korean people. An extensive and full-scale transition would make the North Korean people see no difference between the two Koreas economically and start to ask for unification. Thus, the North Korean leadership would like to avoid such a situation.

Even in a gradual approach, the core of the transition is a change from the state-owned property system to the private property system and the substitution of a planned economic system with an autonomous market mechanism. Therefore, the transition of the economic system fundamentally differs from the economic reforms which have been exercised in the former socialist countries in Eastern Europe, because they were basically improvements within the system rather than reforms of the system, and therefore can be characterized as “system-preserving reforms.” And all of these reform efforts turned out to be a failure.

In this context, the privatization of property rights and the introduction of market mechanisms is an assignment absolutely crucial in the future reform of North Korea. This means that the reform policies the Eastern European countries adopted as they initiated their economic transition in the early 1990s should also be taken by the North Korea. The examples of those reform policies are privatization, price liberalization, financial reforms, trade liberalization, macroeconomic stabilization, and building social security networks. In the case of North Korea, additional reform policies such as annulment of the North Korean self-reliant economic management, joining international financial institutions, and adjusting industrial structures should also be promoted. However, as already pointed out above, simultaneously promoting all of these reform policies is neither reasonable nor realistic. Therefore, it is required to set priorities among the reform policies to be promoted.

In the case of privatization, huge side-effects will occur if all state-owned properties are handed to the private sector at once. The North Korean people do not have the economic ability to buy those properties and foreign firms which can purchase a tremendous amount of the North Korean properties could not easily be found. Even if there exist a number of foreign firms that have the will and ability to buy North Korean assets, it is very likely that the North Korean people, familiar with the socialist system for decades, will have negative feelings concerning the reform process as their self-esteem feels damaged due to the leakage of national wealth and the predominance of foreign capital. On the other hand, a free distribution to the North Korean people can hardly be thought of as a reasonable alternative considering the huge financial resources required for promoting reform. Consequently, in the first stage, it would be rational to start with small-scale privatization. For instance, private rights should be acknowledged in small- and medium-sized manufacturing firms and service industries such as restaurants, snack bars, stores,



and gas stations. Along with the freeing of entrance and exit, the introduction of a law of fair competition is necessary for the smooth promotion of such a privatization.

Price liberalization is also a core part of an economic transition. However, full-scale price liberalization that would nullify government control on all prices at once will bring about an excessive shock to the economy because no economic players in North Korea have experienced a situation in which prices are freely determined in the market without intervention of the government. Moreover, serious inflation will be an inevitable result of full-scale price liberalization and thus the North Korean people will be in great reaction against the economic transition. Therefore, it would be better to liberalize prices gradually, reflecting the situation of the economy. Items such as daily necessities and strategic goods should be the last ones in the price liberalization process. Meanwhile, it is important that the North Korean government control the rent-seeking opportunities that are caused due to the dual structure of prices.

The reform of the financial sector is very important in producing and circulating the capital required in real sector and achieving macroeconomic stability by enabling the absorption and control of excessive liquidity that is widespread within the North Korean economy. The most urgent task in the financial reform is the abrogation of the mono-bank system as seen in the transition period of the Eastern European countries. Although other financial reform plans can be executed on a gradual basis, it is strongly advised to complete the establishment of the two-tier banking system in the very beginning stage. Considering the financial institutions of North Korea today, it would be reasonable to transfer the functions concerning trade and foreign exchanges from the North Korea's Central Bank to the Trade Bank and to establish new commercial banks to take over the commercial functions of the Central Bank.

The normalization of currency functions is also necessary. Traditionally in North Korea, currency has been perceived only as a simple means to execute state plans. However, currency should restore its original functions such as a means of trade, a medium of exchange, a store of wealth, and a measure of value. For this reason, cash transactions should be institutionalized for all cases and the traditional “no-cash-transaction” principle should be abolished.

Moreover, the problem of insolvent debt, which has also been a fruit of the old regime should be solved quickly in order for the North Korean banks to perform their functions normally. As the experiences of the Eastern European countries clearly show, the whole banking sector can be paralyzed unless such a problem is solved in the beginning stage. Hence, it is advised to establish a special institution exclusively responsible for solving the problem of insolvent debt in a timely manner. By doing so, the North Korea banks should



be given chances to survive from competition with the South Korean and foreign banks. Meanwhile, since the unsolved liabilities occurred in the 1970s from the loans from the Western banks are characterized as the national liabilities, it is fair that the Central Bank take them over.

Improvements in exchange rate policies are also needed. The exchange rates of North Korea are divided between the official and the unofficial one, and the reality is that the gap between the two is very large. Unifying them into one official exchange rate is necessary. The level of exchange rates should be able to reflect both domestic and global economic situations. Between the fixed and flexible exchange rate systems, the latter is better in the beginning stage of the transition, considering that macroeconomic stabilization is one of the top priorities.

At the core of the reform of the public finance sector lies abolishing the soft budget constraint. Since one of the most significant goals of the economic transition is to improve efficiency, it is a precondition to alter the soft budget constraint into the hard budget constraint. However, it is reasonable to put in action the hard budget constraint gradually, starting with the small- and medium-sized firms. If the hard budget constraint is applied to all the firms at once, the economy is very likely to be thrown into serious difficulties due to widespread bankruptcy. It is also important to integrate the budgets belonging to the military and the party into the budget of the cabinet. Because it is estimated that the military and the party possess a large amount of available budgets, it is impossible to either promote reform or strive for economic development when their budgets are left alone. Furthermore, if those budgets are not absorbed, the military and the party can rise as a seriously challenging threat to reforms based on economic power when they believe that their interests are being trespassed.

The reform of the trade sector should be pursued as a part of the development strategy for the underdeveloped economy. First of all, any firms that are interested in international trade must be allowed to partake in order to activate international trade. In addition, the non-tariff barriers such as import approval and quotas should be removed. Higher tariffs may be imposed on consumer goods in the beginning period in order to stabilize the economy. Import regulations may also be necessary to protect some strategic industries even if they are inefficient. In that case, however, it is desirable to announce clearly from the beginning that such a protection policy is temporary to secure their competitiveness.

Stabilization of the macroeconomic condition is fundamental to promote transition and reform. It should be remembered that the Eastern European countries like East Germany, the Czech Republic, Slovakia, Hungary, and Poland, which achieved macroeconomic stabilization in the early period were able to reconstruct their economies relatively



smoothly. But countries like Russia, Romania, and Bulgaria failed to control inflation and suffered economic woes as a result. Strengthening the social safety net is also necessary for securing supports for the economic transition. Because the social safety net in North Korea has been weakened considerably since the “Arduous March” and the transition itself from the socialist to the capitalist regime will produce an additional burden on people, the minimum level of social welfare and security must be guaranteed.

The reform of the economic ideologies peculiar to North Korea must be carried out in the beginning stage. In industrial management, the Daean management system should be abolished and changed officially to a manager-centered system. In agricultural management, a contract system based on family units must be introduced to improve productivity although the collective farm system is basically maintained in the beginning period. Such economic slogans as “self-reliance” and “self-support” should be substituted for rational ones like comparative advantage and competitiveness. In addition, more stress must be put on material incentives than on moral ones.

The reformation of the industrial structure must be done in the beginning stage. A gradual reformation according to a well-designed schedule starting with the industries that have the least impact on the economy is more desirable than a full scale and simultaneous one. The most urgent task in this transition and reform stage is to reduce heavy industry, including the military, because it has taken too large a portion in the industrial structure, and its inefficiency due to outdated facilities and low productivity is now too serious. Thus light industry has to be fostered. The expansion of light industry is also important in the sense that it mitigates the shortage of consumer goods which may occur in the beginning stage. The service sector has also to be focused since its development has been delayed under the socialist system. As the migration and visits among the North Korean cities increase in the transition and reform stage, the demand for private services such as restaurants, hotels, and stores will also increase. Moreover, developing these service industries will decrease unemployment considerably because they have a great effect on job creation.

In the transition and reform stage, it is advised for North Korea to join international financial institutions. By joining these institutions, North Korea will be able to receive various kinds of financial and technical assistance. In addition, this development will function as a signal that North Korea has become a responsible member of an international society, which will have positive influences on the environment for North Korea's transition and reform.





## (2) South Korea and International Community

Supports from South Korea and international society are requirements for North Korea's successful transition and reform. Although North Korea will firmly determine to promote economic transition and reform, it will be lacking sufficient internal resources and expertise. Above all, South Korea and international society must recognize that the peace, stability, and prosperity of Northeast Asia cannot be achieved without successful change in North Korea. Thus North Korea's neighbors have to be aware that their support is beneficial not only for North Korea but also for themselves.

The support can be categorized into two forms: making the environment favorable for North Korea's transition and reform and providing financial and technical assistance. The top priority for South Korea and international society is to make North Korea feel confident in maintaining its regime despite having abandoned military-first politics and activated transition and reform. The next leadership of North Korea, whether it is Kim Jung-eun or not, is very likely to have a weaker power base than Kim Jong-il and thus must be anxious about whether he can secure his control over the state in spite of the expected negative effects of transition and reform. In the very beginning stage, therefore, South Korea and international society should conclude various diplomatic treaties with North Korea to guarantee North Korea's political system and indicate their strong intention to provide the maximum amounts of human and material assistance to help North Korea's transition and reform.

In the early stage of transition and reform, there may be serious economic difficulties and social disorder in North Korea due to the system change. So, economic assistance from South Korea and international society to stabilize the North Korean economy are vital. Additionally the investments and assistance for North Korean firms and factories will be required to contribute to the construction of a self-sustainable growth base. In order to arrange and provide assistance to North Korea more efficiently, it will be desirable to form an "international council for assisting North Korea's transition and reform." This council can be under the existing Six-Party Talks and should welcome the participation international institutions and other countries that are interested.

In this period, South Korea must prepare various measures such as tax exemption and financial incentives to encourage local governments, private firms, banks, and NGOs to help North Korea. Forming sister relationships with the North Korean institutions should also be considered. The ministry of strategy and finance of South Korea must establish a blueprint with other related ministries to mediate systematically the financial and technical assistance to North Korea at the government level. South Korea can act as a major export market and



investor for North Korea and will contribute greatly to smooth unification in the future.

It is also of great importance to secure human capital for a successful transition and reform. In this regard, it is strongly recommended that South Korea and international society establish local offices in North Korea to advise on various matters during the transition and reform stage. For instance, South Korea can organize an “inter-Korean consultation office for economic transition and reform” to provide advice and suggestions on issues such as privatization, price and trade liberalization, and stabilization. JETRO, ADB, and the IMF can also establish such offices. In addition, South Korea and international society should invite and train North Korean government officials, experts, and scholars who will be involved in North Korea’s transition and reform and build training centers within North Korea to meet domestic demand.

## 2. Transformation Stage

### (1) North Korea

If the transition and reform is successfully completed, North Korea will enter the transformation stage. From the economic point of view, the transformation stage is the period when the market economy system is settled down while market and plan coexist in the transition and reform stage. In the transformation stage, therefore, North Korea concludes the various tasks which have been promoted in the previous stage to achieve an advanced economy.

In this stage, North Korea starts privatization of large firms. As North Korea finishes privatization for all sectors, property rights belong completely to the private sector. The collective farming system should be disassembled and the private farming should be legalized and encouraged.

Price liberalization should also be completed by lifting government controls on daily necessities and strategic goods to let the market replace all economic decisions. In addition, it is also necessary to abolish central planning legally. But careful inspection and mediation is necessary to prevent sudden and rapid inflation.

For the finance sector, a variety of openings should be pushed forward. The stock and bond markets must open and the foreign portfolio investment must be approved by liberalizing the capital market. And North Korea must allow the foreign banks, including the South Korean, to enter the market in order to earn more capital and acquire advanced financial techniques. Private insurance companies must be set free. And the floating exchange rate system must be introduced in this stage.

Trade should be liberalized fully. Free trade agreements with various countries will be



a as foothold of the economic development. It is especially desirable to conclude a “treaty for the economic community” with South Korea to make inter-Korean economic relations much closer than those of any other countries.

## (2) South Korea and the International Community

In the transformation stage, what South Korea and international society have to do is to support North Korea to complete reform tasks successfully by adjusting financial and technical assistance to the changes and development of the North Korean economy. These steps imply that the assistance is cut in some areas but expanded in others. For example, the need to assist with basic daily necessities will decrease while assistance for privatization must increase as North Korea proceeds with mass privatization at this stage.

In the transformation stage, South Korea and international society must be concerned about the “reform fatigue” of the North Korean people that may accumulate as the system changes. The experience of the Eastern European countries shows that people tend to be negative toward economic reform due to high unemployment, decrease in real wages, and reductions in social welfare although they fully support reform in the initial stage. Thus, South Korea and international society should be able to provide various kinds of assistance for North Korea to accomplish the economic transformation without backlash. Especially South Korea must support actively North Korea's economic transformation to create an opportunity for the co-prosperity of both Koreas and unification on the Korean Peninsula.■

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## Endnotes

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<sup>1</sup> Kim (2005), p.58.

<sup>2</sup> Kang (2002), p.19.

<sup>3</sup> Lee (2003), p.8. Hyeong-Seok Kim (2004) also expresses the same opinion.

<sup>4</sup> According to the recent study, Kim Jong-il presented a guideline of "developing the military industry first and developing the light industry and agriculture simultaneously" on Sep. 5, 2002 and after the process of theorization, it was officially announced as a remark titled "let's accomplish thoroughly the economic strategy in the military-first era proposed by the party" on Aug. 28, 2003. Han (2009), pp.149-150. Kwon (2008) also analyzes that the theorization process of the economic strategy in the military-first era started after Sep. 2002.

<sup>5</sup> "In the military-first era, the military affairs should come first, the military industry should be treated first, and developing the military industry is the most vital task." Kim (2005), p.109.

<sup>6</sup> Jae-Seo Kim (2004), pp.13-14.

<sup>7</sup> Lee (2003), p.5.

<sup>8</sup> Hyeong-Seok Kim (2004), p.2.

<sup>9</sup> Deok-Ho Kim (2004), p.6.

<sup>10</sup> Park (2004), p.16.

<sup>11</sup> Park (2003), p.8.

<sup>12</sup> Cho (2003), p.5.

<sup>13</sup> Kang (2004), p.2



<sup>14</sup> For instance, Sohn (2005).

<sup>15</sup> Yang (2002), p.19.

<sup>16</sup> Han (2009), p.155.

<sup>17</sup> Lim (2009), pp.26-27.

<sup>18</sup> Park (2008), pp.7-8.

<sup>19</sup> Kim (2008).

<sup>20</sup> Hwang (2006), p.14.

<sup>21</sup> Baek (2006), pp.16-17.

<sup>22</sup> Cho (2007), p.11.

<sup>23</sup> Oh (2008), pp.11-14.

<sup>24</sup> Lee (2008), p.19.



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