

How Significant and Effective are North Korea's "Market Reforms"?

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ABSTRACT *Speculation continues as to the real significance and effectiveness of the "market reforms" introduced by the government of North Korea in July 2002. Some commentators regard these as rather minor, while others suggest that they represent the first stage of a significant move towards a much more open and decentralized system. In this paper, the details of the reforms are discussed, and it is argued that their significance can only be judged in terms of the underlying dynamics of the North Korean regime. Using constructs from regime theory and regime dynamics, the current system is defined, and the stability of its elements is evaluated. It is concluded that the reforms are necessary for regime stability, but do not constitute a fundamental challenge to the existing system.*

KEY WORDS: North Korean economy, regime dynamics, socialist transformation, North Korean political system, nuclear proliferation

Introduction

In July 2002, the government of the Democratic People's Republic of Korea (hereafter referred to for the sake of simplicity as the DPRK or North Korea) initiated a series of economic reforms that have been heralded by some as important first steps in the establishment of a true market economy in the country. These reforms were designed to introduce some basic monetization into the economy and to reduce the role of the government in setting prices and controlling the distribution system; to devalue the North Korean *Won* to more realistic levels in relation to other currencies; to decentralize decision-making; and to encourage the development of a number of special administrative and industrial zones. However, there has been a wide range of opinion expressed as to the significance and value of these reforms. Ruediger Frank (2003), for example, has argued that the DPRK is on the verge of "profound and meaningful economic reforms". Similarly, the *Far Eastern Economic Review* (13 May 2004), under the rather upbeat cover headline of "Capitalist Kim: Inside North Korea's New Market Economy", suggested that while many problems and unanswered questions remain, the small changes that have taken place in Pyongyang may be the first steps towards a market-oriented economy. By contrast,

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Marcus Noland (2003, p. 29) has concluded that “there is little evidence that North Korea is seriously committed to reform”.

The aim of this paper is to evaluate the arguments and sift through the often fragmentary and conflicting evidence on the significance and effectiveness of these reforms. The discussion is divided into five major sections. First, the nature of the 2002 reforms is outlined, making no comment at this stage on either their significance or impact. Secondly, the basic architecture of the regime in North Korea is looked at. The argument here is that it is impossible to make judgements about these particular reforms and their significance without first attempting to understand the basic dynamics and strategies of the ruling system. Thirdly, an attempt to evaluate the extent to which the reforms have had a significant influence on various sectors of the economy and particular regions is discussed. Fourthly, and much more importantly, speculation on what the reforms undertaken so far tell us about the nature of change in the regime of the DPRK is studied. Fifthly, and by way of conclusion, the ways in which the reforms and the regime dynamics of which they are a symptom provide clues as to the ways in which the current nuclear crisis on the Korean Peninsula might be resolved most effectively are evaluated.

The Scope of the “Market Reforms”

The July 2002 reforms consisted of four basic parts, which together sought to bring about changes at both the micro- and macro-economic levels and to provide incentives for accelerated flows of aid and investment from foreign countries. The four measures were:

- (1) *Steps to begin the monetization of the economy.* Measures were taken to allow the forces of supply and demand to set the prices of basic commodities rather than to continue reliance on government controls and decisions. The new approach stressing the relevance of market mechanisms was highlighted by DPRK Finance Minister Mun Il-bong in his speech introducing the 2003 budget:

In all institutions and enterprises a system of calculations based on money will have to be correctly installed, production and financial accounting systems be strengthened, production and management activities be carried out thoroughly by calculating the actual profits.

Most dramatic has been the reform of the pricing structure, particularly for food products. The price of rice was increased by a staggering 550 times, bringing the local price more in line with the international market rate. Similarly, the prices of other foods have also been increased, although by much less than for rice. Price increases have also been applied to a range of other daily necessities, such as electricity and bus fares. In order to compensate consumers, especially urban residents, for these changes, wage levels have also been raised. In some sectors, this has involved a 20-fold increase. In addition, some designated occupations have been given especially favourable treatment, with remuneration for military personnel, party

officials, scientists and coal miners increasing by as much as 60 times, or even more by some reports. The aim has apparently been to create incentives for larger production levels throughout the economy, but particularly in the agricultural sector, a theme that will be taken up in detail later.

- (2) *Exchange rate policy.* Under the reforms, the unrealistically high value of the North Korean *Won* was abandoned. The official rate of exchange was lowered from 2.2 *Won* to 150 *Won* to \$US1. This brought the official rate more in line with the unofficial black market rate, but as will be discussed later there has been significant further depreciation against this unofficial rate since the 2002 reforms.
- (3) *Decentralization of economic decision-making.* The old system that relied on highly-centralized decision-making and an elaborate and wide-ranging pattern of subsidies and quotas has been partially reformed. Local officials, and in particular the managers of production units, are given many more powers and responsibilities. Local enterprises are expected to calculate and cover their own costs, and to meet real budget constraints.
- (4) *Special economic zones.* A new emphasis has been placed on the establishment of various types of special economic zones designed to attract foreign investment. This is not an entirely new policy. The Rajin-Sonbong region in the north-east of the country was set up in 1991, and under an agreement with the South Korean conglomerate Hyundai in 1998, a special tourist venture was set up at Mt Kumgang. Under the 2002 reforms, the Sinuiju Special Administrative District was set up for foreign companies to operate quite outside the normal DPRK legal system. At the same time, the Kaesong Industrial District was also established, apparently to cater for small and medium companies from South Korea investing under the implicit protection of Hyundai, which has taken the lead in sponsoring closer economic ties between the two Koreas. Problems with the planning and implementation of the initial Rajin-Sonbong zone have been recognized, although it is not clear how far the government is able to deal with some of the deep-seated problems of that initial project, notably energy shortages and inadequacies in infrastructure.

This short summary of the 2002 reforms is only the beginning of the analysis discussed in this paper. What needs to be explored now is just what these policy changes tell us about the dynamics and intentions of the North Korean regime. Most fundamentally of all, what clues do these changes give on the possibilities for more far-reaching reform and a peaceful resolution of the current crisis over North Korea's nuclear weapons programme? In a recent study, Marcus Noland (2004) has argued that the answers to all of these questions come back to issues of regime dynamics and regime change. I fully agree with this assessment, but I want to present a very different analysis of the DPRK regime, one that is founded in quite a different theoretical framework, and that I believe provides a much more satisfactory picture of future prospects on the Korean Peninsula.

The Nature of the North Korean Regime

Theoretical interest in the concept of regimes has been stimulated by the simple question of why individual economies continue to differ from one another in quite fundamental ways. Various analysts have asked what factors account for these multiple trajectories, and why these differences persist rather than converging on some kind of international “best practice”. This does not mean that national systems do not undergo change, even fundamental transformation, but this also raises some further questions about the causes and mechanisms of such change and about the relative strengths of local and international factors. These key areas are now at the core of comparative international political economy, a sub-field which received much stimulation from the observation of quite distinct national responses to the oil crises of the 1970s, and is now grappling with the markedly differential national patterns that persist in the face of the supposedly homogenizing forces of globalization (for a more detailed review of these issues see McKay, 2003).

Cheng (1990, 1993) has argued that regime dynamics, which are the basis of differing national systems, may be thought of as the relational manoeuvres of leading businesses and government that take place in changing political and economic contexts and which are designed to increase political legitimacy and to consolidate political power. Social pressures for restructuring, he suggests, accompany growth, and these pressures are exacerbated and complicated by changes in the global economy. Capital and the state adjust their authority patterns and legitimation strategies to these changing environments, but they do so within previously established social contexts. Pempel (1998), writing with particular reference to Japan, argues that a regime is composed of three key elements: a set of socio-economic alliances, a number of political-economic institutions, and a public policy profile. These components are overlapping, and reinforce each other, and each is essential to the stability of the total system. They interact in many complex ways and have a unique internal logic. In some situations the elements may be unstable, coalitions may come and go, and new institutions may disappear quickly.

The national systems described by these authors have all evolved, often over a long period, to meet the needs of the local conditions and the heritage of the unique institutional configuration of the nation. This case is made strongly by Boyer and Hollingsworth (1997), who emphasize that there is no single optimum institutional configuration for the modern economy, rather there is a very large array of possible arrangements. The best choice depends upon the larger environment in which the economy is embedded and the precise nature of the societal problems that need to be solved. Importantly, they argue that not even the market should be regarded as the ideal and universal institutional arrangement for coordinating economic activity, and numerous problems can arise if efforts are made to organize the world exclusively in terms of markets. Thus, “the old but pervasive dichotomy between states and the markets has to be disregarded, to be replaced by a broader array of institutional arrangements, which mix in varying degree the pursuit of individual self-interest and social obligation, relations among equals, and power asymmetries” (p. 53). All institutional arrangements have their own strengths and weaknesses, and the best choice at any time will depend on the precise context and configuration of interests within which it is embedded. Since these arrangements evolve according to a distinct

logic in each society, no international configuration can simply be borrowed and implemented in any given social setting. It is not just the nature of the individual institutions that varies between nations; it is more often the unique configuration of these institutions in the entire economic system that is important (Gao, 2001, p. 18).

Perhaps the most difficult task in this kind of analysis is to understand how and why regimes change, and how one regime is replaced by another. Pempel (1998) argues that any regime is faced with a variety of pressures for change from both internal and external forces. But, he suggests that not all changes will destabilize a regime: some will merely cause minor re-adjustments. He recognizes three levels of disturbance in any system. First order changes are confined to just one of the components of the regime identified earlier. Adjustments are made, but the essential nature of the regime is unchanged. Second order changes involve interrelated and recursive shifts in two of the three domains. These pressures are more severe, but again do not bring about a fundamental transformation. It is only third order changes, involving all three dimensions—institutions, coalitions and public policies—that bring about a true regime shift. Gao (2001) has argued that such a shift may take some time, as the forces for change gather strength and the fundamental contradictions in the existing regime are revealed, and as a new regime emerges, made up of some new elements and some remaining fragments from the old system, but combined in a unique new configuration. Writing about the current situation in Japan, he cautions us not to expect rapid economic recovery following a regime shift that he has identified and categorized in detail.

A number of the works already discussed, and in particular the studies of Japan, have highlighted two key dilemmas which must be faced in the development of appropriate institutional structures. Both are very relevant to what I want to say about North Korea. The first is the trade-off that seems to be inevitable between, on the one hand, coordination and control of the entire economy and, on the other hand, the monitoring and control of individual companies. Historical evidence suggests that no nation has ever been able to perform both functions effectively at the same time, and has been forced to concentrate on one or the other. Gao (2001) has suggested that Japan has had a preference for strong coordination, resulting in weak control and monitoring mechanisms, and I have argued that the same has been true of South Korea (McKay, 2003). The second dilemma is the choice between the competing demands for economic and social stability and the need to upgrade the economic structure. Japan, Gao suggests, has had a strong preference for stability, but at the cost of letting the economic structure become more and more outdated and uncompetitive.

How then can we characterize the nature and dynamics of the North Korean regime? Using the approach pioneered by Pempel (1998) I want to suggest that the regime is made up of three key overlapping elements that I will consider in turn: the military-party complex; the *Juche* ideology and system; and the mass mobilization state.

The military-party complex is arguably the core of the North Korean state, and hence it dominates the entire system. It is usual in Communist states for the Party to be the central focus, with the military also playing a key role, but in the DPRK the armed forces are even more influential than in any other socialist state in recent history. This is the result of a number of historical legacies, plus North Korea's

assessment of its current strategic vulnerability. Adrian Buzo (1999) has developed a very convincing case in support of his hypothesis that North Korea since its formation has been ruled by a “guerrilla dynasty”, and this historical tradition continues to be central to the structure and workings of the state system. He argues that in any state governed by a personal autocracy, the life experiences and personality of the leader are bound to penetrate and condition all aspects of state operations. In the case of the founder of North Korea, Kim Il Sung, his early experiences as an anti-Japanese guerrilla fighter in Manchuria left an indelible imprint on his vision of the state and its policy directions. This in turn determined the structure and role of both the Party and the military in the emerging North Korean state, and the relationships between them. This is not to say that the general principles of Marxist–Leninist thought were not important. They certainly provided the foundations for Kim Il Sung’s thought, but these theoretical underpinnings were filtered through a specific reading of the concrete conditions of North Korea’s situation, an interpretation based on Kim’s life experiences and particularly his formative years as a guerrilla fighter. This, Buzo suggests, resulted in some key characteristics of North Korea: militarism, isolation, high levels of centralization, mobilization of the masses, personal autocratic rule, and a strong personality cult. The Korean Workers’ Party (KWP) was central to Kim’s strategy, but after the devastation of the Korean War he rebuilt the Party as an instrument of personal rule.

Kim’s domination of the Party in the 1960s brought about the degeneration of ideology within the KWP and a decline in the intellectual life of both the Party and country as a whole. Ideological truth became self-evident, to be accepted and acted upon with blind obedience by the people. The key factors in this development were Kim’s anti-intellectualism and pronounced militarism, and the key characteristic was an atmosphere of incessant mobilization and struggle in which emulation of the Manchurian guerilla became the dominant role model. (Buzo, 1999, p. 242)

The KWP developed as a vanguard party, but within a dominant culture of militarism—what has been termed “warrior communism”.

More recently, this central role of the military has been articulated even more clearly as the “military-first” policy, which has now emerged as the dominant feature of the regime. On 21 March 2003, *Nodong Sinmun* published a very important article entitled “Military-First Ideology is an Ever-Victorious, Invincible Banner for our Era’s Cause of Independence”. The author described the armed forces as the key foundation of the DPRK’s revolutionary strategy, even more important than the working class. The Korean People’s Army (KPA) was described as the pivotal group in North Korean society—“the gun barrel should be placed over the hammer and sickle”. A direct link was made between this military-first strategy and the philosophy of *Juche*, arguing that the military effort should be entirely self-reliant. Thus the first priority in industrial expansion was the further growth of defence capacity. The military has a key role in protecting the sovereignty of the nation and in economic development, it was argued. The achievement of a strong economy is not enough to protect the nation—even advanced science and technology are no insurance from incursion by powerful enemies. Advanced industries are needed to build up military capacity, but the protection that derives from the barrel of a gun must be in place first. In this regard, any hard line from the US and its allies must be

met with a DPRK "ultra-hard line". The fact that the DPRK has not yet been attacked bears witness to the development of defence forces strong enough to deter any aggressor—a hint at the importance placed on the development of a nuclear capacity.

The *Juche* ideology and system have been at the centre of the ideological underpinnings of the regime. This concept of self-reliance first emerged around the end of 1955. In part, this dominant organizing concept drew on the historical experience of the Soviet Union, and in particular the tactics used by Stalin to concentrate power in his own hands. The concept of self-reliance was used to justify extremely high levels of central command and autarky in the economic system, including the use of centrally determined economic targets and the ideological mobilization of the labour force. The high level of collectivization of agriculture was a logical result of these policies.

But *Juche* also had some very important nationalistic overtones that were useful to Kim in the early stages of his internal battles within the North Korean ruling elite. He was able to denounce opponents as being out of touch with the historical legacies and local realities of the North Korean situation, and allowed him to move away from the Soviet model in some important respects. It also allowed him to defend his essentially Stalinist methods of command in the economy, and his emphasis on heavy industry and control of the means of production at a time when Khrushchev was moving in new directions within the Soviet Union itself. As Buzo (1999) has also shown, the concept of *Juche* has also been used to bolster the succession of rule from Kim Il Sung to his son Kim Jong Il, and thus establish the Kimist dynasty. The father was successfully able to portray his son as the only person with the personal and political skills needed to continue the successful implementation of the whole *Juche* agenda. The early moves in the 1980s to cement the succession of power to Kim Jong Il were accompanied by a great deal of official propaganda about the central role of *Juche* principles in the successful development of the North Korean system. Thus, this central ideological plank of the system has become inseparable from the continuation of the Kimist succession and ideology.

It should also be pointed out that at least some of the features of the North Korean economic model, including high levels of nationalist sentiment, self-reliance and national mobilization could also be found in the economic programmes that were transforming South Korea at the same time. In part this may reflect the concentration of power on a strong central leader, but it could also be argued that the two Koreas shared some important cultural and institutional legacies, that in part derived from the remarkable similarities in the early backgrounds of Kim Il Sung and Park Chung Hee (Yang Sung Chul, 1981, 1999).

The mass mobilization state characterizes the major method of operation of the Party and military complex, and the major means by which the *Juche* ideology has been propagated. Mobilization, by definition, contains a large measure of involuntary action, is dependent on definitions of the common good and the common interest determined by the state, and depends for its implementation on popular campaigns organized by the state, or in the final analysis on coercion (Yang Sung Chul, 1999, p. 590). The role of the population has been to respond to the urgings and directives of the KWP, the self-proclaimed vanguard party, which has the monopoly on visions of the future and on the resources of the nation. Mobilization

at the local level has depended on the creation of a complex network of mass organizations, such as trade unions, youth groups and women's organizations. Not only has complete obedience been expected of the populace, but the distinctive guerrilla flavour of the regime has ensured a particular brand of discipline that is "ruthless, Spartan, secretive, suspicious of intellectual activity, resourceful, predatory, and improvisatory" (Buzo, 1999, p. 28). Two key mobilization programmes were initiated by Kim Il Sung. In 1958 he launched the *Chollima* movement, named after the winged horse of Korean folk culture, able to travel at high speed and cover a large amount of territory very quickly. Under this initiative, work teams were established and given ambitious production targets, and urged on by intense levels of indoctrination and mass mobilization. In some ways, this movement was similar to China's Great Leap Forward, and shared with it an ideologically driven contempt for economic theory and methods. In 1960 the *Taeam* Work System was introduced into industrial facilities. Individual managers were replaced by Party political committees based in the factories and a broadly based system of mobilization.

The immediate response of the North Korean regime to the collapse of the Soviet Union, which swept away a key economic, political and military ally, was to redouble efforts towards mass education and mobilization. Kim Il Sung's stated view was that the mistake made by the Soviet Union under Gorbachev was to show signs of weakness and to contemplate the possibility of certain kinds of political reform. No such compromise would be even considered in the DPRK, and ideological control over the population was intensified. Every effort was made in the economic, political and military spheres to defend the regime and the personal rule of the Kim dynasty, and it was at this time that efforts to develop an independent nuclear capability were intensified.

In this summary of the basic features of the North Korean system, of necessity a short distillation of a large amount of literature, I have attempted to present the key interlocking elements that underpin the regime. As was argued earlier, such an analysis must be central to an analysis of the significance of the DPRK's market reforms, and of the extent to which these changes herald a fundamental shift in the regime. It is to such an evaluation that I now turn.

What has been the Impact of the Reforms?

A key goal of the reforms has been to increase agricultural production and ameliorate the impacts of the long period of food shortages felt within all parts of the country. There is no doubt that since at least 1995, the food situation has constituted a humanitarian tragedy of immense proportions. In a country which has heralded the virtues of self-reliance and the paramount importance of the welfare of its population, this has constituted an undeniable challenge to national pride and policy (McKay, 2002; Lim & Chang, 2003). Estimates of production levels, shortfalls in food supplies and consequent imperatives to rely on food imports or emergency aid vary considerably, but it is generally recognized that annual imports of around 1–1.8 million tonnes of grain have been needed in much of this period since 1995. Many deaths have undoubtedly resulted from this situation, but again estimates vary quite widely. Some commentators have estimated that around 2.5 million people have

perished from malnutrition and related diseases, although the official government figure is rather lower than this. Hwang Jang-yop, the high-profile defector has claimed that 1.5 million people died between 1995 and 1997 alone, while South Korean intelligence sources claim that leaked North Korean documents point to 3 million deaths since 1995. The impact of malnutrition on the children of the DPRK has been particularly severe. In 1998 the World Food Programme in conjunction with the European Union, UNICEF and the DPRK government undertook a detailed survey of nutrition in various parts of the country. Acute malnutrition, resulting in moderate or severe wasting affected some 16% of the children surveyed, including some 3% with oedema. Moderate and severe stunting, or chronic malnutrition, affected 62% of children. Some 61% of children surveyed were moderately or severely underweight for their age. The most severe wasting was found in those aged 1 to 3 years, but stunting and underweight were prevalent in all age groups, with boys being more affected than girls. These are truly alarming results, with some of the nutritional problems almost certain to result in impaired intellectual development (McKay, 2002).

The causes of this severe food shortage have been much debated. The North Korean government has cited severe environmental and natural factors as the key problem. Natural conditions have never favoured high levels of food output. Of the total national area of some 12 million hectares, around 85% consists of mountainous terrain. Only 15% can be classified as arable land, and soils are often poor. The climate is harsh, with a very short growing season of 130–190 frost-free days. Many crops, such as maize and rice, are vulnerable to severe cold snaps. The government has also pointed to a number of damaging natural disasters in recent years: severe floods in 1995, 1996 and 2001; droughts in 1997 and 2000; a destructive wind storm in 2000; and a damaging storm and wave surge in 1997. But these natural disasters have been made much worse in their impact by the serious degradation that has taken place in the natural environment in agricultural areas. Many soils that were not robust or fertile to begin with have been seriously over-cropped and subject to erosion, especially in periods of flood. In the search for extra output, many steep hillsides have been cultivated, again with serious consequences for erosion. The result of all of this has been a serious decline in yields.

Agricultural productivity has also been hit by the impacts of the more general crisis in the DPRK economy. It is generally accepted that during the early 1990s it was the industrial sector that first went into recession, and it was only later that agriculture followed. Much of the agricultural machinery in the country is now very old and inefficient. Only about half of the estimated 62,000 tractors in the country are now operational, and there are reports that oxen are being used increasingly to cultivate the fields. A lack of spare parts is a major problem throughout the economy. The energy crisis facing the country has had a major impact on agriculture, with serious shortages of fuel for agricultural machinery and irrigation facilities. Domestic production of fertilizers has declined, so that now only around 10% of demand has been met for much of the recent period. As the result of all of these factors, rice yields declined from around 7 or 8 tonnes per hectare in the 1980s to around half of that in the late 1990s.

But most outside commentators have also argued that shortcomings in the organization of the economy, and of the agricultural sector in particular, are also a major contributor to the current crisis. The emphasis on military spending has deprived other sectors of much-needed investment. Lack of adequate infrastructure, in particular, has had widespread effects, including in agriculture. It is also clear that problems resulting from the earlier collectivization of agriculture and the adherence to the “*Juche* farming system” have been significant, hence there have been calls for a number of years for a more market-oriented approach to economic management, and it is these problems in agriculture that have been one of the major catalysts for the 2002 reforms described earlier.

But how effective have these reforms been in resolving some of the problems of North Korean agriculture? Although there are no firm figures available, it seems that agricultural output has increased in the last couple of years, and the food crisis has eased somewhat, however it is far from clear whether this is the result of market reforms or other factors, notably the gift of some 500,000 tonnes of fertilizer from South Korea. There are also signs that more agricultural production is being sold through the system of farmers’ markets that was effectively endorsed through the 2002 reforms. Such markets have also appeared in all of the major urban areas. However, it is also clear that the total production of food is still far from adequate, and this will not be solved through tinkering with the price and distribution systems. China, in particular, is still supplying perhaps 30% of North Korea’s grain requirements, and significant amounts of food are also coming from South Korea and other foreign donors.

In the urban areas there are also some small signs of change. Individual enterprises are appearing—small stalls, bicycle repair shops, kiosks selling drinks and cigarettes. Advertising billboards are now appearing in some places. Some of these feature a new car called *Huiparam* made in a joint venture with South Korean company Pyeonghwa and assembled in the North Korean port city of Nampo. Clothes are being imported from China, and these are much more colourful than the drab local products. Some mobile phones are even visible for the first time, and the government has signed a joint venture agreement with Loxley Pacific of Thailand to build a mobile telecommunications network.

But the real puzzle in the urban areas is how many people can afford to take advantage of these new commodities. There are now reports that the increases in urban wages designed in the 2002 reforms to offset the increases in the prices of food paid to farmers are far from adequate, resulting in much hardship. The Executive Director of the World Food Programme, James Morris, recently expressed concern that a new class of urban poor is emerging in North Korea, and pointed to evidence of hundreds of thousands of newly-destitute people in the cities. Thus, while many farmers seem to be better off now, the problem of poverty has been shifted to the urban consumers who cannot now buy even the basic necessities, let alone the new consumer goods that are appearing for sale.

Thus, it appears that the 2002 reforms have had some visible impacts, but they have not really addressed the basic problems facing the North Korean economy. But they do raise the much more important long-term question of whether these reforms are merely the first stage of some more fundamental restructuring, and whether they herald some fundamental change in direction of the political system as a whole.

What do the Reforms tell us about the Directions of Change in the North Korean Regime?

In assessing the real meaning and significance of the market reform process that appears to have started in North Korea, there are a number of possible judgements on what is really taking place:

- The “reforms” are insubstantial and flimsy, and are only the latest in a long line of minor changes that have been introduced by the government and later quietly forgotten.
- The policy changes are real and fairly significant, but they have been introduced under pressure from extreme events, in particular the food crisis, and will probably be reversed as soon as is politically and economically possible.
- The reforms are real and permanent, but they herald only a limited series of reforms along the lines of China or Vietnam, but much less ambitious than in either of those countries.
- The changes are certainly real, and there is no turning back—the genie is out of the bottle and we are witnessing the beginning of a complete break with the past.

In this part of the paper, I want to speculate on which of these explanations seems most plausible at this stage. However, I should stress that we are certainly in the realm of speculation—statistics are almost completely absent or extremely suspect, the other evidence that we have is patchy and sometimes contradictory, and the ruling elite is certainly no more forthcoming about its intentions than in the past. In making this assessment I also want to draw on the tenets of regime dynamics that I summarized earlier and ask whether there are signs of breakdown in any or all of the elements that characterize the current regime.

There are certainly those commentators who believe that the reforms lack any real substance at all, and may have already been given up as a lost cause. Kenneth Quinones, a long-time researcher on the country, has recently been quoted in a number of South Korean newspapers as saying that the reforms have already been shelved. He quotes North Korean Officials as saying that the whole aim of the reforms was to strengthen socialism rather than introduce capitalism, but the growing poverty in the urban areas, with its potential for political unrest, ensured that the process had to be abandoned. It is impossible to verify the truth of such reports, but there seems to be little support from other North Korea watchers, and as I will discuss later there is in fact some evidence of exactly the opposite.

In the agricultural sector, which is central to the questions I am trying to answer, there have been numerous studies of what would be needed to be done to reform the present system in a really thorough and effective manner. It seems generally agreed that while organizational changes are needed, including the introduction of forms of market mechanisms, these are unlikely to produce rapid or significant results in the absence of simultaneous improvements in a number of technical areas and in investment in critical infrastructure. Thus, the key issue is whether there are any signs that such a comprehensive programme is being initiated. Over a number of years the United Nations Development Programme (UNDP) has been working with the North Korean government to assess what is needed, and a series of roundtables have been

organized, resulting in a number of recommendations (UNDP, 1998). These include: rehabilitation of damaged or neglected irrigation systems; repair of local fertilizer plants, and the provision of raw materials needed to resume production; the development of intensive cropping systems in some areas; assistance to farmers in the development of more environmentally sustainable production techniques; the introduction of new rural credit systems; the strengthening of rural markets and other local institutions; the development of local research and training centres; and the initiation of major new programmes of reforestation and environmental protection.

Other experts argue that a major emphasis must be given to the reform of economic and political institutions in the rural areas to support these technical initiatives (Ahn Choong Yong, 2003). Particular emphasis has been given to the system of collective farms. Selig Harrison (1998) has argued that a major priority should be the creation of incentives for members to work harder and produce more. Some measures already introduced include reductions in the size of work teams, and production target systems that allow workers to keep up to 30% of their output if they meet or exceed quotas. Such initiatives have already met with some success in China and Vietnam. A much more detailed agenda for reform has been outlined by Moon Pal-Yong (1995). Again, he focuses on questions of incentives for producers, and considers three alternative systems: family farming under individual private land ownership; individualistic farming under collective land ownership; and joint farming under collective land ownership. Having evaluated these alternatives, Moon concludes that while there are some important advantages in individualistic systems, the adjustment and establishment costs, both in economic and human terms, would be enormous. Also, many small individual farms would probably be uneconomic. It would be better, he suggests, to develop more efficient collective systems, with appropriate incentives available to members. Noland (2000) has questioned whether the costs associated with a rapid or “big bang” approach to reform in this area are necessarily greater than for more gradual changes, but as I pointed out in an earlier paper (McKay, 2002) the necessary preconditions for a rapid change are not present in North Korea—notably, high state capacity, macro-economic stability and the willingness of the population to undertake change.

However, the most important point that needs to be made about agricultural reform in North Korea, and one that could be generalized to cover much of the economy, is that market reforms by themselves are not going to solve the nation’s deep-seated problems. Even the most comprehensive reforms implemented in an effective manner would, in my view achieve only very limited results in the absence of massive supporting investment in infrastructure, energy, agricultural modernization and a range of other important areas. Indeed, in the absence of such investment, market reforms might even be counter-productive. Evidence on the reform process in various parts of Asia, and particularly in China and Vietnam, clearly suggests that the correct sequencing of reforms is of fundamental importance, and North Korea would be no exception. It is also imperative to recognize that the local context—in terms of cultural issues, institutional structures, availability of human and other resources, and so on—is also critical in the design of appropriate reform policies.

This issue of the key role of local realities can be illustrated with reference to the price reforms introduced into North Korea in 2002. The increases in the prices paid to farmers for food products, and the acceptance that some production can be sold by individual farmers for their own profit, were clearly based on similar initiatives in China and Vietnam. But there are crucial differences in the context of these reforms. When China and Vietnam first introduced their reforms in this area, both nations had agricultural sectors that absorbed around 70% of the labour force. Thus when a large number of farmers gained from price increases of agricultural commodities, it was not so difficult to compensate urban consumers who had been adversely affected. By contrast, in North Korea the agricultural sector employs much less than half of the labour force, making the problem of urban price increases for food much more intractable. We have already seen that urban hunger is now appearing as a direct result of poorly thought-through policies.

Similar points might be made about the attempts now being made to attract foreign investors to the new special economic zones. At a business convention held in Pyongyang in early November 2004, businessmen from abroad and 78 officials from North Korean enterprises were addressed by the North Korean Minister of Trade, Mr Kim Yong-sul. He stressed that the government was serious about attracting foreign investment, and had cut corporate taxes and more than halved minimum wages. This attempt to emulate the policies of so many other Asian nations seems rather inappropriate given the problems of infrastructure and energy blackouts that have been so common in the country. There is also the problem of cutting wages at a time when urban poverty is being discussed as a new issue. Those Asian nations that were successful in attracting investors with these kinds of policies also had detailed plans for the broader development of their economies, something that seems to be lacking at present in North Korea. I return to the comment quoted earlier from Boyer and Hollingsworth (1997) that there is no such thing as an optimal set of policies, not even the promotion of the market—everything depends upon the context.

In much of my discussion I have stressed the importance of modernizing the agricultural sector, but it should also be stressed that this probably cannot be achieved without also rehabilitating the industrial capacity. This is essential for providing inputs to agriculture, such as fertilizers, and improving urban wage levels. But none of this will be possible without massive investments that are far beyond the capacity of North Korea itself, and in turn none of this will be possible without some resolution of the nuclear weapons issue, a crucial point that I will return to in my conclusions.

What then can we say about the dynamics of regime change in North Korea and the clues that the market reform initiative might give us about possible directions of change. Earlier I identified three interlocking components of the North Korean regime, and now want to ask which of these might be in crisis and open to change. The military-party complex at the core of the system seems to me to be still very much intact, and will be defended to the last by the current elite. The military-first policy is seen as essential for the survival of the nation as well as of the current ruling group. The market reforms are designed to generate some growth that can be used to legitimize the current regime, rather than set in train a process that will overwhelm the current system. The *Juche* ideology is still used to justify all aspects of

current policy, and is also a key link to the former leader Kim Il Sung, providing legitimacy for his son Kim Jong-Il, the current leader. However, the entire concept of self-reliance is rather vague and has already gone through several transformations in order to meet different political contingencies. The term will still be used, but the meaning may well change if and when North Korea begins to interact more with the global system. The methods of mass mobilization used so much in the past by the regime are also likely to be modified. The use of the market, and the individual incentives that are central to it, implies the employment of techniques of motivation rather than mobilization, and it seems inevitable that the regime will move much more in this direction in the future. Thus, two of the key components of the current regime seem to be under some pressure and may well be modified, but within the parameters of the military-party system. This would suggest that the greater use of market mechanisms, and the beginnings of greater integration into the international system, may be attempted by the current government, but tightly controlled within the dominant military framework. This is, I believe, a key conclusion that has important implications for the way in which the solution of the current nuclear crisis might be resolved.

Conclusions: Clues towards Resolving the Nuclear Crisis in North Korea

I have argued that the North Korean economy can only be effectively reformed through the massive injection of funds into the rehabilitation of a system that has become extremely degraded, and this will only be feasible through foreign involvement at a large and systematic level. The introduction of market mechanisms may form part of this process, but by themselves they can achieve little. But, the recent experiments with policy reform, while they do indicate some willingness to adopt new ideas, should not be interpreted as signals that North Korea is in the process of a transition to capitalism. The government recognizes the dangers of unrest that might grow out of the current economic crisis, but they also realize that a reform process that gets out of their tight control can also threaten the survival of their hold on power.

But it is also apparent that international assistance with economic rehabilitation will only be available if the nuclear standoff is solved in some way. There seems to me to be little hope that pressure from the US will topple the current regime, rather it will entrench the power of the military, portrayed by the regime as the only hope for national survival. The North Koreans simply do not trust the US enough to dismantle their current nuclear programme without what they regard as acceptable security guarantees. Nor can the North Korean government expect that some rather minor policy initiatives will solve their economic crisis.

Neither side, then, can hope to get what it wants from the approaches now being used. All of this suggests, it seems to me, that the only hope for a long-term solution to the current economic crisis as well as the nuclear problem is to negotiate a "grand bargain" of the kind suggested by a number of commentators (for example, O'Hanlon & Mochizuki, 2003). This would involve a staged process of security guarantees and economic assistance from the US and its allies, matched by a process of dismantling of its nuclear and missile capacity by North Korea. Such a process would be difficult, and not without its dangers, but it is probably the only hope for

resolving one of the most dangerous security dangers facing the international community, while at the same time making a real attempt to deal with the myriad economic problems facing North Korea.

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