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Economic and Ideological Transition in North Korea: Universal Principles and Specific Features

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North Korea is going through economic as well as ideological transition. Positive progresses have been made but more needs to be done. This writing will examine what changes have been made and how North Korea is going to cope with the changed international environment and continue with its process.

How ever we may call it reform, change, adjustment, transition something is happening in North Korea. But what are the driving forces, and where is the country heading? Can and do the reformers learn from other cases?

Obviously, there is a global trend of transition that seems hard to resist. But even a superficial analysis of the many different cases in Eastern Europe and Asia shows that there is not just one single way to proceed. A "big bang" in the true sense of the word has in fact only taken place in Eastern Germany, where its effects were bolstered by the West German social security system. However, there are distinguishable stages and policy measures in the context of generally gradual approaches to transformation, which we could call "little bangs" or "small shocks". The changes in Vietnam, in particular the reforms in agriculture in December 1987 (see Dixon 2004: 18) and the comprehensive reform package after 1989 (*doi moi*) with its sharp increase in interest rates, stabilized money supply, currency devaluation, foreign trade liberalization and deregulation of the domestic economy were such a limited macro-economic shock therapy (Ronnas 2001: 2). The reforms in China were a sequence of bold approaches, too. In late 1978, the contract responsibility system in agriculture was introduced (farmers could now sell their surplus crops on the open market), township village enterprises were established, and Special Economic Zones were created. Another far-reaching decision was a reform

of the price system in 1988, which ended up as a great failure that lead right into the Tiananmen-massacre of 1989 (see Kane 1989, Lardy 1993, Zhang 2000).

Vietnam and China are interesting cases because the changes were not induced by state failure, but were implemented and carried through by a system that still functioned effectively. The same is true for North Korea, although the signals being sent by the leadership are mixed and seem to be subject to a certain evolution. On September 9th, 1998, the Rodong Sinmun declared: "It is a foolish daydream to try to revive the economy by introducing foreign capital, not relying on one's own strength". The same editorial went on: "We have nothing to reform and open". Six years later, I was invited to P'yòngyang to give a presentation titled "How to attract and retain Foreign Direct Investment" at the "Workshop on Economic Reform [kyòngje kaehyòk] and the Development of Economic Relations between the EU and the DPRK".

Let us turn to the changes in North Korea. Food is a key commodity in any economy; humans need to eat to stay alive. Ideology might be able to convince people to accept a life without mobile phones; but it cannot talk them into starving. North Korea clearly has a food problem, which is a threat to political stability and must hence be resolved. It is no coincidence that Prime Minister Pak Bong Ju has described agriculture as the main front of economic construction for the year 2005 (Rodong Sinmun, April 12, 2005, p. 2).

If the output is dangerously low and all available options to increase it have been explored, one has to think of more drastic measures. This could lead to the introduction of a market mechanism, which is more or less the free interplay of supply and demand, where prices send important signals to producers and consumers. But how can a socialist state introduce this mechanism without jeopardizing stability?

There are at least two extreme definitions of demand for food: (1) the amount required to stay alive (survival ration) and (2) the amount of food that an individual is willing to consume (full ration). Availability of less than the survival ration will lead to death, and availability beyond the full ration will not meet sufficient demand. Looking at a country's food situation from a macro perspective, we can calculate the aggregate supply that is needed to keep the population alive (multiply the population with an average survival ration) as well as the point where market saturation is reached

(multiply the population with the average full ration).

For a transition from a state- to a market guided economy, distribution is the key issue. As long as the aggregate supply of food is below market saturation, under both systems not all individuals will be able to consume as much as they like. A market system ensures that the individuals with the highest available resources can purchase full rations, i.e., more than they need to stay alive. This can have very grave consequences for people with small resources, since there might be no food left for them. In other words, if a country has a food problem in the sense that the aggregate supply is below market saturation, a market distribution system can result in famine. The state through rationing ensures that distribution takes place more or less equally. Although most individuals can not consume as much as they want, still everybody receives at least a survival ration as long as the aggregate supply is above the minimum level as described above.

This is how North Korea was, for decades, able to keep its population alive even with an output below the optimal level. However, the new circumstances after the collapse of the Eastern block in combination with unfavourable climatic conditions brought about a situation where the aggregate supply went below the minimum level. Now, even equal distribution could not ensure a survival ration for every individual in a period described as the "arduous march" in the DPRK. This would be an unacceptable situation to any government in the world. Accordingly, a solution had to be found on how to react to the changed environment, meeting, as Kim Jong-il (2001) put it, "the requirements of a new era".

But how can a market mechanism be introduced if the aggregate supply is below the saturation level, without risking famine on the side of individuals with small resources? The answer is a hybrid system under which one part of the available supply is distributed equally by the state and the remaining part is left for market distribution. As an article in a North Korean economic journal explains: "In the socialist society, the domestic market is divided into two markets: the market, which is established based on the socialist economic forms, and the farmers market." (Yi 2002). This ensures survival and simultaneously allows the price mechanism to send signals to producers which will eventually result in an increased output. The relation between the part distributed by the

state and the one distributed by the market can be adjusted according to the aggregate supply. In short, the market's share can be bigger if the supply rises, because prices on markets tend to decrease with increased supply, and consumers with smaller resources will be able to purchase more on the markets and hence need less protection by the state.

A reality check shows that the DPRK has introduced such a system with the price adjustments of July 2002, and reports by the FAO (2004) indicate that after an adequate response time, the economy reacts and the output indeed rises while a dramatic famine could be prevented and social stability could be ensured. This, of course, does not mean that the food problem is no more. But a positive development cannot be denied.

If everything was so easy, why has it not been done long ago? Here, we have to leave the logic of orthodox economics and try to incorporate the institutional setting into the analysis. "Change" seems to have a positive connotation in the West; however, in fact it means the departure from established and tested concepts and mechanisms, with often unforeseeable results, and hence entails a great risk. A change in the economic system of a country can only be done in a responsible way if due consideration is given to the prevention of possible destabilizing societal effects.

This leads to the central issue of introducing a market economy in a country with an anti-capitalist ideology. According to the mainstream perception of Marxism, a capitalist is the owner of means of production who exploits the workers who do not own means of production and hence have no choice but to sell their workforce (Burg et.al. 1973: 51). The socialist revolution is the moment when ownership of means of production passes from the capitalist class to the working class, which is represented by the state (dictatorship of the proletariat, see Lenin 1972). Therefore, state ownership of the means of production is one of the core characteristics of a socialist economy in Lenin's sense.

The driving force of individuals in a market system is profit. But it is exactly this profit that, via investment, will be turned into means of production and over time leads to a division of the society in entrepreneurs and employees, capitalists and workers. The introduction of the market mechanism in a socialist country is therefore a challenge to

ideology and a serious threat to system stability. As the example of Eastern Europe and the Soviet Union has shown, this risk is not just of a theoretical nature. On the other hand, the examples of China and Vietnam suggest that there indeed are ways to prevent an implosion despite changes of the economic system.

But North Korea is neither China nor Vietnam. Concepts that work well in one country do not necessarily have to work in another one. Here, the *chuch'e* ideology has proven to be of high value to North Korea. The population has for decades been accustomed to the concept of the uniqueness of its country. Moreover, it is used to the application of the creative principle, i.e., a dynamic adjustment of policy and ideology to the changing environment. One of the major lessons Kim Jong-il drew from the collapse of the Eastern block was to put priority on ideology: "The most serious lesson of the collapse of socialism in several countries is that the corruption of socialism begins with ideological corruption, and that a breakdown on the ideological front results in the crumbling of all socialism's fronts and ends in the total ruin of socialism." (Kim 1995). History so far seems to support this policy.

So, by referring to *chuch'e*, we can explain why significant changes in North Korea's economic reality, such as the reforms of July 2002, did not lead to systemic instability. But still, the contradiction between socialism and a market system remains unsolved. This leads us to a policy line that is often misinterpreted, as I would argue: the military first ideology. While Western media usually critically focus on the military aspect, I suggest digging deeper. My impression is that we witness a remarkable ideological experiment that, without creating the uncontrollable dynamics as witnessed in Eastern Europe, transforms the whole socialist society. Socialism as a class-centered concept is replaced by a nation-based concept: "In the past, it was recognized as an unbreakable formula in socialist politics to put forth the working class. However, the theory and formula that was generated one and a half centuries ago cannot be applicable to today's reality..." (Rodong Sinmun, April 3, 2003). The same source goes on: "Nation is [positioned] over class and stratum, and the fatherland is over idea and ideology." (ibid.). This liberates the decision makers of the corset of principal restrictions under orthodox Marxism/Leninism and opens the way for the application of almost any measure, as long as it serves the cause of the nation, which is represented by the military.

This approach is remarkable because it resolves the root causes of the contradictions between socialist ideology and the reality of a market economy. China, faced with the same problem, has opted for a much less elegant solution that still has to await the test of times. The Three Represents (see the 2002 Constitution of the CPC) implies that entrepreneurs and private ownership are represented and protected by the Communist Party. Forsyth (1997: 254f.) mentions the fear of the party-state in Vietnam to create an independent business elite that might challenge the established power. In North Korea, with the introduction of the Military First Ideology, the old class-centered concept is eliminated radically. This does, however, not mean the transition to a Western-style democracy. Despite all economic changes, the Communist parties in both Vietnam and China have stressed that political pluralism will not be tolerated (Jeong 1997), and it would be a great illusion to expect the Korean Workers Party to adopt a different position.

In non-food producing sectors, such as the industry, at the first glance the need for change does not seem to be as big as in the case of food. However, this impression is wrong. If at least a part of the distribution of vital goods is to be organized via the price mechanism, individual resources and hence incomes determine to which degree an individual can participate in market transactions. In fact, wages in the industry have to rise according to the rising prices on the markets in order for the new system to function. Furthermore, import substitution and export promotion will increase the resources for importing food, thereby reducing inflationary pressure stemming from excess domestic demand. Both concepts imply a functioning, competitive industry and an adequate management and trade structure.

Again, the DPRK has done what theoretical consideration would suggest. Wages have been raised nominally by 20~50 times, and wage discrimination was introduced (People's Korea, 17.08.2002). Moreover, the responsibility of the individual production unit has been strengthened, while the central control over the activities of the enterprises has been downgraded. To bridge the liquidity gap resulting from a time lag between increased production costs (after raising the nominal wages) and the generation of higher revenue (by selling products at a higher nominal price), bonds have been issued. By eliminating a substantial subsidy on grain, the state has saved an estimated 14% of its yearly budgetary expense that could be used to support the economic reform

measures (for the exact calculations, see Frank 2004). The cabinet has been strengthened, and a number of provisions related to the new economic approach have been added to the constitution. To improve the technical ability of the cadres to manage the new system, a large number of training measures have been undertaken. All in all, what we see is an all-out effort in ideology, agriculture, industry and the overall institutional structure. To be sure, this does not guarantee success. However, the DPRK leadership has obviously drawn a number of important conclusions from the fate of the Eastern Block, developed a coordinated, concerted approach, and is now putting it into practice.

How can the process that has just started be continued? The more the institutional structure in North Korea comes closer to the international mainstream, the more sense makes it to look for lessons from the success story of other developing economies. With a strong military leadership, a well educated and disciplined workforce, a low GDP and nationalism as the overarching force of integration, North Korea reminds in many ways of South Korea at the beginning of the 1960s (for an excellent description, see Woo 1991). Seoul had under Syngman Rhee implemented an often overlooked institutional build-up and import substituting strategy, before shifting to export promotion and later a big-push scenario under Park Chung-hee. The time has not yet come to describe North Korea as a developmental state. Moreover, modernization is needed, not industrialization. However, there were two decisive factors behind Park's success that could well be of relevance to the DPRK: (1) External inputs of significant amounts of capital at crucial points of economic development (normalization with Japan 1965, the Vietnam War around 1967-1972, and the First Oil Shock after 1973), and (2) the combination of state-directed economic planning and guidance with the vigour and energy of private entrepreneurship (*chaebòl*). It would be a short step from the *sòng'gun* policy to the creation of large industrial conglomerates, owned and managed by military officers and coordinated by state authorities. The talks with Japan about normalization are stalled, but not cancelled; a solution of the nuclear issue will very likely involve significant amounts of development assistance; and South Korea is ready to lend a helping hand.

The external political environment will be as crucial as markets and sources of finance and technology. It might be a coincidence that the USA have normalized their

relations with China in 1979, right when the reforms started, and even with Vietnam in 1995, when the reforms had produced visible results. This supports the North Korean position that a diplomatic normalization with the U.S. is of great importance for the country's future.

While many uncertainties remain, unlike many other states that struggle for economic development North Korea at least has the chance to get significant external inputs. The necessary institutional structure may well be under construction right at this moment. This is a process that needs to be supported and encouraged not in the hope to bring about regime change, but in the interest of the Korean people and of peace and prosperity in the Northeast Asian region.

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