

STATEMENT OF

Marcus Noland

Deputy Director  
Peterson Institute for International Economics  
1750 Mass. Ave. NW  
Washington, DC 20036  
mnoland@piie.com

and

Senior Fellow  
East-West Center  
1601 East-West Road  
Honolulu, HI 96848  
noland@eastwestcenter.org

HEARINGS ON

BREAKING THE CYCLE OF NORTH KOREAN PROVOCATIONS

1 March 2011

Committee on Foreign Relations  
United States Senate

The views expressed in this statement are those of the author and do not necessarily reflect the views of individual members of either the Peterson Institute for International Economics' Board of Directors or Advisory Committee or of the East-West Center.

The North Korean regime resembles a surfer attempting to maintain his balance on top of a changing, unstable foundation. While attention has understandably focused on the nuclear issue, it is worthwhile to examine the wave as well as the surfer to understand how the ride may end.

I would like to make three basic points:

- The growing centrality of markets in the North Korean economy over the past two decades is primarily due to state failure, not pro-active reform. The market is emerging as a semi-autonomous zone of social communication and, potentially, political organizing. On its own terms, the state is right to fear the market.
- This fear of the market prevents the North Korean authorities from embracing economic reforms that would allow them to address their chronic food problems, which appear to be worsening.
- One aspect of the economy's unplanned marketization has been a substantial growth in cross-border exchange, particularly with China, which accounts for a rising share of North Korean trade. China appears utterly uninterested in implementing sanctions in response to North Korean provocations. In turn, North Korean authorities are attempting to re-centralize trade, eliminating the decentralized market-oriented participants, and replacing them with intermediaries subject to greater direct political control.

The tragedy of North Korea is that while the circumstances of many are abysmal the government is almost wholly unaccountable for its manifest failures.

### **Changing Economic Practices and Mores**

North Korea historically has been a planned economy. The growing centrality of markets over the last two decades is best interpreted as a product of state failure, most conspicuously with respect to the famine in the 1990s that killed perhaps 3-5 percent of

the population.<sup>1</sup> Since then policy has been ambivalent, sometimes acquiescing to facts on the ground, at other times attempting to roll back these developments. Since roughly 2004-05, the policy trend has been negative or illiberal, prioritizing control over deepening or extending reform. A failed November 2009 currency reform and the government's subsequent backtracking destroyed an unknown share of household savings and accelerated inflation.<sup>2</sup> Against the backdrop of a failed agricultural policy and chronic food shortages, grain prices are again rising rapidly in part due to renewed military procurements and global market conditions.<sup>3</sup> Official state media has already begun to blame the rising prices on world markets.<sup>4</sup>

Research derived from two large-scale refugee surveys, involving more than 1,600 respondents, one conducted in China and the other in South Korea, suggest that in some sense a significant share of the population has effectively de-linked from the state.<sup>5</sup> Many people derive most if not all of their income from market activities rather than employment in the state sector, and when we asked the refugees what was the best way to make money in North Korea, the majority responded "engage in market activities" but a growing number said "corrupt or criminal activities."

When asked about the best way to get ahead, the dominant response was state and party. But it appears that state positions are increasingly desired not out of patriotism but rather as a platform for corruption. Refugees who had formerly been employed in government or party offices reported increased corruption among their former colleagues. Similar accounts of corruption among state officials were reported by more than 300 Chinese businesses interviewed about their activities in North Korea.<sup>6</sup> The central

---

<sup>1</sup> Stephan Haggard and Marcus Noland, *Famine in North Korea: Markets, Aid, and Reform* (Columbia University Press, 2007).

<sup>2</sup> Stephan Haggard and Marcus Noland, "The Winter of Our Discontent: Pyongyang Attacks the Market," Policy Briefs in International Economics 10-1 (Washington: Peterson Institute for International Economics, 2010).

<sup>3</sup> Stephan Haggard and Marcus Noland, "Food Prices, Monetary Policy, and Currency Reform (It's More Interesting Than It Sounds)," January 28, 2011, <http://www.piie.com/blogs/nk/?p=89>.

<sup>4</sup> Stephan Haggard and Marcus Noland, "A Hostile Environment? The Case of Food," February 17, 2011, <http://www.piie.com/blogs/nk/?p=338>.

<sup>5</sup> Stephan Haggard and Marcus Noland, *Witness to Transformation: Refugee Insights into North Korea* (Washington: Peterson Institute for International Economics, 2011).

<sup>6</sup> Stephan Haggard, Jennifer Lee, and Marcus Noland, "How China-North Korea trade works," February 19, 2011, <http://www.piie.com/blogs/nk/?p=351>.

authorities have responded by requiring party and government offices to devote more time to ideological indoctrination.

Paradoxically, while the state provides increasingly meager benefits to the population, contact with the state apparatus has grown ever more intimate. The government has undertaken legal code changes that have in effect criminalized much of daily economic life and facilitated the use of the penal system for economic predation. The police are given extraordinary discretion with respect to whom to arrest and detain, and conditions in detention facilities where many of these “economic criminals” are confined are horrific, rivaling those in felony prisons and the political gulag.

This system is a perfect instrument for extortion. The police can arbitrarily place individuals and their families in institutions where beatings, torture, and death in custody occur regularly. Unsurprisingly, people will pay bribes to avoid getting entangled in this system. In short, in addition to its traditional role as an instrument of political repression, the penal system now serves as a mechanism for economic predation as well.

### **Potential Political Implications**

North Koreans have increasing access to foreign media sources, and importantly, inhibitions against consuming foreign media have disappeared. As a consequence of obviously self-inflicted catastrophes such as the failed currency reform, as well as increasing exposure to foreign media, the regime’s meta-narrative, which ascribes all the country’s problems to hostile foreign forces, is increasingly disbelieved.

But the society remains atomized, characterized by low levels of trust. Even among the refugees, a self-selected group expected to have both more negative views of the regime and a lower aversion to risk than the remaining resident population, only a minority reported having discussed or joked with their peers about their circumstances while in North Korea. But this may be changing.

Participation in market activities is associated with a cluster of characteristics:

- A greater likelihood to cite “political” motives for emigration,
- A 50 percent higher likelihood of being arrested,

- Distinctly negative views of the regime, and, crucially,
- A greater propensity to communicate those views to peers.

In short, the market is emerging as a semi-autonomous zone of social communication and, potentially, political organizing. When asked at a recent event what North Koreans are talking about in the market, former UK ambassador to North Korea John Everhard responded, “Egypt.”<sup>7</sup>

The question naturally arises as to how representative the refugees are of the remaining resident population. At some level this is unanswerable—there are no public opinion surveys in North Korea. But extensive multivariate statistical testing of the results suggest that while the raw pool of respondents may oversample individuals with demographic characteristics or life experiences predisposing them to hold negative views, the hypothesis that the results obtained adequately represent the remaining resident population cannot be rejected statistically. And the results line up with those reported from other sources such as the survey of Chinese businesses, which are not subject to the same concerns regarding bias. In short, the survey results should be taken seriously.

While discontent is almost surely widespread, there appears to be an almost complete absence of civil society institutions capable to channeling dissent into effective political action. And while overt demands for political change go unarticulated, the state retains a massive apparatus to compel compliance.

### **The Food Situation**

North Korea suffers from chronic food shortages born of the state’s pursuit of the understandable goal of food security through an inappropriate strategy of self-sufficiency. At present, driven by a variety of factors, the situation appears to be deteriorating.

Roughly two-thirds of the grain consumed in North Korea is produced locally, so the size of the domestic harvest matters for food security. The harvest, in turn, depends on both the weather and the availability of inputs such as fertilizer. During the last

---

<sup>7</sup> Ambassador John Everhard, “The Markets of Pyongyang,” Korea Economic Institute of America, Washington, February, 2, 2011.

harvest cycle the weather was sub-optimal, and North Korea's poor diplomatic relations with South Korea have resulted in a reduction in South Korean aid, in terms of both food and agricultural inputs. Although the United Nations' Food and Agriculture Organization (FAO) estimated that the 2010 fall harvest was slightly above the previous year's, the 2011 spring harvest is now expected to be significantly lower than initially projected, so that heading into the "lean months" of mid-2011, domestically produced supply will be down relative to the previous year.

North Korea receives food aid bilaterally from China and South Korea and multilaterally through the World Food Program (WFP), to which the United States is the largest donor. Imports on commercial terms are limited. However, both commercial imports and aid are affected by global prices, which are now rising. Higher world prices are likely to contribute to a reduction of commercial imports.

Aid could be affected as well. There is an understandable tendency to interpret aid policy as a function of diplomatic maneuvering and as a consequence ignore the role of domestic political considerations in determining outcomes. A Chinese reduction in aid in 1993, undertaken in response to rising grain prices at home, was the proverbial straw that broke the camel's back and sent North Korea into famine. A similar episode played out in December 2007, when in response to rapidly rising grain prices, China embargoed exports, including those to North Korea, contributing to the biggest intensification of hunger since the end of the famine period.<sup>8</sup> The current backdrop of rising world grain prices does not augur well for the availability of external supply via any channel.

Local prices appear to be rising much more rapidly than world prices, however, possibly due to high levels of inflation in the wake of the failed currency reform, as well as removal of supply from the market to restock inventories maintained by the North Korean military and possibly to build up inventories for political celebrations.

It is impossible to know with any precision what this means for food security. The FAO/WFP balance sheet exercises are flawed and at the aggregate level overstate the actual level of distress. Additionally, these balance sheet exercises ignore inventory destocking or accumulation, which can have large immediate effects on supplies actually

---

<sup>8</sup> Stephan Haggard and Marcus Noland, "Famine in North Korea Redux?" *Journal of Asian Economics* (September 2009): 384–95.

available on the market, in either direction. If recent reports are to be believed, the impact of such activities are likely to be in the direction of reducing effective supply.

Moreover, the distribution of food insecurity is highly uneven in North Korea, both geographically and socio-economically, and even apparently adequate supply at the macro level may disguise what could be severe distress in specific locales or among particular population groups. A recent assessment by a consortium of American non-governmental organizations (NGOs) reports intensifying distress in three provinces which were visited.<sup>9</sup> Among other things, the report documents cuts in rations delivered by the government run rationing system; extraordinary shares of household income devoted to the purchase of food; and eyewitness accounts of acute malnutrition among children and a prevalence of low birth-weight newborns.

Unfortunately, the North Korean government has never exhibited any real “buy-in” to the norms of humanitarian assistance as practiced elsewhere around the world. As a consequence of this fundamental lack of cooperation by the recipient government, the quality of the official multilateral aid program in North Korea has never met international standards. Anecdotal accounts suggest that relative to the WFP, the American NGOs were able to achieve a higher level of effectiveness during their involvement in 2008. Recent North Korean provocations have further undercut political support among major donors, with the possible exception of China. In short, the food situation in North Korea appears to be deteriorating once again, though our understanding remains limited and as does our confidence in the quality of the aid program.

The ultimate solution to North Korea’s chronic food insecurity is a revitalization of the North Korean economy, which would allow the country to earn foreign exchange and purchase bulk grains from more efficient producers worldwide. The regime is reluctant to embrace the reforms necessary to achieve this outcome, however, and if anything, economic policy is heading in a negative direction.

## **External Economic Relations**

---

<sup>9</sup> Penelope Anderson and David Austin, “Rapid Food Security Assessment Democratic People’s Republic of Korea,” February 22, 2011.

Historically, North Korea's international trade has been small and politically determined. A byproduct of the famine was the development of decentralized trade, mostly with China, which arose as a wide variety of organizations including work units, local government and party offices, and even military units initially engaged in barter transactions to secure grain, a process that eventually broadened to include monetized transactions over a wide range of products. In 2009 China accounted for approximately 35 percent of North Korean trade, a figure that will likely rise when data are available, insofar as bilateral trade expanded in 2010, while North Korea's trade with other partners appears to have stagnated. (One sometimes reads accounts that attribute to China 70 or 80 percent of North Korea's trade; these statements involve a fundamental misunderstanding of the data.)<sup>10</sup>

As in the case of the domestic market economy, the North Korean regime does not appear to be entirely comfortable with this phenomenon of decentralized cross-border exchange, which potentially poses profound challenges to the North Korean leadership. When economic circumstances deteriorate, the incentives rise to move into China either permanently or in search of business opportunities and food. Informal trade channels became important means of earning foreign exchange and financing much-needed imports. This movement and trade eroded the government's monopoly on information about the outside world. Cross-border trade has also come to include an array of communications and cultural products, which directly undermine the government's monopoly on information: from small televisions capable of receiving Chinese broadcasts in border areas to South Korean videos and DVDs and even mobile phones. In response to these developments, in recent months the government appears to be attempting to execute a highly controlled opening in which North Korean state organs would engage in cross-border commerce with China, but activities not controlled by the state would be quashed.

In parallel, the government has established a supra-cabinet body called the Joint Venture Investment Committee to act as a central approvals agency for all incoming investment. It is possible that this "one-stop shop" could serve as a mechanism for

---

<sup>10</sup> Marcus Noland, "Just How Big are Those Lips and Teeth?" February 10, 2011, <http://www.piie.com/blogs/nk/?p=281>



disciplining the cascading corruption at all levels that has deviled foreign investors. However, the centralization of control may also simply serve to channel bribery in politically approved directions, and as such, the composition of the group could be read as a map of power relationships within the regime. The committee is reportedly chaired by Ri Chol, a former North Korean ambassador to Switzerland, who in his thirty years there was reputed to have been involved in the deposit in Swiss institutions of Kim family wealth, as well as the Swiss schooling of two of Kim Jong-il's sons.<sup>11</sup> Similarly, the Korea Taepung International Investment Group, whose board is chaired by a Korean-Chinese with commercial ties to the North Korean military but otherwise consists of regime heavyweights, was awarded a central place in the recently announced 10-year development plan, which notionally includes large Chinese investments in the Rason area in extreme northeastern North Korea. The government has also established a State Development Bank, reputedly at Chinese urging. These moves could be interpreted as indicating a renewed commitment to economic development and/or as a means of disciplining corrupt practices that have deterred investment. But there are also examples from other post-communist economies where such centralization has been accompanied by an increase in corruption, typically to the benefit of the leader, his family, and close associates.

## **Conclusions**

North Korea's chronic food insecurity once again appears to be worsening. Externally, the country is increasingly reliant on China, which is reluctant to sanction North Korea in response to its provocations. The regime faces a looming succession driven by Kim Jong-il's age and health. Our surveys document widespread discontent among the North Korean people but also a dearth of civil society institutions capable of channeling that mass discontent into constructive political action.

Access to information plays an essential political role. All societies, even democracies, are vulnerable to government propaganda and misinformation. But in

---

<sup>11</sup> Yonhap, North Korea Newsletter no. 142, January 27, 2011, <http://english.yonhapnews.co.kr/northkorea/2011/01/26/52/0401000000AEN20110126010400325F.HTML>

closed societies, authoritarian governments have particular leeway to develop elaborate propaganda machines that fundamentally distort information about the outside world. Connecting individuals to the outside world serves the crucial function of undermining these distortions by providing information, encouraging the government to respond to a more informed public. Our surveys suggest that the North Korean public is receptive to alternative, non-state-controlled sources of information that not only expand freedom of thought but potentially increase capabilities as well.

In this context, the market represents a zone of personal autonomy and freedom. We should be promoting its expansion through a process of engagement—but engagement with our eyes open. The goal would be not only to address North Korea's chronic material needs but also to encourage economic and political evolution in constructive directions.

Humanitarian aid should be divorced from politics. We should not punish poor families in Chongjin or school children in Wonsan for the behavior of a government over which they have no influence. In practical terms this puts us back in the slog of trying to achieve the best outcomes possible given the fundamentally uncooperative stance of the North Korean government. We appear to care more about vulnerable North Koreans than their own government does.

Development assistance is a different matter, however, and policy conditionality is justified. And while development assistance will be a component of an eventual reconstruction of the North Korean economy under whatever political circumstances prevail, official aid alone will not be sufficient. Bringing prosperity to North Korea will require the establishment of a principled and sustainable basis for commercial engagement. This outcome, in turn, depends first and foremost on the stance of the North Korean government, and recent developments in this regard have not been auspicious.

Information and markets alone will not immediately transform the North Korean regime. But they are a start. The expansion of the market internally, exposure of more North Koreans to new sources of information, new ways of doing business and organizing their lives, even exposure to foreign countries, will foster conditions amenable to the North Korean people exerting greater constraints on the behavior of what is now an effectively unaccountable regime.