

The July-1 Measures: A Genuine Change for Economic Reconstruction?

Park Jung-dong

INTRODUCTION

Even nine consecutive years after the collapse of the Soviet bloc (1990-1998) the North Korean economy was still mired in crisis: a severe food shortage and economic collapse. To overcome this difficulty, the Kim Jong-il regime tightened up internal psychological controls under the banners of “arduous march” and the “military-first policy.” The chronic economic crisis could not be overcome, and this became a serious threat to the stability of the North Korean regime. Against this backdrop, North Korea implemented a series of economic reform measures called the “July-1 (2002) Economic Management Improvement Measures” (hereafter July-1 Measures), while opening up its economy to the outside world to attract foreign investment.¹⁾

1) The measures originated in a directive by Kim Jong-il on October 3, 2001. In a document, “the Conversation with Responsible Workers from the Party, State, and Economic Institutions,” he especially directed them to “actively devise proper measures in economic management method.”

The “July-1 Measures” cover the abolition of the rice rationing system, massive price increases, and wage hikes for workers, exchange-rate increases, autonomy expansion for enterprises, an increase in the number of privately-owned farms, etc. All of these measures were indeed unprecedented.

As for foreign capital inducement, North Korea submitted an official application for membership in the Asia Development Bank in April 1997, invited an International Monetary Fund (IMF) investigation team in September 1997, and received an International Bank for Reconstruction and Development (IBRD) investigation delegation in December 1998 in an apparent effort to obtain membership in these important international financial organizations. This implies that North Korea perceives that it will take money, more than anything else, for the country to extricate itself from its protracted economic troubles. And the world is watching the North Korean efforts with keen interest.

This paper intends to look at the characteristics and contents of the symbolic efforts toward introducing economic reform since the launch of Kim Jong-il regime and the changes that reform measures brought to the North Korean economy in 2003 and 2004.

JULY-1 ECONOMIC MANAGEMENT IMPROVEMENT MEASURES

Main Policy Changes of the July-1 Measures²⁾

A. Changes in Price and Wage Policies

The price system reform included in “the July-1 Measures” was

2) The July-1 Measures were implemented on May 11, 2002, by cabinet order, “Regarding improvement to be made in prices and living expenses.” But, there are no official documents to explain detailed contents of the July-1 Measures: only basic directions and overall contents are available. Gang Il-chun, “Provisional

intended to set new price standards and to increase all prices and fees as a result of the change in price-setting principles.³⁾ First, price standards were changed—from basic fuel prices such as coal and electricity to food (rice) price. Second, price-setting principles are now decided by the necessary social labor expenditure as they were before but in setting the price, government involvement was reduced while international market prices were considered. In particular, authorities accept as a natural chain of events that prices can change in accordance with supply and demand.

Table 1 shows price hike rates for major goods and fees in North Korea. The rice price increased from 0.08 won to 44 won, or around the market price, rising almost 50-fold. Wages also increased by 20-40 times from 200-300 won to 4,000-6,000 won. Various living expenses were also increased to reflect reality. The wage adjustment was the largest for workers in the field of key industries such as electricity, steel, railroads, and transportation in proportion to intensity of labor.

In the days of the communist-bloc market, the North could buy one ton of crude oil for 20 Russian rubles, but oil now costs scores of times more compared to the past, while domestically manufactured goods cost the same. Prices were increased to address this imbalance, to recover national competitiveness and to provide balance and equality for the entire economic structure.⁴⁾

B. Shift in Central Planning System: Decentralization

The July-1 Measures stress the decentralization of the economic

Interpretation on the Economic Measures Taken by the Nation Recently (1)” (in North Korean), *Collection of Social Science Theses*, Vol. 15, reprinted in *KDI North Korean Economic Review* (October 2002).

3) Cho Young-gi, *Characteristics of Economic Management Policy in the Era of Kim Jong-il* (Seoul: Konkuk University Press, 2004), p. 11.

4) Kim Jin-hyang, “Crisis and Response of North Korean Economy: Nature and Prospects of Economic Management Improvement Measures” (in Korean), *Korean Journal of Northeast Asia Studies*, Vol. 26 (2003), p. 17.

Table 1. Price Changes after July-1 Economic Management Improvement Measures

(Unit: North Korean won, Multiple)

		Before	After	Increase Rate
Rice (kg)	State Purchase Price	0.82	40	48.78
	Sales Price	0.08	44	550.0
Corn (kg)	State Purchase Price	0.49	20	40.82
	Sales Price	-	24	-
Beans (kg)	State Purchase Price	-	40	-
	Sales Price	-	-	-
Soap (bar)		3.00*	20	6.67
Men's Footwear (one pair)		18.00	180	10.0
Coal (ton)		34.00*	1,500	44.0
Electricity (thousand kW)		35.0*	2,100	60.0
Gasoline/95 Octane (ton)		922.86*	64,600	70.0
Average Increase Rate (manufactured goods)		-	-	25.0
Monthly Magazine (<i>Chosun Munhak</i>)		1.20	35	29.17
Subway Fare (any distance, single)		0.1	2	20.0
Snacks for Daycare Center (monthly)		-	300	-
Entrance Fee (Songdowon Beach)		3.0	50	16.67

* Estimated from increase rate and new prices.

Source: Kang Il-chon, "A Tentative Interpretation of Recent Economic Measures in North Korea" (in Korean), *KDI North Korean Economic Review* (October 2002).

planning system. Strategically important indexes are planned by the National Planning Committee, while less important ones are decided by enterprises concerned.⁵⁾

To significantly increase decentralization and autonomy, the July-1 Measures completely wrote off the debts owed to the government by enterprises and factories in a bid to strengthen the

5) Cheong Se-jin, "A Study of North Korean Economic Changes: A Transitionological Perspective" (in Korean), *Korean Journal of International Studies*, Vol. 43, No. 1 (2003), p. 213.

independent-profit system.

Up until early 2001, there was talk of “the principle of centralized and detailed planning.”⁶⁾ Since October 2001, however, when Kim Jong-il’s directive was released, the main idea was that detailed planning indexes should be accomplished by enterprises according to their situations. This indicates there is enough room for independent decision-making and execution within the range of national planning, which basically discards the principle of centralized and detailed planning.

This change is in line with the emphasis placed on self-reliance for lower units since the economic difficulties in the 1990s. Of course, subsequent measures must be followed up, but the attempt to decentralize across the economy in a systematic way could serve as a means to reduce “risk” from overly-centralized policymaking by the nation.

C. Introduction of currency wages and incentive systems

North Korea has introduced various incentive systems to stimulate the spirit of labor among production units and to boost productivity. In the past, the state paid the full basic labor wage when only 70 percent of the planned quantity was achieved. Even when the planned target was remotely achieved, it paid 60 percent. However, this action undermined active production, thus wasting national production capacity.

Therefore, North Korea introduced an incentive system based on the socialist distribution principle. This system allows people to earn as much as they are willing to work for, bringing significant

6) Kim Myong-chul, “Important Issues Raised in Combat Planning Project to Guarantee Normal Production” (in North Korean), *Kyongjae Yongu* (Economic Study), Vol. 2 (2001), pp. 15-18; Lee Dong-gu, “It is a Natural Call of the Socialist Economy to Manage and Operate the Economy under the Controlled National Leadership” (in North Korean), *Kyongjae Yongu*, Vol. 4 (1998), pp. 9-12; Cheong Se-jin, *op. cit.*, p. 214.

Table 2. Major Changes after July-1 Measures

	Before	After
Strengthening Market Function	Prices	- Huge differences between state prices and market prices - State prices are similar to market prices
	Wages	- 110 won (monthly) - 2,000 won (monthly)
	Price Mechanism	- Prices depends on production and domestic supply and demand - Authority: Central and Local Administrations - Authority: Central and local administrations, and local firms (partial)
	Raw and Subsidiary Materials Market	- Transactions between factories or firms - Raw & subsidiary markets opened - State control of commodity items and price range
	Exchange Rate	- 2.16 won/ dollar - 150-190 won/dollar (Black market rate close to 200 won) - Market rate affects official rate
Decentralization	Planning	- Monopolized Planning - State Planning Commission holds the whole authority - State Planning Commission decides major projects - Detailed projects are planned by respective administrations, firms, and local administrations
	Factory and Firm Management	- Lax independent-profit system (depends on state for raw materials) - Did not consider production costs - Lack of production specialization (the principle of self-support: each factory produces from raw materials to final products) - Strengthened independent-profit system (respective firms and factories make up for material shortages) - Strengthened understanding of importance of production costs (In order to calculate profit, financial planning and accounting method is adopted) - Inducing production specialization
	Distribution Method	- Equal distribution - Socialist distribution principle exists nominally - Evaluate factories and firms based on "profitability" - Avoiding equal distribution (high-profit factories/firms earn more, workers receive incentives)
Improvement in Distribution	- Food, consumption goods, housing supplied free of charge - Food, consumption goods, housing applied market prices - Free education, health care, social insurance remains free of charge	

Source: Cheong Se-jin, "A Study on North Korean Economic Changes: A Transitionological Perspective," Korean Journal of International Studies, Vol. 43, No. 1 (2003), p. 214.

productivity increases in the short-term. These measures adjusted wages and prices to realistic levels to bring changes to the production management system, and sent the message that unprofitable companies could not survive.

The measures could also bring partial change to the social security system in relation to wage and price hikes. So far the nation has provided food, daily goods, housing, electricity and water at almost no cost. But the measures increased those prices almost to the actual production costs. In other words, food distribution under the rationing system has been practically abolished.

The measures also allowed people to buy and sell goods in goods exchange markets just like in peasant markets, which streamlined operations in the material provision sector. The IT industry is also being promoted to spread modernization and informatization throughout society.

Characteristics and Effects of the July-1 Measures

By adopting these measures, North Korea stressed the principle of profitability of the economic management sectors to conduct economic activities in pursuit of profits. The following is a brief summary of the main characteristics of these measures:⁷⁾

First, North Korea set food prices as the standard in the reform of the price-setting system. This is because food is not only most essential for people's lives, but also because it showed the highest price increase rate. By minimizing the highest dual price gaps between the state price and that of peasant markets,⁸⁾ it expects possibly reduced rates of other goods. Another purpose is to ease

7) Lee Chang-hyuk, "Adherence to the Socialist Economic System by Our Party and Promotion to Build a Nation with Strong Economic Power" (in North Korean), *Kyongjae Yongu*, Vol. 4, No. 113 (2001), p. 3.

8) Recent rice prices in the peasant markets were 77 won in 1998, 64 won in 1999, 46.6 won in 2000, and 49.5 won in 2001. (The Ministry of Unification, "North

fiscal deficits that amounted to billions of won a year by setting the sales price higher than the state purchase price. Before these measures were taken, the purchase prices for food were far higher than selling prices.

Second, in terms of socialist distribution principles, the massive wage increase was aimed at maintaining people's purchasing power amid increases in the prices of goods. As the distribution system was paralyzed due to economic difficulties, North Korean people were provided with food and necessities from the peasant markets, so the existing wage did not help increase purchasing power.

The simultaneous hike of wages and prices was designed to force people live to live within their wages budgets, while reducing the numbers eligible for the national distribution system. It seems that North Korea hoped that by doing so it could introduce a monetary economy in the long-term.

Lastly, through those measures, North Korea delegated some planning authority to lower-level organizations. This was a necessary move to increase productivity which had stagnated under the control of the central planning authorities, caused by the low rate of target achievement in the official economic sectors and over-expansion of private economic fields.

Since the measures were adopted, the following changes have taken place in the North Korean economic system:⁹⁾ First, There was an increase in overall productivity and improvement in income distribution. This fostered the attitude in people that they could earn as much as they were prepared to work for, and based on this, equal distributionism and "free rides" were eliminated. As a result, the *Jangmadang* (or black market), perceived as a necessary evil, was hard hit.

Another visible outcome in productivity increase is the rise in

Korea's Price Trend Survey in 2001," December 14, 2001) But the selling price to residents was 0.08 won set in 1946.

9) Kim Jin-hyang, *op. cit.*, pp. 119-120.

trade volume *vis-à-vis* China and Japan. Since the introduction of the July-1 Measures in 2002, export volume has increased by 221.3 percent with China and 22.3 percent with Japan, as compared with the corresponding period of last year. Another factor contributing to this export increase is that fewer factories and enterprises are avoiding export-oriented projects than they have in the past due to distorted price mechanisms.

Second, with the strengthened independent profit system, institutions and factories are putting more efforts into increasing revenues, while reducing expenses. In the past, losses created by each level of production units were taken care of by the state, but this is no longer the case. Those who create the losses have to take responsibility for them.

Third, the North Korean people now have a better understanding of market economy concepts, such as revenues and expenses. This is one of the most remarkable changes evident since the implementation of the July-1 Measures. People are now expected to live on their monthly wages as the state no longer takes care of their housing, food and basic necessities. This resulted in the introduction of a totally new concept of monthly wages.

As mentioned above, the July-1 Measures have brought about not only internal but also external changes in various forms. This can be interpreted as an indication that North Korea is working hard to change its economic institutions to keep pace with the rapid shifts in the domestic and global economic environment.

Designation of Special Districts

As part of its efforts for reform and opening, North Korea is vigorously working to designate special districts and zones: First, it designated the Shinuiju Special Administration District by a decree of the Standing Committee of the Supreme People's Assembly and adopted the Basic Act for the Shinuiju Special Administration District. The Shinuiju Special District will be developed as a center

Table 3. North Korea's Special Zones

	Kaesong		Shimuiju		Mt. Kumgang		Rajin-Sonbong	
Location	South Hwanghae Province (Southeast)	North Pyongan Province (Northeast)	North Pyongan Province (Northeast)	North Pyongan Province (Northeast)	Kangwon Province (Southeast)	Kangwon Province (Southeast)	North Hamkyong Province (Northeast)	North Hamkyong Province (Northeast)
Area	66 km ²	132 km ²	132 km ²	Approximately 100 km ²	Approximately 100 km ²	746 km ²		
Designated	November 2002	September 2002	September 2002	November 2002	November 2002	December 1991		
Features	Industrial Complex	Special Administrative Zone	Special Administrative Zone	Special Tourism Zone	Special Tourism Zone	Economic-Trade Zone		
Purpose	Manufacturing, trade, commerce, finance, tourism	Finance, trade, commerce, manufacturing, high-tech science, entertainment, tourism	Finance, trade, commerce, manufacturing, high-tech science, entertainment, tourism	International tourist attraction	International tourist attraction	Trade and intermediation, processing, finance, service		
Range	Independent guidance and management	Legislation, Administration, Jurisdiction	Legislation, Administration, Jurisdiction	Independent guidance and management	Independent guidance and management	Administration		
Autonomy	-	Local Assembly	Local Assembly	-	-	-		
Jurisdiction	-	Local Court	Local Court	-	-	-		
Administration	Management Authority	Administrative Minister	Administrative Minister	Management Authority	Management Authority	Special Zone Authority		
Ownership	State	State	State	State	State	State		
Developer	Developers	Special Zone Authority	Special Zone Authority	Developers	Developers	Special zone Authority		
Lease Period	50 Years	50 Years	50 Years	-	-	-		
Currency	Foreign currency	Foreign currency	Foreign currency	Foreign currency	Foreign currency	North Korean won		
Income Tax	14% (Promoted areas 10%)*	Undecided	Undecided	Tax free	Tax free	14%		
VISA	Entrance certification	VISA	VISA	Entrance certification	Entrance certification	Invitation Letter		

*Promoted areas are infrastructure construction, light industry, and high-tech science & technology

for international finance, distribution, state-of-the-art technology and service to promote the success of the North Korean economic management improvement measures. North Korea's changes are not merely improvements. It would be fair to say that this designation developed from realistic needs for expanded provision of external materials and foreign currency inducement, adding symbolic meaning as strategic changes through experimentation with the market economy using foreign capital.

However, District Minister Yang Bin has allegedly evaded taxes, clouding the future of the District. Amid this, Chairman Park Nam-ki of North Korea's National Planning Committee stressed the continuity of the Shinuiju District. To this end, it is known that several international figures, such as former Singapore's Prime Minister Lee Kwan Yu, are being considered to possibly succeed Yang Bin.

Second, on November 13, 2004, North Korea announced the "Mt. Kumgang Tourism District Act" through the Standing Committee of the Supreme People's Assembly, which designates Mt. Kumgang as a "special district for international tourism" in every sense. According to the Act,¹⁰⁾ South Koreans and overseas Koreans, and foreign corporations can invest in the tourism industry (travel, accommodation, entertainment and convenience facilities, etc.) and also invest in high-tech areas such as the software industry (Article 22). Investment in construction related to the tourism industry is to be promoted (Article 22), without constraints on foreign currency flows (Article 24). Those recommended by developers will manage the district (Article 12), taking care of tourism planning, research, development and management of touring resources, investment inducement and approval on the establishment and registration of companies, operating licenses, land-use rights, registration of buildings, and management of infrastructure of the district (Article 13).

Third, regarding Kaesong, the "Kaesong Industrial District Act"

10) *Ibid*, p. 23.

was announced in the third round of talks of the South and North Economic Cooperation Promotion Committee held in Pyongyang in November 6-9, 2004. A groundbreaking ceremony was scheduled to take place by the end of December. The Kaesong District will be connected to the Shinuiju Special Administration District to form the inland linkage with the Seoul-Shinuiju Railway while establishing the West Sea coast line linking Shinuju-Nampo-Haeju-Kaesong-Incheon. The Act is expected to include land-use rights, facilities ownership guarantees, personnel, materials, funds and information and communication guarantees, abolition of a variety of regulations and intervention, exemption or minimization of various taxes and public bills. North Korea is expected to use the Act governing the Kaesong District to promote the nation's international competitiveness, by making it more attractive to investors than the Shinuiju District.

It is assessed that North Korea designated three special districts in order to increase its supply capabilities in line with the July-1 Measures, while boosting production capacity at the same time. Therefore, the measures are inseparable from the special economic districts, as they have the same aim of achieving an economically strong nation. Given this aim, North Korea has to modernize its production facilities, introduce more food and raw materials and improve its relations with foreign nations through international economic cooperation.

RECENT STATUS OF NORTH KOREA'S TRADE

Trade in 2003

Following the long period of negative economic growth of the 1990s, North Korea's trade has increased 5.8 percent to \$2.391 billion compared to the previous year, the record high since 1994. Out of that amount, exports accounted for \$777 million—a 5.5 percent

Table 4. Trends of North Korea's Trade

(Unit: US\$ million, Percent)

	Export		Import		Total	
	Amount	Increase Rate	Amount	Increase Rate	Amount	Increase Rate
1994	858	-13.3	1,242	-25.0	2,100	-20.6
1995	736	-14.2	1,316	6.0	2,052	-2.3
1996	727	1.2	1,250	-5.0	1,977	-3.6
1997	905	24.5	1,272	1.8	2,177	10.1
1998	559	-38.2	883	-30.6	1,442	-33.8
1999	515	7.9	965	9.3	1,480	2.6
2000	556	8.0	1,413	46.4	1,969	33.0
2001	650	14.9	1,620	15.2	2,270	2.6
2002	736	13.1	1,524	-5.9	2,260	-0.4
2003	777	5.5	1,614	5.9	2,391	5.8

Source: Korea Trade-Investment Promotion Agency (KOTRA), 2004.

increase since 1999 and a five- year consecutive increase. This was because of the increase in exports of non-metallic goods and fisheries products to China and a rise in textile exports to other major trading partners.

Imports rose to \$1.614 billion, a 5.9 percent increase compared to last year, as a result of higher imports of energy resources from China and Russia and increased non-metallic goods, machinery, electronic and electric products. The trade deficit was thus \$837 million, a slight decrease from \$790 million of 2002.

A closer look at North Korea's trading partners reveals the following trends: First, in trade with China, trade volume increased 38.6 percent from 2002, making China its largest trading partner. Exports to China rose to \$395.34 million, a 46.1 percent increase from the previous year, while imports increased 34.4 percent, to a record \$627.58 million. The sum of these amounts is \$1,022.93 million, accounting for 42.8 percent of North Korea's entire trade volume.

Table 5. North Korea's Major Trade Partners

(Unit: US\$ million, Percent)

Rank	Country	Export		Import		Total		Share	
		2002	2003	2002	2003	2002	2003	2002	2003
1	China	271	395	467	628	738	1,023	32.6	42.8
2	Japan	234	174	135	92	370	265	16.3	11.1
3	Thailand	45	51	172	204	217	254	9.6	10.6
4	India	5	2	187	158	191	159	8.5	6.7
5	Russia	4	3	77	116	81	118	3.6	4.9
Total of 5 countries		558	624	1,038	1,196	1,596	1,820	70.6	76.1
Total		736	777	1,524	1,614	2,260	2,391	100.0	100.0

Source: KOTRA, 2004.

Export items on the rise are crabs, shells, metals, and textiles. The import items on the decrease are oil, corks, frozen pork, rice, wheat, and non-metals.

Second, North Korea's trade with Japan is declining overall due to deteriorating political relations, falling to 25 percent of that of two decades ago. Exports fell to \$173.81 million, a 25.8 percent decrease from last year. Imports fell to \$91.5 million, a 32.3 percent decrease. The total trade volume was \$265.32 million, a 28.2 percent decrease from the previous year.

One of the main reasons behind declining trade with Japan is the issue of the abduction of Japanese nationals. Although a summit meeting between North Korea and Japan was held in 2002, the abduction issue seems to have negatively affected the political and economic relations between the two countries. Major export items such as crabs, shellfish and textiles as well as import items such as machinery, textiles, and non-metallic products decreased dramatically.

Third, in trade with Taiwan, there was a steady increase as their bilateral relations have been maintained. The total trade volume rose

to \$254.32 million, a 17.4 percent increase from last year. The reason behind this increase was that exports of machinery, non-metallic products and textiles, and imports of machinery, plastics and chemical and industrial products have notably increased.

Fourth, in trade with India, there was an overall decline with exports falling to just \$1.62 million, a 66.2 percent decrease from last year and imports declining to \$157.88 million, an 18.4 percent decrease from the previous year. The total trade volume dropped to \$159.5 million, a 16.6 percent decrease from a year ago. Export items on the decrease were machinery and chemical and industrial products while import items on the decline were chemical and industrial products, cement products, and grains.

Finally, in trade with Russia, exports decreased while imports increased compared to those of 2002. Exports amounted to \$2.79 million, a 23.3 percent decrease from the previous year while imports totaled \$125.58 million, a 50 percent increase from last year. The total trade volume rose to \$118.37 million, a 46.7 percent increase from the previous year. The major reason for the increased imports from Russia was the import of purified oil, reflecting the dwindling energy supply due to the suspension of the Korean Peninsula Energy Development Organization (KEDO) Project.

The following important points can be noted in terms of North Korea's trade:¹¹⁾ First, since 1994, the total trade volume has posted record highs, approaching the level of trade before the "arduous march." This shows that North Korea understood the importance of trade and made efforts to expand exports to earn foreign currency while introducing necessary materials from other countries.

Second, North Korea is increasingly dependent on China for its trade. The total trade volume increase in 2003 is closely-related to the increase in the trade volume with China, considering the large share

11) Korea Trade-Investment Promotion Agency, "North Korea's Trade in 2003, the Largest in the Recent Decade" (in Korean), *KOTRA North Korea Economic News Flash*, May 19, 2004.

held by China in the total trade volume of North Korea.

Third, food and energy imports increased, which is related to the chronic food and energy crisis since the mid-1990s. In particular, North Korea introduced purified oil from Russia in 2003, resulting in a surge in trade with Russia. Meanwhile, coke imports from China appear to have led to increased exports of non-metallic products.

Trade in the First Half of 2004

North Korea's trade volume with China and Japan in the first quarter of 2004 increased by 7.9 percent to \$2.6 million, compared to the same period last year. Of this, exports increased 27.1 percent to \$1.1 million compared to the same period last year while imports decreased 3.2 percent to \$150 million. A deficit was recorded in the amount of \$40 million with China and Japan. Traditional major export items such as steel, fisheries, garments, mineral fuel and minerals led the export increase in January-March of 2004. Meat, mineral fuel, grains, and electrical appliances—major import items from China—accounted for 52.7 percent of the total import volume.

Regarding more detailed statistics, North Korea's total trade with China amounted to \$190 million, an 18.7 percent increase over the same period last year, with exports accounting for \$70 million (a 87.9 percent increase) and imports accounting for \$120 million (a 1.1 percent decrease).

Second, trade with Japan totaled \$61 million (a 16.4 percent decrease) with exports accounting for \$410 million (a 17.1 percent decrease) and imports accounting for \$20 million (a 1.1 percent decrease).

Third, inter-Korean trade in the first quarter was \$142.9 million, an 18.7 percent decrease from \$118.15 million from the same period of last year. During this period, South Korea's imports from North Korea amounted to \$61.59 million (a 7.4 percent increase) from \$57.37 million from the same period last year. Meanwhile, South Korea's exports to the North fell to \$42.7 million, a decrease of 39.7

percent from \$77.1 million. In the first quarter, inter-Korean commercial trade was \$77.1 million, a 5.1 percent increase from the same period last year. Non-commercial trade such as assistance to the North, light water reactors, and material provision for the Mt. Kumgang project was \$27.18 million, a 50.4 percent decrease. The decrease in inter-Korean trade was due to the suspension of the light water reactor project in North Korea and reduction in humanitarian assistance goods. According to the Unification Ministry, however, North Korea recorded a surplus of \$46.08 million in inter-Korean commercial trade.

In terms of trade items, the leading export items were steel, fisheries products, garments, mineral fuel and minerals, which have traditionally been the main export earners. In particular, steel exports to China rose to \$25 million (a 245.9 percent increase), accounting for 36 percent of the total exports to China. For reference, exports of pig iron, raw material for steel manufacture amounted to \$14 million (a 385 percent increase), while exports of iron scraps rose to \$7 million (a 382.6 percent increase). Exports of fisheries products totaled \$10 million (a 40 percent increase), while exports of minerals increased to \$5 million or 187.6 percent and exports of mineral fuel rose to \$ 5 million or 170.1 percent. Garment exports, however, decreased by 9.5 percent. The five items including steel, fisheries products, garments, mineral fuel and minerals comprised 80 percent of the total exports to China. Coal accounted for more than 92 percent of mineral fuels. Particularly, non-metallic raw material exports surged, with exports of zinc increasing 2,900 percent to reach \$1 million while aluminum rose 19,150 percent to \$0.8 million.

In trade with Japan, there was a distinct declining trend, except for fisheries and nonmetallic products. Garments decreased by 41.3 percent to \$9 million, while mineral fuels decreased 61.3 percent to \$1 million. On the other hand, fisheries increased 4.8 percent to \$23 million while zinc increased 207.7 percent to \$0.5 million and aluminum 14.8 percent to \$1.2 million.

As for imports, edible meat, mineral fuel, grains and electronic

Table 6. North Korea's Trade with China and Japan

(Unit: US\$ million)

	Jan-Mar 2003			Jan-Mar 2004			Increase Rate (%)		
	Total	Export	Import	Total	Exprot	Import	Total	Exprot	Improt
China	164	36	128	195	69	126	18.7	87.9	-1.1
Japan	73	50	23	61	41	20	-16.4	-17.1	-14.6
Total	237	86	151	256	110	146	7.9	27.1	-3.2

Source: Ministry of Unification, Korea, 2004.

appliances from China accounted for 52.7 percent of the total imports. The biggest import item was edible meat (taking up 20.4 percent of the total import amount) which increased 928.7 percent to \$26 million. A decrease was recorded, however, for mineral fuel (\$22 million, 47.9 percent), grains (\$5 million, 61.0 percent), electronic appliances (\$8 million, 30.8 percent). Out of the mineral fuel, coal increased 21.0 percent to \$2 million, while crude oil decreased 61.6 percent to \$13 million due to global high oil prices. The average import cost of oil increased by 15 percent to \$2.23/kg from \$0.20 as compared to the same period of last year.

In the case of imports from Japan, five major import items (automobiles, electronic appliances, machinery, wool and synthetic fibers) were the only exception to the general trend of decrease. These items, accounting for 68 percent of the total imports from Japan, amounted to \$13 million, a 15.1 percent decrease.

As explained above, North Korea's trade with China and Japan increased 7.9 percent thanks to increased trade with China, despite the trade decrease with Japan due to the abduction issues.

North Korea's major export items were fisheries products, mineral fuels, steel, and garments. In particular, exports of materials for construction (steel and zinc) rose due to the booming Chinese economy this year.

There was an increase in imports of meat, vegetables, fruits, soaps, detergents, rubber and other daily necessities from China, and

cigarettes and pianos from Japan. It is believed that North Korea's increased imports of necessities was to supply the events celebrating Kim Jong-il's birthday (February 16) and to stabilize the livelihood of its residents. The increased imports of cigarettes, pianos and color TV sets reflect the demand for high quality goods. During this period, imports of cigarettes dramatically increased to \$0.3 million (5,324.3 percent) and color TV sets to 28,000 (600 percent). Piano imports were recorded at 12,000, while there was no record of such imports during the same period of the previous year.

The increase in tractor imports (\$0.2 million, 664.9 percent) and glass (\$0.7 million, 25.6 percent) from China seemed to have been used for urban renewal projects in Pyongyang and for agricultural production increase through mechanization of farming equipment.

North Korea is expected to export minerals and other raw materials and to import necessities and consumer goods to overcome its supply shortage problem.

CONCLUSION

Since 2002, North Korea attempted to simultaneously achieve two goals: to stabilize the system politically and to bring about changes, both economically and socially. Despite difficulties caused by nuclear issues, North Korea maintained a stable political situation, solidifying the regime with its military-first policy and consolidating unity among the people. North Korea also actively responded to internal and external changes by reforming its economy, improving the livelihood of its people, and making social and cultural changes based on the concept of profitability.

From an economic perspective, North Korea worked hard to implement the "July-1 Measures" in an all-out effort to bring stability to the lives of its people. Following activation of the measures, there was a noticeable increase in the government's efforts to boost productivity of factories and enterprises by spreading the idea of

capitalism. The name of “the peasant market” was changed to “the market,” officially recognizing the distribution of manufactured goods and allowing some “privately-owned stores.” And they completely scrapped the food-rationing system. People receive distribution tickets for 50 percent of food needs to buy them at state prices. The remaining 50 percent can be purchased at markets.

These kinds of changes seem to be aimed at stimulating the market economy, rather than just stopping the rationing system. Namely, North Korea has operated comprehensive markets since March 2003 to allow distribution of agricultural and manufactured goods in a bid to improve its distribution system. In the meantime, North Korea made it easy for people to come and go in the border areas and implemented a customs-free system for foreign food imports. By letting the market decide food prices, North Korea is minimizing any possibility of inflation due to supply shortages.

Among other things, North Korea has pursued a three-year plan for energy supply and demand (2003-2005), a plan to increase food harvest by 8 million tons (2003-2007), and the second five-year science and technology development plan (2003-2007). North Korea devised mid-and long-term plans in energy, food and science and technology based on which it started taking action.

About two years after the reform policy was announced, around 2.2 million privileged North Koreans in Pyongyang out of the total 22-million population, are getting their first taste of consumerism. Of course, North Korea is still on the brink of disaster due to various shortages. However, there is absolutely no doubt that North Korea is changing. On the streets, women are selling agricultural products and fixing shoes, evidence of entrepreneurship. Across the city small stands made of planks have sprung up selling beverages, cigarettes, and candies.¹²⁾ Shops are operated by small trading companies under the government and the worker-farmer association. And prices are set

12) “North Korea, a First Step Toward the Market Economy,” *Yonhap News Agency*, May 6, 2004.

not by the government, but by the market. Purchasers use cash instead of coupons, while vendors are trying to make profits. A few North Koreans even enjoy expensive mobile phones. For the first time, there are signboards advertising *Huiparam*, an automobile assembled with parts from Italy's Fiat.

Despite these changes, negative views still prevail regarding North Korean economic reform: First, the country still tightly controls people's lives under a military leadership in order to strengthen the unity of the regime. Second, bottom-up change is practically impossible in North Korea's tightly controlled society. Therefore, it is extremely difficult to determine to what extent Kim Jong-il is committed to implementing changes through the "new thinking."

Therefore, for successful reform and market-opening in North Korea, at least the following three stumbling blocks should be eliminated.¹³⁾ First, hostile relations between North Korea and the United States should be overcome. North Korea is afraid that the United States will cause the collapse of its regime and system. Without security assurances from Washington, North Korea believes that it cannot pursue reform and market-opening in earnest. Based on this understanding, it seems that North Korea is working hard to ease the hostility in its relations with the United States.

Second, the structural irony of a separated territory, where a zero-sum situation exists, should be addressed. North Korea has hesitated to change its policy so far out of the concern that reform and opening-up would lead to unification through absorption by South Korea. North Korea will only be able to pursue reform and opening-up when Pyongyang and Seoul accelerate inter-Korean reconciliation and cooperation and institutionalize the development of inter-Korean relations.

Third, the father-to-son succession from Kim Il-sung to Kim Jong-il has limitations in itself. Examples of reform and opening-up

13) Yang Jae-sung, "How to look at North Korea?" (in Korean), Ministry of Unification (2004), [<http://www.unikorea.go.kr>].

by other socialist countries have shown that during times of leadership change, the incoming leadership criticizes the outgoing one, reevaluating the revolution and construction by the communist party and proposing a new policy line. Kim Jong-il succeeded his father, however, making it difficult to accomplish these ideals.

North Korea has to remove the three aforementioned obstacles in order to pursue system reform and its opening-up policy in earnest, thereby introducing a market economy of capitalism to the existing planned socialist economy. It is clear that North Korea will find it difficult to survive unless it embraces the market economy of capitalism.