



## Online Series

2017. 07.28. | CO 17-22

# Will the North Korean Economy be able to Maintain its Growth?

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On July 21, Bank of Korea published growth estimates for the North Korean economy in 2016 — 3.9%, significantly higher than expected. The Bank of Korea's growth estimates for the North Korean economy normally stayed around in the 1% range after Kim Jong-un took power and were even negative in 2015. In 2016, even though sanctions against North Korea got toughened, the growth rate for the North Korean economy hit a record high in 17 years since 1999 when it was 6.1%.

### The North Korean Economy Showing Signs of Quick Recovery

What are the reasons behind the increased growth rate of the North Korean economy? The first reason that can be considered is the base effect. While in 2016 an improvement in weather conditions led to an increase in the agricultural production and the enhanced power generation brought about an increased industrial production, the negative growth rate in 2015 contributed to an even higher growth rate in 2016. The average annual growth from 2015 to 2016 was 1.3%, not that much different from

the previous periods.

However, the base effect seems insufficient as an explanation. This is because that compared to the previous year that had recorded a negative growth, recovery was quick and the rebound range was large. Then, what are the reasons that have allowed the North Korean economy to quickly recover from a recession?

Firstly, there is a need to focus on marketization. Currently in North Korea, markets are closely linked not only to help citizens to maintain their livelihoods but also drive the production process of state-owned businesses. It seems reasonable to infer that the increase of efficiency of resources allocation arising from marketization that has been progressing in the last 20 years has attributed to the rapid economic recovery.

International trade also seems to have contributed to the quick recovery of the North Korean economy. Despite the toughening sanctions, the amount of total exports in 2016 had increased by 4.6% compared to the previous year owing to the active coal exports to China allowed by a livelihood clause. This increase must have helped the North Korean economy to quickly recover from the recession.

The attempt to normalize the North Korea's production is also notable. In the 2010s, North Korea's imports of industrial materials and capital goods have increased. This increase does not appear irrelevant to North Korea's much-emphasized efforts to normalize the production. Its efforts to normalize the production by importing machinery and production materials that cannot easily be procured domestically would have also attributed to speeding up the recovery of the North Korean economy.

### **Gloomy Prospect of Short-term Growth for the North Korean Economy**

Still, the question remains as to "can the growth of the North Korean economy be maintained for the time being?" Several factors that are being revealed at present are clouding the short-term outlook for the North Korean economy.

Firstly, North Korean export this year has been rapidly decreasing. Most notably, the amount of total exports in the second quarter has declined by 34.0% year-on-year, hitting a record low in seven years since the second quarter of 2010. The biggest reason behind the rapid downfall of exports can be found in the UN Security Council resolution 2321, in which a cap was set for coal exports by North Korea, leading to the temporary halt of coal exports to China starting late February.

Another point to note is a rapid increase of North Korea's quarterly trade deficit to China, which usually stayed around \$100-200 million and jumped to \$573.6 million in the second quarter of this year. This is the largest quarterly deficit after the fourth quarter of 2008, and is a result of North Korea having increased the imports of industrial production materials and capital goods even despite the radically falling exports. North Korea's quest to normalize the production seems to be an on-going effort this year.

The problem is that continuing this trend does not appear sustainable. North Korea's ability to sell and purchase the dollar does not seem particularly problematic, as shown by its stable exchange rates. Nevertheless, given the current conditions of the North Korean economy, it does not look sound enough to take the same amount of trade deficit as it had in the second quarter and will eventually reduce the amount of imports, especially industrial production materials and capital goods. This will in turn hamper the production process of state-owned businesses as well as attempts to normalize the production.

Another factor that is darkening the short-term economic outlook is drought. Food and Agriculture Organization of the UN reported that North Korea faces a severe drought and that the amount of crop harvest from double-cropping has significantly decreased — crops that will help the residents live through the hardship period in farming. As a possible result of this situation, rice prices in North Korea, which normally used to be stable, have now been rising since the start of this June. And there is a possibility that the food situation in North Korea will somewhat worsen since the drought is forecasted to affect the fall harvest.

The drought may cause problems not only for the agricultural production

but also the production of electricity. As North Korea is still relying on hydroelectric power to produce half the total amount of electricity, the already problematic electricity shortages will worsen further due to the drought, possibly leading to a declining industrial production caused by shortening of operating hours for industrial production complexes. A main reason behind the negative growth in 2015 was also a dwindling power production triggered by a drought.

### **Increasing Signs of Destablizing Factors in the North Korean Economy**

It seems likely that the North Korean economy will become increasingly destabilized into the future. New sanctions against North Korea, including a ban on importing crude oil, already passed both the Senate and the House of Representatives in the US Congress and the new UN Security Council resolution could also come out in the near future. Moreover, unless North Korea stops its acts of provocation, the intensity of sanctions will be strengthened even further.

The North Korean economy will get hit hard even without extremely strong measures, such as stopping the supply of crude oil — if measures are put in place including a strong secondary boycott by the US or a cut in the current cap of \$400 million on North Korea's exports of coal and the effects of these measures are accumulated, eventually the North Korean economy will be affected. In one way or the other, signs shows that the continual growth for the North Korean economy will not be an easy task. ©KINU 2017

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