



## Online Series

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# Convention Effect of the North Korea–U.S. Summit<sup>1)</sup> and the Balance of Invisible Trade

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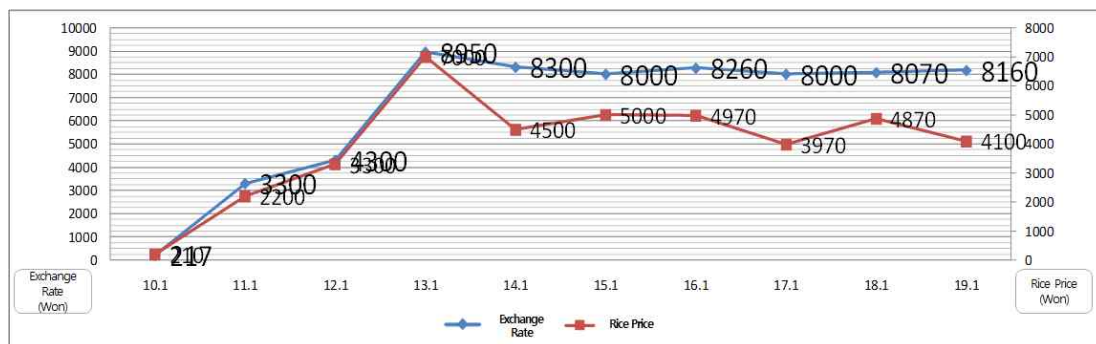
In 2018, the total volume of North Korea–China trade dramatically plummeted due to international sanctions against Pyongyang. However, the inflow of Chinese tourists to North Korea surged during the same period. The biggest factor of the tourist influx appears to be the convention effect: a series of summits occurred in 2018 had improved the DPRK's national image and drew public interests to North Korea. Notably, Chinese trip to North Korea is not a mere tourism but leads to tourism with an industrial inspection purpose to find investment opportunities. As a result, the DPRK had been able to enjoy significant economic benefits from various summits of last year since an increase of the invisible trade balance had effectively offset the impact of the sanctions. To sustain the convention effect, Kim Jong Un is likely to faithfully take steps toward denuclearization. In 2019, the convention effect will be a key incentive for Pyongyang to engage in dialogue.

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- 1) The convention effect initially refers to an increase of support for a political candidate after a major event during the election campaign. In this paper, the term is used to refer to North Korea's improved reputation and the subsequent economic ripple effects stemming from Kim Jong Un's summits with major countries.

### Paradox of Sanctions

In 2017, the UN Security Council imposed the sanctions against Pyongyang to a historical high point. Nevertheless, the North Korean economy appears to have been in relative stability. In particular, the exchange rate and the price of rice remain somewhat stable—two of the indicators frequently used by the West to measure the country’s economic stability. As of January 2019, rice prices and the USD–North Korean won exchange rate are either staying at a 2013 level or even declining, as shown in Figure 1.

<Figure 1> Prices and Exchange Rate in the DPRK



Sources: By the author (based on inflation and exchange rate data available on the Daily NK website)

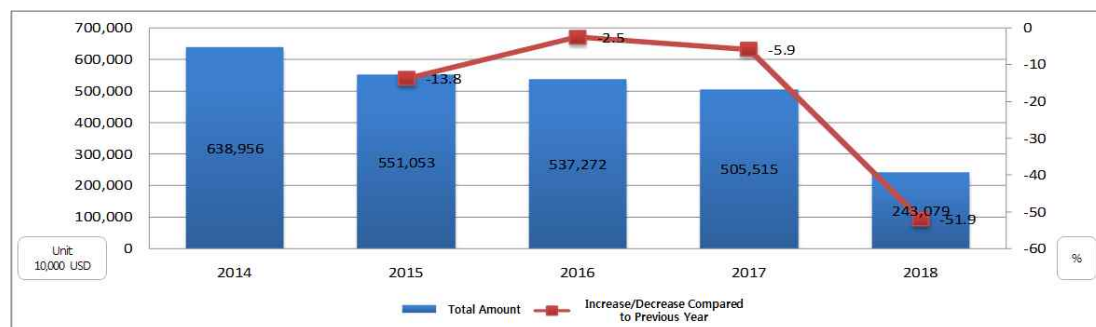
Some may interpret the current situation as a result of an economic contraction dragging down the demand, affected by the sanctions. For example, the Bank of Korea (BoK), which publishes DPRK statistics based on its own quantitative indexes, claims that the North Korean economy shrank in 2017. However, some scholars who have done qualitative studies and field surveys may disagree with the BoK. They suspect that the paradox of sanctions may be at work in the North. Concerning this subject, the author has observed North Korea from the Chinese border for years. Across the border, the author has witnessed a series of continuous changes taking place such as the construction of high-rise buildings in a massive scale, the nightscape becoming brighter, and an increase of cars, tourists, ranch, fisheries, and forest. In the meantime, *sotoji* (small plot) farming has declined. In

addition, the DPRK housing price has remained relatively stable except for some border areas where informal trade is possible. All this indicates that both product and foreign currencies—the source of supply—are in steady supply.

### Source of Foreign Currency in the Face of Sanctions: Trade vs. Tourism

If so, what are the source of all the foreign currencies available in the North Korean economy? One plausible scenario involves its trade balance. Figure 2 demonstrates trends in the DPRK–China trade on the yearly basis. In 2018, the total DPRK–China bilateral trade volume stood at 2.43079 billion USD, down as much as 51.9% from the previous year. North Korea’s export to China totaled at 0.21314 billion USD, down as much as 88% year-on-year. The plunge might be attributable to Beijing’s far-reaching import ban on the DPRK’s major export items: coal and minerals, textile goods (processed goods), and marine products. In other words, the sanctions against Pyongyang were proven to have an impact. Import also dropped by 33.4% to 2.21765 billion USD, a relatively soft fall compared to export.

<Figure 2> Trends in North Korea–China Trade Volume



Source: Statistics by the General Administration of Customs, P.R. China

On the other hand, Pyongyang, Samjiyon, Wonsan, Chongjin, and Kaesong are seeing a significant level of economic growth, according to video recordings by journalists, tourists, and researchers. The author’s longitudinal survey revealed a similar phenomenon taking place around the 1,400 km-long Sino–North Korean border. Many of the North Korean and Chinese scholars, traders, and public officers

whom I interviewed shared the view that the Socialist Corporate Responsibility Management System and the Farmland Responsibility System have made a significant contribution to internal productivity boost—industry innovation—to some extent. These accounts indicate that Kim Jong Un’s economic reform has produced some outcomes.

Equally important to note is the balance of invisible trade. This paper will focus on the tourism industry. While the National Bureau of Statistics of China does not disclose relevant statistics, its official claimed that the number of Chinese travelers going to the DPRK started to soar since July 2018, up around 50% from the previous year. The demand for tours to North Korea has been especially heightened in Dandong, Changbai, and Jian that the number of booked tourists frequently exceeds the capacity of available tour buses. If 300 people would come to the meeting point for a 200–people tour to the North, the travel agency may send 200 of them to North Korea first. The rest would wait until the buses return and drive them across the bridge. As a result, the last travelers would arrive in Pyongyang by midnight, and then their hotel rooms by around 1:00 a.m. Thanks to the surging popularity of Chinese tour to North Korea, there are tour guide shortages in Dandong and other areas where the demand is particularly high.

This development has led to some improvement of quality in North Korea’s tourism. In the past, Shinuiju and Rajin were the most beloved destinations for Chinese group tourists. Today, popular DPRK tour programs include trips to Pyongyang, Wonsan, and Chongjin, signaling a growing interest in Pyongyang and special zones among Chinese travelers. A group tour to Shinuiju or Rajin usually takes half a day or one full day. By contrast, trips to Pyongyang or Wonsan require a longer journey. Those are two- to four-day tour programs, which mean higher prices. As of February 2019, a half-day tour from China to Shinuiju costs around 780 Yuan. A guided group tour to Pyongyang is much costlier, from 2,900 to 3,700–4,000 Yuan, almost as expensive as Southeast Asia tour programs. Furthermore, the money that Chinese tourists spend in restaurants, stores, and souvenir shops probably generates another substantial foreign currency inflow to North Korea. Tourism is generally known as the most optimized industry to earn

hard currency for countries in early development stages, which has been growing in North Korea's open zones.

A growing demand has changed how Chinese group tourists reach Pyeongyang. Since last year, they no longer take a direct train from Dandong to Pyeongyang due to the rapidly rising demand for tourist vehicles. Instead, the tourists would go to the Dandong Customs Office via bus, from which they cross a bridge over the Yalu River to the Shinuiju Customs Office. Then they transfer to a Pyeongyang-bound special train. In addition, the boom also gave rise to new travel destinations. A case in point is Manpo: the completion of a new cross-border bridge connecting the North and China has made it possible to reach Manpo by bus from China driving up the number of tour products. As a result, tourists can go to Manpo with visa-free entries available.

Other growing trends in North Korea's tourism include hiking Mt. Baekdu on the North Korean side and the so-called "red trips"—tours designed to experience the vibe of old China before the economic reforms in the 1980s. The main appeal of this "red trip" is to observe an economically struggling socialist country that is similar to China during the Cultural Revolution. Tour participants, in a manner resembling that of zoo visitors, observe the rigid, standardized daily life in the DPRK. Earlier versions of red trips offered a limited number of advantages for the North. The participants tended to spend little during their visit—less profits for the Kim regime. Thanks to China's personal income growth and the DPRK's partial opening-up, red trips today are offered in varied themes and generate more financial gains for the North Korean government. A key customer group of red trips includes the veterans of Chinese People's Volunteer Army, the Chinese military forces that fought in the Korean War. The trips have been popular among their children as a gift to parents.

### **From Red Trips to Industry Investment-centered Tourism**

According to an interview survey conducted by the author, the number of Chinese tourists going to the DPRK jumped after the 2<sup>nd</sup> North Korea-China summit,

for which Kim Jong Un visited Dalian on May 7-8, 2018, ahead of the Trump-Kim summit on June 12. Each time Kim Jong Un held a summit with the leaders of South Korea, China, and the U.S., North Korea's relations with China have improved. Moreover, the Chinese public has become more interested in the North and started to view North Korea more positively. North Korean tourist attractions that had been well-known in China began to gain more popularity. Travel agencies, in turn, started to competitively develop new tourist programs using the already-famous places as base. Flights to North Korea have also increased.

At the same time, housing prices in Dandong went up by more than 50%. Close to Dalian, Dandong is the biggest city around the Sino-North Korean borders. The Sinchui district, home to a newly-built border-crossing bridge, was at the core of real estate speculation. Investors from Wenzhou and other parts of Southern China flocked to Dandong in hopes of seizing investment opportunities emerging around the DPRK. Amid the fever, fraud cases reported, leading the city government to rein in local real estate markets. The government designated the district as housing speculation zone and imposed a five-year ban on house sales and the issuance of new housing mortgage loans.

<Picture 1>  
Cargo Trucks and Charter Buses Waiting in a Queue  
to Go through Customs on the Sino-Korean Friendship Bridge



Source: Photographed by the author in October 2018.

The real estate boom is not just limited to Dandong. Hunchun, another border city, saw a 10% rise in real estate prices. Still, Chinese investors appear to be ready



to take one step further: investment in North Korean real estate. In fact, there were so many inquiries from Chinese investors on the feasibility of such investment that Xinhua News Agency, China's state media, went so far to interview specialists on investment in North Korea. All things considered, China's tourism to North Korea now has the potential to expand its customer's base from simple vacationers to business people and investors. According to the author's interviews with Chinese business men and women, various inspection groups were organized to have a tour to DPRK's key development zones such as Pyeongyang, Shinuiju, Chongjin, Wonsan, and Rajin after Kim Jong Un's first visit to Beijing. On the internet, travel agencies and real estate development companies actively advertise the DPRK industrial site tours. Themed tours are also popular: helicopter tours to Pyeongyang and Wonsan airshow or Pyeongyang Product Exhibition were all sold out. On the cross-border train from Pyongyang to Dandong, more than 70% of passengers are Chinese. Every day at 4:30 p.m., the Dandong station becomes full of Chinese investors returning from Pyeongyang, as the train from the North Korean capital arrives.

<Picture 2>  
Night View of a Chinese Tourist-only Shopping Mall  
Located Next to the Shinuiju Customs Office



Source: Photographed by the author in February 2019.

On this subject, the author interviewed a Chinese entrepreneur who participated in large-scale construction development projects in Rajin and Pyeongyang and has networks with North Korean high level officials. He claimed that the chairman of a major Chinese state-run enterprise travelled to the North

with North Korean high-ranking officials several times for industry inspection. According to the businessman, there were so many meeting requests from South Korean companies and local governments but the North could not accommodate all of them because they are already fully booked. Multiple SME entrepreneurs of China also testified that they accompanied Chinese entrepreneurs on field visits to a toll processing complex in Pyeongyang and development zones in Wonsan and Rajin. For example, a businessman working with North Korea who visited the Wonsan-Kalma special zone last November found that the framework construction was completed and that the buildings would be ready to open once the interior finishing is done.

The growing popularity of North Korea among Chinese investors is in part driven by Kim Jong Un's newly changed international economic policy. According to Chinese investors interviewed by the author, many foreign investors in the past fell victim to frauds in North Korea in the absence of strong state protection for foreign investments. The 35-year-old Kim has reformed the system to protect international investors. A result of the reform is newly constructed light industry factories around the East Pyeongyang Thermal Power Station. Many of these actively operating factories were funded by Chinese entities. The development of markets has expanded the scope of goods available in the DPRK, which has made it easier to invest in the North. Today, foreign investors can invest in North Korea if they have cash, which is progress.

One may wonder what makes North Korea such an attractive investment destination to some foreign investors at a moment when the investment environment is heavily restrained by international sanctions. While there is little they can do right away, those investors want to find opportunities before others come into the picture. Investing in North Korea may bear significant risk at early stages. However, once Pyeongyang starts opening up and reforming, they believe, the eventual profit may be so massive that it will easily outweigh the risks. They also factor in the fact that recent DPRK-China summits have increased investment stability.



## Outlook: Will the Convention Effect of Summits Continue in 2019?

The North Korean economy seems to have enjoyed substantial economic gains from the U.S.-DPRK, China-DPRK and ROK-DPRK summits since last year. The summits brought a significant convention effect to Pyongyang and special economic zones in the North. Such effect has improved the DPRK's invisible trade balance, possibly offsetting the impact of the sanctions. According to an official of China's National Bureau of Statistics, the number of Chinese visitors to North Korea dwindled by more than 50% in 2017. That trend was reversed after the Xi-Kim summit last June. In fact, around 1.2 million Chinese men and women paid a visit to the DPRK last year. Assuming that Chinese visitors spend at least 300 USD per person during his or her trip, the North Korean regime in 2018 earned at least 360 million USD from international tourism, which is bigger than the total export revenues. The price of petroleum, which had dramatically hit the 25,000 won mark per kilogram, fell every time Kim Jong Un met his Chinese counterpart. As of February 2019, a kilogram of petroleum costs around 13,000 won and is on a steady decline towards 8,000-9,000 won, the pre-heightened sanctions level. This phenomenon can be interpreted as the paradox of sanctions, in which the economy adapts itself and builds resilience in the face of continuous sanctions. As seen earlier, the DPRK economy in 2018 had benefited not only from the convention effect (specifically, improvement in national image) from the summits. Economic damage caused by the sanctions were quite offset by thriving invisible trade balance, which is in part driven by the influx of Chinese vacationers and hopeful investors across North Korea.

In 2019, Pyongyang and special economic zones are likely to welcome even more tourists and investors thanks to momentum generated by the upcoming Trump-Kim summit in Hanoi as well as a possible Kim-Xi summit in Pyongyang and Kim's visit to Seoul. President Xi's trip to Pyongyang is expected to create a particularly strong convention effect. It may attract the attention of the 100 million-plus wealthy people and middle-class entrepreneurs in and around China to its reclusive neighbor. The hard currency that these inspectors and visitors spend

in North Korea's special zones will boost the income of middle- and working-class North Koreans. The economic effect of this additional income will probably help the DPRK address its financial struggles.

In some sense, last year's summits, held under the banner of denuclearization and peace, have already brought Pyongyang some benefits, namely better reputation and improved invisible trade balance. In other words, South Korea, China and the U.S. had given some basic level of rewards reciprocating North Korea's denuclearization and ICBM freeze. In the past, the DPRK needed nuclear weapons to solidify the regime. Now, with denuclearization and peace talks underway, it maybe dawned upon political elites in Pyongyang that peace and dialogue are corresponding with economic development sustaining the regime. Therefore, Kim Jong Un is likely to faithfully make progress in denuclearization at least to keep the convention effect going. Therefore, the convention effect in North Korea might work as a key momentum for dialogue in 2019. ©KINU 2019

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