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Coronavirus Shock and North Korean Economy

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The North Korean economy has muddled through challenging times while managing to avert a severe crisis under the enforcement of tough sanctions. However, starting this year, North Korea-China trade has dramatically decreased due to the coronavirus shock, keeping people's private economic activities at bay and thus aggravating the economic situation. In response to this, North Korea eased its border blockade measure and has gradually increased the importing of mostly food products since May. North Korea is expected to continue this policy until the COVID-19 crisis subsides. However, that measure would not prevent the coronavirus-induced economic recession from further deteriorating. A certain level of rebound could happen in the short-term after the end of the COVID-19 crisis. However, unless North Korea comes up with a fundamental solution to address a lack of foreign reserves, it will soon face again the same economic hardships as the ones experienced under the COVID-19 situation due to a diminishing import of intermediary and consumer goods.

As the COVID-19 crisis seems to have prolonged, the world economy is teetering on the brink of collapse. The situation is so dire that the worst economic recession after the Second World War is expected in the coming months. The World Bank significantly lowered the global economic growth outlook from the initial estimate at the beginning of this year at 2.5% to 5.2% last June, an indication of how dire the situation is.

North Korea, too, is no exception from the coronavirus-induced economic shocks. The aftermath may even be more severe than expected given that not only is intra-country human exchange and contact but also the exchange of goods restricted out of concerns for North Korea's vulnerable prevention system. Besides, North Korea's economic foundation has already become weak due to years-long sanctions enforcement. How will North Korea hold up amidst the Covid-19 crisis that has arisen as if to 'rub salt on the wound,' as another hardship on top of already existing sanctions. One must first look at the current status of the North Korean economy to fully grasp the current situation.

North Korean Economy Muddling Through Difficulties under Sanctions

Strong sanctions began to be fully imposed against North Korea in the second half of 2017. On August 2017, UNSC Resolution no. 2371 went into effect entirely banning exports of coal, iron, iron ore, and seafood products, all of which are major export items for North Korea. On September of the same year, the UNSC Resolution no. 2375 took effect, putting a restriction on oil supplied to North Korea and banning North Korea's export of textiles and a new dispatch of its workers overseas. On December of the same year, the level of restrictions on the oil supplied to North Korea had been elevated and exports of machine, electronics appliances, cars, and metals to North Korea were banned under the UNSC Resolution no. 2397.

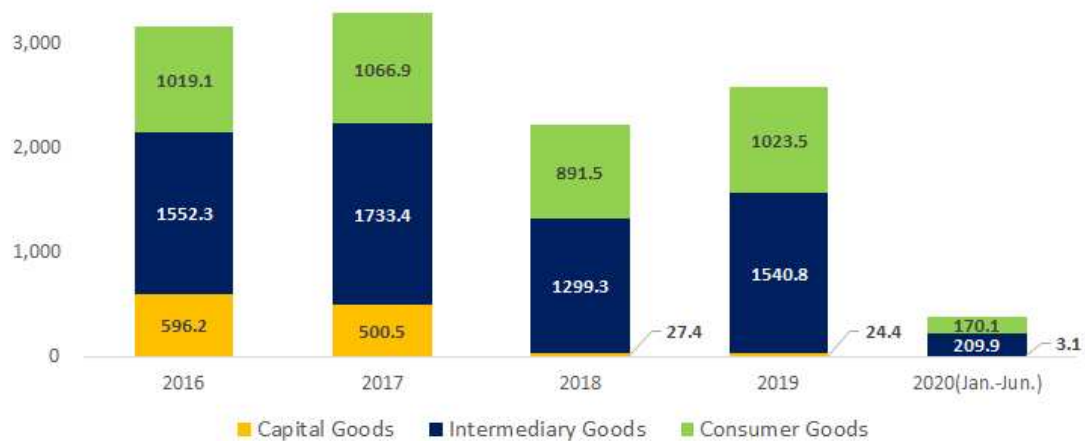
The tougher sanctions have led to a reduction in production. As the exports of major export items were banned, the volume of North Korea's exports to China had dramatically reduced from \$2.63 billion in 2016 to \$1.65 billion in 2017, and to \$200 million in 2018. It has inevitably led to diminishing production, especially in

export-centered industries, such as mining and light industry. As a result, North Korea's GDP has declined for two consecutive years from 3.5% in 2017 to -4.1% in 2018, according to the estimates from the Bank of Korea. A rapid contraction in production was averted because the exports of intermediary goods, not subject to sanctions, were allowed to some extent (see <Picture 1> for details). Another factor that had contributed to averting a rapid reduction in production may have been a development of markets and private sector activities, and a partial evasion of sanctions (through smuggling).

However, the North Korean economy in 2019 appeared to get out of the minus-range growth and was able to maintain the status quo. Statistics recently revealed from the Bank of Korea suggest that North Korea's GDP in 2019 increased by 0.4%. This increase was attributed to the following: there were not significant factors that hindered economic growth in the export sector since exports were already diminished by one tenth that of last year's numbers; the import volume of intermediary goods maintained as the same as last year, which was necessary for production; and good weather conditions led to yielding a sound agricultural production.

Sanctions affect not only production but also consumption trends. However, up until 2019, the shocks felt in the consumer sector appeared to be relatively less damaging compared to the production sector. Most consumer materials except for some durable consumer goods, such as electronic appliances, were exempted from sanctions. As <Picture 1> indicates, it was a result of the import of consumer goods maintaining the similar level as last year even under sanctions. Therefore, the sanctions seem to have had a limited effect on North Korean residents in their daily life.

<Picture 1> Classified by North Korea's Import to China, 2016~2020
(Unit: \$ million)



Data: Statistics on Trade of China, Korea International Trade Association (<http://stat.kita.net/stat/istat/CtsMain.screen>).

Note 1: The amount of oil imported from China has been exempted.

Note 2: Based on January to May, 2020.

Note 3: Capital goods, intermediary goods, consumer goods were categorized with reference to UN Trade Statistics (<http://unstats.un.org/unsd/tradekb/Knowledgebase/50090/intermediate-Goods-in-Trade-Statistics>).

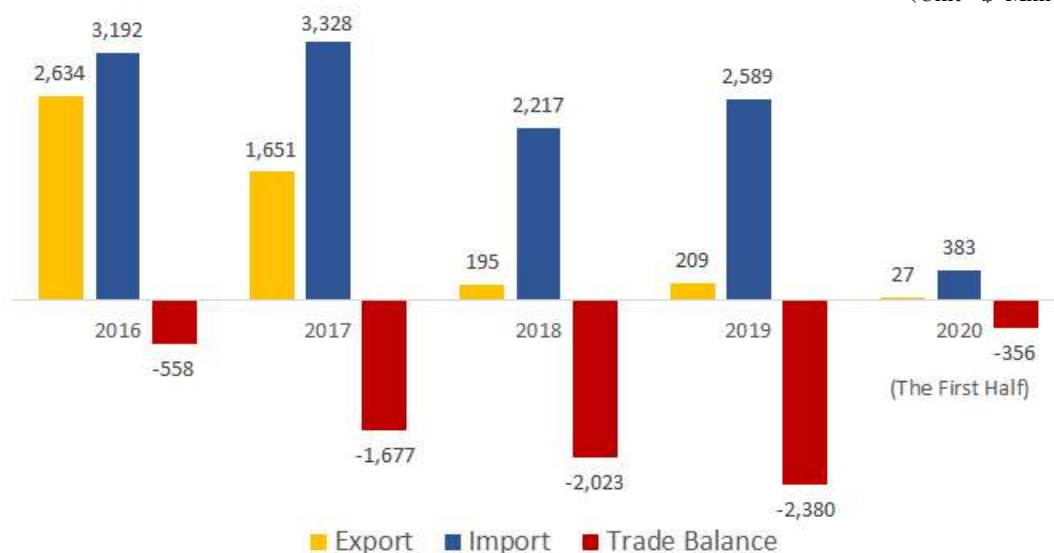
As such, North Korea's economy has been muddling through difficult times while managing to avert a severe crisis even under the strong sanctions. However, the economy had to pay a high price in the form of a dramatic reduction of foreign reserves caused by a rapid rise of trade deficits (refer to <Picture 2> for details). It has been attributed to a continued import of intermediary goods and consumer goods, not subject to sanctions, under the situation of rapidly diminishing exports ever since sanctions were fully in effect. A dramatically declining foreign reserves could pose a serious threat to the North Korean economy given that North Korea does not have enough foreign reserves to weather through the phase of this prolonged foreign deficit.¹⁾

1) Hyoung-soo Jang, Suk-jin Kim, "Estimates of North Korea's Foreign Currency Supply and Demand and Foreign Reserves and Implications on North Korea-U.S. Denuclearization," *North Korean Studies Review*, vol. 22, no. 1 (2019). (in Korean)

North Korean Economy in the Face of New Crisis, the COVID-19 Shock

North Korea went ahead and shut down its borders to block the coronavirus from entering the country at the end of January, 2020. Out of concern for the vulnerability of its epidemic prevention system, North Korea blocked not only intra-country human traffic but also material exchanges while biting the bullet of economic tolls. Such a decision is significantly straining the North Korean economy as the COVID-19 crisis prolongs. Not only has North Korea-China trade significantly dwindled but so has smuggling, due to the strengthening of the border patrol. The efforts of attracting Chinese tourists came to a halt as well. Concerns about the spread of COVID-19 appear to have affected market trade and people's private economic activities, which in turn will aggravate North Korea's difficulties.

<Picture 2> Trends of North Korea's Trade with China, 2016~2020
(Unit: \$ Million)



Data: During 2016~2019, see Statistics on Trade of China from Korea International Trade Association (<http://stat.kita.net/stat/istat/CtsMain.screen>). For 2020, see North Korean Statistics from IBK Economic Research Institute (<http://research.ibk.co.kr/research/board/statistics/list>).

Note 1: The amount of oil imported from China has been exempted.

Note 2: For 2020, it was based on the first half of the year.

North Korea probably would have been hit hard by a reduction in North Korea–China trade. According to <Picture 2> that traces trends of North Korea–China trade, North Korea’s exports to China in the first half of 2020 were \$ 27.37 million, and its imports from China were \$ 383.32 million, which is only 25.3% and 33.5% year-on-year, respectively. The proportion of North Korea’s exports to China has already been reduced so a decline of 0.25 will not make a huge impact on its economy. The problem is that its imports from China have drastically shrunk. Because of that radical decline, the import amount of intermediary goods and consumer goods from January to May, 2020 was \$156.7 million and \$135.8 respectively, which was only 10.2% and 13.3% year-on-year. Even if the imports were to increase in the second half of this year, the import volume of intermediary goods and consumer goods is highly likely to be hovering well below last year’s level.

It was previously mentioned in this paper that no reduction in the importing of intermediary and consumer goods had contributed to North Korean economy having been able to avert a dramatic contraction even in the face of strong sanctions. However, 2020 is witnessing a disruption in the importing of intermediary and consumer goods in the wake of COVID–19. It will not be easy to replace a significant number of items that are lacking by a decreased amount of imports, considering North Korea’s limited production capability even with the use of stockpiles or domestic production. This will inevitably lead to a reduction in production and consumption.

Then, to what extent is the COVID–19 situation affecting the North Korean economy? It is not easy to get to the bottom of the whole situation, given the limited availability of North Korea’s internal information. In fact, realistically speaking, it is impossible to get a comprehensive look at all the following elements required to accurately evaluate the effect of the decrease in North Korea–China trade: the proportion of intermediary and consumer goods in import volume, the level of stockpiles in North Korea, and the possibility of replacing those items with domestic production. However, it is plausible that negative effects could have been observed both in production and consumption given that it has been six months since North Korea started to blockade its borders and that the import of most items has significantly reduced.

Let's take an example from the agricultural sector. The amount of North Korea's imports of fertilizer was \$4.38 million in the first half of 2020, one ninth that of the amount from the first half of last year, \$40.82 million.²⁾ Considering North Korea's limitations in domestically producing and procuring fertilizers, it will be difficult to make up for a lack of fertilizer even when exhausting the inventory. It will eventually lead to a lower North Korea's agricultural productivity this year.

It will not be reasonable to enforce a policy that keeps blockading the borders for a long period given the impact that reduced imports from China will have on North Korea's economy. North Korean authorities, aware of this issue, appear to have changed their blockade policy ever since May. North Korea's import from China has increased from \$21.8 million in April to \$ 58.56 in May to \$87.68 in June. Year-on-year comparison was in the 10% range in March and April but showed a gradual recovery to 22.7% in May and 41.2% in June.

The increase in imports is mostly found in food products. <Table 1> shows a year-on-year comparison for 10 items imported from China in May 2020. What lies in 2019's top of the lists were industrial materials, such as textile fabrics of synthetic filament yarn, materials for clock, fertilizer, knitwear, and tile in addition to food products including soybean oil, rice, and sugar cane. The number one item in 2020, by contrast, was soybean oil, followed by flour, palm oil, and sugar cane, all of which are food products. The import volume of those items has increased year-on-year. Such a change which has been in place since May 2020 indicates that North Korea decided to have a blockade policy in place and increase the import volume of important consumer goods, such as food products.

2) "In North Korea, fertilizer import dwindled by one ninth in a year...what happened?," Yonhap News Agency, August 4, 2020, <<http://www.yna.co.kr/view/AKR20200804052200504?input=1195m>> (date accessed: August 6, 2020).

<Table 1> Comparison of Top 10 Items Imported from China
(Unit: \$10 million, %)

Ranking	May 2019			May 2020			
	HS Code	Item Name	Import Amount	HS Code	Item Name	Import Amount	Import Increase (Year-on-year)
1	5407	Textile fabric of synthetic filament yarn	18,557	1507	Soybean oil	15,257	64.3
2	3102	Nitrogen fertilizer	17,737	1101	Flour	9,453	142.0
3	1507	Soybean oil	9,285	1701	Sugar cane	5,928	43.8
4	9114	Materials for clock	7,650	1511	Palm oil	4,019	221.5
5	1302	Vegetable-based fluids and extract	6,878	2403	Manufactured tobacco	3,378	-10.7
6	3105	Mineral fertilizer and chemical fertilizer	6,808	2922	Oxygen-function amino-compounds	2,149	-14.5
7	6006	Knitwear	6,205	2402	Cigar, cigarette	2,032	-28.8
8	1006	Rice	5,163	4011	Tire	1,786	-47.1
9	6907	Tile	4,991	3004	Medical products	1,641	-55.7
10	1701	Sugar cane	4,123	3920	Plastic panel	954	-66.2

Data: Statistics on Trade of China from Korea International Trade Association(<http://stat.kita.net/stat/istat/CtsMain.screen>).

Grim Prospect for North Korean Economy after COVID-19

The North Korean authorities are facing a double whammy of prevention and the tackling of an economic crisis amidst a prolonged pandemic situation. North Korea is expected to encourage production on the basis of a spirit of self-reliance (*Charkyok Kaengsaeng*) both at home and abroad and implement a policy to increase imports, especially for major consumer products while maintaining a blockade policy in terms of external affairs.

However, even with those response measures, North Korea is highly likely to continuously go through difficulties in the aftermath of COVID-19. Even if North Korea-China trade recovers to some degree, the level of imports in intermediary and consumer goods is expected to still hover below last year's level, which in turn would contract the overall industrial production and consumption in agriculture, the construction industry, and light industry. Moreover, it is also possible that residents'

private economic activities could continue to be restricted until the COVID-crisis ends. It is highly likely to negatively impact the livelihood of North Korean residents given that a majority of people make their ends meet through private economic activities. It is all the more worrisome given that North Korean people, when confronted with economic shock, have to fend for themselves instead of relying on the state for protection and support due to the highly vulnerable financial condition of the state.

What is a bigger problem here is that North Korea's economic prospect is estimated to be gloomy even after the COVID-19 situation. A certain level of rebound could happen in the short-term after the end of the COVID-19 crisis if North Korea-China trade were to recover to the 2018~2019 level and people's economic activities become more active. However, that rebound will not likely continue under the tough sanctions currently enforced. Even with the end of the COVID-19 situation, North Korea would still face a reduction of foreign reserves caused by a rising trade deficit as mentioned above. If sanctions were not eased or lifted through any progress in North Korea-U.S. nuclear talks, a lack of reserves may once again trigger a significant reduction in the import volume of North Korea's intermediary and consumer goods, which in turn could put North Korea into the same economic recession as the COVID-19 crisis did.

However, there exists a variable. A Report of the Panel of Experts Established Pursuant to Resolution 1874 (2009), published by the United Nations Security Council Sanctions Committee on North Korea on March 2020, suggests that North Korea illegally exports coal and imports refined oil, through smuggling, exceeding the upper limit regulated by UN Resolution no. 2397. Furthermore, some North Korean workers overseas, who were supposed to return to North Korea by the end of last year, are still working overseas.³⁾ A classified Report of the Panel of Experts, secured and reported by Japan's NHK and the UK's Reuters, also points out the same problem. There still exists a loophole in sanctions implementation. In addition, if the North Korean economy deteriorates, China might come forward to actively aid the North Korean

3) United Nations Security Council, *Report of the Panel of Experts Established Pursuant to Resolution 1874 (2009)*, S/2020/151, 2 March, 2020, pp. 4-5.

economy, which could help alleviate the crisis.

However, those measures are hardly a fundamental solution to tackle the root cause of North Korean economic hardships. They may provide breathing room for the North Korean economy to some extent in the face of a crisis under sanctions, but it will not be significantly helpful to an extent that offsets the shocks that sanctions would bring to the North Korean economy. Making a breakthrough in the North Korean economy is a daunting task, fraught with a series of plights one after another: weathering through the shock of the coronavirus and then a bigger challenge in the form of sanctions. ©KINU 2020

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