

Impact and Outlook of Currency Exchange in North Korea

Hyeong Jung Park

(Director, Center for South-North Korean Cooperation Studies)

1. Introduction and Summary

North Korea has been pursuing conservative economic policy since 2005. Suppression on the market and attempts to strengthen or reinstate state control are the efforts in this regard. Some conventional mobilization policies emerged in the form of the 150-day struggle or 100-day struggle in 2009. On November 30, a drastic measure of currency exchange was taken.

The basic purpose of the currency exchange is to weaken the market and the private sector and to reorganize distribution of favor and disfavor by the regime according to categories of the population. In this respect, the North Korean authority has temporarily scored a victory. Yet, the cost it has to and will have to bear is highly significant. To begin with, its economy is in a major chaos. The state-run economy has to be restored in due time. However, considering the domestic situation in North Korea at the moment, these goals will be extremely challenging, if not impossible, to achieve. Moreover, the government will have to quell the soaring discontent of the residents.

From the economic point of view, the recent currency exchange is a policy choice in an aim to weaken the private sector, which has been proven vital in the North Korean economy, and to revive the state economy, which has been serving as the breeding ground of inefficiency, extravagance and bureaucracy. This is a decision that a wise politician would hesitate to make, because the weakening of the private sector will come quicker than the positive outcome of the revived state economy, is much more feasible and will bring about bigger impacts. The North Korean economy will be faced with aggravated economic depression as a result of the currency exchange.

The political, social implication is also significant. The reform has undermined the relationship between the regime and its people at a stroke. From a mid-to-long term perspective, the measure is likely to serve as a catalyst that activates people's accidental as well as organized opposition against the regime.

2. Trend of Conservative Policies and Currency Exchange

North Korea's economic policy had been reformative in the 2000-2004 period, but turned conservative from 2005. The currency exchange is in line with such reverse.

Preparation for the reform on the policy front began in 2001 in a full swing. The outcome was the July 1 Measure in 2002. The reform accelerated as Park Bong Ju was appointed Premier in September 2003. He was receiving strong support from Kim Jong Il and was encouraged to pursue the reform. He started drawing up a policy draft for more audacious economic reform from the mid-2004. However, his ambitious plan consisted of measures that could seriously undermine the vested rights of the privileged economy (party and military economy).

Resistance by the authorities of the party and the military against reform began in full scale in the beginning of 2005. Park Bong Ju was incapacitated in the process and eventually lost his position in April 2007. There was a significant conflict over the direction of the reform policy within the leadership between early 2005 and April 2007. In the broader picture, there were the two opposing forces with conflicting interests. On one hand, the 2000-2004 reform was against the interest of the privileged economy, which includes party economy, military economy, and commercial firms operated by various powerful public organizations. On the other, it was in accordance with the cabinet economy, managers and employees of state firms for civil production, small and medium-sized businesses in markets and farmers of the cooperative economy. There were three different forces within the movement against the reform, which began in 2005. Those in the military industry and the party economy opposed the reform that could compromise their interest. The party organizations strived to regain the power that had been taken away by the cabinet. The public security authority was concerned about the spread of "anti-socialist phenomena."

The overall policy direction since 2005 is as follows. First, the conservative forces uncovered their hostility to the market, insisting that the market is the soil for disorderliness and anti-socialism. Therefore state control over the economy had to be strengthened and the market had to be subdued. Various market control policies have been reinforced overtime. At the end of 2008, a policy that turns general markets into the conventional farmers' markets in 2009 was announced. In 2009, the classic mobilization campaigns such as the 150-day struggle or 100-day struggle emerged. Against this backdrop, the currency exchange was carried out on November 30, 2009.



3. Purpose and Impact of Currency Exchange

<Purpose>

The purpose of this measure was to increase regime's control over the economy and its people and to bolster economic conditions of defunct state sector and still state-dependent stratum at one stroke. Under the purpose, it has achieved some satisfactory results, at least temporarily. However, the cost and negative effects are also significant. Therefore, in overall assessment, the accomplishments are temporary and the problems will be lasting.

First, while the measure and the follow-up measures will certainly strengthen the state-run sectors for short-term, they will not make the areas self-sustaining in the mid-to-long term. Second, the measure has extorted the general public, under the name of the currency exchange, of their assets accumulated through trading activities at the market and other livelihood activities. A significant proportion of the North Korean residents seems to have suffered a major blow, which caused frustration and anger among the people. Moreover, this measure has clearly reminded the people of the fact that the reason for their suffering comes from the policy of the central government. People's resistance against the regime is likely to be stronger and more manifest.

<Temporary Accomplishment>

Taking a look at the temporary accomplishment in detail, the essence can be summarized in two points: the first is that the measure has significantly strengthened regime's control over the economy and the people for the time being; the second is to drive a wedge between groups of population, mainly between those who are regularly going to official work places and those who are seeking livelihood outside.

To begin with, look at the first point. Exercising its right to issue currency, the regime will issue new currency in large amount and use the money for its priority projects. The money will primarily be put into reviving the planned system of the state and regaining control over the state-run businesses and workers. Mobilizing the recovered financial resources, the state will provide the state industrial materials supply system and the state-run consumer goods trading system with supplies. The state is expected to put resources first in the leading industries such as coal mining, electricity, railway, metallurgy and chemistry in an aim to revive these sectors. It is likely that the attempt will result in substantial accomplishments within the next year. On the other hand, many of those who lost their property and means of living will have to return to their original jobs. If the workers are paid their salary in the new currency that is of the face value of the old currency, their earnings will be at the



corresponding level with the money they used to earn through market activities. Most of the state-run companies will face improved energy and labor situation.

Now we turn to the second point of driving a wedge between population groups. A measure of the money exchange is that "payment for living costs," as is called salary in North Korea, "will be paid in new currency according to the previous nominal amount." Additionally North Korean authorities legitimized the currency exchange as for "protecting interests and stabilizing and improving the living of the workers." Under this condition, those are benefitted from currency exchange, who are regularly going to official workplaces and more dependent of the salary. Among them are mainly officials of above city level party organization, state security, police, prosecution, judiciary, and military members. In reality, they are living more on incomes from corruption than salary. The group, most benefitted from the currency exchange, will be most likely the low-level factory workers, who has been still regularly going to official workplaces. Considering the operation level of North Korean industrial factories is known to be about 20%, a great part of factory worker would have to seek living outside their official workplaces. Among them are who have been relatively successful in adapting to market relations, and who are not. It is undeniable that between them jealousy and envy have existed. In this sense, the currency exchange has been designed to provide favor to the middle and lower group of population, who could not have successfully adapted to the emerging market relations or has to be on the job, whether from choice or necessity.

<Limits of the Accomplishment and Negative Impact from the Economic Point of View>

Nevertheless, these changes are not sufficient to predict that the management conditions and self-sustainability of state-run companies in general will be improved lastingly. There are seven reasons as following.

First, the facilities, industrial structure and management structure of the state firms were destroyed in the 1990s. Even if the workers return to their workplaces, it will not be easy, if not impossible, to organize the production activities that are sustainable. Therefore, the effort to normalize the management of state-run companies with the sudden increase of government's resources may be a temporary campaign, but is not likely to last in the mid-term.

Second, the workers who return to work will be a big burden for the management of the state-run companies. In the past, state-run companies enjoyed the benefits of downsizing and restructuring by dismissing many of them as "8·3 workers." These were called who maintained or had to maintain their official status as the workers to a state firm, but allowed to earn their living outside the firms in return



for paying their due to the firms. However, according to the recent measure, most of them will have to come back to their old workplaces. The state will be able to give them paychecks for two to three months from now on, regardless of their performance. However, in the longer term, the issue of production normalization and surplus labor will resurface as an insurmountable challenge. After a certain period of time, most of the state-run companies will go back to the past for better management and the workers will do so for their own well-being. In other words, the companies will have to let go of the surplus labor and the workers will have to earn their living outside the factories even as they are employed by the factory for form's sake.

Third, many state-run companies are already engaged in sectors other than what had been required under the original planned system. Even the state-run companies have changed the internal management structure for survival and have been deeply involved in market activities in its external relations. Therefore, the existing management environment and survival system that is tailored to the current situation through trial and error will be destroyed in the process of bringing them back to the planned system. Even though the state gives orders and provides financial resources, it is likely that the companies do not have capability to follow the order under the current circumstance. Even with state's financial dominance recovered, reconstructing the nationwide division of labor system with state-run companies at the center in a short period of time comes close to a delusion.

Fourth, the prerequisite of the success of this measure is the normalization of the national material supply system and the state-run consumer goods trading network at a stroke, which is far-fetched. Until now, most part of material purchase and product selling has been done voluntarily among companies or between companies and the market, without state's intervention. 80-90% of necessities have also been distributed through market activities. It is unimaginable that the state would be able to replace the existing system at once. In fact, the North Korean authority has been constantly trying to recover the state distribution system or the state-run trading network. The attempt of introducing the state-monopolized system of food in October 2005 was part of the effort in this regard. The attempt has failed. This time, the authority chose the drastic measure of killing its competitor, the market. However, while the currency exchange brings market transactions at a halt, it fails to provide goods through the state-run trading network. This is incomprehensible because the obvious result here is the ultimate chaos of the economy. Even though the competitor of the state-run trading network is gone, its ability to operate itself properly is questionable. It is more likely that the network will fail, which means that the market will have to resurface after a while. The same can be expected in the transactions of materials and finished goods among the companies.



Fifth, it is doubtful that the new currency of North Korea will stay credible as a means of exchange and a store of value. The monetary reform is attempting to restore the planned economy and state resource distribution, while closing the market. The most probable result in the near future would be that the state sectors will remain mostly defunct and extreme shortage of goods for distribution by the state will persist, while the market should remain closed. Under this circumstance, those who have only the new money would get nothing, while those who are privileged or corrupt enough to have special accesses to the state goods would get something with fraction of market price. The inevitable result will be that the drain of resources from the state sectors would aggravate and the market transaction will persist with higher price level due to the need to compensate the higher risks of being cracked down.

Ironically, the old currency of North Korea was, though weak, hard money, in the sense that it had real purchasing power in the market. The background was that, due to the collapse of the planned system, the state order to distribute resources became ineffective and the actual distribution was affected by the market transactions. Of course, the North Korean currency has been shunned even in major transactions between state-run companies as well as in many other occasions on behalf of foreign currency. After the monetary reform, North Korean authorities would like to dictate the flow of resources, though it would not function in reality. Under this circumstance, the new money will become even softer than the old money, so the former will be shunned even more than the latter.

Sixth, quasi-public companies, which are not under the planned system of the state, have emerged in a great number and have been playing an important role in North Korea. These are the companies that are set up and run by major power authorities of the military, the party and the government for their survival. These companies are not bound to the planned economy and basically run on market transactions. They have been vibrant amid the collapse of general state-run companies thanks to the power and privilege given by their operators. In short, they are the private subsidiaries of the power authorities in the military, the party and the government. Therefore, it would be hard to meddle with these companies without touching power authorities. As independent players, they have been running state-run companies as subsidiaries, taking advantage of their power, financial resources and exclusive right to engage in overseas trading. It is certain that these companies already hold a large amount of foreign currency. They will most certainly try to exchange all of their old currency with the new currency, using their power and privilege.

Seventh, for the above reasons, state's control over the economy will be uneven across different sectors. The operating capacity of factories of the priority sectors and military sectors will be significantly improved. However, confusion is likely to be unavoidable for the majority of state-run companies. They have gradually and illicitly adapted themselves to the new environment of plan collapse and market



surge since the 1990s, and deviated widely from the state plan system. Now the challenge for them is to overturn the current situation and to readapt themselves to the dictate of plan restoration. This will not only be a great blow to the transactions in the markets in general, but also temporarily cripple the industry sectors, such as the fisheries, self-auspice mines, construction and transportation. They have run by the collusion between the private money and the public organizations and prospered on market relations and private capital. Considering they are being seriously damaged, the result will be that the energetic part of the North Korean economy will be eliminated and therefore production and employment in North Korea will be significantly reduced.

<Short-to-Mid Term Impact from the Socio-Political Point of View>

The following is the short-to-mid term impact of this measure on the socio-political front. The biggest outcome is, first of all, that it has dramatically boosted the economic power of the privileged class and companies run by power authorities in North Korea. Second, it will accelerate the tendency of "the-rich-getting-richer-and-the-poor-getting-poorer." Third, people's expression of discontent with the regime could take on a new dimension with this measure in place.

First, a certain part of the society has made large gains out of this measure –the privileged class and the companies under the privileged power authorities. The measure has been a serious blow to small and medium-sized merchants and the general public who have been using the North Korean currency as the means of business and saving. To the contrary, it was of relative benefit to those who manage their assets in foreign currencies such as the dollar or the Chinese renminbi. Even though they have also suffered some damage in the North Korean money, the benefit from the soaring value of the foreign assets outweighs the loss.

Second, the privileged class and companies did not only see the increase in their assets but also will expand their control over the market. As a result, the rich will get richer and the poor will get poorer all across the country. Under the current circumstance of North Korea, market transaction has already become indispensable for consumer goods, certain producer goods, production service and finished goods. Market transaction could be contracted for a short while, but will return soon. When market expansion resumes in a while, the privileged class and companies will be faced with a favorable environment for the following reasons. First, the majority of the small and medium-sized merchants who had been dominating the market have been ruined and weakened after the currency exchange was put in place. Therefore, the privileged class and companies will be able to easily seize the ground which was originally in the hands of the small and medium-sized merchants. Second, as the currency exchange



was a serious blow to the mid-to-low income class, the cost of the production factors provided by the class will go down. They will be reemployed by state-run companies for the time being, but will have to be dismissed into the market in the medium term. Then, they will have to put out the production factors they have in the market at a low price. The buyers of these production factors will be the privileged class and companies.

Third, while the measure was a big blow to many people, the relation between cause and effect is quite clear. The cause is the central government, Kim Jong Il or his third son, Kim Jung Un, which can result in a different situation from the past. The 1990s saw the co-collapse of the regime and the people. Conventionally, under the dictatorship, residents tend to blame the corrupt officials they contact directly while believing in the good intention of the central regime. However, in this currency exchange, people can see clearly that the cause of the disaster is the decision of the central government or a certain person. In the short term, the North Korean residents will not be able to put up aggressive resistance against the authority. However, such high level of frustration and anger raises the possibility for accidental clashes. In the short term, this type of accidental uprising will be subdued rather easily, but it could accelerate the process of paradigm shift. Also, it is more likely that the North Korean resident will start realizing that the ultimate cause of the problem is not just the corrupt officials before their eyes, but also the decision makers in the central government.

4. Conclusion and Summary

Putting the above together, the North Korean economy will face a substantial depression in 2010 on top of rising internal instability. This will affect the internal and external environments and its policies.

The recent currency exchange is about reviving state's planned sectors and killing the market and the private sector. What matters is whether the positive impact of the former outweighs the negative impact of the latter. Taking the above-mentioned factors into account, it is more likely that the negative impact will prevail. To begin with, the currency exchange could considerably lower the purchasing power of the majority of the residents. Moreover, it will impact on the numerous sectors that have had production and employment effect backed by the relations with the market and the capital from the private sector, boasting sustainability amid difficulties. Retail and wholesale business in the general markets, fisheries, construction industry, transportation industry, small-scale extraction industry such as self-auspice mines are the examples. The currency exchange was a decision to kill such industries and resuscitate the state-run companies that have practically gone bankrupt, lost creativity and entrepreneurship, and



shown all sorts of inefficiency, extravagance and bureaucracy. The expected outcome is obvious. The contraction of the private sector will come instantly and the effect will be significant. On the other hand, the resuscitation effect on the state-run sectors will come with a considerable time lag and the outlook on the scale of the positive effect is not very optimistic. The North Korean economy, which is already in trouble, will sink deeper into the trouble.

To sum up, the foremost purpose of the recent currency exchange is to strengthen regime's control over the society at one stroke. The North Korean authority has temporarily succeeded to this end. However, the cost it will have to bear is large and the problems it will have to solve are very challenging.

The recent measure will certainly reinforce state's control over the economy, companies and the labor force temporarily. However, the state-run companies and workers have adjusted themselves to the collapse of the planned economy since the 1990s and independent companies under the privileged entities that are not included in the planned economy have also emerged. Therefore, many challenges will have to be overcome in the process of permanently reinforcing state control against such development, which is not likely to be successful.

Also, the recent measure has done a serious blow to small and medium-sized merchants while giving big special favor to the privileged class and companies under the privileged entities that possess foreign currency. The privileged will dominate the market once the market reemerges. "The-rich-getting-richer-and- the-poor-getting-poorer" tendency will be reinforced in the North Korean society.

Moreover, the measure is a manifestation of the fact that the source of frustration and disaster that caused great suffering of many individuals is the central government. When the possibility for accidents out of frustration and anger becomes higher in the short term, it could lead to an historic turning point where conscious resistance against the regime becomes stronger in the mid-to-long term.

