

**NORTH KOREA'S ECONOMIC POLICY
IN THE ERA OF "MILITARY FIRST"
- REFORM MEASURES IN JULY AND
'DEFENSE INDUSTRY FIRST' STRATEGY
FROM SEPTEMBER 2002**

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The economic reform measures in July 2002 has been the subject of greatest attraction in the world recently. But just two month after July, i.e. in September, North Korea secretly, in the sense that at that time it had not officially announced any new economic policy, set a new economic strategy for developing its defense industry first, and then the light industry and agriculture, simultaneously. The July economic measures have attempted to both reserve and reform the command economy in the new conditions and environment surrounding North Korea. They may be compared to the reform measures taken between 1979-1985 in China. Although they were designed on the basis of keeping the socialist principles, they abolished the most rigid aspects of North Korean style command economy: The party lost command in the factory as the planning system decentralized; the factory and local government were managed economically and greater attention were placed on the categories of cost, profit, etc., so that they may invest their profit in

new undertakings; wage and price obtained more concrete meaning. But since September 2002, North Korea's economy has been reoriented towards developing its defense industry first. Almost every policy announcement included the axiom of developing the defense industry first, or has been legitimized by it.

I. Introduction

Kim Il-sung died on July 4, 1994. Kim Jong-il's idiosyncratic political rule began with the catchwords 'military first politics' from January 1, 1995. During the North Korean 'march of suffering' period (1995-1997), there appeared to be no special policy orientation regarding economy. After assuming chairmanship of the Korea worker's party in September 1997, Kim Jong-il started renovating state structure and embarked upon active economic policy, resuming 'on the spot guidance' for the economy from January 1998.

North Korea's economic policy thereafter can be analyzed in four phases: 1998 can be regarded as the first phase, in which North Korean authorities prepared the groundwork for economic recovery, attempting a 'new great upsurge' in production through the second Chollima movement in agriculture, coal mining, electricity, railway and transportation, and metal industry. The second phase ranged from 1999 to 2000, when they attempted to normalize production in all sectors and emphasized both strengthening planning discipline under the centralized unified guidance and harvesting actual material gain in the economic undertakings. The third phase of 'improving and strengthening the socialist economic management' started late in 2000 and included the more or less well known July economic measures of drastic wages and price increases in 2002. The fourth and current phase began in Sep-

tember 2002 with the catchwords, 'developing defense industry first,' which replaced the traditional principle of 'developing heavy industry first.'

Among the various economic measures, the July measures in 2002 have attracted much attention - they have been praised as 'reform measures introducing market economy' by many experts. In order to understand the context and theories of the July measures, we should be more or less well versed in the theories of 'improving and strengthening socialist economic management,' which has been propagated since 2001 (chapter II). The July measures will be revisited through analysis of articles in the North Korean economic journal in 2002 to find several 'economic (reform) measures,' which have not been given due attention (chapter III). Compared with the July measures, the new 'basic economic policy line of developing defense industry first' has received little attention even though North Korea's economic policy has been centered on achieving it. The economic policy of 2003 and the issuance of public bonds for people's lives in May 2003 should be understood in the context of a new principle (chapter IV).

II. Reform in Kim's Method?

- 'Improving and strengthening the socialist economic management' since 2001 -

As was previously stated, the third phase began in late 2000. Its basic orientation can be summarized with three slogans based on the report by Prime Minister Hong Sung-nam at the supreme people's assembly in April 2001: firstly, to pursue actual material gains while keeping socialist principles; secondly, to improve and perfect the socialist economic management; and thirdly, to develop management methods of socialist economy on North Korea's own idiosyncratic method, adapted to change environment and conditions.

What these mean is more concretely explained in October 3, 2001 in Kim Jong-il's lecture delivered on October 3, 2001, "On improving and strengthening socialist economic management towards the need for construction of a powerful and prosperous state."¹ His speech can be regarded as the most important and influential document on the current orientation of North Korea's economic policy. On the one hand, it emphasized the socialist principles: to regard collectivism to be superior over individualism; to maintain firmly and put rightly into practice the principle of planned economic management by the state; and to guarantee the centralized guidance by the state, etc. On the other hand, it suggested several policy innovations in the economic management to earn actual material gains: to enhance the creativity of the lower units; and to take the material interests of workers and firms into consideration more seriously, etc. They included the followings:

- Decentralization of the planning process: The state planning board only plans strategic indexes, concrete and specified indexes are left in the hands of the lower organizations and firms;
- Creating a goods exchange market between firms: Factories and firms can exchange a certain percentage of their products with others for the purpose of securing material supply;
- Setting priority for quality indexes, such as technical-economic indexes, cost, and profit, etc.: Monetary accounting systems and financial planning methods for the firms are to be established;
- Promoting production specialization while gradually abrogating self-reliance facilities in sectors and factories;
- Strengthening independent accounting and rationalization of production and distribution;
- Promoting science and technology, modernization of national

1 The Korean version of this paper can be found in the web page, http://nk.chosun.com/original/original.html?ACT=detail&mode=year&original_id=584&year=2000.

economy, and accelerated introduction of information technology in the economy;

- Rational mobilization of surplus workers in factories for territorial and agricultural construction and urban renovation;
- Strengthening linkage between contribution and material compensation;
- Reducing what has been supplied freely by the state.

Besides these, this lecture contained one more new policy orientation which was never mentioned before - 'developing military industry first.' The following is a quotation from the lecture: "We must develop military industry first and concentrate our power on electricity, coal mining, metal industry, railway and transportation, and last but not least, agriculture. Then, we can solve food shortage problems, recover our economy step by step, and induce a new upsurge in economic construction."

This phrase, 'military industry first,' attracted little attention when the lecture was exposed by the South Korean press and made public. At that time, it was read as an announcement of policy intention for a certain period and not as a 'general line of economic construction' as has been proclaimed since September 2002.

One more innovation is contained in the lecture although it is not mentioned directly in the letter of text. Since 1961, the Daeaner (factory management) system, in which factory party commission is regarded as the supreme institution and the (right) role and behavior of party organization in factories and economic practices have been the two central subjects of both Kims' lectures almost every time they discussed economic management. But in this lecture, Kim Jong-il did not mention anything in regards to these.

III. Economic Policy in 2002 and the July Measures

As in the past, North Korea's economic policy of 2002 has been made public through several occasions, besides the co-authored new year's editorial of the party organ, *Rodong Shinmun*. It showed little difference from that of 2001. As in the past, extractive industry, electricity, metal industry, railway and transportation have been regarded as the main fronts of economic construction. A dramatic increase in agricultural production, straightening out of the farmland in Hwanghae province, completing construction of waterways between Gaechon-Taesungho, and other problems related to people's lives have been suggested as the 'priority tasks.' Additionally, development of science and technology, cultivating human ability, improving urban management, reconstruction and modernization of industrial technology, and production movement under the catchwords 'Ranam's beacon' have been mentioned. At the supreme people's assembly in April, Prime Minister Hong Sung-nam reported several measures, which were understood as 'improving economic management' in 2001.²

1. Essentials of the July Measures

The July measures attracted much attention in 2002. Combining information, North Korea's July measures are composed of three parts: the first was increase in wages and prices on July 1st. The second was related to improving economic management. The third was temporal repression of the farmer's market.

In general, only the increase in prices and wages has been regarded as the July measures. In the beginning of July, North Korean authorities increased the state prices and wages to a realistic level - i.e. that of

2 Report on the fifth meeting of the supreme people's assembly in the 10th legislature, *Rodong Shinmun*, March 18, 2002.

the farmer's market. The price of rice, regarded as the base for other prices, was increased 55 times from 0.8 Won to 44 Won, a little lower than in the farmer's market. Basic wage was increased from 110 Won to 2000 Won. Besides this, prices of consumer goods for daily use were increased by about 20 times, and the exchange rate increased to a realistic level from 2.14 Won to 150 Won per dollar.

In regards to improving economic management, there have been no official pronouncements about which measures have been newly taken. South Koreans knew mainly from pro-North Korean Choson Shinbo in Japan and other sources that after July, besides factories and firms, management of all economic units are being assessed according to 'earned income,' the principle of distribution according to work done is now strictly put into practice; and the impact of party organization in the factories has been reduced, etc.

Repression of the farmer's market has been, from the start, unrealistic, and so, before long, it came to have no purpose. After July, North Korean authorities mobilized physical forces to increase control over the farmer's market while attempting to increase supply to state commodity distribution chains and thereby strengthen them. But, because these attempts reaped no success and only worsened hardships, the authorities allowed re-opening of the farmer's market. Surprisingly, in March 2003, North Korean authorities acknowledged the farmer's market as a part of socialist commodity circulation. From late March, the farmer's market in Pyongyang is now simply being called the 'market' and no longer the 'farmer's market,' taking into account the reality that not only agricultural goods but also industrial commodities are exchanged there.³ It perhaps hints at the re-evaluation of the market by North Korean authorities.

Here, reviewing articles in the North Korean quarterly, 'Economic journal' in 2002, the background and purposes of the July measures

3 *Choson Shinbo*, April 1, 2003.

will be discussed, centered on the increase in prices and wages, as well as introduction of the 'earned income' index and other decentralization measures.

2. Background and Purpose of the July Measures

At first, we can observe that with the passage of time after 1998, North Korea successively pursued policies with more active and ambitious purposes. In 1998, North Korea attempted to restore the basic sectors of its industries such as agriculture, electricity, machinery and steel-making, railway and transportation. During 1999-2000, it attempted to restore the basic structure of centralized command economy, emphasizing planning discipline and normalization of production. Upon the results of years prior to 2001, North Korea has been pursuing more ambitious goals of modernized reconstruction of industry, decentralization of economic management, stressing profitability, and rationalization and restructuring of the economy.

However, as was stated by North Koreans because of new conditions and environment due to 'the demise of the world socialist market, pressure by imperialists and continuous natural catastrophe,' the traditional planned economy, which had functioned till the early 1990s, could not be restored as it was without adaptation. Restoration must take the new realities and situations into account.

Firstly, because of economic hardship, the surplus at the hands of the state has been greatly reduced and financial and material resources for the minimum function of centralized command economy are in short supply. Not only could the center not control production capacities and workers in the state factories, but it also had to promote self-reliance of the lower units, encouraging extra-plan undertakings utilizing surplus facilities and workers.

Secondly, North Korea's economy has in reality evolved into a dual economy with the state sector and farmer's market (second economy)

and with contrasting economic regularities. Traditionally, money played a passive role in the state sector, but with the development of the second economy, it increased its potential active roles (preserving values, medium of exchanges, etc.).

The duality of the economy and the increased active role of money have made it difficult to re-establish traditional centralized command economy as it was before the economic crisis of the mid-1990s. The reasons thereof can be summarized in four points: First, factories and firms would rather divert their products to the second economy with higher prices than sell them to the state with lower prices. Second, assets and resources already at the hands of the state flowed continuously into the farmer's market through larceny and corruption because of lower wages of employees. Third, the state prices for basic goods have been maintained at the lowest prices, which have no relation to the real cost, supply and demand situations, or world market prices, even if they promote squandering of goods in short supply. Fourth, disciplining of state employees has eased greatly. Officially, almost everyone in North Korea is employed in the state sector, but with the lowest wages, disappearance of subsidized goods, and highest price levels in the farmer's market, the state could not guarantee them a minimum standard of life. They would rather try to find work in the farmer's market or use their administrative power and knowledge for private purposes.

The policy of 'improving and strengthening socialist economy' from 2001 has, on the one hand, officially acknowledged the irreversible reality of the loosened grip of the state's capacity to control the lower economic units and attempted to adapt to the new situation proactively, allowing new space for the lower units where production could be increased without state guidance and material supply. On the other hand, the state attempted to secure firmly a part of the increased products to guarantee its financial income under the new circumstances.

3. General Increases in Wages and Prices

The increase in wages and prices in July has the purpose of enhancing the level of wage and price in the state sector to that of the farmer's market. First, the state price of rice has risen from 0.8 Won to 44 Won, which is almost the same as the farmer's market. It has been said that the new price of rice was determined after calculating the production cost of rice, even if it was quite impossible considering the realities of North Korea's pricing system. Actually, it was set according to 'supply and demand in the domestic market' - i.e. market prices in the farmer's market. Prices of other goods were determined by taking into account the price of basic food - i.e. rice as the standard.⁴ Second, "the volume of wage was decided after calculating living costs including payments for rice, housing, etc., with new prices." The basic wage was raised from 110 Won to 2000 Won. In this case, the average household income per month may be 4000 Won, considering almost every housewife has a job in North Korea. The new wage level may be calculated based on the price level in the farmer's market because under the current situation, almost all daily needs should be bought there. According to a survey of North Korean refugees in South Korea, the average living cost of North Koreans was said to be 3000 Won per month, and the average expenditure in the farmer's market was said to be 2000 Won.⁵

The increase in wage and price was intended to narrow the gap in wage and price levels between the state sector and farmer's market, thereby enhancing the functionality of the state sector while attempting to close the operation places of the farmer's market. Its intended impact could be summarized as follows: first, factories and farms would sell their products to the state if the price level is roughly equal between

4 *Choson Shinbo*, July 26, 2002.

5 Park Sok-sam, "Research on the Private Economic Sector in North Korea - Inferring the Scale of Private Economy, Volume of Money in Circulation, *Foreign Currency Owned by the People*," (Korean) (Bank of Korea, 2002).

state sector and farmer's market, and thereby, the state can amplify controlling power over them. Second, the firms and farms would transfer and sell their assets and resources (facilities, semi-products, foods for public distribution, etc.) to other state organizations if there is no visible advantage in selling them to the farmer's market. Third, the price increase of goods and services for daily needs, which has been supplied by the state at the lowest price level, would promote economic use of these. Fourth, the increase in wages in the state sector to reflect actual living costs could raise disciplining of state employees.

4. Measures for Improving Economic Management

Besides increases in wages and prices, several other measures are intended to enhance production and strengthen state finance. They did not resort to measures of simply increasing centralization as before. Rather, they attempted to increase or guarantee the revenue of state finance while promoting and increasing independence and responsibility of factory management. The measures are geared to enhance the productivity of state firms and local units and to establish financial relations between state and firm, in which the state could secure a certain portion of increased products as state revenue. The introduction of the 'earned income' index and the revision of financial relations between the central and local governments could be interpreted in such a context.

Introduction of the 'Earned Income' Index

Though the introduction of the 'earned income' index has not attracted much attention as part of the July measures,⁶ it constituted the economic infrastructure, upon which price and wage increase could

6 *Choson Shinbo*, November 22, 2002.

exert its effect. It replaced the index of actual goods gross production and the index of the value of gross production as the main criteria for assessing the result of a firm's management. 'Earned income' means the newly created value in monetary terms and is the sum of the social net income plus the wages of a particular firm. The introduction of the earned income index signifies the priority of the quality index and money index in the planning,⁷ and that everything be calculated and assessed in monetary terms.

There are two major merits of the earned income index.⁸ First, in order to fulfill this earned income index, the volume of realized sale must be increased. In the past, with the actual goods index or gross value of production index, if produced anyhow, the firms would be assessed as fulfilling plan targets - it does not matter whether products are sold or not. The earned income index can improve production and management quality by emphasizing indexes such as efficiency in production and profitability. In the past, the firms were appraised if having produced more even if at higher costs. Second, the earned income index makes it possible to realize the potential of firms to its fullest even if the production is not fully normalized, because it contains earned income from both planned and extra-planned production. The firms are created to endeavor to save materials and mobilize inner reserves in order to produce extra goods not foreseen in the plan for their own interests and expenditures.

The earned income would be distributed among the state, firms, and producers, and is to be distributed according to prescribed proportionalities among them,⁹ or after deduction of a certain amount of

7 Gang Eung-chul, "In order to realize the principle of our system being the best system, we should carry out the chu-che management principles of planned economy," *Economic Research* (Korean), Vol. 4, 2002, p. 12.

8 Gang Il-chun, "Temporary Interpretation on the Recent Economic Measures in our State," *KDI Economic Review of North Korea* (Korean), Vol. 4, No. 10, October 2002, p. 39.

money for the state and firms, the residues would go to the employees. In any case, if the amount of earned income becomes bigger, the distributed income for firms and employees also increases. In the past, even if the plan was not fulfilled, the state guaranteed 80% of the salary, but now, firms and factories are required to pay employees only from their earned income. Above all, under the system of earned income, firms and factories could use, on their own, surplus facilities or workers. For example, if there were no state orders or disruption of production due to interruption of supply from the state, the firms could organize production of timber, which has not been included in the plan. It was illegal to organize production outside the plan in the past. Now, the firms are able to do something with surplus facilities and workers, and if the product can find buyers, it would be acknowledged as an accomplishment.¹⁰ The piecework system as a method of payment has been reinforced and the role of reserve money for the firms has been increased - the demand for working funds is met mainly by the firm's own money or credit from banks; the firms should guarantee the depreciation by itself, and basic construction financed by the firm's own money has been increased.¹¹ The firms would be able to invest in new undertakings outside the plan if they can provide them with money.¹²

Improvements in Planning System and Methods

Besides introduction of the earned income index, planning system and methods have also been changed to encourage 'creativity' of lower

9 Chang Sung-eun, "The Substance of Earned Income in Factories and Firms, and Principles for Distribution," *Economic Research* (Korean), Vol. 4, 2002, p. 40.

10 *Chosun Shinbo*, April 28, 2003.

11 Lee Won-kyung, "The Principled Way of Solving Money Demands in the National Economy," *Economic Research* (Korean), Vol. 3, 2002, p. 28.

12 *Chosun Shinbo*, April 28, 2003.

units. The division of labor for setting plan indexes has been decentralized and rationalized¹³ - the state plans only the strategic and most important indexes regarding the priority sectors and basic industry, and firms and local governments plan the detailed and local indexes.

Above all, the independent accounting system, which has been reinforced with the introduction of the earned income index, demands also that the firms be able to concretize the indexes from above according to their own circumstances and be responsible for themselves. Thereby, the firms should earn enough money to cover their expenditures and to obtain profits, as if the firms cannot fulfill the actual material indexes, they are to be penalized through legal measures or fine imposed.¹⁴

Modifying Financial Relations Between Central and Local Governments

The introduction of the earned income index makes it possible to create a context, in which the amount of earned income can be related not only to that of firms and worker's income but also with that of state revenue, as all parties become interested in the increase of earned income. With the same intention, the financial relationship between the central and local governments has been revised.

In the case of financial relations between the state, firm, and employee, after introduction of the earned income index, the firm is to pay part of their income to the state in the first place, and only thereafter, the residual income is to be distributed between the firm and workers. In the past, from the total sales results, wages and allotments for the firm were deducted in the first place, and thereafter, the residuals went to the state.¹⁵ In this case, if the production plan has been ful-

13 Gang Eung-chul, "In order to realize the principle of our system being the best system, we should carry through the Chu-che management principles of planned economy," *Economic Research* (Korean), Vol. 4, 2002, p. 9.

14 *Choson Shinbo*, November 22, 2002.

filled to its entirety, there would be no problem, but if the plan is not satisfactorily fulfilled after deducting cost and allotments for the firm, the state would receive less than anticipated in the original plan.

Financial relations between central and local governments have been also revised on the one hand to enhance local creativity, and on the other hand to pay the state in the first place. Nowadays, the payment to the state is included in the local budget planning from the start and becomes legally binding. In the past, the local government paid this with residuals after its expenditure plan was fulfilled. The new responsibility is based upon new competency of the local government; regarding the local plan, the state decides only the amount of revenue it should collect from the local governments, and other details are left in the hands of the latter, making the local government responsible for the economic well being of the locality. Now the social welfare expenses must be paid from the local budget, not from central budget, as in the past.

In order to reinforce the local government's finances and control over firms in its locality, the revenue collection system according to locality has been reestablished. In late 2000, North Korean authorities abolished the former locality-centered revenue collection system and installed the sector ministry-oriented system. In the latter, the firms and organizations are to pay part of their income to the state through their ministry. Under the reinstalled locality centered system, they are to make payment through the local government according to their whereabouts. It is said that this measure enhances the function and role of the local governments and makes guiding and controlling local finance more efficient.¹⁶

15 Chang Sung-eun, "The Substance of Earned Income in Factories and Firms, and Principles for Distribution," p. 40.

16 Oh Sun-hee, "Some Problems in Improving Organization of Local Finances," *Economic Research* (Korean), Vol. 2, 2002, p. 44.

Goods Exchange Market Among Firms

With the creativity of the lower units enhanced, organizations and firms can concretize their plan indexes and also produce goods not envisaged in the plan. This situation makes it imperative to allow exchange of goods among firms outside the plan. Related to this is 'goods exchange market among firms.' Through this market, firms can exchange various surplus goods for various reasons, which would be allowed for disposal independently to increase creativity and responsibility. This type of direct exchange of goods among firms is regarded as a secondary goods supply method besides the planned supply system and as the favorable mechanism for planned development of socialist economy.¹⁷

Others

Additionally, there have been several measures worthy of attention. Firstly, factory party organization has been cut down.¹⁸ In the past, the secretary of the primary party organization would have three or four under secretaries or party guides. Now, he or she has two or three staffs. The three or four cells under the primary party organization have been cut down to essential members, and a part of the paid party officials has been replaced by non-paid members. Secondly, the area of the farmer's plot has been enlarged from 30-40 pyong (119-158 square yards) to 400 pyong (1580 square yards). The purchase price of agricultural products by the state has been increased. Distribution regarding the work group, the basic subunit of collective farms, has also improved; in the past, the results of the work group were divided evenly among its three or four smaller subgroups, but now, the distrib-

17 Lee Chang-hee, "Chu-che Opinion on Circulation of Production Goods," *Economic Research* (Korean), Vol. 1, 2002, p. 24.

18 *Choson Ilbo*, August 27, 2002.

ution is made according to the results of each subgroup. The state started to charge fees for land use to collective farms and farmer's plots, and last but not least, after Shineuju, a border city to China, was designated as a special administrative zone (Sept. 12), the Mt. Kumgang tourist zone (Oct. 23) and Gaesung industrial zone (Nov. 3) were also established.

IV. 'Defense Industry First' Policy from Sept. 2002

The fourth phase of economic policy after 1998 began in Sept. 2002 as Kim Jong-il changed the catchwords of 'basic orientation of economic construction' from 'developing heavy industry first' to 'developing defense industry first.'¹⁹ Since last September, North Korea's propagation regarding its economic policy has been related to or argued on the new principle of 'developing defense industry first.' Considering the current state of information, it is unclear as to how it has influenced North Korea's economic policy. What is certain is that it has not abrogated the reform measures from last July. Thus, it may be interpreted as mere *ex ante* ideological adaptation of economic theory to the primary political catchwords of 'military first policy.' Or, it may have reflected the intention of the leadership to change the allocation of economic resources on behalf of the defense industry to the detriment of other sectors of industries.

1. The Relationship between the Economy and the Military in the Theory of 'Military First' Politics

The policy of 'defense industry first' was supported by a new North Korean concept of the relationship between the economy and military

19 *Choson Shinbo*, April 11, 2002.

in the era of 'military first.'

It was clearly stated in an article: "The military first politics is the infallible precious sword for independence of the nation," as stated by the editorial board of *Rodong Shinmun*, the party organ on April 3, 2003. According to the article, traditionally, the relationship between the economy and the military has been falsely contemplated from the economy-centered viewpoint. On the contrary, it should be affirmed that the military plays the leading role in the relationship between the two, with economic prosperity and military first policy being observed as one entity. And even if economic power should be considered as the foundation for military power, this would mean playing the role of guarantor and propelling engine for the former.²⁰

It is true that former North Korean articles about military first policy were not written about the relationship between the military and the economy. They did not consider for the military to play the leading role. Also, when they talked about economy, they usually did not mention defense or the military industry. Representatively, the new year's editorial of 2001 declared, "The strong and grand state, which we are constructing, is a socialist paradise where all prosper and the people live without any envy," and in 2001 continued, "We have endeavored our utmost to improve the lives of the people." Additionally, it ascertained, "In the tightening of our strong economic power to the demands of a military-revolutionary era, our unfailing military power and great politico-ideological potency must be based on strong economic power." Referring to North Korea's four foremost institutions of the leader, ideology, military, and economy, the new year's editorial of

20 *Korea Central News Agency* translated the Korean word for 'military-first policy' into 'Army-based policy' before April 7, 2003. From this date, it has been designated as the 'Songun policy' as is pronounced in Korean: "Songun means regarding the military affair as the greatest state affair, and strengthening the main agent of revolution and promoting national defense and socialist construction as a whole, with the people's army as the mainstay."

2002 mentioned military and economy separately. Thereafter, it only expressed the most important problem in realizing that the potential of the economic institution was in improving the lives of the people by expediting economic construction.

However, this line of logic has changed since September 2002. At that time, it is said that Kim Jong-il propagated it as the direction of economic construction in the era of military first to develop the defense industry first and then simultaneously, the light industry and agriculture.

2. The Direction of Economic Construction in the Era of Military First Since September 2002

This 'basic line of economic development' should be regarded as a meaningful change of policy orientation. In other words, North Korea has maintained this for 50 years as the basic line of economic development to develop the heavy industry first and then simultaneously, the light industry and agriculture. This has changed since last September. Undoubtedly, North Korea had once put into practice the 'parallel policy of economic and defense construction' after the fifth general assembly of the central committee of the Korean workers' party in the fourth legislature in December 1962, but nevertheless, at that time, the 'basic line of economic development' remained in developing the heavy industry first.

We should take note of the time, September 2002, when the policy of military industry first was promulgated. This was the time, not after, but before Under Secretary of the State Department James Kelly visited North Korea during October 3-5, and North Korea's secret highly enriched uranium (HEU) nuclear weapons development was exposed. At that time, the euphoria about North Korea's opening and reform was widely kept because of North Korea's July economic measures, the improvement of relations between the two Koreas and between North

Korea and Japan. Various meetings between the two Koreas were held including North Korea's dispatch of larger sports and cheering teams to the South. Summit meetings between North Korea and Russia in August and between North Korea and Japan in September were held. Shineuju, the western border city to China, was also designated a special administrative zone in September.

Regarding the defense industry first strategy as the necessity of the era, North Korea's media brought forth the following arguments: In a Rodong Shinmun article on February 5, it said that the line of military industry first is the important demand of economic construction in the era of military first, and that they had no other alternative to overcome the reckless challenge of US imperialists and to protect national pride and independence. In an article from a pro-North Korean newspaper, the Choson Shinbo, in Japan on April 11, it said that the principle of military industry first reflects the idiosyncratic economic structure of North Korea, and is the method for enhancing economic power of the state in the shortest period under the condition of the vicious machinations of enemies.

3. The Economic Policy for 2003

As in the past, North Korea's economic policy for 2003 could be understood by reading the new year's editorial of Rodong Shinmun and the reports at the supreme people's assembly in April. The economic policy for 2003 is very similar to that for 2002, though with one important difference in that all the same policies in 2002 are mentioned under the umbrella of the 'military industry first' policy in 2003.

The 6th meeting of the supreme people's assembly in the 10th legislature on March 26 foresaw a 13.6% increase in income and 13.3% increase in expenditures for the 2003 budget. The supreme assembly has set aside 15.4% of the total budget for defense in order to "develop the defense industry and improve the defense power of the nation in

an environment of mounting tension caused by nuclear issues.” The share of defense expenditure in the budget had been 14.5% from 1999 to 2001. It had decreased by 0.1% to 14.4% in 2002, but in closing accounts it was 14.9%, thereby having increased by 0.5%. Thus, the share of the defense expenditure in the national budget of 15.4% in 2003 means a 1% increase in comparison with the original plan, but a 0.5% increase in comparison with the closing accounts of 2002. If we think in absolute terms, the expected increase in defense expenditure in 2003 is about 20% in comparison to the closing account of 2002. The budget for 2003 has expected increases in investment for electricity by 12.8%, for coal mining by more than 30%, for agriculture by 21.3%, and for the light industry by 12.4%.

The supreme people’s assembly also consented to issuing of public bonds for the lives of the people.²¹ Its purpose has been publicized as, ‘to mobilize surplus money to supply capital for economic construction, to make even the state budget, and to guarantee defense construction and people’s lives financially.’ Three kinds of public bonds - 500, 1000, 5000 Won, with ten years validity - are planned for issuance from May 1, 2003 to April 2013. During the 10 valid years, lotteries for the bonds will be held twice a year for the first 2 years and once a year for the remaining years. For the prize-winning bonds, the prize and the capital will be returned, and for the remaining ordinary bonds, only the capital will be returned. North Korean authorities have said, “The issuing of bonds undertaking mobilization of a great amount of capital demand needed for constructing a strong and prosperous nation is dependent on our people’s lofty patriotism and public consciousness, and buying plenty of bonds will be regarded as patriotic behavior, and accordingly, highly awarded politically and materially.”

In addition, one more point should be noted. North Korea has put forward a three-year plan for solving the problem of fuel and electrici-

21 *Choson Sinbo*, March 3, April 2, 2003.

ty. This is the first multi-year plan in ten years - the last was the third seven-year plan between 1987 and 1993. According to Choi Hong-kyu, director of the state planning commission, the plan sets up in detail how to modernize the power plant technically to solve fuel and power problems, such as how much coal is needed to produce electricity, and what kind of machines should be produced by the department of machine industry. The plan has also set targets for sectors of industries such as metal and chemical fertilizers, on the conditions that fuel and electricity be produced as expected by the three-year plan. Traditional multi-year plans in the past set targets for all sectors of the economy, but the three-year plan focuses on energy.

V. Conclusion

To sum up, North Korea's theory and policy of "improving and strengthening socialist economic management" is geared to increase production of state firms and to hoist the earnings for the state budget by establishing new relations with the planning center on one hand and the localities and state firms on the other under the so-called "new conditions and environment." That is to say, under the condition of the state's inability to fully supply materials and financial resource, the state granted the localities and firms more independence and responsibility in management, so that they could be more productive. Simultaneously, the state improved revenue collection from the increased production in order for it to also perk up its financial situation.

Ideologically, the theory of 'improving and strengthening socialist economic management' implied both continuity and discontinuity - continuity, because it had not abolished the centralized command economy but had attempted only to adapt and change it to "the new conditions and environment." And so, it emphasized the old principles, such as the superiority of 'socialism' and 'collectivism,' 'planned

economic management by the state,' 'priority of politico-ideological incentives,' and discontinuity because it abrogates, in reality, major institutions and arguments that specifically represented the North Korean characteristic of a socialist economic management system. The 'Daeaner factory management system' and 'unification and detailed planning' are not only not mentioned, but in fact, also abolished. Although the 'priority of politico-ideological incentives' is still emphasized very strongly, it is emphasized only pathetically. On the other side, Kim Jong-il has ordered the priority of material incentive to be strictly put into practice. Besides this, North Korean authorities maintained that monetary and financial relations must be taken advantage of, that distribution according to work must be strictly adhered to, and that independent accounting for the firms must be strictly applied, all because socialism implied characters of a transitional system between capitalism and communism. They lower the ideological hurdle for speaking about the 'market,' while analyzing 'organized market in socialism' and 'goods interchange market among firms' in theoretical journals, or changing the designation of 'farmer's market' to simply 'market.'

In its overall orientation, the basic theory and policy measures of 'improving and strengthening socialist economic management' could be compared with Chinese economic reforms between 1979-1983. During this period, Chinese reforms were based on the belief in the possibility of improving the efficiency of centralized command economy through practical measures while maintaining its basic structures and principles. That is to say, in order to raise systemic efficiency, the economic units should bear more financial responsibility and increase productive motivation through decentralization and reforms of command and incentive structure. The followings are the focal points of the period: firstly, the decentralization between central and local governments, and between planning center and firms; secondly, improvements in incentive system, in which the central government allowed localities,

firms, and farms to increase their share of their products; thirdly and second, permitting private sectors and establishment of special economic zones.

Naturally, there are also differences. What differentiates the North Korean case from the Chinese counterpart is that North Korea's 'improving socialist economic management' is being linked to the policy of military industry first. The two may not be combined to be successful. One other significant difference is that one of the most important Chinese reforms at the time had been agricultural reform, which introduced a family unit production system. North Korea had not brought in a similar agricultural production system till the end of June 2003.