

# The North Korean Economy After Economic Sanctions



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## Introduction

Recently, global economic uncertainty has been growing due to the US-China trade war and Japan-South Korea dispute. Such clashes can develop into the form of economic sanctions. Economic sanctions are a step that the party imposing the sanctions takes against the receiving party in order to push through their demands. The US trade tariffs imposed on China are a measure to achieve policy change in China. The country imposing sanctions imposes the most effective ones by taking into considering the economic interdependence between the two countries. In the country on the receiving end of the sanctions, the inconvenience and disadvantages to the general public arising from the sanctions function as political pressure. Policy-makers calculate the cost benefit of maintaining power and decide whether to change policies or not. This is the general theory on economic sanctions.

Powerful economic sanctions are also being imposed on North Korea. However, rather than changing policies, North Korea is further strengthening its opposition. While we can interpret this reaction to mean it will take more time until its policies change, considering North Korea's past pattern of behavior, it is highly likely that opposition will escalate rather than its policies changing. The reason for this assumption can also be drawn from the general theory of economic sanctions. In the following paragraphs, I would like to look at the impact that the economic sanctions have had on the North Korean economy. After considering the general theory of economic sanctions, I will begin with a discussion on whether the sanctions imposed on North Korea by the international community are actually functioning and the changes that have emerged in the North Korean economy and society through analysis focusing on recent events. Then I will consider why a phenomenon that does not match the

primary goal of economic sanctions is being observed in North Korea.

## General Theory of Economic Sanctions

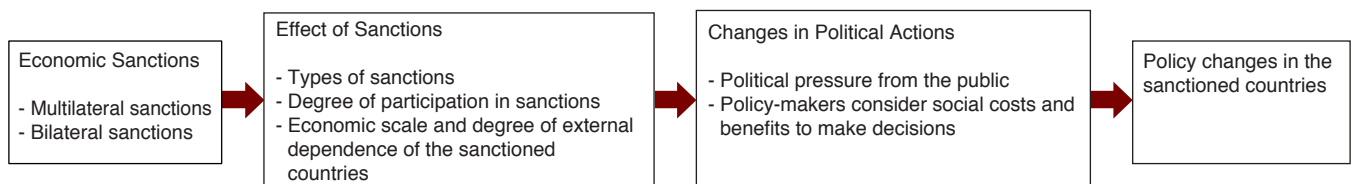
Academically, it is difficult to find an analysis that shows the general theory that economic sanctions are effective. This is because the effect of sanctions may differ according to the situation of the country in question. The results may also differ depending on the economic interdependence of the imposing party and receiving party, and the level of political stability within the country in question. I have summarized the general theory in the flow chart below (*Chart 1*).

Economic sanctions are used by the imposing party against the receiving party to push through the imposing party's demands. Therefore, whether to impose sanctions or not is determined by the degree of the relevant parties' benefits and disadvantages rather than by the legitimacy of the action. Thus it can be said that the imposing party is not always righteous, as well as the receiving party did not necessarily do something wrong. We must consider sanctions on the premise that we cannot apply right-or-evil values.

The form of sanctions can be largely classified into multilateral sanctions and bilateral sanctions. Multilateral sanctions are mainly measures taken by a resolution of an international organ such as the United Nations (UN). When a country in question takes action that goes against international standards, the international community decides to impose sanctions on that country in order to control or correct it. However, because the UN does not have the power to force implementation, individual member countries choose to orchestrate bilateral sanctions against the target country. Member countries report their degree of implementation of UN resolutions to the UN

CHART 1

### Flow chart of economic sanctions



Source: Compiled by the author

and it then evaluates them. The disadvantages faced by a member country that does not implement sanctions by a resolution of the UN can also be regarded as sanctions in a broader sense. Representative examples of such sanctions in modern society are the UN resolutions for sanctions against North Korea and Iran and the implementation thereof by respective countries.

Economic sanctions can be categorized into trade sanctions, financial sanctions, and sanctions against individuals. Trade sanctions are cases in which trade with the receiving country is prohibited or restricted. In modern society, in which economic exchange in the international community is active, not being able to conduct trade is an extremely large disadvantage. The higher an economy's external dependence, the higher the degree of disadvantage is due to sanctions. Financial sanctions are a method to restrict financial transactions with the receiving country. When comparing it to the human body, finances in modern society are like blood. The main function of blood is to carry various substances throughout the body. Finances also have the function to make the transportation of goods possible in the international community. To restrict financial transactions is to naturally restrict the transportation of goods. Therefore, it is recognized as a powerful sanction.

Financial sanctions also include investment restrictions. Sanctions against individuals are cases that restrict the travel and residency of people. They limit the dispatch of workers from abroad as well as restrict the overseas visits and stays of people from sanction-receiving countries. Conversely, they include cases in which visits to the sanction-receiving country by citizens of the sanction-imposing country are restricted as well. In this way, the types of sanctions can be classified by targets: people, goods, and the currencies that link them.

The effects of sanctions manifest in different ways depending on the economic scale and dependence of the sanction-receiving country. With regard to economic scale, the economic sanctions between the United States and China are a representative example. The US and China boast the first and second most powerful economies in the world respectively. If the US imposes trade sanctions on China, the economy of China – called the world's factory – may face atrophy. However, we cannot underestimate the disadvantages the sanctions may cause to the US as well as to the international community. Because the US-China trade war would cause turmoil in the global economy, the two countries as well as the international community are concerned about the US-China trade war. That is the reason the two countries cannot head in a drastic direction. Iran and North Korea can be mentioned as representative examples of the degree of economic dependence. Iran's economic structure depends on exporting oil and importing industrial goods. Its external dependence is extremely high. On the other hand, North

Korea's economic structure depends on exporting goods in order to import goods that are not produced or are lacking in North Korea. Thus its external dependence is extremely low. Therefore, while Iran is highly susceptible to economic sanctions, North Korea's susceptibility is relatively low.

Susceptibility to sanctions is influenced in general by the political environment within the country in question. If the political voice of the people of the country in question rises as their inconvenience grows due to sanctions, and if the government can overcome this situation, it will not accept the demands of the other party regardless of sanctions. On the other hand, the weaker the political structure to the demands of the people, the less susceptible it is to sanctions. However, because sanctions have a relative effect, the sanction-receiving country is not the sole affected body. The citizens of the sanction-imposing country may also face disadvantages due to the sanctions, which may stumble as they continue. In such cases as well, the situation is swayed by the political voice of the citizens. Overall, the reason we still cannot consistently organize the effects of economic sanctions is that it is difficult to maintain sanctions continuously because of numerous variables existing due to the interconnection of the sanction-imposing and sanction-receiving parties, internal political environments, and so on.

### **Powerful Economic Sanctions Against North Korea & Their Impact**

The economic sanctions imposed on North Korea span all areas: trade, finance, and people. It is no exaggeration to say that the most powerful methods that the international community as a whole and respective countries can mobilize are being employed. North Korea cannot export its biggest export goods such as coal, iron, textiles, and fisheries products. These account for over 70% of North Korea's exports. Because of the export bans, naturally, imports also become difficult. The import of crude oil is restricted to 2 million tons per year. Because China, which accounts for about 90% of North Korean trade, is also participating in these economic sanctions against North Korea, difficulties in trade are on the rise.

Financial sanctions are even more powerful. Foreign financial institutions conducting financial transactions with North Korea are subject to a secondary boycott by the US. Because of this, foreign financial institutions have revoked agreements with North Korean financial institutions and North Korea cannot conduct international bank transactions. Furthermore, North Korean corporations as well as individuals of North Korean nationality cannot open accounts at foreign banks. Therefore, most transactions in North Korea must be conducted in cash, more or less making transactions impossible. North Koreans residing overseas cannot conduct financial transactions either, making trilateral transactions difficult as well.

Expat North Koreans whose primary business is intermediary trade have lost their source of income. Most North Koreans working abroad have been sent back to North Korea. Even China and Russia plan to stop reissuing most of the work visas to North Koreans after their current employment term expires by the end of 2019. Of course, new applications for work visas for North Koreans for overseas stays will not be issued either. Because of this, the number of North Korean workers returning to North Korea through China is increasing. Maritime transactions are also difficult due to elaborate monitoring. In this way, North Korea is facing international sanctions in all areas.

Due to such circumstances, North Korea's foreign trade, which had been on a steep rise since 2010, has fallen by nearly 50%. Immediately after the collapse of the Eastern Bloc in the early 1990s, the scale of North Korea's foreign trade fell drastically from about \$4 billion to under \$2 billion. The current situation is reminiscent of North Korea's serious economic difficulties following this fall. Looking at the situation in terms of numbers or chronologically, it is clearly a similar situation to that of the early to mid-1990s. Therefore, if a little more pressure is applied, there should be changes in North Korea's policies. This is the view of the US and the international community.

While we cannot conclude that it is due to the impact of the sanctions, North Korea has set out to improve its relationship with the US. Taking the opportunity of the Pyeongchang Winter Olympic Games held in South Korea in February 2018, North Korea has also started to improve inter-Korean relations. In order to impress upon

the international community the suspension of nuclear experiments, North Korea closed the Punggye-ri Nuclear Test Site and suspended the testing of long-range missiles. In June 2018, a US-North Korea summit was held in Singapore. The US and North Korea agreed to make efforts towards establishing a new relationship between the two countries. Based on this agreement, North Korea returned the remains of US soldiers. With such shifts by North Korea, an optimistic view became dominant that maximum pressure had started to influence North Korea and that its denuclearization would be achieved as long as US-North Korea relations normalized. However, negotiations broke down at the US-North Korea summit held in Hanoi in February 2019 and the situation started to change. While North Korean leader Kim Jong Un professed that he was no longer fixated on ending the sanctions, he also resumed the testing of missiles (*Chart 2*).

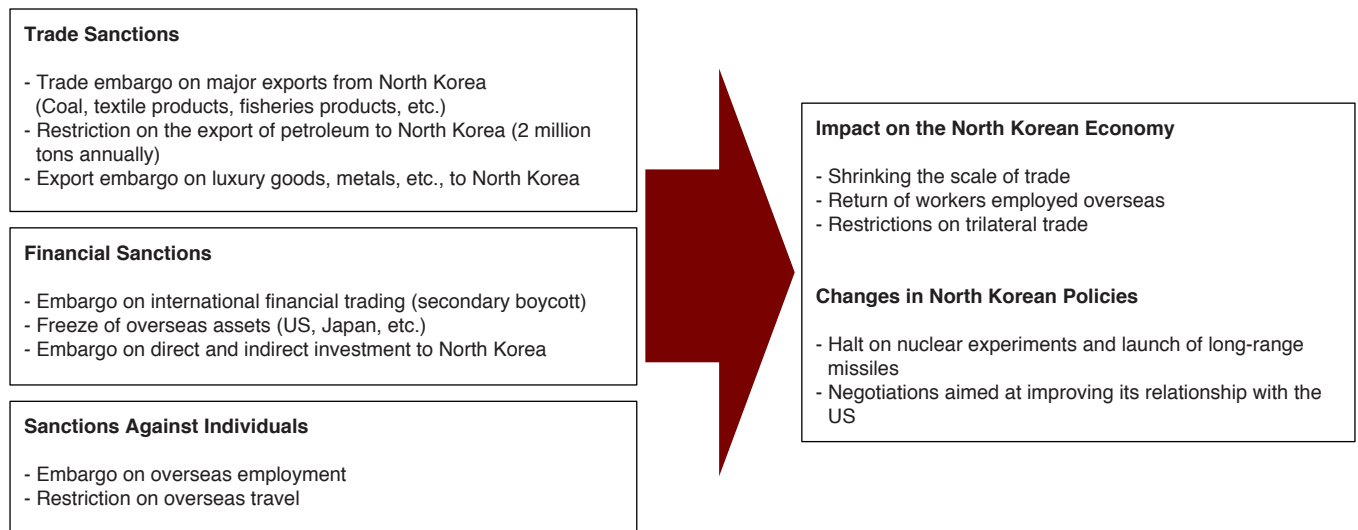
### The Dilemma of Economic Sanctions Against North Korea

The international community has not eased up on economic sanctions against North Korea. Around the time of the US-North Korea summit, North Korea explored changes in its policies internally. However, an inexplicable phenomenon has emerged within North Korea. That is to say that no major fluctuation in market prices has been seen and an emphasis on self-rehabilitation has emerged once again recently.

It is widely known that in North Korea, the market became

CHART 2

### Economic sanctions & changes in North Korea



Source: Compiled by the author

TABLE

**Price trends in the Pyongsong Market in Jan.–Aug. 2019 (North Korean Won/kg)**

	Jan.	Feb.	March	April	May	June	July	Aug.	Sept.
Rice	4,794	4,875	5,250	4,780	4,600	5,000	4,850	4,800	4,920
Corn	2,091	2,237	1,950	2,120	2,200	2,350	2,400	2,470	2,300
Soy	3,986	3,625	3,580	3,500	3,520	3,430	3,500	3,500	3,250
Cooking oil	12,150	9,387	9,765	11,000	13,500	13,100	12,800	12,600	11,100
Wheat flour	3,550	4,662	5,500	4,300	4,300	4,000	4,100	4,250	3,750
Gasoline	14,760	14,650	13,125	13,200	15,000	16,700	16,700	16,200	15,100
Diesel	8,610	8,692	8,725	8,800	9,700	9,400	9,100	8,900	8,700
Sugar	4,180	4,687	4,654	4,700	4,610	4,350	4,150	4,200	4,100
Chinese cabbage	985	965	898	1,200	1,200	1,350	850	920	950
Coal	150	175	165	170	230	190	180	180	210
Pork	14,700	15,100	18,750	17,900	17,000	8,500	9,500	14,000	16,000
Exchange rate (North Korean Won/US\$)	8,075	8,100	8,125	8,250	8,400	8,300	8,310	8,350	8,330

Source: Compiled by the author

widespread and established. Due to the amendment to its constitution, North Korea put into statutory form a socialist corporate responsible management system that in essence permits a market. This indicates just how much of an absolute position the market has in the lives of North Koreans. However, the market is starting to fall into dysfunction. According to North Koreans, they can no longer even think about new enterprises. It has come to the point that there are more people who want to sell things than people who want to buy things. The supply of goods, which provides the basis for market dispersion, was being fulfilled by Chinese-made goods. Additionally, even as many goods supplied on the market in recent years were replaced with North Korean goods as domestic production advanced – mainly food and clothing – from the supply of raw materials to final goods, Chinese goods still play an important role. However, the economic sanctions caused the inflow of goods to markedly decline. With the inflow of goods decreasing, the people who had been making money in the intermediary distribution stage fell into a difficult situation, and finally the diversity of products on the market fell. The market scale could not help but shrink.

However, market prices, which should naturally rise with decreased supply, did not show any major changes. Excluding changes in pork prices due to African swine fever (ASF) which broke out in China, changes in the price of other goods remained mostly a temporary phenomenon. This was due to withering demand, but the characteristics of North Korea’s distribution structure also played a

part. For example, when importing Chinese products, the money for the products is paid after delivery. First, the products are sent to and sold in North Korea. The money is then paid to China from the sales of the products. The import price is decided before importing goods. North Korean merchants add their profit margin on to that price and sell the goods. This is why they cannot lower prices even if the goods do not sell. In the end, all they can do is return the goods to China or keep them in inventory until they sell. Most of the importers who paid in advance went bankrupt (Table).

On the other hand, the North Korean authorities are still holding up. While implementing the socialist corporate-responsible management system and field-responsibility system, the authorities have made an agreement with cooperating organizations to pay 30% of their production. However, this means 30% of the planned volume rather than 30% of the final products. So even if production decreases, the reality is that 30% of the planned volume must be paid to the authorities. Therefore, if corporations pay the government according to the planned volume, the amount they keep to eat decreases. This is the reason for the shortage of food – because currently, corporations are made responsible for the living of their workers. Additionally, in order to move forward with the large-scale projects directed by Kim, the government has implemented a quota system for each organization. Due to this, the North Korean authorities have yet to recognize the need to consider policy change. Furthermore, during the time when North Korea maintained a

planned economy, its external dependence remained around 6–7%. In recent years, its external dependence has risen to around 30%, but that is not relatively high. It means that North Korea is able to produce that much goods internally, and because the payment of planned volume is fixed there is relatively little difficulty. Looking at the situation comprehensively, the supply of goods that the North Korean authorities require is being secured by squeezing it out of organizations and citizens under the pretext of self-rehabilitation.

Next, let us look at smuggling. North Korea has been facing sanctions since the Korean War. Economic sanctions target normal transactions rather than illegal and abnormal transactions. Paradoxically, North Korea has been very familiar for a long time with international methods and routes to circumvent sanctions. A balloon effect is emerging in illegal external transactions. Because the scale of illegal transactions is expanding, North Korea has begun to receive VIP treatment in the global black market. Representative commodities are gold and human activity.

While it is difficult to estimate the scale of the black market for gold in the world, it is common knowledge that it is considerable. It is difficult to look for a breakdown of gold transactions even looking at North Korean trade statistics. North Korean gold mines are mostly controlled by the Workers' Party of Korea and the military (in principle, the Party, military, and government own a third each). North Korean bullion has long maintained transactions on the international black market, but recently it has come to the point that they have been forced to increase volume. The more the economic war between the US and China intensifies, the higher the international gold price will rise. Gold is the biggest source of foreign currency for North Korea.

As for human activity, computer hacking and arms dealing are typical examples. The US Treasury placed major North Korean hacker groups on the sanctions list, but the viability of the sanctions is unknown. While North Korea's cyberattack capabilities grow stronger on a daily basis, defensive abilities have not yet caught up. Most financial transactions including virtual currencies take place in cyberspace. North Korean hackers are the cream of the crop selected at a national level and are already recognized internationally as having considerable skills. As for arms dealing, we should consider that what is being traded is instruction on techniques provided by experts, rather than actual weapons. These are mainly related to missile technology. It is an open secret that North Korean missile experts are being dispatched to countries such as Iran and Syria. Such transactions are not conducted as normal financial transactions, but rather as various methods of money laundering. Therefore, they can circumvent the economic sanctions imposed on normal transactions.

In this way, the North Korean authorities are capable of securing the foreign currency they need through various routes. Internally as

well, they are securing goods by exploiting the people. While there are inconveniences due to the sanctions, it is not to the extent that North Korea would abandon its policies. Furthermore, it is not an exaggeration to say that there are no movements in the market to overthrow the government, which maintains a powerful centralized rule. So the sanctions do not function as pressure on the government. Rather, North Korea emphasizes self-rehabilitation and encourages the people to endure pressure from foreign powers. In fact, Kim says while giving onsite guidance that he often felt that the economy would make a turnaround as soon as North Korea's relationship with the US improved. The second US-North Korea summit held in Hanoi at the beginning of 2019 ended unsuccessfully and Kim blames the US for this. Because the market is in such a situation, the North Korean government can take an even more hardline stance against external pressure.

Additionally, the outside world has been paying close attention to the North Korean market, considering it is the driving force to change North Korea. However, a dilemma has emerged with the power of the market weakening due to the sanctions instead and the central government becoming comparatively stronger. Amidst this situation, the cost to the North Korean people and difficulties are increasing. This is the dilemma of sanctions. The aim of the economic sanctions against North Korea is its denuclearization. The choice of denuclearization is up to the North Korean authorities. However, while the power of the North Korean authorities is becoming stronger following the sanctions, the force of the North Korean market to raise a voice against the government is becoming weaker. The complete opposite of the general theory on economic sanctions – that the power of the market would grow and the North Korean authorities would face political pressure and change their policies – is occurring in North Korea. This might suggest that the strength of the sanctions imposed on North Korea should be adjusted accordingly. Perhaps we are still not at the stage to discuss the effect of the sanctions. However, in order to solve the dilemma of weakening the power of the market which should change North Korea from the inside with hardline economic sanctions, a more effective application of economic sanctions against North Korea is necessary. **JS**

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