

IS CHINESE-STYLE REFORM AND LIBERALIZATION POSSIBLE IN NORTH KOREA?

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North Korean leader Kim Jong-Il's visit to China in January can be seen as a preparation for reviving the North Korean economy. Like the unofficial visit to China in May last year before the South-North Summit, this visit seems to forebode new policies. In particular, the fact that the entourage spent most of its time in Shanghai, China's economic center, suggests that the visit was a step in the direction of economic reform and opening.

During the past 20 years, China pursued an "internal reform and external opening" policy to achieve impressive economic growth. As a result, China is seen as the most successful case among the socialist countries that have attempted a systemic transition. The focus of this article is whether North Korea will follow China's example. This knowledge would be very useful in trying to forecast the direction North Korea's economic policy.

This article examines the characteristics of Chinese-style reform and opening as well as North Korea's situation, and offers a forecast of North Korea's economic reform and opening. In addition, the conditions needed for successful reform as well as considerations for South Korean businesses are discussed.

Characteristics of Chinese-style reform and opening and North Korea's decision

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Since the late 1970's, China's reform and opening policies combined the advantages of the socialist planned economy and the market economy to create a "socialist market economy". China's economic development strategy had characteristics such as simultaneous internal reform and external opening, reform of economy before politics, and highly incremental methods and experimental character.

Internal reform developed in a number of stages: reform of farm village economies (laying the foundation for reform), reform of urban economies (planned production economy), economic adjustment period (resolving the side-effects of reform and opening), and intensified reform (macroeconomic stabilization through indirect regulatory adjustment). The policies of each stage were characterized by their strongly experimental nature, in which adjustments were made through trial and error. Meanwhile, side-effects due to external opening were minimized by a gradual approach consisting of opening of four economic zones, followed by 14 coastal cities, then three deltas, and finally comprehensive opening.

China's adoption of a gradual and experimental approach was out of consideration for the possible side-effects of a capitalist system, and the ultimate goal of the reform and opening policies was the preservation and development of the

communist regime.

Presently, North Korea's political and economic environment is similar to that of China in its early stages of reform. Therefore, if North Korea intensifies its reform and opening policies, the basic framework of change is expected to resemble that of China. However, due to unfavorable conditions such as small geographical size, lack of a domestic market, and the late-starter disadvantage, it is expected that North Korea will have to adopt more conservative policies than China. In other words, while North Korea's policies will resemble China's in that politics will be left alone while economic change will be pursued, the policies will also reflect a gradual and experimental approach, the ultimate objective of regime preservation, and the conservative attitude of North Korea's elites, who wish to minimize shock to the existing system.

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Prospects for North Korea's economic reform and opening

1) Expected development model

As mentioned above, North Korea is expected to adopt China's basic framework for economic development. However, the development model is expected to be adapted to fit North Korea's conditions, with external opening to be emphasized over internal reform.

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The North Korean economic development model centers on minimizing the side-effects (such as stress to the system) from adopting foreign attitudes, and envisions economic development brought about by external opening. Therefore, internal reforms will be pursued after confidence in external opening is gained. Unlike China's simultaneous implementation of external opening and internal reform, North Korea is expected to pursue external opening first.

2) External opening

At present, it is unlikely that the North Korean economy will be able to recover on its own. Therefore, North Korea is expected to emphasize economic recovery and development based on external opening. Such an attitude is reflected by North Korea's opening of the Rajin-Sonbong Area, Mt. Kumgang and in the future, the Kaesong Area. North Korea's efforts to improve ties with Western countries also indicates such a position.

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This year, North Korea is expected to continue pursuing its active policy of external opening which focuses on special economic zones. The policy will be limited to one or two areas however.

The areas where the opening policy is being implemented include the Kaesong area, which has already declared its openness. The Shineuiju and Nampo regions, which are near China, are potential future candidates. Currently however, investment conditions in the Rajin-Sonbong area and Mt. Kumgang are not too good.

The Shineuiju area, through which the Kyonggeui Railway passes, accounts for 80% to 90% of North Korea's trade, and through two visits from Kim Jong-Il,

agreements have been reached with China for the creation of a special economic zone. This economic zone will include sections of Shineuiju and the Chinese city of Dandong, and is expected to have a unique system in which the same laws and regulations apply through the whole area.

It is expected that other economic zones will be developed gradually after gauging the progress of the existing zones. The areas declared as special economic zones are expected to be completely cut off from the rest of the country. In addition, it is possible that the top authorities will arrange favorable measures for companies investing in the zones.

3) Internal reform

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Compared to China, North Korea has relatively unfavorable conditions, and there will be greater resistance to capitalist practices. Therefore, internal reform is unlikely to be adopted in the short term.

China started its internal reform with the “farm household responsibility production system”, which provided incentives to individual farm households. However, North Korea is not expected to immediately adopt Chinese-style measures such as pluralistic ownership (from national to national, group, and individual ownership), shift in the incentive system (from public to private, mental to material), or change in the economic management system (from direct central management to indirect management based on market mechanism).

The basic reason for North Korea’s passive approach is that the country wants to preserve the existing regime more than China did in its early stages of reform and opening. This atmosphere is not expected to change in the short term even with external opening.

Conditions for success in North Korea’s economic opening

For North Korea to successfully implement external opening, it is not enough to simply give preferential treatment to investing firms, the supporting conditions should also be created. A number of conditions for success are noted below.

1) Establishing a theoretical basis

North Korea needs to create a theoretical basis to justify opening to the outside world and to pacify opposing voices within the regime.

For North Korea, the adoption of capitalist practices through external opening clearly violates the country’s existing ideology. In China’s case, theories such as “Chinese-style Socialism” and the “Theory of Rudimentary Socialism” were created to overcome this problem. North Korea needs to create a theoretical basis to justify opening to the outside world and to pacify opposing voices within the regime.

2) Introducing individual incentive systems

Even if North Korea adopts an external opening policy centered on special economic zones, the workers in those areas will be North Koreans. An individual-based incentive system will directly improve the productivity of the workers, who are accustomed to a socialist system. Improved productivity will help attract business to

the areas. Therefore, North Korea should introduce an individual-based incentive system for workers in the special economic zones.

3) Improving understanding of capitalist economy

Reform and opening of a socialist country involves many problems. An important problem is lack of understanding about capitalist economies. China also had a similar problem in the early stages of reform. Thus, North Korea, while pursuing its opening program, should adopt measures to educate involved persons on capitalist practices.

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4) Incentives to continuously attract foreign capital

One reason that inflows of foreign capital increased after the establishment of special economic zones in China was that various special measures existed within the zones. However, China's huge potential domestic market was a more basic reason for the capital inflows. Although China still has the conditions to attract foreign capital, North Korea lacks such conditions. If North Korea wants to increase the effects of its external opening, it should go further than investment exclusively in the economic zones, and further incentives for capital inflow should be created.

5) Favorable treatment for South Korean businesses

While there are many factors in the success of China's reform and opening effort, one decisive factor was the capital of overseas Chinese, which accounted for 70% to 80% of foreign capital inflow. At the present time, even if North Korea opens its special economic zones, it will probably be difficult for firms that are not from South Korea to actively invest. Therefore, South Korean firms should be given favorable treatment so they can play a role similar to that of the overseas Chinese.

Considerations for South Korean businesses

If North Korea pursues opening of its economic zones and investment in North Korea intensifies, South Korea should consider the following points.

First, the South Korean government should directly support investing companies by measures such as prompt creation of investment laws and regulations, promotion of inter-Korean trade, and introduction of loans collateralized by permits to use North Korean land.

Second, there are a couple of requests that South Korean firms should ask of the Northern government. First, they should request creation of laws and regulations related to the three fields of transportation, communication, and trade. They should also ask for autonomy of management within the special economic zones, permitting measures such as individual incentive systems for workers in the zones.

Third, investing firms should try to gain more understanding about North Korean attitudes and practices. In addition, they should be prepared for changes in policy, as the North Korean reform policy is expected to be similar to China's in its experimental nature. **VIP**

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