

Muddling along with Missiles

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On April 5, 2009, North Korea carried out a rocket launch. North Korea argued that it was a satellite launch vehicle rather than a warhead-carrying ballistic missile, and portrayed the launch in innocuous and civilian terms, even naming the rocket “*Unha*,” which means “Galaxy” in Korean, to emphasize its space-oriented function. However, most nations, including Japan, South Korea, and the United States, suspect that these words were only a cover for a test of North Korea’s long-range missile technology. In addition, North Korea conducted an underground nuclear test on May 25, followed by several launches of short-range missiles from its east coast. Furthermore, North Korea test-fired four short-range missiles on July 2 and additional seven missiles on July 4, despite the United Nations Security Council’s unanimous adoption of Resolution 1874 on June 12, condemning North Korea’s hostile activities in the strongest possible terms.

Why has North Korea gone ahead with its provocative actions in the face of serious opposition from most of the outside world? To date, analysts have focused on the political aspects of the missile launch. They speculate that its purpose was to push the United States toward bilateral dialogue or to pressure the South Korean government to return to its more positive stance known as the “sunshine policy.” Others argue that the launch was meant to strengthen leadership’s weakening hold inside the country and to ensure its dynastic line of succession. All of these explanations

are plausible, and North Korea, of course, may have had multiple goals.

But observers seeking to understand the North Korea’s actions are missing one critical component: the economic factor. The North Korean economy was in very poor shape in the 1990s and is still experiencing difficulties. This economic hardship, however, has not only been evident in recent decades but had already begun in the early 1970s, mainly due to lack of capital. Since then, the country’s top economic priority has been to determine how to encourage foreign capital to help the North Korea escape from economic shortages. One alternative pursued since the mid-1990s has been to develop the missile program as an effective means of earning foreign exchange. Understanding the part played by the economic situation in North Korea’s decisions about its missile program is the purpose of this brief article.

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Capital as a Key Element for Economic Growth

After the Korean War ended in 1953, rapid economic growth was the preeminent task for both North and South Korea. Economic growth was needed not only to restore the industrial production bases that had been destroyed during the war and to raise the extremely poor living standards but also to demonstrate to the people the superiority of the economic system established in their half of the country. Whichever half had faster economic growth would add to its legitimacy on the divided Korean Peninsula.

Economic growth is defined as the increase in the amount of the goods and services produced by an economy. Regardless of the type of economic system, factors of production must increase in order to achieve economic growth. Among such factors, capital is the most fundamental, especially when an economy is underdeveloped. The importance of capital becomes even greater for labor-abundant economies such as North and South Korea. The strategy for growth, therefore, is closely linked to the mobilization of capital. A government can raise internal or domestic capital by collecting taxes or issuing bonds. To obtain external or foreign capital, basically four alternatives exist: assistance, loans, foreign direct investment (FDI), and exports.

Relying on Assistance, 1950-1960

As the Korean War drew to a close, the North Korean economy was in dire straits. In addition to the distortion of the economic structure due to the division of the Peninsula in 1945, the damage from the war had a catastrophic effect. About 661,000 North Korean soldiers and 2.7 million civilians died or were injured, which means nearly 30 percent of the North Korean population suffered casualties during the war (Kihl 1988, 65). According to North Korea, about 700,000 houses, 5,000 schools, 1,000 hospitals, and about 40

percent of the total capacity of industrial production were destroyed. It is estimated that the per capita Gross National Product (GNP) in North Korea in 1953 was US\$46 (Hwang 1993, 41-42).

As these figures imply, there was no internal capital for North Korea to try to mobilize. Furthermore, attracting foreign capital such as loans, FDI, and exports was virtually impossible because of North Korea's deteriorated economic conditions, poor investment environment, and low credibility. Reliance on foreign assistance seemed the only option. Socialist countries rallied to North Korea's side, and it received a substantial amount of grant-type assistance from these allies. In the 1953–1960 period, total assistance was US\$1.43 billion, or about 20 percent of North Korea's GNP, and in 1957–1960 outside countries contributed 82.1 percent of national investment for construction (Yeon 1986, 71). Thanks to this largesse, North Korea was able to achieve very fast economic growth.

Table 1 North Korea's Assistance in 1953-1960

(unit: US\$ million)

Total Assistance (A)	1,433.5
A/Imports (%)	148.0
A/Revenue (%)	37.1

Source: Chun and Park (1995, 706).

Yet foreign assistance could not last forever, and it began to drop off sharply in the 1960s. The total amount of assistance in 1961–1970 was only 23.7 percent of what had been given in 1953–1960. Thus, North Korea had to find stable alternatives to draw in foreign capital and should have implemented an outward-looking economic growth strategy, because its domestic market was very small and the only meaningful resource it had was labor.

But North Korea chose an inward-looking strategy emphasizing self-reliance and its own exertion as it followed the declared principle of *Juche*. One reason



for this decision was the antagonism between the Soviet Union and China, North Korea's two greatest sponsors, in the early 1960s. For its own safety, North Korea had to maintain neutrality between the two. However, an independent inward-looking strategy brought about a sharp decline in support from socialist countries and had a seriously negative effect on North Korea's accumulation of capital in the 1960s. This diminution in turn expedited North Korea's economic fall in the 1970s.

Applying for Loans from Western Countries, 1970s

Détente in the early 1970s, which included the Strategic Arms Limitation Talks I treaty, *Ostpolitik* in the former West Germany, and the U.S. president Richard Nixon's visit to China, provided a favorable environment for North Korea to grope for economic relationships with Western countries. Thus, it began to borrow money via commercial loans from countries such as France, Japan, and the United Kingdom. From the viewpoint of North Korean authorities, such borrowing was inevitable. First, North Korea still did not have

enough internal capital to support economic growth. Second, assistance from the socialist countries could no longer be expected, and assistance from the Western countries was not possible because of the Cold War. Third, North Korea's economic conditions were nowhere near attractive enough to tempt foreign investors, whether private or public. Fourth, active promotion of exports was not seen as a wise alternative because it ran counter to the spirit of *Juche*. Fifth, loans were thought to have the least negative effects on the closed self-reliant system.

Twenty-one western countries made loans to North Korea, representing about three-quarters of the volume of its total loans in the 1970s.¹ Unfortunately, however, North Korea was unable to pay back the loans due to the stagflation followed by the worldwide oil shocks. Following the failure of several negotiations to reschedule the debt, North Korea's Western commercial bank creditors finally declared the country to be in formal default in August, 1987. Since then, North Korea has remained a default country and its total debt was estimated at US\$12.5 billion by 2001, including penalties and accrued interests.²

Table 2 North Korea's Grants and Loans in the 1970s

(unit: US\$ million)

Year	USSR		China		Western loan	Total
	Grant	Loan	Grant	Loan		
1971	-	129	10	3	53	195
1972	-	110	50	-	205	365
1973	-	15	40	-	357	412
1974	-	6	60	-	491	557
1975	-	139	120	-	92	379
1976					28	
1977	-	-	-	-	8	8
1978	-	43	-	-	-	43
Total	-	442	280	3	1,234	1,959

Source: Yeon (1986, 73).



Thus, North Korea's first attempt at involvement with Western economies ultimately failed, and the country's economic growth began to slow down in the 1970s. The Central Bureau of Statistics of North Korea announced in 1975 that for the first time in its history certain target goals of its Six-Year Economic Plan begun in 1971 were not being met. Moreover, North Korea had to set a buffer period of two years before it established the next plan, the Second Seven-Year Economic Plan.

Attracting FDI, 1980s

The shortage of capital deepened in the late 1970s and the early 1980s. Since assistance and loans were no longer forthcoming and active promotion of exports was not countenanced in the context of *Juche*, North Korea began to take an interest in the last option available, FDI. In 1984, the Joint Venture Law was introduced in order to attract severely needed foreign capital.

The law was destined to fail, however, because it was not based on a solid and clear determination to open and reform the economy. The law also did not allow complete ownership by foreign companies, because it defined joint ventures as companies made up of joint investment and management between North Korea and foreign partners. In addition, the poor economic environment, which included political inflexibility, lack of a viable financial system, underdeveloped infrastructure, and lack of skilled workers, made foreign businessmen shy away from North Korea. In fact, only six contracts were made until 1986.

Kim Il-sung, therefore, strongly encouraged the *Jochongnyeon*, the pro-North Korean residents in Japan, to invest in North Korea. However, merely 101 *Jochongnyeon* firms followed the order and even those patriotic firms withdrew from North Korea within a few years due to breach of contract, unreasonable demands and interference by North Korean partners,

insufficient infrastructure, unstable supply of electricity, and so on.

Table 3 The Results of the Joint Venture Law

Year	1985-90	1991	1992	Total
Contract (<i>Jochongnyeon</i>)	79 (67)	17 (16)	20 (18)	116 (101)

Source: Korea Trade-Investment Promotion Agency (1993, 129).

Establishing Special Economic Zones to Activate FDI, Early 1990s

Around 1990, the North Korean economy encountered unprecedented shocks that seemed almost insuperable. Internally, the Joint Venture Law did not succeed in bringing in substantial amounts of capital and the Third Seven-Year Economic Plan that had begun in 1987 turned out to be a complete failure. Externally, North Korea had to watch the collapse of the Soviet Union, which had been its greatest economic partner; China's intensification of economic reform and bold overtures to South Korea; the sudden absorption of East Germany by the West; and comprehensive economic transformation in most of the eastern and central European countries.

The need for capital became greater than ever in North Korea, and yet it had already pursued all the possible alternatives. Once again, North Korea decided to intensify its efforts to attract FDI by establishing its first special economic zone in the areas of Rajin and Sonbong in December 1991. The efforts by North Korea to vitalize the zone were enormous. The North sent several delegations to Western countries, even including the United States; introduced an independent cost accounting system and a floating exchange rate system in the zone; and entry visas were not required for foreign investors. Nevertheless, the project failed, for the same reasons that efforts described earlier failed. According to data provided by the United Nations Development Program, the value of investment that had actually been received was only US\$88



million by the end of 2001. This result was far from North Korea's original expectation, and as shown in Table 4, was extremely disappointing compared with the relative success of competing areas, such as Yanbian in China and Primorsky in Russia.

the mid-1990s, therefore, survival naturally became the supreme task and growth had to take a back seat.

The *Songun* or Military First strategy was introduced to cope with the crisis and to enable the regime to survive. Instead of undertaking perilous reforms,

Table 4 Actually Implemented Investment to the Tumen River Area

(unit: US\$ million)

Year	1985–93	1994	1995	1996	1997	1998	1999	2000	2001	Total
Rajin-Sonbong	1	1	4	31	26	25	-	-	-	88
Yanbian	42	61	78	134	95	47	33	29	32	551
Primorsky	141	2	53	97	95	56	54	78	66	642

Source: United Nations Development Programme.

A Fight for Survival

North Korea had now tried all possible options to attract foreign capital: direct assistance, loans, FDI through the Joint Venture Law, and then the establishment of a special economic zone. But so long as the North Korean economy remained risky, poor, underdeveloped, and discouraging to foreign investors and maintained a closed socialist economic system with no comprehensive reform program, the situation was unlikely to improve. To make matters worse, the breakdown of external economic relations and natural disasters in the 1990s were near fatal blows, and the sudden death of Kim Il-sung in 1994 was another shock. North Korea's negative growth for nine consecutive years after 1990, known as the "arduous march," was an inevitable result and several thousands of people were reported to have died from starvation in the latter half of the 1990s.

However, the reforms that might have been a fundamental solution to the ever-worsening conditions could never be adopted by Kim Jong-il's North Korea, because maintaining the regime was always more important. The possible negative impact of economic or political reforms on the regime were seen by its leaders as much too worrisome. For North Korea in

therefore, North Korea sought new channels for acquiring foreign capital, such as missile sales and illicit activities, including the counterfeiting of "supernotes," cigarettes, and pharmaceuticals.³

Missile exports have been the biggest new source of revenue. North Korea began by exporting Scud clones with a range of 300–550 km, called *Hwasong 5*, but by the mid-1990s had also developed their own *Nodong* missiles with a longer range of about 1,000–1,300 km. It was reported that North Korea's first missile export deal was worth US\$500 million with Iran in 1987.⁴ Since then, Iraq, Pakistan, Yemen, Egypt, the UAE, and Libya have been identified or suspected of missile or missile-related purchases.

It is not easy to determine how much North Korea has earned from missile exports. The 1997 Arms Control and Disarmament Agency reported that missile sales in the second half of the 1980s averaged over US\$500 million a year in constant 1996 dollars or just under 20 percent of total exports for that period. According to a U.S. military source, North Korean missile exports to the Middle East in 2001 totaled about US\$580 million.⁵ However, much bigger estimates exist. Ko Young-Hwan, a former official of the North Korean Ministry of Foreign Affairs, testified in 1997 that "North Korea was earning about US\$1 billion a



year when the export was smooth.” He also added, “the export of missiles occupies the largest portion of North Korea’s total export volume, and if North Korea is unable to export missiles to the Middle East countries, then its import of crude oil must be stopped (Ko 1997).” During the fifth round of U.S.–North Korean missile talks in Kuala Lumpur on July 12, 2000, North Korea demanded US\$1 billion in compensation for halting missile exports.

It is argued that the export market for North Korea’s missiles has been shrinking since the 1990s as the North Korean models began to become obsolete, more suppliers stepped in, and scrutiny became much tighter. A Japanese observer reported that North Korea’s revenue from missile exports has been estimated to be US\$300 million a year in the first decade of the new millennium (Takesada 2006). Another source estimated that the value of deliveries in 2001–2004 was US\$500 million (Grimmett 2005). However, there is an opposite view which insists that North Korea has managed to export more than 1,000 missiles to Middle Eastern countries in spite of international nonproliferation efforts, and still exports around US\$1.5 billion a year (Kim 2009). Although it is almost impossible to capture the exact revenue, we can say that North Korea still earns substantial amounts from missile exports. Thus, recent launches of missiles may be interpreted as an effort to keep attracting the attention of customers.

Collapsing while Growing

But it is very likely that all the revenues from missile exports and illicit activities have not been used to revitalize the economy. In July 2002, North Korea introduced new economic measures, which included increasing price and wage levels, adjusting exchange rates to more reasonable levels, extending freedom of decision-making by production units, providing higher work incentives, and most importantly, allowing

establishment of marketplaces. The purpose, of course, was not to reform the economy toward a market-oriented system, but to absorb into the official planned sector, unofficial, and sometimes illegal economic activities that had expanded during the “arduous march” in the 1990s.

Since the North Korean government could not continue to supply enough energy and raw materials to guarantee normal operation and thus to keep people working in the official sectors, however, the measures were not able to succeed. People started to leave their work sites again and most of them are now involved directly or indirectly with private trade and business to make a living. Ironically, contrary to the original intention of the North Korean government, the measures have made those private activities possible and lively outside the planned sector by establishing market places, easing central control, and expanding individuals’ autonomous decision making. As people make more of their money from private activities, they become more actively engaged in those activities. The improvement of economic conditions in recent years is thought to be mainly based on such voluntary economic activities.

As two sides of the same coin, however, the growth of vigorous private economic activities must necessarily lead to the shrinking of officially planned activities. Furthermore, it is inevitable that private activities tend to increase as people come to realize the efficiency of the “market” and to find that they get richer from the activities in the market than from elsewhere. The fact that the market has its own dynamic is also a historical lesson from the process of eastern European economic development (Jo and Kim 2004).

Even though North Korea is still insisting that it must stick to and will never change the socialist planned economic system, the system seems to be already starting to cease to work in reality. Therefore, we may conclude that the North Korean economic system while growing from the viewpoint of private



economic system seems to be already starting to cease to work in reality. Therefore, we may conclude that the North Korean economy has been collapsing from the viewpoint of the official system while growing from the viewpoint of private economic activities or Gross Domestic Product (GDP).

Multifaceted Approaches are Required

This discussion has several implications for North Korean and international society.

First, North Korea should give up its missile program. Although missile exports have been a great way to earn foreign capital, they cannot be an everlasting source. Markets for North Korean missiles will be getting smaller due to the much tighter watch imposed by United Nations Security Council Resolution 1874. North Korea will face very strong sanctions in various ways if it continues to maintain the program, and sanctions will result in serious long-term damage to its economic management. Furthermore, the benefits from abandoning the program will be bigger than the net revenue from the missile exports, because the surrounding countries will be pleased to provide huge amounts of economic and noneconomic assistance to North Korea once the program is abolished.

Second, North Korea should pursue an active reform program, since the *songun* strategy cannot be a means of regime survival or economic growth. Otherwise, the economic situation will only continue to deteriorate, and more and more people will be engaged in private activities. As a result, North Korea will see a faster collapse of its economic system and the eventual demise of its regime even if it tries to hold on to its missile program to survive.

Third, international society should diversify its efforts to solve the missile issue with North Korea. Since North Korea developed the missile program with multiple purposes, the approaches should also be multifaceted. Punishment by itself cannot succeed in stopping the program. On the one hand, international society

must try to impose sanctions on North Korea and the counties importing North Korean missiles. On the other hand, international society must be able to persuade North Korea to abandon the program by designing and presenting better ways to earn foreign capital. ■

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Notes

- ¹ The term of redemption was four to five years and the interest rates were six to seven percent (Lee and Seo 2007, 73).
- ² See Central Intelligence Agency (2005).
- ³ For the revenues from illicit activities, see Perl and Nanto (2006), Perl (2007), and Haggard and Noland (2006).
- ⁴ See Wisconsin Project on Nuclear Arms Control (2000).
- ⁵ See Center for Nonproliferation Studies (2006).

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