North Korea Moves (Further) to the Left

Marcus Noland says the Pyongyang regime’s currency “reform,” which replaced all currency in circulation, was an attack on the emerging market economy that could stir unhappiness among private economy elites.


Steve Weisman: North Korea, a focus of concern in the West for its nuclear ambitions, is now also coming to the attention of policymakers over its recent currency reforms, as they put it. Marcus Noland, deputy director of the Peterson Institute and author of many studies on North Korea and its economics, is here to explain what’s going on there. Thanks for joining us, Marc.

Marcus Noland: My pleasure, Steve.

Steve Weisman: At the end of November, North Korea announced what it said was a reform to replace all its currency in circulation with a new set of currency of bills and coins. Why did they do that?

Marcus Noland: Currency reforms are in principle not a bad thing. They are often undertaken by governments that want to put an exclamation point after a period of economic policy improvement, often times after periods of high inflation. And when they do this, they normally propagate the rules well in advance. The new currency and the old currency circulate in parallel for some period of time, typically on the order of months. And then the old currency ceases to become legal tender.

Steve Weisman: But that didn’t happen in this case.

Marcus Noland: What the North Koreans did was something very different. It was essentially confiscatory in nature.

Steve Weisman: How so?

Marcus Noland: They announced that currency had to be converted within one week, and that families would only be able to convert a limited amount of currency—in effect destroying some unknown share of the money supply; wiping out people’s savings; importantly wiping out the working capital of private sector entrepreneurs, which have developed in North Korea over the last 15 years or so. That is ultimately the real motivation. This is less about good economic policy than an attempt to reassert government control, rebuild orthodox socialism, and squash this private market that has developed over the last 15 years that this state has never been very comfortable with.

Steve Weisman: In a policy brief that the Institute published that you co-wrote with your colleague, Stephan Haggard, you speculate that various powerful economic interests were the
targets—something you just said—of this new policy. How dangerous is it for the regime in North Korea to go after these sectors of the economy, or maybe even these constituents whose money is now about to be confiscated if this policy is carried through?

Marcus Noland: That’s really the central question, Steve. I think we can say pretty confidently that as economic policy, this confiscatory currency reform—and then the ban on the use of foreign currencies that followed it soon after—will have a negative impact on the North Korean economy and a negative impact on the welfare of most North Korean residents. The real question is what kind of implications might it have for political stability. Clearly, the state is not comfortable with the emergence of the market and the potential independence from state control that it represents. And they were going after the market when they did this, so they were quite open about this. In our policy brief, we quoted a number of statements along these lines.

What I think is more interesting is the ban on foreign currencies. Foreign currencies had come to be used in the country, precisely because the domestic currency was so worthless and this confiscatory move provided an even greater incentive for people to shift into foreign currency. So the government did what the necessary second step was, which was to ban that use as well. If they really try to do this, this will require an extraordinary degree of political repression, and it will go after the interests of some very important institutions within that society, including the military and the security services. Personally, I am quite skeptical that they will actually carry this out and if they do, that they won’t attempt to literally take away the dollars and won from the army and security services. But if they do, that is one thing that could actually threaten to politically destabilize the country.

Steve Weisman: To what extent are the army and security services involved in economic activity?

Marcus Noland: They are involved in economic activity in two sorts of channels. Historically, under the classic socialist system, a lot of activities that would be carried out by the civilian part of the economy in, say, the United States or South Korea, were done by the North Korean military. So, a lot of infrastructural activities that would be carried out by private sector construction firms in the United States or South Korea were handled by the North Korean army. And that was probably something on the order of—it was a double-digit share of the economy. If you calculate the man hours involved, it was probably about half a million people out of a labor force of nine million. So, it was a significant activity. The other thing the army is involved in, however, is direct military sales. The army controls its own trading firms, its own banks, and obviously, this has come to the fore with the issue of missile proliferation.

Steve Weisman: Right. And sales to whom are we talking about?

Marcus Noland: Well, basically anyone who exports oil. At the top of the list, Iran. So, they are involved in direct military related transactions. The other thing that has happened is over the last 15 or 20 years as the economy frayed, the military got involved in all sorts of other commercial activities and it made sense. This was an organization that had access to trucks, had access to fuel, and large numbers of men who would follow orders. So they got involved in all sorts of just trading activities, trading all sorts of things in China; and interestingly enough, North Korean entrepreneurs who
want to go into informal money lending typically affiliate themselves with a police or military unit because of their unique ability to collect debts.

Steve Weisman: So the elite, economically, has been targeted here but as you suggest, doing so might backfire especially as I gather that we may be on the verge of a succession crisis in North Korea.

Marcus Noland: Interestingly, and with all things in North Korea, we have to stipulate that the facts have quotation marks around them where there are stylized facts, as the economists say. There were reports that this confiscatory currency reform is being associated with Kim Jong Un, the youngest of Kim Jong Il, and the one who is sometimes touted as a potential successor. This is really quite interesting. It is notable that this reform, as fundamental as it is, was not mentioned in the New Year’s joint editorial announcement, which is a thing that happens every year where a number of party and state publications publish a common editorial and which could be taken reliably as a signal of state policy.

This fundamental reform was not mentioned, which suggests that there may be some willingness to back away. If Kim Jong Un gets pinned with this policy and it doesn’t work out, it could be less a feather in his cap for succession than him being set up as the fall guy. I want to make one thing very clear though: They have gone after the private sector with this policy. I mean, they are trying to destroy private sector entrepreneurs and drive resources back into the state sector and rebuild socialism. They are absolutely explicit about those motivations.

What is less clear is their willingness to go after, as I said, the military or the security services in terms of this ban on foreign currency. I think that’s a real key issue to look after. It would not be the first time that the North Koreans did a confiscatory currency reform and basically wiped out the civilian private sector; they have done that before. What would be different this time around, if they actually do what they claim they are doing, would be this actual forcible seizure of foreign exchange, which really could hurt some political key groups.

Steve Weisman: But going after the private sector entrepreneurs indicates that there must be a lot of unrest and discord underneath the surface between the government and, I suppose for lack of a better term, wealthy interests even though it’s a poor country. Is there any way that the West, in confronting North Korea over the security issues, can exploit those kinds of differences?

Marcus Noland: It’s a very interesting question and it goes really to the heart of issues with respect to engagement with North Korea—something that Stephan Haggard and I have written on in the past for the Peterson Institute. Yes, we want to engage with North Korea. One of the reasons we want to engage with North Korea is precisely to encourage the development of centers of wealth and power and prestige independent of the state. But at the same time, we have to recognize the state dominates the economy and controls a lot of the channels through which external economic interaction operates. So that one has to be careful that when one engages one is, in fact, building up these kinds of private sector groups and not simply reinforcing state power.
So, even the argument for engaging with the country has to be nuanced to try to carry it out in a way that we can actually promote the internal changes that I think most of us would like to see.

Steve Weisman: And this action that North Korea took at the end of November took a lot of people by surprise. I suppose that’s just another indication of how little we really know what’s going on inside this very mysterious and isolated government.

Marcus Noland: Because it was a confiscatory reform, it had to be kept secret. If it was a normal currency reform like the ones that Ghana or Romania or Turkey have done in recent years, you would in fact publicize it for months in advance, so everybody understood what was going on, and then you would allow it to occur for a sustained period of time to make sure everybody had the opportunity to convert their old currency. This was done precisely to confiscate currency, so it had to be sprung on the people without warning.

What’s interesting is there are some reports that there were these kind of audits or seizures of goods—including things like Chinese-made consumer goods—done in a number of these military units, trading houses, and so on just before the November 30 announcement, as well as a spike in the black market exchange rate. It’s not clear whether that spike occurred because of these seizures and audits or because of worldly doubt of Pyongyang that what was about to happen and people who were in the know tried to dump their old won in favor of foreign currencies. But yes, because of the way it was carried out, it was absolutely essential that no one know, particularly foreigners.

Steve Weisman: Marc, your paper with Stephan Haggard is incredibly interesting. Thanks for discussing it today.

Marcus Noland: My pleasure.