

North Korea more stable than experts say

Benefits of Kim's underground economy

by Steve Hanke in Baltimore

Wed 2 May 2018

Much ink has been spilled about how economic sanctions have crushed the North Korean economy and brought its leader Kim Jong-un to the bargaining table. Not so fast. For starters, there wasn't much to crush. And, contrary to repeated conjecture by experts in international affairs, whatever there is of a North Korean economy appears to be quite stable.

While it is difficult to obtain dependable economic figures about the Hermit Kingdom, there are reliable data on key prices that, when properly interpreted, provide insights into the performance of the economy. The most important price in any economy is the free-market exchange rate between its domestic currency and the dollar, the world's reserve currency. But is there a free market for currency in North Korea? Well, yes, there is. North Korea has an active currency black market where reliable won-dollar rates are regularly reported.

And that's not all. There's also a black market for rice, the most important staple in North Korea. Black-market rice prices are regularly reported, too. Armed with these two prices, we can lift the shroud of secrecy that covers the North Korean economy.

Before Kim assumed power in 2011, North Korea experienced severe economic problems, including hyperinflation and famine.

In 2009, the North Korean government attempted to address runaway inflation by implementing a phoney currency 'reform' programme, which it promptly bungled. The so-called reform was actually just a currency redenomination programme, which arbitrarily lopped two zeros off every won note. North Koreans were given less than two weeks to exchange all their won for new notes. And the government set limits on the quantity of won a family could exchange for new won. For those North Koreans who had saved a little bit too much, the redenomination programme was effectively a wealth tax.

Not surprisingly, Pyongyang's mishandled currency reform sparked a panic in North Korea's won black market and its underground markets for goods and services. Indeed, the value of the won against the greenback collapsed, and the price of rice skyrocketed.

With the plunge of the won, inflation surged. My studies show that a hyperinflation episode began in December 2009. It was then that the monthly inflation rate first exceeded the hyperinflation threshold of 50% per month. North Korea's hyperinflation peaked in early March 2010, when the monthly inflation rate reached 926%.

When Kim assumed power, the North Korean economy was a disaster zone. The new leader immediately pursued policies to stabilise the won, prices and the economy. Rather than attempting another disastrous currency reform, Kim followed a two-pronged monetary approach.

The North Koreans set domestic monetary policy so that the won shadowed the dollar on the black market. Won-dollar exchange rate stability became North Korea's unwritten monetary objective.

At the same time, Pyongyang allowed for the spontaneous 'dollarisation' of the economy. The renminbi and the greenback effectively became coins of the realm, replacing the won.

Furthermore, Kim looked the other way as the underground economy flourished. Indeed, he allowed large chunks of the economy to privatise themselves spontaneously.

Kim's approaches have worked much better than the press and experts in international affairs would have us believe. The won-dollar exchange rate – the most important free-market price in North Korea – has been very stable since 2012, as have rice prices. This suggests the spectre of inflation is no longer haunting North Korea.

Maybe the North Korean economy, which is largely underground, is more resilient and in better health than the press and experts assert. If so, Kim has more cards to play than the experts think.

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