

Pyongyang goes to market: Marketization of the North Korean economy

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Abstract

North Korea is undergoing a sweeping but limited process of marketization. The most dramatic measure was a profound change in prices and wages in July 2002, but there were precedents before and there have been developments since. In that reform subsidies were removed, the price of rice went up 549-fold, wages were increased substantially but on a variable basis, and the won was officially devalued 74-fold. This has led to greater inequality, but those with access to money, through higher wages, trade or remittances, have seen a great improvement in their standard of living. Latest reports from visiting US experts talk of flourishing markets and suggest that 'A market economy, however limited, has arrived'.

Keywords

Marketization; economic reform; transition economies, North Korea, markets, social inequality

Introduction

On 1 July 2002 the North Korean government announced radical changes in economic policy, particularly revolving around prices and wages, in a distinct, if limited, further move towards marketization.

It increased the retail prices for basic goods, which in the case of rice meant a nominal increase of 55,000%. It devalued the North Korean currency against the US Dollar by roughly 6,800%. It divided the North Korean society into earners of ordinary and special wages, with the latter being three times as high as the former. The procurement price of rice is now lower than the retail price, i.e. the state stopped subsidizing this basic grain. (Frank 2003)

The announcement took foreign observers by surprise. For instance, Business Week, in a story published 8 July, made no mention of it although the article was primarily a description of a rather enthusiastic report by a group of Hong Kong-based fund managers who had visited North Korea in June and thought it was going the way of China (Clifford 2002).

Item	old	new	increase	Item	old	new	increase
	won	won	times		won	won	times
Rice (sell)	0.08	44	549	Wages (miners)	110	6,000	54
Rice (purchase)	0.8	40	49	Bus fare	0.1	2	19
Maize	0.49	20	40	Electricity (kwh)	0.035	1.8	50
Wages (average)	110	2,000	17	US\$	2	150	74

Table 1: Price and wage changes in the July 2002 reforms

Notes (Noland 2003: table 4) says that grain prices rose approximately 11 fold after January 2002; (WFP 2002b,c) gives figures for rice and maize 'before July' as 'about 0.9 and 0.68 won/kg respectively'

Clifford was not alone in failing to see changes brewing, or reacting at the time. Indeed, many North Korean officials (let alone the people at large) seem to have been taken by surprise and there were no official statements until August. Most outsiders thought that whatever the rhetoric things would go on as before. Those more familiar with North Korea recognised that change was afoot. Masood Hyder, the United Nations Humanitarian Coordinator in North Korea commented that, 'Fundamentally, what is changing is the attitude toward change itself. Instead of stoutly defending a supposedly perfect system that needs no amendment, authorities now allow for the possibility of change and adaptation (Hyder 2004)

Disentangling substantive transformation from cosmetic makeover is a perennial problem; plus ça change, plus c'est la même chose. On the other hand, we also face the case of change masked by a continuing lexicon, where we have new wine in old bottles. An article by Jonathan Watts in *The Guardian* entitled 'How North Korea is embracing capitalism by another name' took this approach. Though he confused marketization with capitalism – they are not quite the same things as China's 'market socialism' indicates – Watt took the line that there was more change than the authorities let on, or rather that they were not facing up to the implications of the reforms. 'Nobody here calls it capitalism, but that is the direction North Korea is headed', he writes (Watts 2003).

So what is happening in North Korea? Do we have changes that merely enhance the inherent superiority of the system, as the official press often suggests. Or empty talk and promises with no fundamental change, as argued by Business Week? Or is there a new climate of change and adaptation (Hyder) or even, pace Jonathan Watts, creeping capitalism?

The reality is, unhelpfully, a rather confusing melange of all of this. Economic reforms are intended to preserve and strengthen the existing political and social structure, not to replace it although that might be their ultimate effect. The changes have not come out of the blue; there are precedents and antecedent causes. Previous attempts at reform and economic rejuvenation have largely foundered, probably as much from the strength of exogenous forces as lack of commitment. The threat posed from outside, mainly by the United States, has constrained the regime from, for instance, opening up as much as it would otherwise have done to foreign investment, thus dooming early attempts to develop special economic zones. Hyder continued his description of change by asking, 'The question is: Will the world stand aside or help the process along?' So far external threat has tended to inhibit change. There is a large degree of dramatic change and transformation (as well as continued stagnation, it would seem, in the devastated old industrial heartland) but to talk of capitalism is probably premature. Marketization is another matter. Social differentiation is increasing, and changing, with a new middle class being created and deepening impoverishment amongst large segments of the population unable to adapt (Cho 2003e).

There is no agreement as to the success, of failure, of the reforms, or their depth and direction. This paper attempts to answer these questions, starting with a

necessarily over-brief description of the North Korean economy and system, and to suggest some managerial implications.

Overview of economy to 2002

North Korea is little known or understood and much demonised. There have been however, in recent years, a number of general surveys of which the best are Cumings, 1997 and 2003, Oberdorfer 1999 and Harrison 2002. The best window on trade and economic matters is provided by the (South) Korean Trade Investment promotion Agency KOTRA (see references). Official North Korean news releases can be found on the Korea Central News Agency site or *People's Korea*. There has been an increasing number of press reports on the economic reforms over the last year or so, but these are of uneven quality. Recently, the Hong-Kong based *Far Eastern Economic Review* ran a cover story entitled, rather hyperbolically, 'Shop until you drop' (Lintner, 2004). The major source of information on developments in North Korea are the aid agencies, such as the World Food Programme (WFP). Long term relationship-building, fairly long-term postings and frequent and extensive trips around much of the country monitoring aid means they have a much better knowledge of what goes on than journalists (or academics) who drop in for a week or so. Professor Hazel Smith of Warwick University, who spent a year on secondment to the WFP in Pyongyang, has been very uncommon in being able to combine academic rigour and detachment with in-country familiarity (Smith, 2002, 2004)

With the defeat of Japan in 1945, Korea a colony since 1910, was liberated but divided into two parts, north and south. The north, under Soviet tutelage, became the Democratic People's Republic of Korea (DPRK) and the south, under US influence, became the Republic of Korea (ROK). The Korean War (1950-53) was followed by a period of fierce economic, diplomatic and military rivalry between the two contesting Korean states. Initially the north had much higher economic growth than the south and was in some respects the most successful developing country in the world until the 1970s. The South Korea scholar Huang Eui-Gak has calculated that the south overtook the north in per capita GDP between 1976 and 1984, depending on which exchange rate is used to convert to US\$ (Hwang.1993).

North Korean economic growth was focused on rapid industrialisation (including crucially industrialisation of agriculture) and limited foreign trade. Whereas South Korea, from Park Chung-hee's military coup in 1960 onwards went for export-led growth, the North opted for import-substitution, with exports being seen as an unfortunate necessity in order to generate the imports needed for the growth of the domestic economy. The guiding policy was labelled *Juche*, usually translated as 'self-reliance'. Although trade was seen as subsidiary to the domestic economy it was still substantial and crucial. Just as important was the fact that, despite efforts to diversify to China, Japan and Western Europe, a large part of it was with the Soviet Union – nearly 60% in the late 1980s, and with the collapse of the Soviet Union that trade virtually disappeared (Beal 2004: Fig 7.6).

Collapse of the Soviet trade had a devastating effect not merely on industry, which in terms of contribution to GDP and percentage of labour force employed was the major sector of the economy, but through input linkages to agriculture. There had been substantial increases to agricultural production based on a four-pronged strategy – irrigation, chemical fertilisers ('chemicalisation'), electrification and mechanisation. All of these were crucially dependent on industrial inputs. The drying up of imports of oil and spare parts from the Soviet Union were particular problems. On top of this the country was hit by extremely bad weather conditions in the mid 1990s and food output plummeted (WFP 1998, 2002). Annual production of rice and maize fell from eight million metric tons in the 80s to 2.9 million in 2000 (WFP 2003). Estimates of the number of people who died in the resulting famine vary from 200,000 to 2 million plus (Noland 2003). Although the situation has improved in many respects UN agencies reported at the end of 2003 that 6.5 million people, nearly a quarter of the population, would need international assistance in 2004 (FAO/WFP 2003).

The most important development during this period from the mid 1990s onwards in the context of marketization was the failing ability of the cooperative system to feed farmers, the virtual collapse of the Public Distribution System (PDS) in the urban areas and the rise, and subsequent legitimisation, of farmers markets (Noland 2003).

Farmers, and their dependents, receive their quota of the grain output in October after the main harvest. This appears to have been calculated centrally on the basis of overall production, taking into account the needs of the urban population and what was required for export (the DPRK was the main supplier of rice to the Soviet Union). Prior to 1995 the average allocation was 260 kg per person per year. By 1997/8 it had fallen to 135 kg. Farmers supplemented their food by producing potatoes, green vegetables, etc. on private family plots (95m² in the countryside). Cooperatives would sell surplus output to the state at prescribed prices and the revenue would be distributed to member of the basis of work points earned.

The rest of the civilian population received cereals and staples through the Public Distribution System, varying according to categories (such as age but also, it seems, according to occupation) at prices which were highly subsidised until the July 2002 reforms (WFP 1998. section 4.3.1).

So what we have is an allocative, rather than a market, system of distribution. Before the crisis on 1990s this seems to have worked well enough in many respects. Life expectancy, for instance, was on a par with the south, and very high by developing world standards (Eberstadt 1992. 46-50). However, with the faltering of domestic agricultural production, and a limited ability to import food, the ability of the government to provide rations through the PDS declined dramatically. To a large extent the decline was muffled by international aid from the mid-nineties onwards. This was mainly provided by the World Food Programme (or which the US was the major donor), and by bilateral aid from China and to a lesser extent Russia. Further aid came from NGOs. Although harvests have improved in recent years, international aid through multinational

agencies has dried up, through a combination of 'donor fatigue' and political pressures related to the nuclear issue. The FAO and WFP warned in October 2003 that the PDS was only able to supply half the calories that people needed (FAO/WFP 2003).

It is unclear when farmers markets first sprung up. Frank (2003) says 'early 1990s'. The Library of Congress 1993 country study on North Korea says 'Less than 1 percent of retail transactions are carried out at peasant markets, where surplus farm products are sold at free-market prices.' (Savada 1993) By 1998 they had clearly grown so important that an economist at Kim Il Sung University was addressing the issue of the disparity between prices in farmers' markets and those set by the state in what may be considered a seminal article (Ri 1998). 'To allow farmers to freely trade or sell their surplus agricultural produce will stimulate their zeal for production', he argues. 'The market price is not established intentionally by the state but is decided by the free will of residents and farmers. Thus, the market price is determined in accordance with mutual supply and demand relations.' He warns that 'unstable elements in market prices', presumably a euphemism for price volatility and inflation, cannot be solved by price regulation alone; 'Placing various restrictions and legal control on prices alone can not solve this instability issue.' Indeed an 'improper intervention in the market will aggravate underground dealings', in other words, the black market will grow. Ri suggests, in effect, that the state must adapt to market conditions and become better at marketing. The price set for state purchases of agriculture produce 'constitutes an important condition for guaranteeing price stability', and affects the 'farmers' zeal for production'. The other side of the equation is the availability, and price, of industrial consumer goods. High prices for consumer goods will drive up prices of agricultural products in the farmers markets. Again the danger of the black market looms: 'If consumption goods sold by the commercial networks of state-run and cooperative bodies are not available, people bring back home the money paid for their surplus produce, generating underground dealings'.

Professor Ri concludes that agricultural and light industrial production can be greatly stimulated if the price relations are properly handled. Although he doesn't quite articulate it, and certainly would not use the terms, he seems to be edging towards a mixed economy, where the state controls the 'commanding heights', i.e. heavy (and strategic) industry, with agriculture and light industry being a (unspecified) combination of cooperative and private enterprise. The state, in this vision, still control key prices, but in a market-oriented way, where a major consideration of state pricing policy is the effect it will have on the free market. This line of thinking seems to have been carried forward, and greatly expanded, by the July 2002 reforms.

Economic reforms of July 2002

The reforms attracted a flurry of interest in the South Korean and Western press (Ahn 2002; Donald 2002; Kim, 2002b; Economist 2002) However they were soon overshadowed by other events, principally the nuclear crisis which erupted with

the visit of US Assistant Secretary of State James Kelly to Pyongyang in October that year. It now seems likely that the US action was triggered by a desire to head off a possible rapprochement between Pyongyang and Tokyo following the September summit between Japanese Prime Minister Koizumi and North Korean leader Kim Jong Il (Pollack 2003). Although the origins and course of the nuclear crisis are beyond the scope of this paper the profound effect it had on the prospects of success of the reforms should be noted. Inter-Korean economic relations have continued to move forward (Cho 2004b) and trade with China especially has continued to grow. However the crisis has halted, indeed reversed, any improvement in DPRK-Japan relations, seriously hampering North Korean trade with Japan and putting into abeyance the prospects of Japanese reparations of \$8-10 billion for the colonial period (Kim K I 2003). It has also meant, of course, that US sanctions have stayed in place as well as blocking DPRK access to international financial institutions (Seo 2003; Shin 2001).

Although there had been an official (but anonymous) description of the reforms published by People's Korea on 17 August 2002 (PK 2002) it was not until September, according to KOTRA, that there was a high-level, official confirmation.

The centrepiece of the new economic policy (a phrase, it will be recalled, coined by Lenin in 1921) was a simultaneous, but asymmetrical, raising of prices and wages (Table 1). There is some confusion about actual prices before and after July; Noland (2003) suggests there was an interim period in the first part of the year when rice, wheat and barley rose 11-fold, and corn (maize) rose 14-fold. The price of the preferred staple grain, rice, rose over 550-fold compared with year before, and about 50-fold on 1 July. Bus fares went up 19-fold and electricity, 50-fold. Apartment rental went up an unspecified amount: 'Apartment dwellers are to be charged for rooms and utilities' (PK 2002). To counterbalance these increases wages also rose, but by varying amounts. 'Basic wages' rose from 100 to 2,000 won but those of coal miners rose to 6,000 won.

Outside observers were quick to point out that these changes would lead to inflation (Noland 2003). KOTRA warned that 'North Korea will possibly be confronted by the worst inflation it has seen.' (Kim 2002b). By January 2003 it was reported that 'rice prices have gone up 50% and those of other necessities have tripled in black markets all over the country during the last three months.' (Kim S. S. 2003). Although the won had officially been devalued 74-fold against the dollar to bring it in line with the then prevailed market price, it is said that within a year the black market value had plummeted seven-fold (Carroll 2004). However, this is a far cry from the sort of hyperinflation we identify with 1920s Germany, or with Latin America. Moreover, a KOTRA report of March 2003 remarked that 'the N. Korean won's foreign exchange rate has been readjusted to a realistic level following economic reform measures (upward revisions of prices and wages) in July.' (Koo 2003a)

The other predictable result of the reforms was growing inequality. This was part of the purpose.

'The more one produces profits and the harder he works, the larger share he takes. On the contrary, if one does not work hard and produces less profits than required, he receives a less wage.'(PK 2002)

The idea was to provide incentives for management, workers, farmers and foreign investors:

There is no doubt that strict adherence to the socialist principle that profits should be distributed according to one's ability, will be an incentive for people to create profits. Meanwhile, the raise in government's purchase price of rice is expected to stimulate farmers' enthusiasm for agricultural production.

A successful implementation of the government's new economic policy will also contribute to strengthening the Korean won and creating favorable conditions for foreign investments in the country. (PK 2002)

Noland, for one, had questioned why the changes had been so great and suggested that similar differentional effects could have been achieved by much smaller increases (Noland 2003). The answer, it may be surmised, was that it was an attempt to bring domestic wages and prices more in line with international ones and hence facilitate inward investment and exports, including that of labour (Cho 2003c).

Already, since 2000, it was claimed, factories and enterprises which had failed to produce profits had been closed down. What happened to the unemployed is not known (WFP 2002c). The government promised that it would 'still provide 30 kinds of services, such as social security and welfare, for free, just as in the past'(Kim 2002c). Nevertheless it was clear that privation would increase for those unable to cope, for whatever reason, with the effects of the reforms; one million 'urban poor' were created, according to the World Food Programme (Cho 2003e).

But it could be argued that the economic benefits of increased efficiency and production would justify these ill effects and that, in addition, it would enable the government both to increase the people's welfare: By 'cutting much of state subsidies and applying a market price system to all sectors.. state subsidies thus reduced are to be returned to the people in the form of improved welfare' (PK 2002).

The price and wage reforms of July 2002 were not the only part of the reform process. There has been an ongoing attempt, going back to the early 1990s, if not earlier, to attract foreign investment, and to build joint ventures with foreign companies mainly, but not exclusively. South Korean. One very significant and symbolic example has been the development of software, e-commerce and other IT exports and joint ventures.(Beal 2001a, 2002; Cho 2003b). North Korean studios have been active in the animation market, doing contract work mainly for French, Spanish and Italian houses (PK 2000; Kim Ki-tae 2003).

Tourism has also been important, although the flagship joint venture with Hyundai at Kumgangsan (Diamond Mountains) has encountered various

problems (Beal 2001b; Byun 2004). Special Economic Zones, which have been a feature of China's opening up, and which have been used in market economies throughout much of the world, are also an important part of the North Korean strategy. The first zone, Rajin-Songbong Economic and Trade zone, in the North Korean part of the Tumen River Area Development Programme (shared with China, Russia, and with participation from South Korea and Mongolia) has not been very successful (Park 2001; Tumen 2004). The economic zone at Sinuiju on the Chinese border opposite Dandong has been a fascinating example of both bold thinking and inept execution, with perhaps a big dose of bad luck thrown in. North Korea appointed a Chinese-Dutch businessman, Yang Bin, as governor with sweeping powers (Kim 2002a). Unfortunately he was subsequently arrested by the Chinese for tax evasion (Carroll 2004). The third zone is at Kaesong, close to the border with South Korea and not far from Seoul itself, where a big industrial park designed for South Korean small and medium business is being developed in cooperation with Hyundai (PK 2003; Cho 2004b). The port city of Nampo was designated as a 'special city' on 9 January 2004 apparently in an attempt to attract foreign direct investment (Jung 2004).

There are many other instances of 'opening to the outside world', and experiments with new forms of market-based mechanisms. To take just two examples to illustrate the range of activities. The National Tourism Administration started marketing cycling tours, targeted at Japanese visitors in 2003 (Koo 2003b). Recently North Korean enterprises have opened restaurants in Dandong, China (Cho 2003d) and Phnom Penh, Cambodia (Cho 2004a).

These are just examples, and rather bizarre ones at that, of a deep-seated commitment to economic transformation and engagement with the international economy. As Hazel Smith puts it:

Pyongyang has already engaged in an intensive study of economic transformation processes in China and Russia, and has demonstrated a willingness to look seriously at these examples of economic change. After initial reservations, the government has now fully accepted that it can only revive and resuscitate its economy with the help of investment from liberal capitalist states, and/or international financial institutions such as the World Bank and the Asian Development Bank. (Smith 2004).

Ironically it is the current US administration which is the major impediment to this process (Shin 2001). If the Democrats win the forthcoming presidential election it is likely that this will change and, as George Soros has said, 'the Bush doctrine would be seen as an aberration in US foreign policy' (Tran 2004).

Assessments

It is impossible to make a definitive assessment of the progress of marketization in North Korea, except that it is underway and probably unstoppable. Much revolves around relations with the United States and no breakthrough is likely before the US presidential elections. If the Democrats win then there may be a relatively speedy resolution of the confrontation and market reform and opening

may accelerate. One British businessman, Roger Barrett, who runs a consultancy in Beijing focusing on business with the DPRK, predicts that North Korea may be the 'next Asian tiger' (York 2004). It is possible in the right circumstances.

By January 2004 the reforms had been in place 18 months, and there have been a number of eye-witness reports that throw some light on what is happening, especially in Pyongyang. In June 2003 KOTRA published a report on the first anniversary and had some interesting observations:

People can reportedly purchase as many goods as they want if they have money, while they couldn't get goods even with money (without a supply certificate) before the reform. Sources generally admit that market conditions for daily necessities have much improved since their trade (including industrial products) was allowed. North Korea's trading firms import electric home appliances in large quantities, such as electric fans, TVs, refrigerators and computers, and even expensive interior decorating materials in some cases, in an effort not to let slip this good opportunity, according to some sources. ...North Koreans reportedly use the word 'reform' much more than the former days and affirm the result of the Chinese reformative and open-door policies. ...North Korean residents have heard much about foreign affairs from overseas resident officials or business travelers and are familiar with developments in South Korea and China. (Cho 2003a).

In January 2004 John W. Lewis, a retired Stanford Asian expert who has been to North Korea ten times since 1987 led a small, but high-powered, group to Pyongyang. The main focus was on the nuclear issue but he and another member of the group, Charles 'Jack' Pritchard, were probably more familiar with North Korea than virtually any other Americans. Pritchard had been the leading State Department official dealing with DPRK until his resignation in 2003. They were both taken aback by the changes they saw.

An unofficial U.S. delegation to North Korea last week saw a vibrant and thriving capital, with the main market in Pyongyang selling clothes, vegetables, meat and electronics, according to a former State Department official who was part of the delegation.

"I was stunned by the activity," Charles L. Pritchard said at a briefing organized by the Brookings Institution. He said there were many vehicles on the street, compared with almost none a few years ago.

Pritchard said the visit indicated that change is occurring in one of the world's most closed societies, even during a crisis over its nuclear ambitions, and that North Korea is far from economic collapse. (Kessler 2004).

John Lewis made much the same point:

The changes from 1987 to 2004 have been dramatic, and they continue. Along the roads and in the towns, small entrepreneurs are taking

advantage of the new pricing and market policies. The real shocker was the massive semi-private market on Tong Il Street in Pyongyang, where potential buyers can find quantities of meat, vegetables and fruits as well as hardware, furniture and clothes. While life in the countryside remains stark, similar markets are said to be springing up in other cities, and South Korean money is flowing in to build a huge industrial park just north of the Demilitarized Zone. A market economy, however limited, has arrived in the North. (Lewis 2004).

Managerial and research implications

Whether or not North Korea is the next Asian tiger, the process of marketization, and the growth of marketing as we know, will be profoundly important to this nation of 22 million people, as well as being a fascinating case study for marketing academics of the role of marketing in transforming societies.

The literature, theoretical and empirical, of transition economies in the former Soviet Union and Eastern Europe, will be of limited relevance and may well be misleading. Managers may do best to stay clear. Much more appropriate are China and Vietnam, where ruling Communist parties have led the economy to marketization while still retaining control over the political process. This liable to be the case in DPRK, barring a catastrophic collapse, and it is no secret that these are the models being studied (Ryu, 2004). However, it would also be dangerous to extrapolate mechanistically from the Chinese and Vietnamese experience, because there are substantial differences, most particularly to existence of ROK. Much of the economic reform in DPRK is being articulated through ROK initiatives, such as the Kaesong industrial park being set up by Hyundai Asan.

The usual caveats apply. The economic reform process may well be derailed by geopolitical or domestic instability. Transition processes are unpredictable. It is important to research the business environment thoroughly and dispassionately, perhaps in cooperation with business associations such as Korea - Europe Technology & Economy Services (KETES) set up with the help of the European Chamber of Commerce in (South) Korea (<http://www.ketes.org>). But most of all, as elsewhere in East Asia, attention should be paid to relationship building; that is the key to everything.

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