

Sanctions and Marketization: Economic Instruments for North Korea's Transformation

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1. Economic factors in the process of denuclearization

- Kim Jung-un wants to maximize the probability of maintaining his power using nuclear weapons and economic development. The weights to these two might be variables.

$$\text{Max } U = \alpha W + \beta E$$

W: Nuclear weapons, E: Economic development,

α, β : The respective weight to W and E.

- This suggests that we need to prepare a comprehensive package to deal with both W and E.
- Kim Jung-un might have decided to have talks on denuclearization at least partially because of economic factors.
 - As a young leader, his lifetime utility can greatly increase from economic development.
 - He has been facing increased pressure from marketization on economic development.
 - However, economic sanctions prevented growth, which has been affecting the welfare of a majority of the people, and thus undermining his leadership.
- Economic sanctions should remain intact, giving pressure on Kim to give up his nuclear weapons and missiles.
- In the medium- and the long-run, economic interactions with North Korea such as cooperation and integration are likely to increase an opportunity cost for the development (or use) of the nuclear weapons and missiles.
 - Markets fundamentally change the society as well as the economy of North Korea. Furthermore, it will significantly contribute to its economic development.
- At the same time, a mechanism to assure peace in the Korean peninsula should be established.

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2. Sanctions

- According to the index of the effectiveness of the sanctions, they are still effective with a score of around 60 as of Dec. 2018.
 - They have been effectively blocking N. Korea's export, especially minerals, and rapidly reducing foreign currency reserves.
 - Trade and foreign currency earnings, which are directly affected by the sanctions, have been hit hard. There have been substantial spillover effects on markets and industry but a full scale of crisis is yet to come.
 - The crisis may include foreign exchange crisis, a massive drop in consumption of households and management crisis of state institutions and enterprises.
- There are some signs of shocks on markets: price changes; apartment price; increase in energy bills, decrease in stalls at market.
- Lifting or easing sanctions is likely to take place step by step (in accordance with the process of denuclearization).
 - The sequence of lifting sanctions is of critical importance. The effect of each sanction should be accurately measured together with other issues pertaining to it.
 - The U.S. and S. Korea should closely cooperate on what sequence sanctions should be lifted and at what stage of N. Korea's denuclearization.
 - Gaesung Industrial Complex may be a good candidate as the object of lifting sanctions in exchange for Yongbyeon plus alpha but with certain conditions.
- Incentive package can be offered upon irreversible stage of denuclearization.

3. Economic engagements posterior to lifting sanctions

- Further changes in the N. Korean society are possible due marketization of her economy.
- Markets affect the following aspects:
 - The mindsets of people
 - Incentive structure of government officials through bribery
 - Informal small-scale privatization
- The above factors will push Kim Jong-un to the road to a market economy.
 - The public mindset will change in favor of a market economy.
 - Government officials are bribed to accept market activities. Kim's order to repress markets is unlikely to work. They act as protectors for market-related activities.
 - Government assets are informally sold to (a group of) individuals.