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# **North Korea Looks at Chinese Economic Reform**



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**A Research Paper**

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*EA 85-10079  
April 1985*

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# **North Korea Looks at Chinese Economic Reform**

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**A Research Paper**

This paper was prepared by [Redacted]  
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**North Korea Looks at  
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**Summary***Information available  
as of 27 March 1985  
was used in this report.*

North Korea, pressed by domestic and foreign economic problems and by pressure from Beijing, is taking a careful look at the economic reforms that China has implemented since 1978. An unusually large number of high-level North Korean delegations have visited China in the last two years, where  they have been lectured on the benefits of economic liberalization.

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We do not believe that P'yongyang is ready to go far enough with reform to improve the country's economic prospects substantially or its economic relations with the West. By allowing even a hint of liberalization, however, Kim Il-song may be attempting to expand his options—and, perhaps more important, the options for his son and designated heir, Kim Chong-il—to pursue a more liberal economic program should the country's Marxist policies continue to achieve results far short of the accomplishments of South Korea and China.

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P'yongyang has already taken several measures that, at least on the surface, are consistent with a liberal reform program:

- The promulgation of a joint-venture law that allows foreign investment in North Korea.
- The promotion of light industry to improve living standards.
- An apparent effort to decentralize economic management and increase worker incentives.

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P'yongyang, however, has given no indication that it will accept features of market-oriented economies—such as widespread use of agricultural free markets and small-scale, private service-related enterprises—that we believe are the key to China's recent economic success.

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Past mistakes, such as the massive borrowing to import Western capital equipment in the mid-1970s that was followed by default, continue to thwart the influx of foreign investment or even the development of a significant foreign trade sector, as does lack of access to natural export markets such as the United States and South Korea. More important, economic liberalization in China has come at a cost to the military—which now receives a smaller share of national resources—and some of the Communist Party's controls on the population have been weakened. In North Korea we see no signs that either the Army or the Korean Workers' Party is willing to relinquish the power that economic liberalization inherently would entail.


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April 1985*

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China's interest in trying to persuade North Korea to move toward economic liberalization stems from Beijing's concern that its own reforms could strain political links to a doctrinally conservative North Korea. Beijing appears to be willing to apply some pressure—refusing to increase economic aid to the North and allowing unofficial commercial links with South Korea to develop—but Chinese officials have told US diplomats they doubt they alone have enough influence to effect reform in North Korea. They warn that without Western encouragement—in the form of better political or economic relations—P'yongyang will be ripe for increased Soviet influence. Although North Korean-Soviet relations have improved over the past two years, we see no indication that Moscow is willing to increase significantly its economic aid to North Korea. 

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### North Korea Looks at Chinese Economic Reform [Redacted]

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#### China as an Economic Model

P'yongyang has kept a watchful eye on the economic policy shifts that have swept China in the nine years since Mao's death in 1976. These have helped China forge strong economic links to the United States and could lead to overt commercial links between China and South Korea. They have also induced remarkable economic growth in China. Key features of the reforms include:

- An economic opening to the West that has greatly stimulated foreign trade and investment.
- A shift in priority from heavy industry to light industry with the intent of improving living standards.
- A decentralization of decisionmaking that, if fully implemented, will sharply increase the role of market forces at the expense of the party and the state planning apparatus. [Redacted]

At least since Kim Il-song visited China in September 1982, P'yongyang has been studying the Chinese economic reforms for possible adaptation. In November 1982, for example, the North Korean party daily, *Nodong Sinmun*, reported that Kim had visited China's Sichuan Province (the birthplace of many of the reforms under the then governor and now premier, Zhao Ziyang) and expressed great interest in the new production responsibility system. This system, which has now largely replaced the Chinese commune system, gives farmers much more freedom to manage their farms and allows them to sell above-quota output in relatively open markets. [Redacted]

Soon after Kim's visit to China, [Redacted] a North Korean study group had visited the Shenzhen Special Economic Zone near Hong Kong—China's showplace for its reforms in action. According to press reports, four other North Korean delegations visited Shenzhen in 1983 and 10 in 1984, including one in February 1984 led by Foreign Minister Kim Yong-nam. [Redacted]

Seven or eight other high-level economic delegations from the two countries exchanged visits in 1984, providing further opportunities for P'yongyang to

learn about Beijing's reforms. General Secretary Hu Yaobang visited P'yongyang in May, and Kim Il-song made a return trip to China in November (see appendix A). [Redacted]

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A visit to China by North Korean Premier Kang Song-san last August is of particular interest. Kang, an economic technocrat, was installed as premier in January 1984, just after a plenum of the Korean Workers' Party (KWP) announced new policies designed to promote light industry and exports. During his visit to China, articles in both the Chinese and North Korean press compared that plenum, the Eighth of the Sixth Party Congress, with the Chinese plenum of 1978 that had marked the ascendancy of Deng Xiaoping and Zhao Ziyang and the beginning of economic reforms. [Redacted]

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[Redacted] much of Kang's visit was devoted to discussions of light industry and that he toured a number of factories in Beijing and Shanghai producing consumer goods. [Redacted]

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[Redacted] His departure statement noted, however, that, while the reforms were "unfolding a vigorous and bold struggle ushering in great prosperity for China," North Korea "would continue to work hard for socialist construction in the spirit of self-reliance." [Redacted]

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#### North Korea's Need for Reform

Kang's cautious statement notwithstanding, even Kim Il-song recognizes that the North Korean economy stands in dire need of reform. [Redacted]

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The current state of P'yongyang's long-term economic planning process also suggests a need for drastic reforms. In his New Year's address this January, Kim failed to mention either the Second Seven-Year Plan, which ended in 1984, or the Third Seven-Year Plan, originally scheduled to begin in 1985. Instead, he referred only to accomplishments of the one-year 1984 plan and the prospects for the annual 1985 plan. We believe, therefore, that 1985 is being used as a buffer year before a new long-term plan begins in 1986. Even with the buffer, P'yongyang will find it difficult to set reasonable goals, given the extent to which industry fell short of the 1984 goals set in 1978. We estimate that output in 1984 was only about two-thirds of planned levels. [redacted]

Because P'yongyang publishes little in the way of valid economic statistics, it is difficult to determine economic trends. Nonetheless, [redacted] the economy continues to suffer from severe shortages of fuels and raw materials, long delays in the completion of investment projects, and low standards of quality, while the population endures threadbare living conditions. We estimate that economic growth has averaged only 3 to 4 percent yearly in recent years or about half the South Korean rate. North Korea's poor economic performance, in our view, stems from several factors:

- The high priority given the well-equipped, offensively poised military establishment of 800,000 men.
- Kim's policy of running the economy at a pace far beyond the capabilities of its human and material resources.
- The Korean Workers' Party's petty tutelage over economic activity at the national, provincial, and local levels; Kim himself makes disruptive allocation changes in the course of his on-the-spot guidance to production facilities.
- The lack of foreign exchange and the deep-set policy of *chu'che* (national and individual self-reliance), which have isolated North Korea from global technological currents.

We believe that only major changes in North Korean policies or striking reforms in the economic system will enable North Korea to improve its economic performance over the next 10 years. [redacted]

**Obstacles to Reform**

Viewed solely from an ideological perspective, P'yongyang might have less difficulty liberalizing its economy than has China. North Korea has never experienced such extremes as the Great Leap Forward (1956-60) or the Cultural Revolution (1966-76), following instead a relatively conservative economic course, more along the lines of Khrushchev and Brezhnev than Mao. From a practical viewpoint, however, North Korea faces serious obstacles to reform:

- The country's large foreign debt burden and poor reputation, which has cut it off from foreign credit.
- The reduction in defense spending needed to free resources for light industry.
- The weakened party control resulting from increased reliance on market forces. [redacted]

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**Opening to the West—A Second Try?**

To open the country to foreign trade and investment, for instance, P'yongyang must first settle or at least make a substantial downpayment on its \$1.3 billion hard currency debt, which has been in arrears since 1975. Although a jump in gold sales last year helped P'yongyang meet principal payments to some West European countries, North Korea missed interest payments to Japan and in recent months has again missed interest payments to European creditors. We believe it would take a sustained increase in hard currency exports and further debt payments to give North Korea access to new credits. Instead, North Korea has had to assign top priority to exporting to the Soviet Union and China to satisfy their demands that annual trading accounts be balanced. [redacted]

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Chinese officials claim they had a major role in persuading P'yongyang to promulgate a foreign investment law in September 1984, and indeed the law is very similar to one passed by Beijing in 1979.

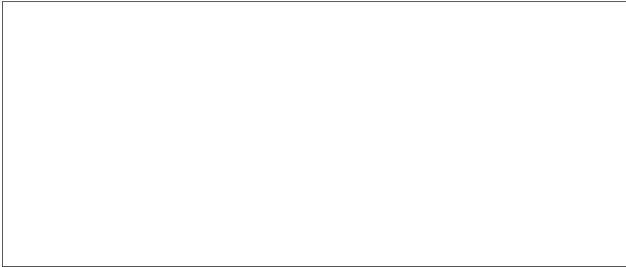
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tasked with producing these items with whatever spare materials and manpower that they can muster. In 1984, according to media sources, some 1,400 consumer goods workshops were organized within factories for this purpose. These workshops generally account for a very small proportion of factory output and more than likely produce goods of inferior quality. [redacted]

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Joint ventures—in which foreign firms provide machinery and expertise and share either profit or output—in theory provide a way for North Korea to import capital equipment without using foreign exchange or credit. In reality, however, most potential investors will link projects to an improved debt repayment record. [redacted]

Given the economy's inability to meet current requirements for raw and intermediate goods and the massive requirements imposed by the defense industry, it is no surprise the North Koreans have had difficulty establishing light industrial factories capable of producing quality consumer goods. In fact, in his New Year's message, Kim Il-song stated that top priority in 1985 would go to mining, transportation, steel, and agriculture in that order, making only a vague reference to improvements in living standards. We believe P'yongyang would need to significantly reduce military spending levels to allow more investment for light industry. [redacted]

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Finland, for example, recently rejected a proposal for a \$12 million nonferrous mining project proposal because of P'yongyang's outstanding debt. Other would-be investors do not believe P'yongyang has set up the complex legal structure that would be required to defend their interests. As a result, P'yongyang has registered only minor successes: some Japanese companies have invested in fishing ventures that can readily sell their produce in Japan, and a French firm is helping build a luxury hotel in P'yongyang. Financial terms for the latter project have probably not yet been completed, however. [redacted]

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**Market Forces—A Threat to Party Control**

The most controversial, and what we believe to be the most important, of the Chinese reforms comes under the general concept of increased use of market forces—or economic levers as Chinese and now some North Korean literature refer to them—in economic decision making. This is closely related to the decentralization and removal of party politics from enterprise- and farm-level management. China has by no means solved the problems associated with combining features of command and market economies at the enterprise level—in many ways it is just beginning to face them. Even so, by allowing some individual initiative to develop in agriculture and service industries, Beijing has sparked major jumps in economic growth and efficiency. [redacted]

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**Light Industry—Can It Compete With the Military?**

Experimenting with light industry to increase the supply of consumer goods and improve living standards also faces difficulties. Since the Eighth Party Plenum in November 1983, North Korean media have touted light industry [redacted]

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[redacted] although there is more concern for the production of consumer goods, few new resources—either manpower or capital—have been allocated to the light industry sector. Instead, heavy industrial plants are being

Kim's New Year's address as well as several articles published in *Nodong Sinmun* and *Kulloja* (the theoretical monthly journal of the KWP) suggest that in

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January 1985 North Korea took a step toward decentralizing economic decision making by putting an "independent accounting system" into broader use. First implemented on a small scale in North Korea in 1960 and similar to one adopted by China in 1979, this system is designed to make enterprises more responsible for their own profits and losses and to tie worker income more closely to productivity. Under the system, a portion of a worker's wages is dependent on the work unit's level of output. The individual unit, in turn, is given greater discretion in its methods for meeting state production targets and more accountability for use of raw materials. [redacted]

The *Nodong Sinmun* and *Kulloja* articles indicate that North Korean theorists believe this could lead to "capitalist tendencies." They nevertheless argue that in the transition period between capitalism and Communism it is just as dangerous to disregard the usefulness of market forces in helping to motivate workers and manage factories. [redacted]

A marked divergence from Chinese policy, however, can be seen in P'yongyang's attitude toward party management of the economy, at least as presented by the country's media. In an article discussing the independent accounting system, *Nodong Sinmun*, in December 1984, stated that, to prevent any "deviation in the slightest" from socialism, the party is implementing the independent accounting system in close coordination with the Taaen Work System. The Taaen Work System, established in 1962, assigns the KWP an important managerial function in every enterprise. Indeed, an article in *Nodong Sinmun* in November 1984 said, "The most important thing in increasing the production of consumer goods is to increase the role of party and government functionaries in local areas." Beijing, in contrast, is trying to remove the party from day-to-day management responsibilities in the factories. [redacted]

A related issue is the replacement in China of the commune-oriented agricultural system with one that lets farmers exercise more freedom in managing their farms and marketing their above-quota produce. North Korea has been generally tolerant of small private plots and rural markets, but in the 1970s the trend was toward increasing collective and state control over farmers. In 1977, for instance, P'yongyang cut the maximum legal size for a private plot in half. [redacted]

Aside from Kim's expressed interest in China's new agricultural system in 1982, we have little evidence that P'yongyang has liberalized its policy. [redacted]

**Prospects—The Limits of Chinese Influence**

The tentative nature of P'yongyang's experiments suggests that North Korea is unlikely in the short term to take reforms far enough to make a major difference in its economic prospects. The economic needs are great, but the political and security costs—particularly the weakening of party control over the populace—of opening to the West and allowing market forces to operate, even on the scale now being allowed in China, must still appear prohibitive to P'yongyang. [redacted]

The flexibility that P'yongyang is exhibiting, even in terms of its modest reforms, suggests that over the longer term—most likely after the death of Kim Il-song—major changes in economic policy are possible, perhaps even likely. Certainly Kim has made it easier for his son, Kim Chong-il, to align himself with a reformist faction after the elder Kim's death if the situation warrants.<sup>1</sup> [redacted]

Whether North Korea takes a reformist path may depend in part on China—both the success of Beijing's own reforms and the degree to which it can pressure P'yongyang to follow suit. China's active interest in North Korean issues over the past year has been demonstrated by the number and level of official exchanges with North Korea and by Beijing's willingness to intercede on P'yongyang's behalf with Washington and Tokyo on the issue of North-South talks. [redacted]

<sup>1</sup> In a similar vein, we believe that Kim Il-song's recent initiatives toward South Korea and improvement of relations with the Soviet Union may be designed to give Kim Chong-il more room for maneuver. [redacted]

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The Chinese have [redacted]

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[redacted] stressed the need for North Korea to liberalize its economy and achieve some degree of economic parity with South Korea before talks of unification could be seriously entertained. Beijing claims, moreover, that Kim Il-song appears genuinely interested in reforms but that he needs a great deal of economic aid from China and better trade relations with the West for the reforms to succeed. [redacted]

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The Chinese statements also include warnings that their ability to aid and influence North Korea is limited and that the Soviet Union may be using China's tilt to the West to gain advantage in P'yongyang. North Korean-Soviet political relations have warmed over the past two years, but we have no indications that the Soviets are willing to provide more economic assistance. Despite being North Korea's major supplier of oil and coal, Beijing finds it difficult to get P'yongyang to meet its annual export commitments, let alone make fundamental economic policy changes (see appendix B). [redacted]

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Even at the risk of alienating North Korea, China is putting some pressure on P'yongyang. [redacted]

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[redacted] Beijing signed an aid agreement for North Korea's 1986-92 economic plan in January that offers no increase in the level of aid over the 1978-84 plan period. P'yongyang had asked for a sharp increase, especially in oil deliveries. P'yongyang has made no mention of the aid agreement, which was given media treatment by the Chinese, a fact that we read as an indication of North Korean dissatisfaction.

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[redacted]

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A more subtle and possibly more effective pressure tactic may be China's recent laissez faire attitude toward its own trade with South Korea, including its willingness to let key South Korean industrial leaders visit China and discuss joint venture projects. Publicly, Beijing continues to disavow direct commercial links with South Korea, but we estimate that "unofficial" trade is now above the level of Chinese-North Korean trade.<sup>2</sup> [redacted]

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<sup>2</sup> We estimate that South Korean-Chinese two-way trade in 1984 totaled \$625 million, compared with our estimated \$600 million in North Korean-Chinese trade. [redacted]

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**Appendix A**

**North Korea-China:  
 Selected Economy-Related Delegations,  
 1984-85**

Date	Delegation	Purpose or Comment
<b>1984</b>		
21 Jan	Chinese Minister of Railroads visits P'yongyang.	To celebrate 30 years of railway cooperation.
28 Jan	North Korean Minister of Railroads visits Beijing.	Same.
7-14 Feb	North Korean Foreign Minister Kim Yong-nam visits China, including Shenzhen Special Economic Zone (SEZ).	Main issue probably the tripartite talks proposal but included economic discussions, particularly at Shenzhen.
25 Apr	Chinese Vice Minister of Foreign Trade visits P'yongyang.	To sign 1984 commodity accord.
4 May	Chinese General Secretary Hu Yaobang visits North Korea.	Wide-ranging discussions. Hu states that North Korea is making "maximum effort to promote economy and living standards." [redacted]
1 Jun	Chinese S&T commission delegation visits North Korea.	To sign annual technology exchange protocol.
17 Jun	North Korean Minister of External Economic Affairs Chong Song-nam visits China.	To discuss joint coal mine development.
18 Jun	North Korean Trade Bank Vice President visits Beijing.	Met by Vice Premier Li Peng.
19 Jun	P'yongyang Municipal Committee visits Beijing.	To discuss urban problems.
12 Jul	Chinese Electric Power delegation visits North Korea.	Annual meeting to discuss electric power shaping and construction of Yalu River hydropower plants.
1-17 Jul	North Korean nonferrous metals group visits China.	Invited by Hu Yaobang.
31 Jul	Korean Workers' Party delegation led by Kye Ung-te visits China—goes to Shenzhen SEZ.	Met by Chinese President Li Xiannian who states, "We must learn from each other." Visits small-scale service industry.
5-10 Aug	North Korean Premier Kang Song-san visits Beijing and Shanghai.	[redacted] the visit is dominated by economic issues including considerable discussion of light industry and foreign investment. [redacted]
		North Korea promulgates joint venture law soon after Kang returns to P'yongyang.
14-21 Sep	Chinese Minister of Commerce Lin Yi visits North Korea.	Met by Kim Il-song. Yi states he has come "to learn more about North Korean commodity circulation." P'yongyang subsequently makes major changes in domestic commerce system.
5-12 Oct	North Korean Vice Foreign Minister Kim Chae-suk visits China.	To celebrate 35 years of Chinese-North Korean relations.
8 Oct	Chinese Vice Foreign Minister Xao Guang visits North Korea.	Same.

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**North Korea-China:  
Selected Economy-Related Delegations,  
1984-85 (continued)**

Date	Delegation	Purpose or Comment
29 Oct	Chinese coal experts visit North Korea.	Probably to discuss joint venture project.
31 Oct	North Korean synthetic fiber delegation visits Beijing.	Briefed by Li Peng on Chinese economic reforms.
26-28 Nov	Kim Il-song makes "unofficial" visit to China.	[redacted] the Chinese explained their economic reforms. Kim stated he intends to revitalize North Korea's foreign trade and improve living standards and to do that he needs peace. Visit immediately follows breakdown in North-South talks because of Soviet defector incident at DMZ.
18 Dec	North Korean Minister of Construction Cho Chul-chun visits China including Shenzhen.	To "acquaint" themselves with Chinese accomplishments.
31 Dec	North Korean Foreign Minister Kim Yong-nam visits Beijing.	Kim on his return from a trip to Eastern Europe and Iran.
25 Dec	North Korean Academy of Sciences vice president, Cho Chang-hui, visits Beijing.	Signs 1985-86 plan for scientific cooperation.
<b>1985</b>		
12 Jan	North Korean Vice Minister of Foreign Trade visits Beijing.	Signs 1985 protocol on commodity exchange.
13-17 Jan	North Korean Vice Premier Kong Chin-t'ae visits Beijing.	Signs new aid agreement, presumably for North Korea's new Seven-Year Plan period. Zhao states, "China wishes it could fulfill more of its international duties." Kong thanks China for economic assistance and support, but North Korean press fails to report the agreement.

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### Appendix B

#### North Korea-China: The Trade and Aid Relationship

China's primary importance to North Korea, from an economic standpoint, is as a source for oil and coking coal. China provides about half of North Korea's oil and almost all of its coking coal. Oil exports have increased slowly over the last decade but, with that exception, the volume and scope of two-way trade have remained substantially the same since the mid-1970s (see figure 1). [redacted]

The major impediment to expanded trade is North Korea's inability or unwillingness to increase the volume of its exports to China. These consist primarily of anthracite coal, cement, nonferrous metals, and various manufactured goods. [redacted]

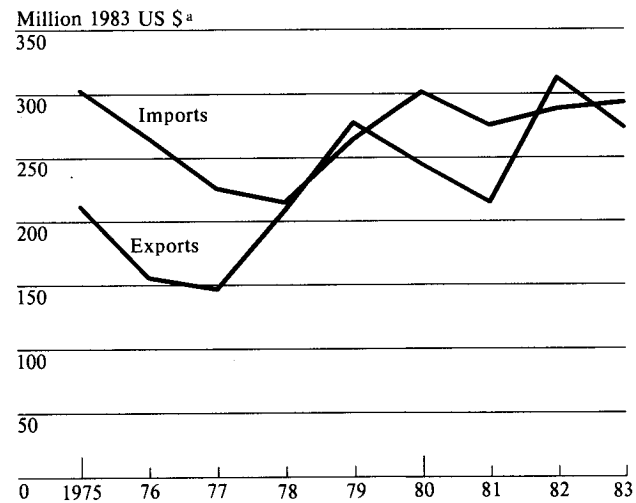
P'yongyang has supplied [redacted] roughly 75 percent of the value of goods promised in the annual protocols. Beijing, meanwhile, has met about 85 percent of its commitments. This imbalance has led to a buildup of about \$500 million in debt that P'yongyang owes Beijing. No interest is charged and, for all practical purposes, shortfalls in North Korean transfers become de facto Chinese aid. [redacted]

Probably in response to large North Korean export shortfalls in 1983, China slashed its shipments to North Korea in early 1984. This get-tough policy appears to have had the desired effect, as had similar tactics in 1978 and 1982. According to press articles, P'yongyang in 1984 gave top priority to exports to China and the Soviet Union. Moscow had also threatened to cut exports. [redacted]

[redacted]

China is also important to North Korea as a source for major industrial facilities, provided on an aid basis. This project aid, however, is much smaller than provided by the Soviet Union. The most important Chinese aid project in the Seven-Year Plan (1978-84) was the completion of the Ponghwa (also known as the Paengma-ri) petroleum refinery near Sinuiju. This

Figure 1  
North Korea: Trade With China, 1975-83



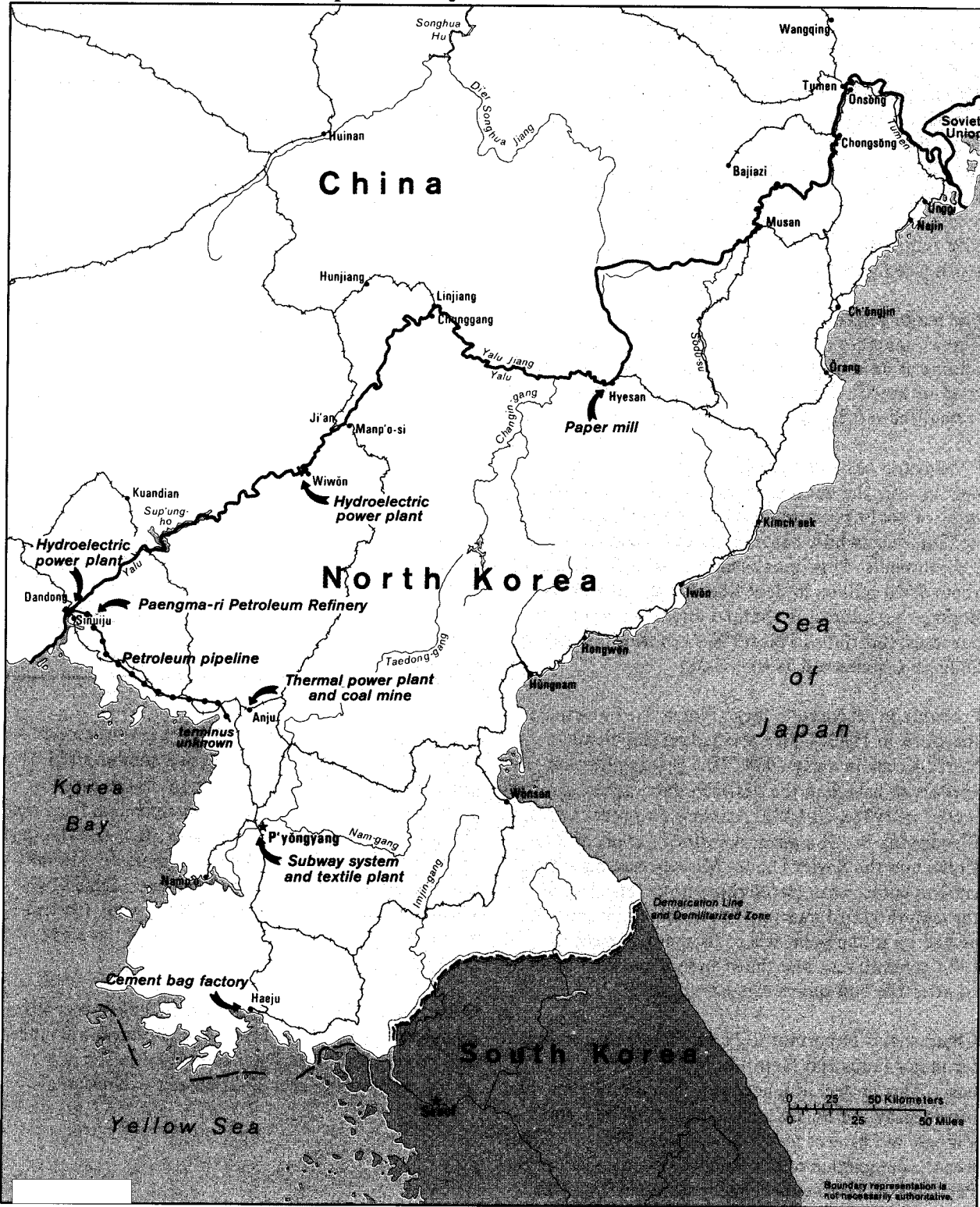
<sup>a</sup> Chinese RMB divided by 1983 US dollar exchange rate.

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30,000-barrel-per-day (b/d) refinery is the second built in North Korea. (The first is a similar-sized plant built with Soviet aid at Unggi in the early 1970s.) Ponghwa, served by a short pipeline from the Chinese city of Dandong, processes all of the Daqing crude oil imported from China. [redacted]

Other major Chinese aid projects include a recently completed papermill at Hysean, a 200-megawatt thermal power plant near Anju completed in the late 1970s, equipment for a 30-kilometer expansion of

Figure 2  
North Korea-China: Economic Cooperation Projects



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P'yongyang's subway system (which had been delivered but not installed by 1983), a cement bag factory in Haeju, and a textile plant in P'yongyang, the construction status of which is not known. North Korea and China are also jointly building two new hydropower plants on the Yalu River, adding to the series of dams from which they share electricity.

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[redacted]

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fewer than 100 Chinese engineers were in North Korea helping with these projects in mid-1984, indicating that most of the aid consists of equipment transfers and not construction help. In contrast, the Soviet Union has several hundred and perhaps as many as a thousand technicians in North Korea. Moscow boasts that it has provided the facilities that produce 63 percent of North Korea's electric power, 50 percent of the petroleum refining and coal mining, and 33 percent of its steel.

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