Chapter 4
De-monetisation, Re-monetisation, and Parallel Currencies in North Korea

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Abstract North Korea has been, and arguable still is, an extreme case of a state socialist system. Due to ideological and economic reasons, by the late 1980s, the country had been largely de-monetised in the sense that money existed but was unable to fulfil its basic functions. A massive economic shock resulting from the collapse of the global socialist system after 1990 contributed to a re-monetisation including a reform of the domestic currency from the mid-1990s. Individuals have reacted in a predictable way, thus weakening the power of the state. Currently, North Korea is, in some aspects, more monetised than, for example, East Germany was in 1989, thanks to the de facto existence of parallel currencies. This chapter analyses the process of re-monetisation, its impact on society, and the state's efforts to curb these effects, which we are only beginning to comprehend fully.

4.1 Introduction

The Democratic People's Republic of Korea, or North Korea, did not emerge on a blank spot. When it was founded in 1948, it succeeded a country that had existed for a long time as a close ally of the Chinese Empire and had been colonised by Japan for 35 years from 1910 to 1945. This is important to note because we can assume that the Koreans have had centuries of experience with a central government and decades of experience with a modern, monetised industrial economy in a Western sense. In particular, the colonial pre-1945 economic system essentially adhered to market principles including relatively[1] free market entry and exit, private ownership of the means of production, and de-centralised price setting according to the interplay of demand and supply. During the period of Japanese colonisation, money

[1]The Japanese authorities initially discouraged investment in particular areas such as industry, and promoted investment in agriculture. After a brief period of moderate liberalism, the beginning of the World War 2 in East Asia marked a transition to a military economy with strategic investments in heavy and chemical industry. The participation of Koreans was possible, but limited to collaborators. See D. McNamara (1990).

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was largely able to fulfil its functions as a medium of exchange, of storage and of transfer of value, and as a unit of account.

In the first decade after the country was liberated from Japan in 1945, the Soviet Union exercised significant influence on the economic system of North Korea (Armstrong 2003). This did not mean the abolition of money, but it led to severe restrictions in its functions, as has been widely documented in the literature on state socialist systems (Kornai 1992). The absence of the threat of market exit led to a soft budget constraint on the side of producers and a decision to a focus on quantity instead of quality. Most importantly, price-setting was centrally regulated, and access to goods and services depended, to an increasing degree, on political capital, not on the ability or willingness to pay. As a result, the reaction of supply to changes in demand was disturbed, if not completely disconnected. State-set prices remained nominally stable despite a chronic shortage, and inflation was hidden (French 2005).

Individuals reacted to this situation. Their career decisions were not driven by concerns over job security, because there was no unemployment; and they were only weakly related to the size of their salaries, because wages were standardised and money had very limited buying power. Instead, individuals aimed at improving their *access* to goods and services. They did so through acquiring Party membership, by other measures to improve their status in the eyes of the state, or by getting jobs that would allow them to interact with foreigners. Improving access to goods and services became the dominant motive of economic activity, as opposed to a maximisation of funds, as would be typical for a market economy.[2]

Enterprises reacted, too. With a focus on nominally fulfilling the plan, access to inputs had to be maximised, and since the latter was difficult to achieve under the conditions of a chronic shortage, output had to be minimised through plan bargaining. Neither prices nor money or cash played a major role here. Rather, political and social capital was used to secure supplies and to reduce output requirements (Eberstadt 2009). These mechanisms are typical for state socialist systems and were among the reasons for the near collapse of East Germany's economy after a sudden change of the "rules of the game" following the parliamentary elections in March 1990, monetary union with West Germany in July 1990, and after actual unification in October 1990 (Ritter 2007). The level of empirical detail available on this kind of development in North Korea is lower than in the case of Eastern Europe, but it has nevertheless been sufficiently documented to provide us with a fair understanding of the situation.[3]

However, as of 2016, North Korea is, in some aspects, more monetised than East Germany was in 1989, thanks to the de facto existence of parallel currencies. The aim of this chapter is to analyse the process of re-monetisation that has taken place

[2]For a glimpse on the life of North Koreans in the early years after 1945, see S. Kim (2013).

[3]An excellent study of the mechanisms of business-to-business relations in North Korea, based upon a thorough analysis of North Korean publications such as *Kŭlloja* or *Kyŏngje Yŏn'gu* can be found in P.H. Park (2016, p. 115).

in the last two decades, its impact on society, and the state's efforts at curbing these effects, which we are only beginning to comprehend fully.

Major sources used in the secondary literature on this field are North Korean defectors and outside visitors who have been residents in North Korea, including occasional business people (Abt 2014). In addition, given the scarcity of fieldwork on North Korea, I dare to use the insights which I have systematically collected during my numerous visits to the country since 1991 as supplementary empirical information to generate a more tangible image of the effects of de- and re-monetisation.

4.2 De-monetised North Korea

De-monetisation in North Korea after 1948 took place as a process. The role of markets for the distribution of goods and services was gradually reduced. Simultaneously, rationing was expanded from the provision of staple food to textiles, consumer electronics and alcoholic beverages. In addition to the extension of the range of rationed goods, the amount that was distributed by the state also rose. In the case of staple food in North Korea, it did, at some point, reportedly reach as much as 700 g per day, although, in reality, the rations consisted of grains of different quality and were often downsized (Lankov 2007). The aim of the state was clear: to realise a vision of Communism as a moneyless society in which constant and reliable oversupply would make money, including cash, unnecessary. Considering the cases of Lenin and Mao, it is rather typical that the realisation of such a vision was attempted in a socialist economy that was by no means as highly developed as Karl Marx had in mind for his image of a Communist society.[4]

By the late 1980s, North Korea was described as "perhaps the modern world's most demonetized economy" (Kihl and Kim 2006). When I spent one semester in North Korea as a student in 1991–1992, the situation which I could observe corresponded perfectly with this characterisation. Three currencies existed in parallel with one another: a domestic currency, called "our money" (*uri hwa*) which was only to be used by North Koreans; "red" foreign exchange certificates[5] (*palgan ton*) to be used by non-Koreans who came from socialist countries such as China, Cuba or Vietnam; and "blue" foreign exchange certificates (*purŭn ton*) that were to be used by foreigners from capitalist countries.[6]

[4]Marx argued that economic development takes place in stages and according to objective laws. There is no room for shortcuts in this way of thinking. A society first had to go through a full capitalist stage before it could move on. This simple rule has been ignored or bent massively by the leaders of states that had hardly moved beyond feudalism, not to speak of capitalism, but nevertheless wanted to use the brand image of "Marxism" for ideological and legitimacy purposes.

[5]The official term was "*woehwawa pakkun ton*" (foreign exchange money).

[6]It should be noted that other socialist countries including Cuba and East Germany had used foreign exchange certificates. In China, these certificates were abolished only in 1994.

The three currencies were not interchangeable, and their use was severely restricted. To purchase products in regular stores or restaurants, local currency was required. For such purpose, foreign exchange certificates could not be used at all. In hard currency shops, however, only "blue" capitalist foreign exchange certificates could be spent. In hotels, both kinds of certificates were accepted; the owners of "red" certificates, however, were de facto charged a lower price because they had to pay relatively less in their own currency to obtain the certificates, while the prices remained the same regardless of the type of certificate used.

The political context is interesting to note. The main reason for the existence of "blue" Won at that time was the regular inflow of Japanese Yen, sent by relatives who lived there as part of the Zainichi community.[7] Until 2002, Japan was also North Korea's main trading partner. In order to avoid the hoarding of large amounts of hard currency cash, and to have immediate access to this valuable resource, the state demanded that the transferred money be exchanged into certificates. We know little about how this was received by North Koreans. In East Germany, the introduction of the so-called "*Forumscheck*" in 1979 in combination with the ban on the use of *Deutschmarks* was not very popular, and the restriction was often ignored.

In North Korea, dissatisfaction, if it existed, was not openly expressed. However, there were occasional irregularities. I was, for example, able to benefit from the system of multiple exchange rates as described above by illegally exchanging a few US Dollars into "red" socialist certificates from fellow Chinese students to buy a train ticket to Beijing. The ticket price was the same in red or in blue Won, but, due to the different exchange rates, it was more expensive if bought with capitalist currency.

This example hints at a few opportunities for profit through the creative utilisation of the various currencies, but it was a complicated and potentially risky endeavour. I could only purchase the train ticket with the "wrong" type of (red) forex certificates because I was able to present my East German passport,[8] and the railway officer was sufficiently confused even though he had heard about German unification.

However, when I attempted to buy an ice cream from a vendor on the street in 1991, neither "blue" forex certificates nor US Dollars or *Deutschmarks* were accepted, although one would assume that they would have been valued much higher than the non-convertible domestic currency. The vendor obviously had no use for this kind of cash because money alone, without some kind of political capital, would not be able to buy her anything. On the other hand, I was not allowed to possess domestic currency. I got the ice cream because a friendly person bought

[7]For more detail on the Zainichi, see C. S. Lee and G. De Vos (1981). The pro-North Korean part of this group is organised in the Chōsen Sōren (ch'ongryŏn).

[8]Despite German unification that had taken place a year before, the GDR (East German) passport was still valid for another five years. This was a technical regulation to avoid the need to convert over ten million East German passports into new documents immediately.

it for me; the same happened when I needed local currency to use public transportation including the subway, which also required "our" money.

My most memorable experience with the de-monetised North Korean economy was my attempt to buy a coffee mug in Pyongyang's Department Store No. 1 in October 1991. On the first floor of the store, there was a pyramid of about 50 or more such cups. But the saleswoman plainly refused to sell me a single one of them, first saying "we don't have any", and then just running away. I was left flabbergasted and thus found out the hard way that a product on display did not mean a product for sale. Following a government directive, which was allegedly based upon an on-the-spot-guidance from Kim Il-sung, the few existing shops and department stores always had to be fully equipped, but the goods on display turned into mere decorations whenever nothing to restock the shelves was available.

The chronic shortage in combination with the limited utility of money led to an extreme version of a typical feature of state socialist systems: the distribution sector was largely neglected. Shops and restaurants were rare in numbers and hardly recognisable. Advertisements and commercials did not exist, neither in public nor in the media. The behaviour of sales personnel in shops and restaurants did not indicate any interest in selling. Goods for actual sale were usually not unpacked but sold out of packages that were sitting on the ground. The availability of something was indicated by the actual process of selling, which instantly attracted a large crowd until the stocks were depleted.

To sum it up, the interest in selling and in making money was very underdeveloped. For the whole of the 5 months that I stayed in the country at that time, beyond the state organised collection of fees, there was not a single attempt by individual North Koreans to extract money from me. The high political risk of doing so would hardly have been counter-balanced by the questionable gain of money that would have been difficult to spend and was thus more or less useless.

Accordingly, phenomena such as corruption were not as rampant as one would expect in a system with a chronic undersupply and a strong bureaucracy. In fact, there are various reports about corruption in North Korea even from that time, but it took different, non-monetary forms.[9] Since money was not useful as a means of exchange or storage of value, access to goods and services became more crucial. Such access was based not only upon superior information, but also on membership in certain groups including the military, the Party, or the citizenry of Pyongyang.

Many goods were distributed for free. Clothing, for example, was handed out on the occasion of major holidays such as the leader's birthdays. Other goods, such as staple food, were sold at extremely low subsidised prices. The so-called public distribution system was operated in buildings that were hard for outsiders to recognise. Such distribution centres were only accessible to local residents who

[9]In a long conversation with a North Korean (anonymity of this source is kept for safety reasons) in 1992, I was, for example, told about some young women using their physical attractiveness to obtain Party membership. Men often "volunteered" to serve in the military for up to one decade in order to get Party membership after deobilisation. Smaller favours could be bought with a bottle of liquor.

were registered there. The administrators of each of these centres kept a book with the names of the residents and the amount of rice or other food that they were entitled to receive. For goods such as television sets, Koreans received coupons that could be redeemed once the desired good was available. Money had to be paid for these goods, but it only played a secondary role in this process.

All this is important to note in order to comprehend the magnitude of the transformation that happened from around 1994.

4.3 Re-monetisation since the Mid-1990s

The major game changer in this situation was the collapse of the foreign trade structure of North Korea as a result of the implosion of the Communist *bloc*. Goods and services had, for decades, been imported from socialist countries based upon long-term low-interest loans or barter trade. North Korea is rich in minerals and thus could offer valuable inputs for the COMECON[10] economies, although contracts were often not respected and the minerals were bartered at unrealistic values (Frank 1996). The background for such practices were the Cold War as well as bilateral competition between the Soviet Union and China, which made it politically desirable for Moscow and Beijing, and their respective allies, to maintain trade relationships with North Korea that were economically not profitable.

In addition to advanced technology, the most crucial material inputs that had been acquired through such preferential trade were crude oil, which North Korea does not produce, and chemical fertilisers. Both are essential for North Korea's agriculture which, due to geographic and climatic conditions, needs to be highly intensive in order to feed the country's growing population (Haggard and Noland 2007). Oil was processed into fuel for machines and pumps for irrigation systems and to produce fertilisers and other important chemicals, but was also directly used to generate electricity.

The relatively sudden conversion of the Soviet Union's and later Russia's trade to hard currency and world market prices resulted in the virtual stop of imports by North Korea. Crude oil imports from Russia dropped from 640,000 t in 1988 to 190,000 t in 1992, while those of coking coal dropped from over 1 million tons in 1988 to zero in the same period (Park 2016, p. 115). China was not yet a major trading partner, and, anyway, had its own difficulties after the shock of the Tiananmen Square protests of 4 June 1989, known in China as the June Fourth Incident. Other trading partners such as Poland or Hungary followed the Russian example, while the German Democratic Republic, another important trading

[10]The Council for Mutual Economic Assistance (COMECON) was a formal organisation to co-ordinate the economic activities of the Soviet Union's socialist satellite states. The basic idea was the same as for every domestic socialist economy: the conviction that competition through parallel production facilities was a waste of resources, and that economic efficiency could be maximised through a centrally organised division of labour. See Springer Gabler Verlag (2016).

partner with a long-standing bilateral relationship (Kang-Schmitz 2010), simply disappeared.

This sudden shock happened in addition to the long-standing structural problems of North Korea's socialist agriculture and regularly occurring natural disasters, some of which have been exacerbated through man-made deficiencies, such as de-forestation. As a result, agricultural production dropped dramatically and fell below subsistence level, which is estimated by the FAO to be around 4.5 million tons of rice equivalent annually. Production of rice fell from 4.5 million tons in 1992 to 1.4 million tons in 1996, output of maize fell from 3.7 million tons to 0.8 million tons in the same period (FAOSTAT 2016). The distribution system collapsed in most parts of the country except Pyongyang and even in the capital life became harder (Smith 2005).

This is when distribution of goods via so-called "farmer's markets" (*nongmin sijang*, also *changmadan*g) started to gain a hitherto unseen level of importance. Such markets had been present in North Korea throughout its existence; their size and the scope of the available goods was, however, both strongly regulated and curbed by the government. They typically opened only three times a month (on days with a "1", such as the 11th, the 21st, and the 31st) and offered a limited range of local products, fruits, wild plants, etc. Farmers had to submit almost all of their production to the state and thus had little left to sell individually, which would have been a relatively pointless endeavour anyway because of the limited utility of money. The private economy, as much as it existed, did so at a low level of equilibrium.

With the collapse of public distribution, the previously sidelined farmer's markets suddenly became the major distribution channel for food and anything else of either domestic production or of Chinese origin, entering through the only superficially guarded border. Almost overnight, money started to matter in North Korea. As far as we know, domestic currency was used at the beginning, later in parallel with Chinese Renminbi, Japanese Yen[11] and, to a lesser degree, US Dollars.

Around the mid to late 1990s, Western interest in North Korea began to grow due to the news of a major famine. Images of hungry children appeared in mainstream news, and aid organisations were allowed to become active in North Korea (Smith 2005). Reports from defectors, which had previously been accessible mostly to South Korean intelligence circles alone, made their way into the media spotlight, and thus the collapse of the public distribution system and the spontaneous upgrading of the farmer's markets in North Korea became known in South Korean and Western academic circles. As soon as South Korea had overcome the worst of the Asian Financial Crisis of 1997/1998, and facilitated both by compassion for the suffering of fellow Koreans and the election of a progressive president

[11]The role of Japanese currency can be explained by the close economic relationship between North Korea and the pro-North Korean group of Zainichi Koreans in Japan who regularly sent money to relatives. In fact, trade relations were brisk; at the time of my studies in North Korea, most products in the hard currency stores were obviously imported from Japan including Coca Cola, shoes, stationery, etc.

in Seoul, South Korea's co-operation with North Korea achieved a few milestones including Mt. Kŭmgang tourism in 1999 and the first inter-Korean summit in June 2000 (Moon and Swenson-Wright 2014).

Clearly pushed by the experience of the famine and pulled by the new, forthcoming attitude of South Korea, perhaps also impressed by the evermore visible success of the cases of China and Vietnam, Kim Jong Il, since 1994 the new leader in North Korea, decided to legalise the spontaneous developments that had occurred during the chaotic years of the famine. He restored the state's control over distribution by partly re-establishing the public distribution system, but left the markets intact and even legalised the trade of goods other than food, renaming them officially from "farmer's markets" into "markets". The number of such markets in the whole country was reportedly around 380 by the end of 2015 (Silberstein 2015).

The July 2002 reforms harmonised prices, eliminated subsidies, introduced wage differentiation and devalued the domestic currency *vis-à-vis* the US Dollar. The foreign exchange certificates were scrapped, and the country now had only one currency. State prices were multiplied to match the market prices, thereby acknowledging, for the first time, a phenomenon called inflation (Frank 2005).

In various training seminars both in Pyongyang and in other countries including Switzerland, I was asked again and again by the North Korean participants from the Party, the Central Bank, and universities, about how best to fight inflation, which seemed to be the major concern of the leadership. Considering that right before the Tiananmen Square protests in China, inflation there had reached double-digit levels, and given that inflation in North Korea was estimated to be even higher, this focus was understandable.

It became clear that the North Korean government had, to a certain extent, decided to turn away from direct administration and was endeavouring to use macroeconomic and monetary instruments to achieve its goals. Not all these measures were successful; the introduction of People's Life Bonds in 2003, the first such attempt since the issuance of war bonds in the early 1950s, was designed to reduce liquidity in North Korea in order to curb inflation.

Meanwhile, North Korea's society underwent a change of little less than epic dimensions. When I visited Pyongyang in 2005, I was stunned to see hand-written signs on the door of a watch shop inviting customers to benefit from discounted prices on the occasion of the 60th anniversary of the Party foundation. Avoiding empty shelves did not seem to be a priority anymore. Rather, sales had to be maximised, and discounts were used to incentivise potential buyers. A few blocks down the street, I passed by a textile shop that, again in hand-written posters on its doors, invited customers to enter and enjoy a cup of tea or a glass of beer. A semi-legal cafe had been set up to attract more visitors and to make more money. The contrast to my experience a decade before was stunning.

A few days later, I visited a cultural heritage site in one of the provinces and wanted to buy an aquarelle as a souvenir. I asked for a discount if I bought four pieces but the vendor either did not understand the concept or was unwilling to reduce the price further. I insisted, and, in the end, he agreed. When I unpacked what I expected to be four paintings in my hotel room in the evening, I found that the vendor had cheated me; he had wrapped up only three paintings. My initial anger made room for the recognition that the goal of profit maximisation had trumped the very real fear of serious repercussions; defrauding a foreigner would almost certainly have been punished severely by the state if I had reported the incident.

Similar anecdotes appeared from various sources. It became clear that, within a few years, the attitude of most North Koreans towards profit had changed completely. This was possible through the resuscitation of money as a means of exchange and of the storage of value. The resulting behaviour, as such, was what is regarded as normal elsewhere and thus escaped the attention of most Western visitors. But compared to my experience a little more than a decade earlier, North Korean society had changed almost beyond recognition.

One visible expression of the re-monetisation was the emergence of cash cards.[12] As soon as money started to matter, some individuals were able to acquire so much of it that carrying cash was simply too cumbersome. The phenomenon of cashcards was a first proof of the emergence of a new middle class; I suggest using the number of mobile phone subscribers as a rough estimate for the size of this group (Frank 2012). It is important to note that this does not include the upper class in North Korea, who live in secluded areas and rarely interact with the ordinary population. Rather, the new middle class is an integral part of society. Differences in external appearance such as clothes became apparent; even the body language changed. Some North Koreans were seen with dyed hair or pet dogs, indicating the growing influence of South Korean fashion about which they learned from illegal DVDs or USB sticks.

The re-introduction of money had changed a formerly highly egalitarian society. Signs of different levels of affluence became obvious. The state's power was weakened through the ever-growing role of the markets for the distribution of goods and for price-setting. Political capital, which was once the only decisive factor to acquire almost any good or service was pushed into the background by money. In conversations with North Koreans, I rarely heard the desire to become a Party member or to spend a decade in the military anymore. Rather, learning English or Chinese, and doing something with "business" was what parents desired for their children, and what young people wanted to do.

[12]They function as a pre-paid card. They can be charged with cash and then used with a password at designated shops, even taxis. The most popular cash card in North Korea is the red-blue "Narae Card", issued by the Foreign Trade Bank.

4.4 The Currency Reform of 2009

It is not surprising that such changes raised concerns among parts of the leadership about regime stability. The result was a phase that I have called “socialist neo-orthodoxy”,[13] lasting roughly from 2005 until 2009, but having been in preparation from about 2003.

The domestic driver of this policy shift has most likely been the seismic change within North Korean society as described above, and the resulting fear, on the part of the state, of losing control of society through the loss of its function as the sole provider of everything, and the growing individual self-confidence resulting from increasing economic autonomy. However, there was also a major external factor, namely, the uncompromising “War against Terror” of the George W. Bush administration after the 9/11 attacks on 11 September 2001. North Korea had been branded as a member of the “Axis of Evil” in January 2002 (Bush 2002). With the invasion of Iraq in March 2003, it became likely that such rhetoric might be followed by action. Economic reform including re-monetisation is risky for an authoritarian system that seeks to maintain stability. It is understandable that such a risk will only be taken, if it is taken at all, if the security of the regime is not otherwise threatened. Accordingly, reforms were stopped, and the state even attempted to repeal some of them.

The number of reports about the state’s efforts to reduce the influence of private, money-based economic activities increased. They included the rumour that new regulations had been passed requiring a minimum age for women to be granted a license as a market trader. I was unable to verify this particular information during my visits, but a systematic study of the official media revealed a return to pre-reform wording (Frank 2010b).

The neo-orthodox turn lasted for a few years and culminated in an ill-fated attempt at curbing rampant inflation in 2009. On 30 November 2009, it was announced that, within one week, old banknotes would have to be exchanged for new ones. Only a limited amount of cash could be converted. Initially, this was only 100,000 Won, equivalent to about 40 kilograms of rice at the markets. The amount was later expanded to be 150,000 Won in cash and 300,000 Won in bank savings (Moon 2009). The rate of exchange from old to new money was 100:1 for cash and 10:1 for savings (Yonhap 2009). While prices and savings were reduced, wages remained at the previous nominal level, thus resulting, for a brief period, in a real wage increase of 10,000%. This should, however, be contrasted with the fact that, in the decade before, wages had remained rather stable while market prices had soared. It could thus be argued that, by the currency re-valuation, the state had intended to make regular work financially attractive again.

[13] In fact, I had initially used “socialist neoconservatism”, but this led to confusion among American colleagues who had a very specific understanding of the term “neocon”. See Frank (2010a).

North Korea has had a number of currency reforms before, including the reforms in 1959, 1979, and 1992 (Lankov 2013). The goal had usually been to re-establish the state's control over cash holdings in the country, and to eliminate excessively high savings, including those accumulated by sideline economic activities. For this purpose, however politically questionable, the replacement of an old currency with a new one was a sensible instrument. In 1979, the year of the introduction of domestically printed bills, there was the additional political motive of reducing dependency on the Soviet Union, which, until that time, had printed North Korean banknotes, and thus gathered valuable information about the amount of cash in circulation (Hunter 1999, p. 185).

In 2009, however, one of the main goals seems to have been not only to expropriate the middle class, but also to curb inflation. As indicated above, North Korean officials have repeatedly approached me over a number of years regarding this issue. The re-monetisation since the late 1990s, and, in particular after the 2002 reforms, had magnified the problem of skyrocketing prices, to reach dimensions that had not been known before in North Korea. There are no official figures, but my own estimate of annual inflation between 2003 and 2005, based upon a small basket of goods and services, was in the range of 200% (Frank 2005).

Politically, the state wanted to regain its control over the lives of its people by bringing them back into employment in the state sector. The markets had helped the country to overcome the famine but now had to be curbed again. A North Korean economist, clearly speaking on behalf of the state, explained in an AP interview in March 2010 that "Markets will be removed in the future, by reducing their numbers step-by-step, while continuously expanding the planned supply through state-run commercial networks" (Boston.com 2010).

One effect of the currency re-valuation was a massive expropriation of those who, in the past years, had been able to generate huge amounts of cash through the classic technique of selling products at a price above their costs. The term "confiscatory currency reform" (Haggard and Noland 2010) is thus well deserved. Once again, we lack solid data, but anecdotal evidence suggests that the big players were mostly unaffected by this measure because they had habitually converted their earnings into foreign currencies, mainly Chinese Yuan. Those who saw their savings de-valued were the smaller traders and private households (Park 2016, p. 199).

The public reacted with protest, something that is very unusual for North Korea. Reports of minor skirmishes with the authorities as well as of suicides emerged (Lee 2009). As a consequence, the government again increased the amount of cash that could be exchanged to 500,000 Won and savings to 1,000,000 Won or even more, if the origin of the money could be properly explained.

Andrei Lankov has argued that "the person who suggested this [the currency measure] was unbelievably naïve, not to say ignorant, about the fundamental workings of an economy" (Lankov 2013, p. 218). He implied that Kim Jong Il himself could have given the order. Whether or not this was the case, being the top leader includes responsibility. A scapegoat had to be found. As far as we know from defector reports, the currency measures were later declared to have been an attempt by a pro-American individual to undermine the dignity of the state. Pak Nam-gi, a Department Director of the Korean Worker's Party, was presented as the culprit and disappeared, in the true sense of the word (Branigan 2010). In North Korean newspaper articles, his name was edited out.

After the failed reforms, the neo-orthodox phase was over. Most restrictions on markets were lifted, and their activities were tacitly acknowledged as part of ordinary North Korean life. The currency revaluation of 2009 was followed by the re-emergence of explicit claims on the part of the state that it aimed to improve the consumer economy by focusing on light industry and agricultural production (Abrahamian 2011). Within a few months, prices returned to pre-reform levels, which means that the originally very substantial real wage increases were reduced to zero.

From a strictly economic point of view, the 2009 currency measure suddenly reduced the money supply, especially the amount of cash in circulation, which, in North Korea, plays a central role.[14] If all wages and all other sources of income were reduced by the same rate, not much would have happened except for the above stated expropriation or a forced disclosure of hidden cash reserves. But this was not the case; in addition to the above-mentioned 100-fold real wage increase and the tenfold increase in the value of bank savings, cash holdings in other currencies were not affected. The wage-earning and bank-saving part of North Korea's society saw its purchasing power jump up, which resulted in growing demand while supply remained stable or even decreased due to a shortage of cash among wholesale merchants, at least in the short run. This led to an upward pressure on prices and thus to massive inflation that further devalued savings and cash holdings.

The logical reaction of individuals in any society would be to abandon local money and to conduct business in alternative currencies. In the post-war economies of the twentieth century, cigarettes have often played this role. In North Korea, those traders and their clients who had not yet done so switched to foreign exchange such as Chinese Yuan, US Dollars, or the official main foreign currency[15] in North Korea, the Euro.

The state reacted by banning the use of foreign cash in the country. In January 2010, the Foreign Trade Bank informed foreigners residing in Pyongyang, including diplomatic missions, NGOs, and businesses, that the use of foreign currency in North Korea was no longer permitted, and that all transactions had to take place in North Korean Won at a nominal conversion rate of 1 € to 140 KPW as of 2 January

[14]I once asked a North Korean friend what she does with her monthly salary. She replied that she takes it home, in cash, and keeps it there. When I explained that, in my country, wages would typically be transferred to a bank, she gazed at me in bewilderment, and, over the next days, kept asking about the reasons why we considered the use of a bank to be a good idea.

[15]During a closed door meeting with North Korea's Vice Minister of Foreign Affairs in Brussels, the participants including myself were informed as early as 14 October 2002, that North Korea would stop using the US Dollar and introduce the Euro as its official currency for hard currency operations. This measure was officially implemented on January 2003. In reality, however, the US Dollar did not disappear from North Korea, and the Chinese Yuan became stronger.

2010. Payments including for accommodation, electricity, salaries etc. had now to be made in the form on non-cash cheques or bank transfers and denominated in KPW (Foreign Trade Bank 2010).[16]

It is unclear whether the ban on the use of forex in North Korea is still technically valid. In reality, it is definitely not. It is even difficult to get a quick reply when asking traders at North Korean markets about the prices of their goods in North Korean Won. This is not because they are reluctant to answer; they simply do not know, because they conduct their transactions mainly in "*Inminbi*" (Chinese Yuan). The currency disaster of 2009 taught North Koreans that they cannot trust their government when it comes to monetary stability, and, as a result, they found alternatives. Remarkably, the government seems to have accepted this, showing once again a degree of pragmatism that does not correspond with its stereotypical image in the West.

4.5 The Symbolism of North Korean Banknotes

Money is usually seen as having mainly economic functions. It is, however, also an important carrier of ideology. The *Euro* notes, for example, are decorated with images of bridges to symbolise the connecting function of the common currency, and none of these images is drawn after an actual original to avoid harming national feelings (Schmid 2001).

In North Korea, the images on banknotes have long been used for mainly three purposes: to promote leader Kim Il Sung; to symbolise the various strata in society, such as the farmers, the scientists, the workers, the military, etc.; and to display national symbols such as the national flower, the Chuch'e Tower, or the Kaesŏnmun (Arch of Triumph).

In 2002, the emergence of significantly higher denominations of up to 5000 Won accompanied the July measures and the resulting price adjustments. In December 2009, two major changes could be observed on the new banknotes that implicitly foreshadowed the solution of a major problem—the succession of power (Frank 2010c).

The 50, 10 and 5 Won bills of the new North Korean currency showed the people of North Korea. The Workers Party (50 Won) was valued higher than the military (10 Won), and the farmers were missing altogether; the 5 Won bill honoured the technical intelligentsia. This provided some food for thought for those who interpreted the Military First Policy as the expression of the dominance of the military over the Party.[17]

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[16]Foreign Trade Bank of the DPRK (2010) Document No. DC03310-004. 29 January 2010.

[17]This is a view that I emphatically do not share. The Party and the military are both instruments of power, and are closely interconnected; each high-ranking officer is also a Party member. Dividing lines in North Korea's élite certainly exist. However, they run between families and regions, not between (but inside of) institutions.

The truly significant message was to be found on the three highest denominated bills. Not unexpectedly, on the 5000 Won note, we find the Eternal President Kim Il Sung. Comparing this to the bills issued in 2002 with the somewhat timeless pictures on which he had black hair and seemed to be in his fifties, he was now depicted as an elder man, with grey hair, glasses, and a smile on his previously stern face.

The 2000 Won banknote was the most remarkable piece of the new currency: it complemented the message of the 5000 Won banknote by showing the second generation, providing a symbolic reference to Kim Jong Il. Never before had this been done in North Korea. Kim Jong Il's portrait was still missing, but the banknote showed the log cabin at the "secret camp" beneath Jong Il Peak, where Kim Jong Il was born in February 1942, according to official North Korean mythology. Kim Jong Il's close connection to his father was symbolised by the 1000 Won banknote, which shows the birthplace of Kim Jong Il's mother, Kim Jong Suk, in Hoeryŏng.

Two things became obvious: by changing the age of Kim Il Sung, room was created for upgrading the status of his eldest son Kim Jong Il. He had ruled the country since 1994, and his image was hanging inside office buildings and apartments next to that of his father. But he had avoided replacing Kim Il Sung as the primary national symbol, as well as the erection of statues of himself, or bestowing his name upon streets, universities, or plazas. Kim Jong Il's image was also conspicuously missing on coins and banknotes.

By adding his birthplace as well as that of his mother, in 2009 Kim Jong Il effectively changed the message on the banknotes from "this country is ruled by Kim Il Sung" to "this country is ruled by the family of Kim Il Sung". This opened the way for the introduction of the next successor, Kim Jong Un, who was presented to the public less than 1 year later in September 2010.

4.6 The Choco Pie Mystery and Two Competing Currencies

The ups and downs in North Korea's monetary system and the existence of parallel currencies can be rather confusing, especially for *ad hoc* observers. The difficulties in understanding this complex situation are reflected by what I call the "Choco Pie mystery".

This phenomenon emerged when South Korean employers in the now closed Kaesong Industrial Zone (Frank 2016a) sought for ways to motivate their staff materially. Wages were negotiated and collected by the North Korean state on behalf of the workers, so the standard way of providing an incentive to work harder through wage discrimination was not available. The employers therefore introduced in-kind incentives. The latter included snacks the size of a flattened golf ball consisting of two small round layers of cake with marshmallow filling and covered with chocolate. They were wrapped in foil and were thus non-perishable. This made them popular among Kaesong workers because these Choco Pies could be taken out of the compound and either given as presents to those at home or even be sold.

Apparently, news about the latter reached the South Koreans, either directly through Kaesong workers or, more probably, through China. The price of one Choco Pie on North Korean markets was about 1000 North Korean Won. Someone who was not familiar with the North Korean economy divided this amount by the "official" conversion rate for foreign shoppers as it is displayed in international hotels in Pyongyang, which is 100 Won per US Dollar. This is how the idea emerged that one Choco Pie sells for a whopping 10 (!) US Dollars on the North Korean market.

The problem is that North Korea still has different kinds of distribution systems: facilities in which payment can be made either in local currency *or* in hard currency, converted at the market exchange rate; and facilities in which payment can *only* be made in Euros, US Dollars, Japanese Yen or Chinese Yuan. In the latter case, to avoid having price tags with four different prices or using one of the foreign currencies as the official accounting unit, prices are provided in a fictitious currency which is, confusingly, also called Won. But the exchange rate here does nothing but reflect the value of these four foreign currencies in relation to each other. It is often called the "official exchange rate" but this is technically not correct. North Korean currency cannot be converted into hard currency at this rate, and *vice versa*. In other words, if someone enters a shop in Pyongyang and the price tag on a can of soda says that it costs 100 Won, it means he or she will not be able to pay with Won, but only with hard currency, which is, in this case, about 1000 Chinese Yuan. If a foreigner wants to buy an "Eskimo" ice cream from one of the kiosks on the streets of Pyongyang, the price will be around 2000 Won and can be paid either in local currency or in hard currency, typically one or two Chinese Yuan depending on the seller's salesmanship.

Against this background, it is obvious that the assumption that a single Choco Pie costs 10 US Dollars in North Korea is absurd. The actual price is 80 times less, because the market rate is in the range of 8000 Won per US Dollar. One 1000 Won Choco Pie thus costs about 12 US Cents, which is only slightly above the price at which this product sells in China.

Even without knowledge of the complex situation which determines North Korea's exchange rates, it would be easy to discover that a price of 10 US Dollars would simply be unrealistic. All it requires is that we recall that North Korea is a country where food supply is not secure for most people. It is very unlikely that they would spend the equivalent of several kilograms of rice on a small 120 calorie snack. It is also not realistic to assume that the North Korean population would indeed possess the enormous purchasing power for buying millions[18] of Choco Pies at that price.

[18]We are indeed talking about millions. If each of the 50,000 Kaesong workers received only two Choco Pies per day, this would amount to about 35 million such snacks annually.

It is thus somewhat surprising that a major news company such as CNN (Park et al. 2014) carried the story about the 10-Dollar-a-piece Choco Pie, and it is disturbing that the former National Security Advisor for North Korea to US President George W. Bush repeated the story in his memoirs (Cha 2012).

4.7 Present Status and Outlook

Despite all the recent changes, the state maintains its grip on the economy. Traders on markets need a licence, and the authorities control the markets to make sure that no illegal trading is taking place. Prices on the markets are freely set through the forces of demand and supply, using China as a benchmark with a premium for transportation and other transaction costs. The currency used by traders and their clients is mostly the Chinese Yuan, but domestic currency is also in use, in particular, in areas that are not close to the Chinese border. Exchange rates are calculated based upon the market rate which is on display in some banks and shops.[19] Thus, calling either the markets or the exchange rate "black" is not justified. Instead, we should speak of a dual, or actually triple, distribution structure, consisting of public distribution at state set prices, market distribution at freely set (but state controlled) prices, and hard currency facilities.

The currency re-valuation of 2009 was, in many regards, a remarkable event. It demonstrated how well money now functions in the previously de-monetised society of North Korea. Its failure marked a stop of the neo-orthodox push, even though it has not been reversed. As of 2016, it is fair to say that North Korea's economy is, in many ways, more monetised than those of countries like East Germany ever were. The state has tacitly accepted the existence of markets and, for the time being, does not try to curb them further; on the contrary, they are now being integrated into the official distribution system.

Since the currency re-valuation, the situation has been relatively stable. Prices including exchange rates have developed up and down according to demand and supply. No new experiment has taken place. There are still hard currency stores where goods and services can only be purchased with foreign money, and elsewhere domestic and foreign currencies exist in parallel.

The North Korean economy has effectively been re-monetised. Currently, there is no indication that this will be undone, even though the overall trend in economic policy under Kim Jong Un points at an attempt to normalise the operation of the national economy. This includes the strengthening of centralised control through the Cabinet.

It is clear that there are strong forces in Pyongyang that are trying to reduce the role of markets and to strengthen central control again. But their chances of success

[19] Among those that I have personally seen are the Golden Triangle Bank in Rasŏn and the Kwangbok Area Supermarket in Pyongyang.

are limited, given the low efficiency of a state administered economy, on the one hand, and the necessity for Kim Jong Un to provide a visible and sustainable improvement in the people's living conditions, on the other. In his speech at the 7th Party Congress on 8 May 2016, Kim showed no sympathy for a further marketisation and de-centralisation, but instead repeated a number of concepts that had been popular in the 1980s when North Korea very guardedly modernised its socialist economic system to make the operations of its enterprises more efficient (Frank 2016b). The general tenor seems to be that exceptions had to be made in order to cope with the mid-1990s crisis, but that now is the time to return to a normal operation along the lines of the *status quo ante*. This does not, however, mean a return to the 1950s, but rather to the 1980s when North Korea was attempting its own, much more cautious and often overlooked Chinese-style adjustment of the obviously unsustainable post-Stalinist economic model.

It remains to be seen how the economic sanctions of March 2016 (Gladstone and Sanger 2016), and, in particular, the designation of the whole country as a jurisdiction of primary money-laundering concern under Section 311 of the US Patriot Act in June 2016 will affect the monetary economy of North Korea (Treasury 2016). It is difficult not to see the connection between monetisation and marketisation; allowing the use of foreign currencies within the country was a decisive factor to make the spread and growth of markets in North Korea possible, because it provided a trusted and stable means of payment. Friedrich von Hayek would have called this competitive money supply (Hayek 1990); in particular, the Chinese Yuan is challenging the Korean Won.

Economic pressure on North Korea is among the few peaceful options on the table to respond to the continued expansion of the nuclear programme and is thus understandable from a short-term security perspective. However, sanctions will significantly limit foreign trade and the circulation of money in North Korea and thus suffocate the very forces that provide the best chance for a long-term solution to a number of issues including the nuclear problem. If the financial side of trade cannot be handled by banks, the remaining options are barter trade and payment in cash. The former has its limitations, especially if the trading partners are single enterprises, not states that represent multiple trading partners. Payment in cash has been used by North Korea in the past but the limitations here are of a technical nature: it is simply too cumbersome, and, in some cases, it is forbidden by foreign authorities to carry bags with large amounts of clean 100 Dollar bills.

The changing role of money and of cash in North Korea presents an interesting case. A more or less modern economy had first been almost completely and deliberately de-monetised on order to strengthen the immediate role of the state in the distribution of goods and services for producers and consumers, and was then re-monetised as a method of coping with a severe economic crisis. We might now see attempts at undoing this again. These ups and downs turned North Korea into a gigantic economic experiment. The fly in the ointment for scholars was and is the limited access to study the actual effects of these measures, but we can nevertheless make a number of interesting observations.

A minor point that gains in importance if we consider the ongoing general debate in the West about the abolition of cash is the dependence of electronic means of payment on a stable supply of electricity and data connection. North Korea has introduced at least four different cash cards, but they often do not work due to problems with the infrastructure. From a broader perspective, the North Korean case shows that the de facto de-monetisation of a modern economy is technically possible, but that it will remain hollow unless scarcity is eliminated, too. It further demonstrates how a foreign currency can step in if the domestic currency is unable to fulfil its functions, and how opening the economy to trade resulted in the importation not only of goods and services, but also of habits and currencies.

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