

## **Trade and Investment in North Korea**

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### **Introduction**

Given North Korea's inherited Soviet-type socialist economic system, where foreign trade and investment play a very limited role and where its ideology is one of self-reliance, North Korea's foreign trade and investment never occupied a major position in its economic system. The debacle of the Soviet Union and Eastern European socialist regimes further weakened North Korea's foreign trade, and the declining North Korean economy and its political frictions with the Western countries, in particular with the United States and Japan, aggravated both North Korea's foreign trade and investment.

However, the recent experiences of transition economies show that in order for North Korea to develop its economy and transition to a market economy, it must rely heavily on foreign trade and investment. Therefore, in this paper, the current status of North Korea's foreign trade and investment will be examined and some policy directions to develop them will be suggested.

North Korean statistics are notoriously scarce. Statistics on FDI in North Korea are very limited, however, with regards to North Korea's foreign trade—a quite good estimation can be obtained by using the trade statistics of North Korea's trading partners.

### **Trends and Main Characteristics of North Korea's Foreign Trade**

North Korea's foreign trade decreased substantially in 1991, and it continued to diminish until 1998, even though it recovered slightly in some years. As a result, the total volume of North Korea's foreign trade<sup>1</sup> shrank from US\$4,170 million in 1990 to US\$1,442 in 1998. This downward trend was reversed in 1999, and North Korea's foreign trade continued to grow until 2004 when it recorded US\$2,857 million, which was almost two times bigger than its lowest level of 1998 and slightly superior to its level of 1991. Both North Korea's export and import showed similar trends (see Figure 1).

The lack of trade in North Korea's trade volume is more evident when it is compared to that of South Korea. In 2003, South Korea's total trade volume was 155.9 times bigger than that of North Korea,<sup>2</sup> while South Korea's nominal GNI was estimated 32.9 times larger than that of North Korea.

Apart from its low level, one of the main characteristics of the North Korean foreign trade is its chronic deficit. Its import always surpassed its export in the 1990s, and the size of the former was more than twice bigger than the latter since 2000.

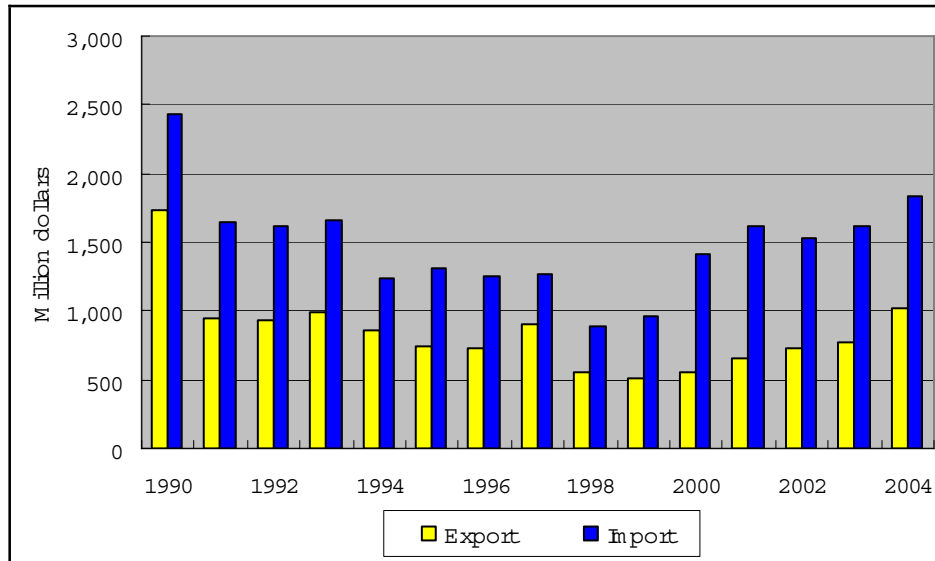
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<sup>1</sup> Not including the trade with South Korea.

<sup>2</sup> In 2003, South Korea's export and import were 248.5 times and 111.1 times bigger than North Korea's export and import, respectively.

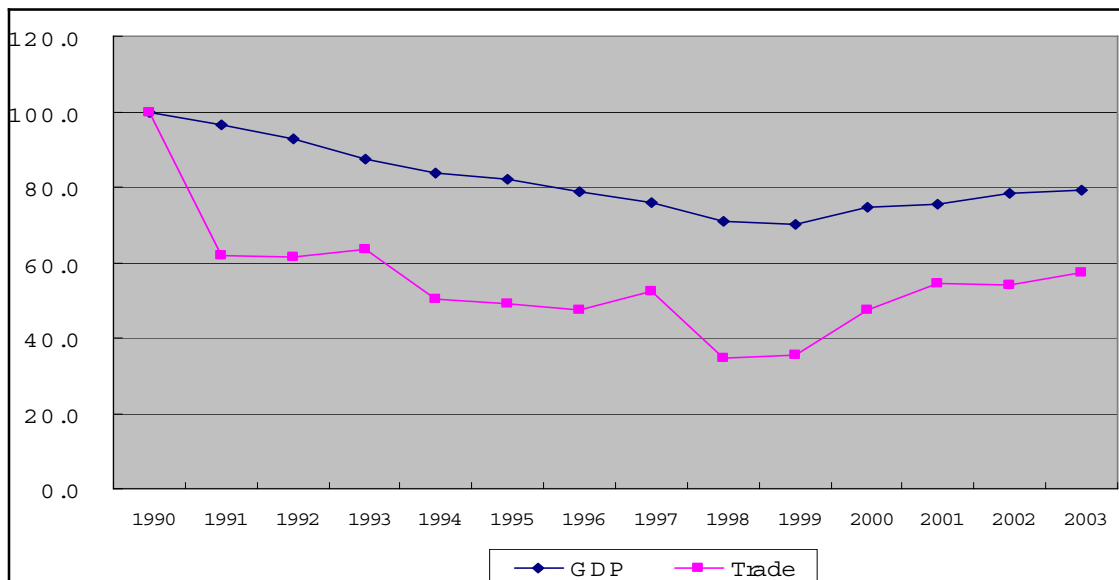
The sudden decrease of North Korea's foreign trade in the early 1990s was caused by the collapse of the Soviet Union and Eastern European socialist regimes—which used to be North Korea's main trading partners—and the change to a system of payment in hard currency. In the following years, the trend of North Korea's foreign trade can largely be explained by the continuous decline and recent recovery of its economy (see Figure 2).

**Figure 1. North Korea's Foreign Trade**



Sources: Ministry of Unification, ROK; KOTRA

**Figure 2. North Korea's GDP and Trade (1990=100)**



Sources: Bank of Korea; KOTRA

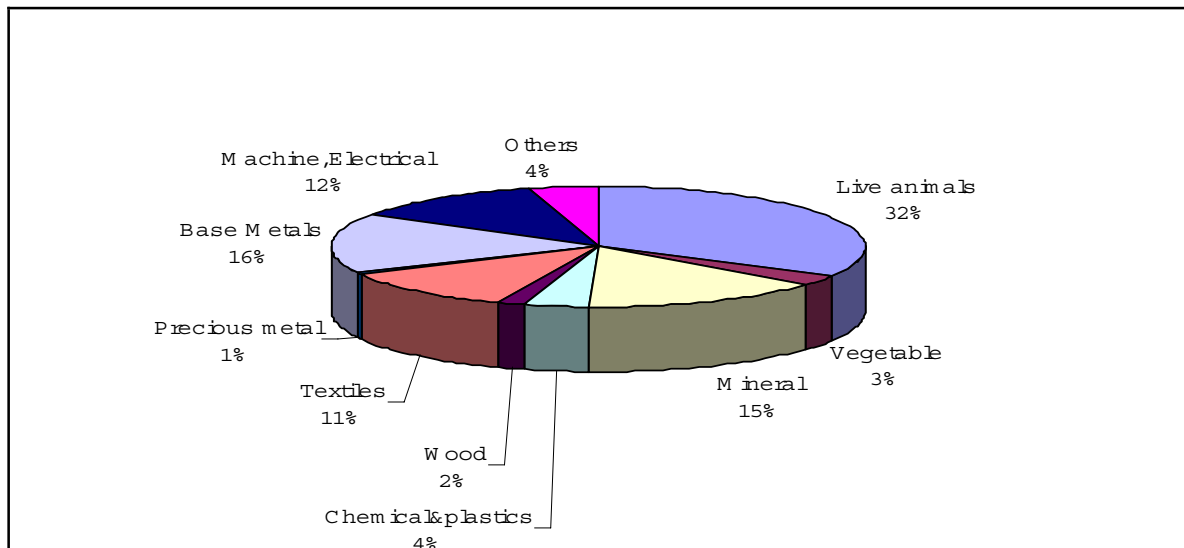
On the other hand, North Korea's trade with South Korea grew from US\$13 million in 1990 to US\$697 million in 2004.<sup>3</sup> During the same period, North Korea's export to South Korea increased from US\$12 million to US\$258 million, and its import from South Korea went up from US\$1 million to US\$439 million. In particular, the procession-on-commission trade increased from US\$800,000 million in 1992 to US\$176 million in 2004.

Vis-à-vis South Korea, North Korea recorded a trade surplus until 1997 and a trade deficit since 1998. However, in terms of commercial transaction trade, North Korea recorded a trade surplus vis-à-vis South Korea. For instance, in 2003, North Korea recorded a trade deficit of US\$145.71 million. But excluding non-commercial transaction trade (export: US\$0.17 million; import: US\$315.37 million), it recorded a surplus of US\$169.49 million vis-à-vis South Korea in commercial transaction trade.

When it comes to North Korea's foreign trade, unlike inter-Korean trade, the statistics on commercial or non-commercial transaction trade are not available. However, in view of the structure of the intra-Korean trade, the level of North Korea's recent import in terms of commercial transaction trade must be much smaller than Figure 1 indicates. North Korea's possibility to maintain chronic foreign trade deficit can also be largely explained by the non-commercial transaction.

Recently, North Korea's major export items were fishery products, base metals, minerals, machines and electrical products, and textiles, whereas its major import items were chemical products, machines and electrical products, vehicles and associated transport equipment, and food.<sup>4</sup>

**Figure 3a. Export Items of Northeast Korea (2004)**

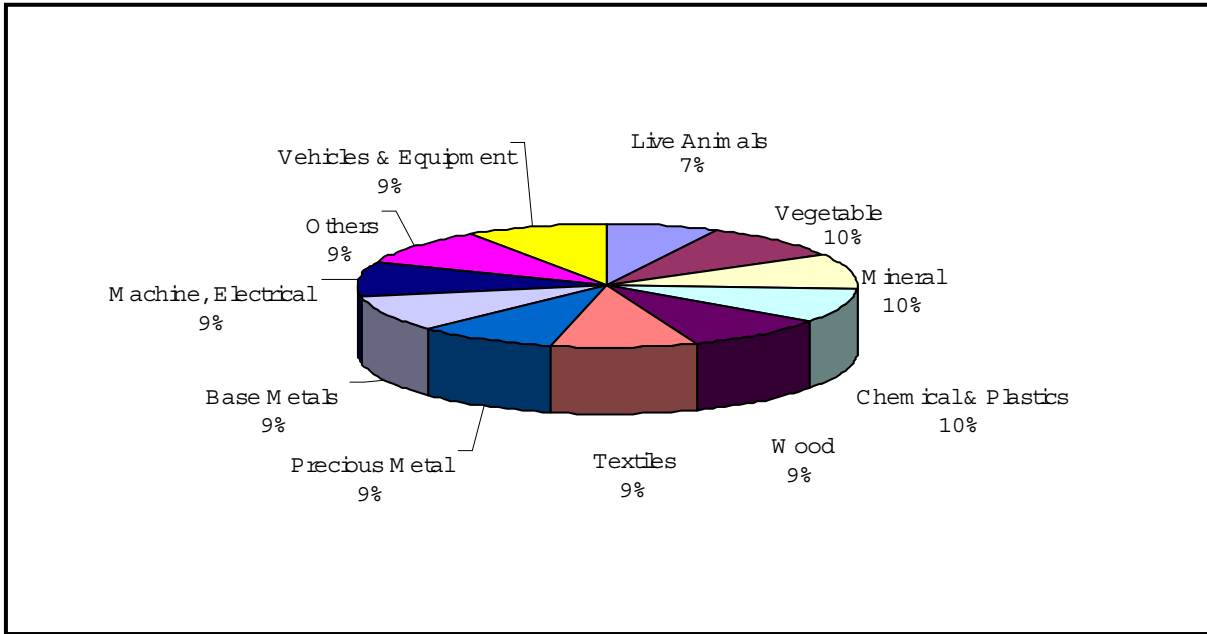


Source: KOTRA

<sup>3</sup> Thus, North Korea's total trade including that with South Korea amounted to US\$3,554 million in 2004.

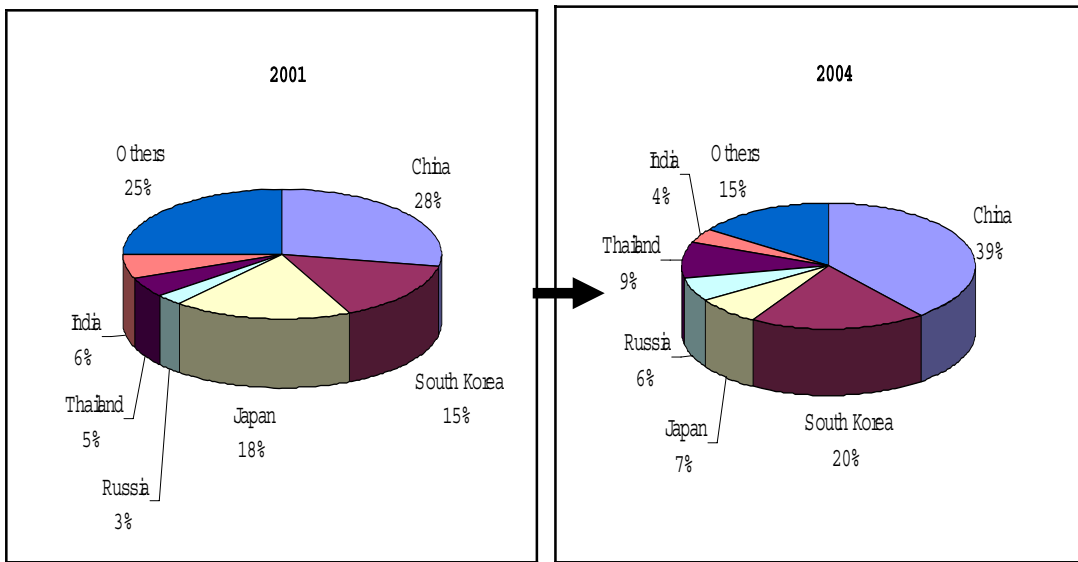
<sup>4</sup> North Korea's major export items to South Korea were also agro-fishery products and textiles, while its major import items from South Korea were chemicals (including fertilizers), textiles, and agro-fishery products.

**Figure 3b. Import Items of Northeast Korea (2004)**



Source: KOTRA

**Figure 4. North Korea's Major Trading Countries**



Source: KOTRA

China has become North Korea's most important trading partner. It occupied 27.6 percent of North Korea's trade (including intra-Korean trade) in 2001, and its share grew to 39.0 percent in 2004. On the contrary, Japan's share in North Korean trade shrank from 17.8 percent in 2001 to 7.1 percent in 2004. Thus, Japan, the second largest trading partner in 2001, became the fourth largest trading partner to North Korea in 2004.

Meanwhile, South Korea has become the second most important trading partner to North Korea since 2002. It is also important to note that the shares of Thailand and Russia grew recently amounting to 9.3 percent and 6.0 percent, respectively, in 2004. The growing importance of Thailand and Russia as a trading partner seems to reflect North Korea's increasing dependence on imported food and energy.

### **Current Status of Foreign Direct Investment in North Korea**

North Korea enacted the Joint Venture Law in 1984 and designated the Rajin-Sonbong area as a Free Economic and Trade Zone in 1992 to attract foreign investment. However, the results were poor. As shown in Table 1, according to UNCTAD's estimation, North Korea's FDI stock increased from US\$572.3 million in 1990 to US\$1022.0 million in 2003, while Vietnam's FDI stock jumped from US\$260.1 million to US\$18,574.1 million during the same period.

Moreover, a large portion of FDI to North Korea came from the companies run by the Korean diaspora in Japan and China, and very few FDIs were from other developed countries. So political reasons rather than economic rationale seem to have been a key determinant for FDIs in North Korea.<sup>5</sup>

The low level of inward FDIs in North Korea vividly reflects their investment environment. Despite some efforts, North Korea still lacks institutional and physical infrastructure for foreign investment. In addition, the North Korean government failed to convince the international business community regarding its economic reform policy. Furthermore, non-economic factors such as nuclear and missile issues definitely aggravated an already difficult investment environment.

Recently, an increasing number of Chinese companies seem to show interest in North Korea. In fact, Chinese and Korean newspapers reported some cases of Chinese FDIs in North Korea.<sup>6</sup>

On the other hand, as of April 2005, 57 South Korean "economic cooperation projects" have received permission to invest in North Korea from the South Korean government since 1995. Among them, 30 projects received permission since 2004, and one project was cancelled in 2004. This surge of projects in 2004 was mainly related to the Kaesong Industrial Complex, while the most important projects in terms of size were those related to the Light Water Reactor (KEDO) Project and the Geumgansan Project.<sup>7</sup> The total size of these 56 projects amounts to around US\$5.6 billion.

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<sup>5</sup> *North Korea Development Report 2002/2003*. Korea Institute for International Economic Policy.

<sup>6</sup> In 2004, Chinese FDIs to North Korea amounted to US\$173 million, while they represented only US\$1.3 million in 2003 (KORTA).

<sup>7</sup> KEDO project and Geumgansan project are also rather political projects than economic ones.

**Table 1. FDI Trends of North Korea and Vietnam (Unit: millions)**

	North Korea			Vietnam		
	Inflows	Stock	(Percentage of GNP)	Inflows	Stock	(Percentage of GNP)
1990	-60.8	572.3	(3.4)	180.0	260.1	(4.0)
1991	138.8	706.1	(4.5)	375.2	635.3	(6.6)
1992	1.9	708.0	(5.1)	473.9	1109.2	(11.2)
1993	8.5	716.1	(6.1)	926.3	2035.6	(15.9)
1994	-0.7	715.8	(7.7)	1944.5	3980.1	(25.6)
1995	0.0	705.8	(13.7)	1780.4	5760.5	(27.8)
1996	1.8	717.7	(6.8)	1803.0	7563.5	(30.7)
1997	307.4	1025.0	(9.8)	2587.3	10150.8	(37.9)
1998	30.7	1055.7	(10.3)	1700.0	11850.8	(43.7)
1999	-14.9	1040.8	(10.1)	1483.9	13334.7	(46.8)
2000	5.0	1045.8	(10.0)	1289.0	14623.7	(48.2)
2001	-3.8	1042.0	(9.8)	1300.3	15924.0	(51.5)
2002	-15.0	1027.0	(9.5)	1200.1	17124.1	(50.2)
2003	-5.0	1022.0	(9.2)	1450.0	18574.1	(50.6)

Source: UNCTAD (2005), *World Investment Report 2004*

### Future Policy Directions

North Korea's foreign trade structure, which heavily depends on primary products, clearly indicates its dilemma. In order to increase its export, it needs to develop its manufacturing sector. But to develop its manufacturing sector, it needs machinery, equipment, and technology, which cannot be financed by limited export.

Therefore, in our view, the only way to break the vicious circle of low economic competitiveness and low export is foreign direct investment. As for the intra-Korean trade, the procession-on-commission trade represented 50.6 percent of commercial transaction trade in 2004.<sup>8</sup>

Of course, as mentioned earlier, North Korea's environment for foreign investment is not attractive. Thus, the following policies must be chosen and implemented. First, North Korea must eliminate the main obstacles to foreign investment, including the nuclear issue. Second, it must adopt unequivocal economic reform and open-door policies. However, given North Korea's politico-economic situation, it may be difficult for North Korea to pursue comprehensive economic reform and open-door policies. So, it seems to us more realistic for North Korea to adopt a gradual approach by establishing special economic zones. It can concentrate on the Kaesong Industrial Complex and the Geumgangsán project, and then extend to other regions. At

<sup>8</sup> Ministry of Unification, ROK.

the same time, with the help of the international community, North Korea can embark upon its transition to a market economy.

**Annex Table 1. North Korea's Foreign Trade (Unit: US\$ million, %)**

Section	Export		Import		Total	
	Volume	Growth Rate	Volume	Growth Rate	Volume	Growth Rate
1990	1,733	-	2,437	-	4,170	-
1991	945	-45.5	1,639	-32.7	2,584	-38.0
1992	933	-1.3	1,622	-1.0	2,555	-1.1
1993	990	6.1	1,656	2.1	2,646	3.6
1994	858	-13.3	1,242	-25.0	2,100	-20.6
1995	736	-14.2	1,316	6.0	2,052	-2.3
1996	726	-1.3	1,250	-5.0	1,976	-3.7
1997	904	245.5	1,272	1.8	2,177	10.1
1998	559	-38.2	883	-30.6	1,442	-33.7
1999	515	-7.9	965	9.3	1,480	2.6
2000	556	8.0	1,413	46.5	1,970	33.1
2001	650	14.9	1,620	15.2	2,270	15.1
2002	735	13.1	1,525	-5.9	2,260	-0.4
2003	777	5.6	1,614	5.9	2,391	5.8
2004	1,020	31.3	1,837	13.8	2,857	19.5

Sources: Ministry of Unification, ROK; KOTRA

**Annex Table 2. Inter-Korean Trade (Unit: million dollars)**

Year	Import	Export	Total
1990	1	12	13
1991	6	106	112
1992	11	163	174
1993	8	178	186
1994	18	176	194
1995	64	223	287
1996	70	182	882
1997	115	193	308
1998	130	92	222
1999	121	122	243
2000	273	152	425
2001	227	176	403
2002	370	212	582
2003	435	289	724
2004	439	258	697

Sources: Ministry of Unification, ROK; KOTRA

**Annex Table 3. Major Items of North Korea's Export and Import (2004)**  
(Unit: US\$ million, %)

Selection	Export		Import	
	Amount	Share	Amount	Share
Live animals; animal product	336,581	33.0%	159,450	8.7%
Vegetable	27,542	2.7%	140,442	7.6%
Mineral	152,282	14.9%	173,117	9.4%
Chemical & Plastics	38,750	3.8%	409,550	22.3%
Wood & Articles of Wood	16,044	1.6%	106,413	5.8%
Textiles	114,948	11.3%	78,052	4.2%
Precious metals	5,738	0.6%	93,232	5.1%
Base Metals and Articles of Base Metal	164,268	16.1%	128,364	7.0%
Machine, Electrical	121,726	11.9%	262,911	14.3%
Others	42,321	4.1%	77,254	4.2%
Vehicles, Vessels & Associated Transport Equipment	-	-	208,126	11.3%
Total	1,020,200	100.0%	1,836,911	100.0%

Source: KOTRA

**Annex Table 4. North Korea's Trading Partners (Unit: US\$ million, %)**

Selection	2001		2002		2003		2004	
	Trade	Share	Trade	Share	Trade	Share	Trade	Share
China	737.5	27.6%	738.0	25.4%	1,022.9	32.8%	1,385.2	39.0%
South Korea	403.0	15.1%	641.7	22.1%	724.2	23.2%	697.0	19.6%
Thailand	130.1	4.9%	216.6	7.5%	254.3	8.2%	329.9	9.3%
Japan	474.7	17.8%	369.5	12.7%	265.3	8.5%	252.6	7.1%
Russia	68.3	2.6%	80.7	2.8%	118.4	3.8%	213.4	6.0%
India	157.8	5.9%	191.7	6.6%	158.4	5.1%	135.0	3.8%
Others	702.1	26.3%	633.9	22.9%	572.0	18.4%	541.0	15.2%
Total	2,673.5	100%	2,902.1	100%	3,115.5	100%	3,554.1	100%

Source: KOTRA