



**Development Cooperation with North Korea:
Expanding the Debate Beyond
the Political Horizon**

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Executive Summary

Policy makers in the United States, South Korea, China and other countries continuously craft plans of action for a potential future scenario when North Korea becomes more open, either by collapse or through a gradual process. This paper seeks to spark a similar discussion but about development cooperation with North Korea. To do this, it draws upon lessons from both success stories and pitfalls of the development of the post-communist transitions in countries like Mongolia and Vietnam, and regions such as Eastern Europe.

This paper makes eight policy recommendations to be included in contingency planning for development cooperation with the country, to be implemented in a future where political sensitivities have decreased. The policy proposals are made on two different time horizons: relatively short-term proposals that are less politically sensitive and complicated, and longer-term ones with greater political sensitivity and more complex implementation.

The first policy area is food security and the markets. The policies proposed here are intended to support the efficiency of markets. In the short-run, a relatively apolitical policy of assistance to the markets is suggested. Scales, storage space, stall structures and other practical material support should be considered to make the markets function better. Such support would increase the efficiency of the markets and benefit both consumers and producers. In the longer run, the international community should give capacity-building assistance and help create a nationwide authority that controls market-trading permits. This would be an important measure to decrease the corruption and arbitrary administration surrounding the markets.

The second policy area is the financial system. This paper suggests trial attempts at microfinance services for North Korea's nascent market entrepreneurs. It also advocates that the country be offered membership in international financial institutions such as the World Bank and the International Monetary Fund once political conditions are ready to receive assistance to build up its own financial system.

International trade and foreign investment are the third policy area. In the short run, assistance to construct an international arbitration institution is suggested. Such an institution would need to publish its findings for the general public, and to be able to show a record of going against the government's interests in impartial judgments. In the longer run, capacity building support for North Korea's mining industry is suggested because revenues from its most abundant natural resource will undoubtedly be crucial to boost its economy in a transitional stage. Such support needs to be conditioned on transparent records about these revenues, and membership in organizations like the Extractive Industries Transparency Initiative.

Finally, two policy proposals are made in the area of governance, in practical and administrative forms rather than democracy and popular influence. In the short run, assistance is advocated for North Korea's statistical agency and data gathering capacity. Solid data is a prerequisite for informed decision-making. The international community and the North Korean regime have a shared interest in improving data collecting capacity in the country. In the long run, the international community should offer broad support to build up the administrative capacity of North Korea's provincial and local government institutions.

Development Cooperation with North Korea: Expanding the Debate Beyond the Political Horizon

By Benjamin Katzeff Silberstein

Introduction

Like much else with North Korea, aid and development cooperation with the country is often subject to political controversy. At the time of writing, both the North Korean government and institutions like the World Food Program have stated that a drought in the country may come to greatly damage its harvests and make the current food shortage even direr.¹ For years, increasingly frosty relations between North Korea and the international community has led to the steady downsizing of what was once one of the largest-scale humanitarian aid operations in the world, and in 2014, the UN's World Food Program, which at times has been feeding as much as one third of the country's population, claimed that it would need to shut down its operations altogether if no additional funding was acquired.² Debates about aid programs in the country are as old as the programs themselves. While proponents claim that they are not only necessary from a humanitarian standpoint, but also serve as windows into a society which the outside world otherwise lacks access to, critics say that programs at best have little or no impact,³ and at worst, they stabilize the regime and benefit its military and ruling apparatus.⁴

This paper seeks to go beyond those debates and broaden the discussion on development cooperation between North Korea and the international community.⁵ It introduces ideas for development cooperation with North Korea that could be beneficial for North Korea but have not yet been introduced on any significant scale. In other words, this paper seeks to introduce ideas for development cooperation focus that would, given North Korea's conditions, be likely to be particularly beneficial for its needs and potentials. To do so, the paper not only draws upon the experiences of countries with conditions comparable to those of North Korea, but also surveys

¹ AFP, "Rainfall gives respite to drought-hit North Korea; WFP pleads for funds," *The China Post*, June 24, 2015, accessed July 5, 2015, <http://www.chinapost.com.tw/asia/korea/2015/06/24/439065/Rainfall-gives.htm>.

² Jonathan Cheng, "U.N. North Korea Food Program in Danger," *Wall Street Journal*, Sept. 25, 2015, accessed July 5, 2015, <http://www.wsj.com/articles/u-n-north-korea-food-program-in-danger-1411626874>.

³ Ibid.

⁴ For more on this debate, see, for example, Hazel Smith, *Hungry for Peace: International Security, Humanitarian Assistance and Social Change in North Korea* (Washington, D.C.: United States Institute of Peace Press, 2005), various chapters; Stephan Haggard and Marcus Noland, *Famine in North Korea: Markets, Aid and Reform* (New York: Columbia University Press, 2007), 79–165.

⁵ The terms "aid" and "development cooperation" are used interchangeably throughout the paper and do not imply a political stance, though "development cooperation" is certainly the more politically correct term in aid professional circles. The term "international community" is used without close definition and in a broad sense, but refers to those entities – primarily the United States, European Union, South Korea – that have or currently pursued development cooperation with North Korea in the sense that the phrase is commonly used in the west. In other words, projects like Chinese infrastructure investments in North Korea, though they certainly could be considered as economic cooperation for development, are not included in this term because they usually happen with direct linkages to the Chinese economy rather than for their own right.

the general literature on development economics in search of ideas that would be especially rewarding given North Korea's situation.

Development cooperation with North Korea is controversial, not only because of doubts about the impacts and recipients of the aid, but because of divergent ambitions and goals of donors and the North Korean government.⁶ Donor governments are eager to ensure that their aid doesn't reward "bad behavior" – that is, North Korean weapons testing or progress on its nuclear program. The dire human rights situation and political oppression are other major factors. They also want to make sure that aid can be properly monitored inside the country to ensure that it reaches those with the greatest needs, and is not diverted to the army or to government officials with political connections.⁷ The North Korean government, on the other hand, heavily restricts international assistance in the country out of fear that such activities could be used as cloaks for intelligence gathering, and to avoid the risk of undue political influence on its system.⁸

This paper seeks to spark a debate on what sort of development cooperation would be ideal for North Korea in a scenario where political boundaries were not imposed. This discussion is more than an intellectual exercise about what would have the greatest possible impact in a theoretical world. Contingency plans and debates about potential scenarios help prepare for a future that might arise both sooner or later than anticipated, but which is difficult to predict. For example, scholars and pundits regularly debate how reunification between North and South Korea should be designed and handled even though such a scenario seems far-fetched given the current political reality on the Korean peninsula.⁹ Or consider the announcement of the Myanmar regime that the country would reform its governance system and open its doors to the outside world, which came as a complete surprise even to some seasoned experts.¹⁰ In short, drastic changes, particularly in countries like North Korea, are often difficult or impossible to predict. Nevertheless, preparing for such scenarios is critical.

Approach and methodology

This paper introduces four areas and eight ideas for development cooperation projects that would serve both North Korea and the international community well to undertake. The point is not to introduce a full "laundry list" of initiatives. Rather, the policy suggestions serve to broaden the perspective and discussion on development cooperation with North Korea.

For example, while food aid tends to be the focal point of most debates about aid to North Korea, and rightly so, this paper instead outlines how North Korea's private markets could be supported through capacity building, to work more efficiently and become a more solid part of North Korea's food security system. While such an idea goes well beyond the bounds of the

⁶ Smith, *Hungry for Peace*, writes extensively about such problems.

⁷ For more on this debate, see, for example, Gordon L. Flake and Scott Snyder, *Paved with Good Intentions: the NGO Experience in North Korea* (Westport, C.T.: Praeger, 2003), 1–5.

⁸ Smith, *Hungry for Peace*.

⁹ This debate is too extensive to be summarized in one footnote or reference. For one example among many available, see Jonathan D. Pollack and Chung Min Lee, *Preparing for Korean Unification: Scenarios and Implications* (California: Rand Corporation, 1999).

¹⁰ For more on these reforms and their rationale, see, for example, David I. Steinberg, *Burma/Myanmar: What Everyone Needs to Know* (Oxford, UK, and New York, NY: Oxford University Press, 2013).

politically possible in the current climate, looking at how long-term food security could be supported can broaden perspectives on aid to North Korea.

Similarly, many crucial and obvious ideas have been omitted. For example, on a global scale, food and nutrition aid continues to be one of the most efficient measures to improve long-term economic development for the least amount of money.¹¹ But such assistance is already being carried out in North Korea, which is why this idea and similar ones are left out of this paper.

This paper also aims to learn from the developmental experiences of other countries that share important traits with North Korea both in terms of their conditions at the outset of the implementation of successful developmental cooperation policies, and in terms of the problems they have faced. These include the post-communist former Soviet states, Mongolia and Vietnam. Their developmental experiences and the policies of the international community hold lessons for development cooperation with North Korea.

The policy proposals are introduced in four categories: food security and the markets, the financial system, trade and investments, and governance. There is inevitable overlap between these areas, and both the policy areas and proposals interplay with each other.

Sources and structure of the paper

The policy proposals are divided into two time-horizons within each category: short-term and long-term. These time periods are vague. The paper does not specify a clear horizon for when the policies will be possible to implement. The ideas are meant to be implemented in an undefined future where political constraints are not necessarily absent, but much lower than today.

The remainder of this paper is structured as follows: first, a brief overview of the history and current state of development cooperation between North Korea and the international community is given. Then, policy proposals are introduced, and the final section is a concluding discussion of the feasibility and potential impact of these policies.

Development cooperation with North Korea: an overview

Development cooperation between North Korea and the international community goes back to the mid-1990s. Even though North Korea had been dependent on transfer from the communist world for decades,¹² it was not until 1995, when major floods hit the country, that the North Korean government made large-scale and unprecedented appeals for multilateral assistance.¹³ The floods, however, were just the tip of the iceberg that was North Korea's

¹¹ For the efficacy of nutrition assistance, see, for example, Bjorn Lomborg, "How to Spend \$75 Billion to Fix the World," *Huffington Post*, May 29, 2013, accessed July 6, 2015, http://www.huffingtonpost.com/bjorn-lomborg/how-to-spend-75-billion-t_b_3354277.html.

¹² See, for example, Scott Snyder and Kyung-Ae Park, "Introduction," vii–3 in Scott Snyder and Kyung-Ae Park (Eds.), *North Korea in Transition: Politics, Economy and Society* (Lanham, Maryland: Rowman & LittleField Publishers, 2013), xi.

¹³ Haggard and Noland, *Famine*, 79.

humanitarian disaster. The country's economy had been crumbling for years. The impacts of major structural deficiencies were exacerbated by the drastic decline of subsidies from the Soviet Union and China in the late 1980s and early 1990s.¹⁴

It took a full year for aid operations to be fully started, both because it was difficult for donor nations to assess the full extent of damages and needs, and because North Korean authorities placed too strong an emphasis on the floods as the specific cause of their problems.¹⁵ Though the donor community at first found it difficult to agree both on the assessment of the situation and on policies, these aid efforts began to be coordinated through the annual common humanitarian appeal mechanism of the UN by 1998.¹⁶

Because of a great multitude of actors – multilateral organizations, states and non-governmental organizations (NGOs) – aid flows have been difficult to track with precision.¹⁷ Still, it is clear that food aid has taken absolute prominence in the aid flows. Between 1995 and 2005 the international community provided more than \$2.3 billion worth of aid, 67 percent of which has been directed toward food aid, and another 9 percent toward enhancing food security.¹⁸ The scale of the program was massive. By 2000, the program in North Korea had become the largest in the history of the World Food Program, feeding about 8.5 of the roughly 24 million North Koreans. The volumes quickly began to wane as the crisis passed, and as of 2014, the biggest donor through UN channels, Switzerland, contributed \$6.7 million in food aid.¹⁹

Controversies

Development cooperation with North Korea has always been controversial for several reasons. Though the regime had little choice but to appeal for humanitarian aid, it has often been very suspicious of the impacts and motives of aid, before 1998 referring to it as “sugar with poison” – a form of Trojan horse aimed at changing the country's system.²⁰

From the start of the aid flows, the regime attempted to control and curtail the distribution of aid, often leading to conflicts with the humanitarian principles of the international community. Suspicions that aid was diverted to the military and privileged groups caused the aid community to worry that one of its most important principles – that aid should go to those that need it most – was being systematically violated by the regime. Monitoring efforts by the international community were heavily curtailed, and in 1995-1996, the entire northeast of the country, where the needs were thought to be greatest, was completely off-limits for aid monitoring.²¹

¹⁴ Nicholas Eberstadt, “Western Aid: The Missing Link for North Korea's Economic Revival?,” 119–153 in Snyder and Park, *North Korea in Transition...*, 121.

¹⁵ *Ibid.*

¹⁶ Smith, *Hungry for Peace*, 102.

¹⁷ Haggard and Noland, *Famine*, 81.

¹⁸ *Ibid.*

¹⁹ Jonathan Cheng, “U.N. North Korea Food Program in Danger,” *Wall Street Journal*, Sept. 25, 2014, accessed July 7, 2015 <http://www.wsj.com/articles/u-n-north-korea-food-program-in-danger-1411626874>.

²⁰ Smith, *Hungry for Peace*, 125.

²¹ Haggard and Noland, *Famine*, 93–95.

The North Korean regime was particularly suspicious of efforts to go beyond simple food inputs into the system. At first, the regime completely resisted any efforts except mere inputs of food and equipment into the system: attempts by the international community to engage in capacity building to increase North Korea's long-term food security were thought to be a way of introducing political reforms.²² Some programs of this nature, however, were eventually introduced.²³

Drastic changes but difficulties remain

Development cooperation with North Korea has changed drastically since the 1990s. Whatever the reason, the regime seems to have grown increasingly more open in its attitude toward capacity building and training in matters that were previously thought to be too controversial, such as market economics. Humanitarian aid flows have decreased, but capacity building, teaching and training in formerly controversial topics like market economics and business have seen a fundamental boom in the last few years. NGOs like Choson Exchange regularly conduct training with North Koreans on topics like business, and North Korean delegations are often brought abroad to study economic policies and reform examples.²⁴ Institutions such as the European Union, too, fund study trips and even human rights training for North Korean officials, and courses are held in countries like Sweden and the United Kingdom.²⁵ Difficulties remain, however. Topics related to domestic reform and the country's markets remain controversial, and UN officials that have suggested capacity building programs in such areas have found themselves shot down by their North Korean counterparts.²⁶

The efficacy of aid is a controversial topic.²⁷ Put simply, we do not know to what extent aid contributes to economic development or other goals it commonly asserts. This paper takes no position on the efficiency of aid.

Eight ideas for development cooperation with North Korea

Food security and the markets

Private markets play an expanding role in the North Korean economy and food supply. As the public distribution system (PDS) broke down in the early 1990s, private markets took its place as the chief supplier of food and necessities for most North Koreans.²⁸ Markets have been granted increasing legal space by the state, and to a large extent even been incorporated into the

²² Smith, *Hungry for Peace*, 125.

²³ Ibid.

²⁴ "Our Programs," Choson Exchange, accessed 7 July, 2015, <http://www.chosonexchange.org/our-programs/>.

²⁵ Smith, *Hungry for Peace*, 215.

²⁶ The author interviewed an official in Washington D.C., May 28, 2015. I refrain from revealing the identity of this person due to the controversial nature of the topic.

²⁷ For the controversial nature of aid to North Korea, see, for example, Eberstadt, *Western Aid*. For the aid debate in general, see, for one example out of many, William Easterly, "Aid Amnesia," *Foreign Policy*, Jan. 23, 2014, accessed 7 July, 2015, <http://foreignpolicy.com/2014/01/23/aid-amnesia/>.

²⁸ The proportion of the markets in the overall food supply of the public is detailed and discussed in Haggard and Noland 2011, 45–58.

official economic framework through formalization and taxation.²⁹ Still, however, markets remain severely constrained and are often subject to arbitrary policy changes by the government. The government's attitude has been one of skepticism and existing legal frameworks primarily serve to curtail rather than promote market activity.

This section introduces two policy proposals for development cooperation with North Korea that would integrate and promote markets as integral parts of the food supply system. Both suggestions aim to increase the security and predictability of market conditions, as well as to enhance the efficiency of market operations.

Short-term policy proposal: practical equipment support for the markets

Much of North Korea's market activity remains relatively primitive. Though no systematic study of the practical, on-the-ground conditions for market trading exists, those with practical experience working in the country have complained of a lack of solid market structures, storage and stalls, and proper equipment for trading management, such as scales, calculators, cash registers and other items that are fundamental to trading at farmer's markets in the western world. So-called "grasshopper markets", that operate completely outside of building structures, are still illegal.³⁰ The UN has allegedly suggested cooperation to alleviate these problems to the North Korean regime in the past, but been turned down due to political sensitivities.³¹

At heart, this is a problem of insecurity and lack of trust: because practical conditions are so lacking, market traders need to dedicate a proportionately greater share of their resources and time to ensuring that their transactions are conducted correctly and to their benefit. Lack of proper storage facilities leads to waste, which entrepreneurs have to hedge against by charging higher prices. One of the most fundamental problems facing entrepreneurs in poor countries, and particularly those on the lower end of the economic ladder including

North Korea's petty market traders, are the constant risks that surround trading.³² This deters incentives for further investment and expansion. Insecurity increases costs of operation – in time or actual resources – costs that, it can be assumed, like in any regular market economy, are eventually forced upon the consumer. In sum, lack of proper equipment to make market trading function smoother leads to unnecessary costs, both for North Korean traders and consumers.

This paper suggests that capacity building for the markets be introduced as an integral part of the international community's efforts for enhancing food security in North Korea. This could take a number of forms, but the emphasis here is on practical matters: equipment like

²⁹ For an overview of such reforms, see, for example, Dae-Kyu Yoon, "Economic Reform and Institutional Transformation: A Legal Perspective," 43–73 in Philip H. Park (Ed.), *The Dynamics of Change in North Korea: An Institutional Perspective* (Seoul: Kyungnam University Press, 2009).

³⁰ "Even in the heart of Pyongyang, grasshopper market (in Korean)," YTN News, last modified Oct. 10, 2013, http://www.ytn.co.kr/ln/0101_201310101119430318.

³¹ Interview with former UN official stationed in North Korea, 28 May, 2015, Washington, D.C.

³² See Abhijit V. Banerjee and Esther Duflo, *Poor Economics: A Radical Rethinking the Way to Fight Global Poverty* (New York, NY: Public Affairs, 2011), 134–155, for an overview of the heavy influence of risk on poor people's economic lives and choices.

scales, calculators, secure storage for both goods and cash, functioning market structures with proper climate control, and others should be donated and distributed with proportionate geographical spread across North Korea's markets.

This policy proposal is placed in the short-run category because of its practical nature. As measures like this may be controversial, it is not explicitly aimed at altering or even impacting any of the North Korean government's economic policies. It can be motivated as a form of development cooperation that strengthens and supports currently existing economic frameworks in North Korea, like markets that have been officially recognized and incorporated into the formal economy.

Long-term policy proposal: capacity building for an impartial and transparent permits authority for the markets

The lack of security and a transparent legal framework with consistently enforced rules is one of the main causes of inefficiency and insecurity surrounding the markets. To that end, the international community should lend capacity building assistance to the North Korean regime to create a centralized permit authority to administer market-trading permits.

As mentioned, the government later largely formalized North Korean markets that sprung up illegally and spontaneously in the wake of the famine in the 1990s.³³ The state regulates these formalized markets and permits are required for those that want to trade within their bounds. Such licenses are highly attractive, and not infrequently, those that wish to participate in markets bribe officials to obtain the permit license.³⁴ The reluctant liberalization of the North Korean economy, through the regime's response to the bottom-up marketization that followed the famine, means that those with government connections can reap large rents by exacting bribes to those that wish to participate in the economy (in addition to using their privileged position for trading themselves).³⁵

In a 2011 survey, a strong majority of respondents said that the best way to get ahead in North Korea is to become a government or party official. At the same time, market trading is seen as the easiest way to make money.³⁶ This is a testament to the importance of rents within the economy. Bribes and rents, many of which surround market trading, have even been estimated to constitute almost 9 percent of total household expenditures in the country from 1996-2007.³⁷ Although rules and regulations permit market trading, they are often subject to arbitrary changes. Crackdowns on market traders are frequent, and since North Korean local governments and authorities often have significant authority of their own, it is not clear that all

³³ For a brief overview, see Haggard and Noland 2011, 5–12.

³⁴ Such stories are frequent in North Korean defector-run press reporting stories that leak out of the country. For more on the topic, see, for example, "A Changing North Korea," Liberty in North Korea, accessed 8 July, 2015, <http://www.libertyinnorthkorea.org/learn-a-changing-north-korea/>.

³⁵ For more on these crony capitalists with state connections, see, for example, Andrei Lankov, "Low-Profile Capitalism: The Emergence of the New Merchant/Entrepreneurial Class in Post-Famine North Korea," 179–194 in Snyder and Park, *North Korea in Transition*.

³⁶ Haggard and Noland, *Witness*, 76.

³⁷ Byung-Yeon Kim, "Markets, Bribery and Regime Stability in North Korea," *East Asia Security Initiative Working Paper No. 4* (Seoul: East Asia Institute, 2010), 2.

these crackdowns are ordered by the central government.³⁸ In one interview study of corruption in North Korea, a majority cited market traders as the primary group exposed to bribe extraction by the authorities.³⁹

The lack of a transparent and consistently enforced legal framework for markets is a major cause of this waste. As with all forms of corruption, such costs are eventually transferred onto the market, and both buyers and sellers lose out. If a clear and centralized authority existed to regulate who can trade on the markets, operating with transparent rules, the rate of insecurity and inefficiency on the markets should decrease. Establishing such an authority would force the regime to clarify legal frameworks guiding markets and introduce foreseeability in the markets, making trading much safer. Attempts by local officials to arbitrarily introduce and enforce new rules would be curtailed and traders would be able to decrease the proportion of resources used for bribes.

The international community should help facilitate such an authority. Moreover, it could assist the North Korean authorities in the administration of such a system through donations of computers and other electronic equipment. This policy would not directly meddle in North Korean politics and policymaking but would make markets more efficient. Still, it could well be seen as an attempt to influence the direction of North Korea's economic policies. Therefore, and because of the large scale such operations would take, it is proposed here as a long-term policy goal.

The Financial System

North Korea essentially lacks a financial system. Basic services such as banking are not used by the general population, and debit cards have only recently been introduced in the capital city.⁴⁰ Most citizens and institutions simply keep their cash in their possession rather than invest it or deposit it in a bank. The extent of this practice, a major obstacle it poses for the North Korean economy, was evident in a proposal from a regime-controlled university (as all universities in North Korea are) in 2014 to mobilize "idle funds" to funnel cash from the market economy into state banks.⁴¹ Banks exist, but people generally choose not to put their funds in them out of fear that the authorities will confiscate them.⁴² The banking system was established in 1946 and modeled after Soviet lines, during the occupation.⁴³ Moreover, their connections with the global financial system are limited due to the sanctions imposed on North Korea.⁴⁴ On

³⁸ For an example of such a crackdown, see Choi Song Min, "Vendors fight to the death for right to sell," *DailyNK*, July 1, 2015, accessed on July 8, 2015, <http://www.dailynk.com/english/m/read.php?cataId=nk01500&num=13313>.

³⁹ Kim, "Markets, Bribery..."

⁴⁰ As of 2012, according to one foreigner who lived in Pyongyang for an extended period of time, there were only two banks that operated in the city. See Felix Abt, "North Korea Out of the Dark: The Story of the Pyongyang Business School," *38 North*, Dec., 23 2012, accessed July 9, 2015, <http://38north.org/2012/12/fabt122312/>.

⁴¹ Institute for Far Eastern Studies at Kyungnam University (IFES), "Mobilize of Idle Funds Emphasized for Fiscal Expansion," *NK Brief No. 14-06-17*, accessed July 9, 2015, http://ifes.kyungnam.ac.kr/eng/FRM/FRM_0101V.aspx?code=FRM140618_0001.

⁴² *Ibid.*

⁴³ The Stanley Foundation, "Policy Memo: Future Challenges for the Democratic People's Republic of Korea (DPRK) Financial System," Policy memo, July 11, 2008.

⁴⁴ Bradley O. Babson, "Dilemmas in Financial Engagement with North Korea," *38 North*, March 26, 2015, accessed July 9, 2015, <http://38north.org/2015/03/bbabson032615/>.

paper, a government bond market exists, but since North Korea defaulted on international creditors in the 1980s, its debt has become virtually worthless.⁴⁵ Some limited reform has been attempted in the last few years, such as the establishment of a State Development Bank and various institutions aimed at attracting foreign investments.⁴⁶ Yet, the situation remains dire. North Korea's institutional financial system remains more underdeveloped than virtually all others in Asia, which was part of the reason that the country was recently denied membership in the Asian Infrastructure Investment Bank.⁴⁷

The lack of a functioning financial system is a major obstacle for North Korea's economic development. The development of financial systems generally has a significantly positive impact on the economic development of poor countries. A solid financial system not only benefits medium- and large-scale entrepreneurs, but can also boost smaller-scale entrepreneurs, not least through channels like microfinance.

Short-term policy proposal: microfinance to support North Korea's markets

North Korea's markets have become an important part of the country's economy. From the start, they arose in a bottom-up fashion, and stories are abound of North Koreans who took what they had available – produce from kitchen gardens, television sets, scrap metal, or other items that could be exchanged for money or food – and sold these on the markets to survive. Some turned their survival attempts into businesses; for example, by selling home-manufactured goods for a small profit.⁴⁸ These entrepreneurs, however, work under difficult conditions. Capital is scarce and difficult to acquire. In the aftermath of the famine in the 1990s, moneylenders emerge, but borrowing is expensive. According to figures from 2008, interest rates range between five and 30 percent.⁴⁹ A stark attestation to the high costs of money lending is the fact that moneylenders, or *donju*, as they are popularly termed in North Korea, have risen as a social upper-middle class of their own.⁵⁰

The economic conditions leading to this situation are not unique to North Korea. The same economic rationale can be seen in poverty-stricken countries all across the globe: people living in poverty are often subject to interest rates far beyond what most well-off people pay. Moneylenders perceive lending to poor people a risky endeavor and the interest rate they charge represents the risk. Bank loans are not an alternative – sums are too small for banks to find

⁴⁵ Prabha Natarajan and Erin McCarthy, "North Korean Bonds? Now Could Be the Time," *Wall Street Journal*, Dec. 23, 2011, accessed July 9, 2015, <http://www.wsj.com/articles/SB10001424052970204464404577114961074711158>.

⁴⁶ Bradley O. Babson, "Future Strategies for Economic Engagement with North Korea," 153–179 in Snyder and Park, *North Korea in Transition...*, 158.

⁴⁷ Bradley O. Babson, "Could the New Asian Infrastructure Investment Bank Change the Dynamics of Economic Engagement with North Korea?," *38 North*, May 26, 2015, accessed July 9, 2015, <http://38north.org/2015/05/bbabson052515/>.

⁴⁸ These stories are eyewitness accounts by North Koreans who lived in the country during the famine and subsequently left. For an example, see Barbara Demick, *Nothing to Envy: Ordinary Lives in North Korea* (New York: Spiegel and Grau, 2009).

⁴⁹ Andrei Lankov and Kim Seok-hyang, "North Korean Market Vendors: The Rise of Grassroots Capitalists in a Post-Stalinist Society," *Pacific Affairs* 81(2008, 1): 67.

⁵⁰ See both *Ibid* and Hwang Yong Kim, "Private Lenders Emerge as N. Korea's New Middle Class," *Voice of America*, June 10, 2015, accessed July 8, 2015, <http://www.voanews.com/content/private-lenders-emerge-as-north-korea-new-middle-class/2816737.html>.

lending to poor people profitable, and the lack of collateral implies too large of a risk.⁵¹ This leaves poor people in a situation where the only loans that they can get will have an interest rate so high that their planned investments may often not be worth the risk.

Microfinance can break this paradox. Microfinance is a loan given to a person without means to provide adequate security and collateral. It is usually given to a group of borrowers in the same community, who are liable toward each other for repaying the loan.⁵² Studies show that microcredit can create an element of safety in lives otherwise dominated by large economic risks, and that many of the projects do end up growing relatively viable.⁵³

There are many reasons to believe that microfinance could have a positive impact in North Korea and particularly for market traders in the country.⁵⁴ Through microfinance, small-scale vendors such as elderly women selling cigarettes on the streets (a common sight across the country) could borrow funds to grow their operations without getting indebted to loan sharks. As in other countries, one should not expect to see a drastic transformation of the lives of North Korean borrowers, but microfinance could have a positive impact, albeit a modest one, in helping more North Koreans enter the country's markets as traders. This should also increase competition on the markets, to the benefit of consumers as well.

This paper therefore suggests that microfinance projects of significant scale be undertaken and supported by the international community in North Korea. It would be advisable to test such projects both in the northern and southern parts of the country, since the economic bases are very different in each. Programs could be attempted at individual village level and later expanded. There are several reasons to list this as a short-term proposal: first, its scale can be adapted to the preferences of both the North Korean government and the donor community. Second, it would not seek to impact government policy, but rather enforce a development (the growth of markets) that has already occurred under regime watch. Third, the fact that smaller projects of this sort seem to have been approved by the government indicates that the government might not regard them as too sensitive.

Long-term policy proposal: support North Korean financial systems integration

A large body of academic evidence suggests that global financial integration, and the growth of a country's financial system, correlates with economic development.⁵⁵ A well-

⁵¹ Banerjee and Duflo, *Poor Economics*, 158–162.

⁵² *Ibid.*, 166–168.

⁵³ See, for example, *ibid.* See also “About Microfinance,” Kiva, accessed July 8, 2015, <http://www.kiva.org/about/microfinance>.

⁵⁴ Allegedly, one or several microfinance projects have actually been attempted in North Korea. Not much could be gathered about these projects at the present time of writing, and it is reasonable to assume that their scale, as well as the conditions surrounding them, was not sufficient for these projects to be considered robust attempts. In 2008, it was reported that future projects had received approval from North Korean authorities, but not much has been heard since. See, for example, KBS World Radio, “UN Agency to Resume Microfinance in N. Korea,” *KBS World Radio*, Dec. 12, 2008, accessed July 8, 2015, http://world.kbs.co.kr/english/news/news_in_detail.htm?No=59829.

⁵⁵ For more about financial markets and globalization, see, for example, David O. Beim and Charles W. Calomiris, *Emerging Financial Markets* (New York: McGraw Hill, 2001).

functioning financial system creates efficiency gains and helps allocate resources to where they can generate the greatest wealth. Moreover, financial systems help improve corporate governance, since lending and investment leads to demands for oversight by investors.

These factors might seem distant for a country like North Korea, whose financial system is out of access for the majority of the population. However, in developing countries and emerging economies in particular, the development of financial systems has proven to hold great potential for spurring economic development. Research has shown a causal relation between the level of development of a country's financial sector and its economic growth.⁵⁶ When a financial system opens to the rest of the world, it gives that country access to capital from a much broader range of investors than just those available domestically.⁵⁷ Access to financial services can be a major step for people in developing countries to change their poverty situation, and financial systems tend to be engines for job creation.⁵⁸

North Korea's financial institutions today fill virtually none of these needs. Most of its banks with SWIFT-numbers belong specifically to the court economy of the leadership, and the general population completely lacks access to a well-developed domestic or international financial system. Some changes have happened in banking in recent years, but most have been confined to its capital city and special economic zones.

The North Korean regime has made some rhetorical gestures in recent years, suggesting a willingness to become part of the global financial system. Issues related to finance have been mentioned in important rhetorical channels like New Year's speeches, where the leadership's policy priorities are often proclaimed.⁵⁹ Moreover, the country recently joined the Asia Pacific Group on Money Laundering, run by the Organization for Economic Cooperation and Development (OECD) as an observer state.⁶⁰ This indicates a willingness to become integrated into multilateral organizations and to make domestic policy efforts to that end.

Building up North Korea's financial system will be a long-term endeavor that will have to occur in several steps, with outside help. Countries like Vietnam, Poland and Mongolia have benefitted enormously from technical assistance made available to them as members of organizations like the World Bank and International Monetary Fund, two international financial institutions (IFIs). Should North Korea be encouraged to join either or both of these organizations, it would be able to request such assistance and begin to build its financial system from the ground.

Therefore, this paper suggests encouraging the North Korean government to eventually seek membership in these two IFIs. Through them, technical assistance could be delivered to help build the country's financial system. This is a long-term proposal since membership for North Korea could first occur in a radically different political situation – for example, it is

⁵⁶ For more on this topic, see, for example, Abdul G. Abiad, Enrica Detragiache and Thierry Tresselt, "A New Database of Financial Reforms," *IMF Working Papers* 266 (2008): 1-28.

⁵⁷ Beim and Calomiris, *Emerging Financial Markets*.

⁵⁸ World Bank, *Finance for All? Policies and Pitfalls in Expanding Access* (Washington, D.C.: World Bank, 2008).

⁵⁹ Babson, "Dilemmas...".

⁶⁰ *Ibid.*

unlikely to be allowed to join as long as the nuclear issue remains unsolved. Moreover, its membership would hinge on drastic domestic reforms such as greatly increased economic transparency and monitoring – a beneficial bi-product of its application, but an effort that will take a long time.

Trade and foreign investment

Background

Trade has been important for North Korea's economic development, but it has rarely existed in the traditional sense through which trade is conceived in the West. Prior to the breakdown of the communist bloc in the late 1980s and early 1990s, North Korea primarily conducted barter trade with its fraternal communist countries. Most of this trade was with the Soviet Union and China, and a great proportion occurred under "friendship terms" – pricing that were greatly subsidized in North Korea's favor.⁶¹ As mentioned, the country suffered greatly from the breakdown of the communist bloc because it ended the flow of subsidies that its economy was heavily dependent upon. The flow of subsidized fuel, for example, was one of the main causes of the breakdown of North Korea's industrial capacity in the early 1990s. In the 1970s and 1980s, the regime reached out to some major industrial countries in the west to enhance its competitiveness within the global trading system and made expensive large-scale purchases of capital goods from countries like Japan. This experiment was relatively short-lived, however, as North Korea defaulted on its loans in the 1980s.⁶²

In recent years, the regime has made significant economic changes that involve foreign trade. For example, in 2014, it designated a previously unforeseen number of special economic zones (SEZs) around the country and declared that each province would be able to set its own rules for SEZs.⁶³ Moreover, North Korean attitudes to economic exchange and trade seem to have changed considerably over the course of the 2000s.

Trade and foreign investment is a crucial area to discuss within the context of North Korean development cooperation. For virtually every communist country that has undergone successful transformations – such as China, Vietnam and Mongolia – and greatly increased trade and foreign investment, has been a crucial part of the growth equation.⁶⁴ Mongolia, for example, was dependent on the Soviet Union for over 90 percent of its trade before the fall of the communist bloc, and foreign trade quickly came to form a crucial part of its economic base during and after its transition to a market economy.⁶⁵

⁶¹ See, for example, Adrian Buzo, *The Guerilla Dynasty: Politics and Leadership in North Korea* (Boulder, Colorado: Westview Press, 1999), 126.

⁶² *Ibid.*, 122.

⁶³ See, for example, Andray Abrahamian, "The ABCs of North Korea's SEZs," Special report by the U.S.-Korea Institute at SAIS, accessed July 19, 2015, http://uskoreainstitute.org/research/special-reports/aabrahamian_sez111914/.

⁶⁴ For example, see Adam Fforde and Stefan de Vylder (Eds.), *From Plan to Market: The Economic Transition in Vietnam* (Boulder, Colorado: Westview Press, 1996), 287.

⁶⁵ See, for example, The Asia Foundation, *Mongolia's Political and Economic Transition: Challenges and Opportunities*. Proceedings from The Asia Foundation Conference on Mongolia's Political and Economic Transition: Challenges and Opportunities. Sept. 11-13, 2000, Government House, Ulaanbaatar, Mongolia.

Therefore, this section calls for development cooperation to assist North Korea in increasing its foreign trade volumes and on using foreign investment and trade to support its broader economic development. Both suggestions represent a small part of what would be necessary for North Korea to utilize trade and foreign investment as engines for broader development, and a broader infrastructure would be necessary for North Korea to become fully integrated into the world trading system.

Short-term policy proposal: help North Korea establish an international arbitration institution

One of the main obstacles for North Korea to attract foreign trade and investment is a general lack of trust in the government by international companies. The regime is known to be very unpredictable in enforcement of contracts relating to trade and foreign investments. The SEZ that the regime operates in cooperation with the South Korean government in Kaesong has been shut down on several occasions, and North Korea's lack of an independent judiciary means that foreign investors cannot trust the legal frameworks that exist. It is imperative that the Pyongyang government establishes institutions that give foreign investors and trading partners the confidence they need to trust business agreements will be honored.

In the long run, North Korea needs an impartial judicial system and full property rights for its citizens as well as any foreign investors. In the shorter run, an institution that handles and makes judgments on disputes between North Korean and foreign entities would be a start. An arbitration institute comprised of specialized and highly trained legal experts would be able to settle potential disputes in an impartial manner, and the existence of such an institute should increase international trust in the North Korean investment environment. Because North Korea presumably lacks the capacity to set up such an institute, both financially and knowledge-wise, international assistance from countries that have set up such institutions, as well as multilateral institutions with relevant expertise, would be necessary.

Two prerequisites exist, however. First, the institution should publish its findings and make them available for the global public. Second, the institution must be able to show that it is prepared to make judgments against the government. Only by holding up to international standards of transparency will trust be built in the institution, and only when it proves itself impartial and immune to government pressure will foreign investors trust that their interests will be protected.

Long-term policy proposal: capacity-building for North Korea's mining industry

According to available estimates, North Korea is home to some of the greatest untapped mineral resources in the world.⁶⁶ Before the industrial breakdown in the early 1990s, heavy industry and mining were important parts of North Korea's industrial composition; today, mines only operate at a fraction of their capacity.

⁶⁶ On North Korea's mineral wealth, see, for example, Scott Thomas Bruce, "North Korea's Six Trillion Dollar Question," *The Diplomat*, Aug. 30, 2012, accessed July 14, 2015, <http://thediplomat.com/2012/08/north-koreas-six-trillion-dollar-question/>.

For an eventual future transition and economic buildup, the mining industry is a potentially crucial driver. In countries like Mongolia, mining became an important part of the transition process, not least because the industry contributed greatly to financing the transition process itself.⁶⁷ No matter what direction North Korea would take, its mining industry is likely to become the backbone of any economic development.

The international community should support such a development, but only under certain conditions. This policy proposal would by necessity entail a great number of specific parts, and because all these segments would be necessary to achieve in order for the policy to be worthy of implementation. The capacity building support would not only be for mining operations, but also for the legal frameworks surrounding them. This policy is only recommended in a scenario where the North Korean regime makes a fully credible pledge to transition to democracy and market economy, which is not currently a realistic vision.

This policy would need several components. One is to demand and support North Korean transparency in natural resource revenues, potentially through organizations like the Extractive Industries Transparency Initiative.⁶⁸ Another is to ensure fair administration of mining operations. One stark lesson from previous communist transitions is that one of the greatest threats to a smooth transition comes from interest groups that seek to control government resources for their own benefit.⁶⁹ It would be crucial that any aid to help North Korea's mines to function better be conditioned on its revenues going to finance reform and transition programs. The risk that the international community could contribute to supporting North Korean cronies must not be ignored.

Governance

Background

Governance, here, means governing and administrative capacity and function rather than as a concept of democratic and "good governance" with popular influence.⁷⁰ Such reforms and assistance to North Korea is far too unrealistic to be conceptually interesting to discuss. Instead, this paper takes aim at the governing capacity and structures of the state.

Development practitioners agree that North Korea has a fairly well built governance structure. Levels of governance are usually clearly defined, and the structure, from central

⁶⁷ For information on Mongolia's mining industry throughout the transition years, see Ole Bruun and Ole Odgard (Eds.), *Mongolia in Transition: Old Patterns, New Challenges* (Oxford: Routledge, 1996), 246-248.

⁶⁸ For more, see "What is the EITI?," Extractive Industries Transparency Initiative, accessed July 20, 2015, <https://eiti.org/eiti>.

⁶⁹ Anders Aslund, "Transition Economies," in David R. Henderson (Ed.), *The Concise Encyclopedia of Economics* (Liberty Fund Inc., 2008), accessed July 20, 2015, <http://www.econlib.org/library/Enc/TransitionEconomies.html>.

⁷⁰ When governance issues are usually discussed within the realm of international development cooperation, it usually occurs with an underlying assumption that popular influence should be strong and increase. For a definition and discussion, see, for example, "Good Governance and Human Rights," Office of the United Nations High Commissioner for Human Rights, accessed July 19, 2015, <http://www.ohchr.org/EN/Issues/Development/GoodGovernance/Pages/GoodGovernanceIndex.aspx>.

government down to village level, is clearly defined.⁷¹ Despite North Korea's lack of democracy, local officials have often been known to stand firmly by the interests of their localities in relations to the central government, not least during the famine of the 1990s.⁷² However, obvious deficiencies exist, too: as state structures and capacities have deteriorated since North Korea's economic collapse, so, too, has the capacity of the government to execute its most basic functions. North Korea's governance capacities can be improved with outside assistance, but an array of measures not only to assist improvements in administrative capacity, but also in popular influence, will be needed.

Short-term policy proposal: assistance to improve North Korea's data gathering capacities

Lack of reliable data is a crucial challenge for economic development. Often, poverty statistics are either deeply flawed or unreliable. This can harm choices not only in aid and development cooperation, but also often in national government policy making. Capacity to gather reliable statistics, as the advisory group mentions in their report, is often the main obstacle.⁷³ The UN Secretary General designated a specific advisory group to come up with proposals for how global data gathering can be improved.⁷⁴

North Korea faces similar problems. According to one development practitioner formerly stationed in Pyongyang, government authorities often function in silo structures. Ministries often refuse to share information with each other, and the Central Statistics Bureau – in theory, a crosscutting statistics agency – has a difficult time acquiring data from government agencies whose statistics it is supposed to compile.⁷⁵ More seriously, North Korea's statistical authorities lack capacity to gather even basic statistical data.⁷⁶ For example, the last population survey conducted in the country, the first in decades, in 2008, was done with assistance from the United Nations.⁷⁷ The North Korean government virtually stopped publishing statistics altogether decades ago, and scholars attest to enormous difficulties associated with quantitative research on the country.⁷⁸ Part of the reason may be political, as the regime has sought to hide its economic downturn from the outside world (primarily prior to the 1990s and 2000s), but the lack of adequate statistical capacity is probably equally significant.

⁷¹ This topic was well covered and interestingly explored by Lu-Yu Hwang, "Panel on Health-based Engagement" (panel at the 2014 Student Conference on the DPRK by Engage Korea, Boston, Massachusetts, Sept. 13, 2014).

⁷² Such dynamics are discussed in Haggard and Noland, *Famine in North Korea*. See also Marcus Noland, "Famine and Reform in North Korea," *Working Paper 03-5*, July 2003, Institute for International Economics, accessed July 19, 2015, <http://www.iie.com/publications/wp/03-5.pdf>, which also alludes to this dynamic.

⁷³ *Ibid.*, 3.

⁷⁴ Data Revolution Group, "A World That Counts: Mobilising the Data Revolution for Sustainable Development," Independent Expert Advisory Group, November 2014, accessed July 19, 2015, <http://www.undatarevolution.org/wp-content/uploads/2014/11/A-World-That-Counts.pdf>.

⁷⁵ Interview, May 28, 2015.

⁷⁶ The lack of capacity is briefly touched upon in Mika Marumoto, "Project Report: Democratic People's Republic of Korea Economic Statistics Project," Published by the U.S.-Korea Institute at SAIS, March 31, 2009, accessed July 19, 2015, http://uskoreainstitute.org/wp-content/uploads/2010/02/DPRK_Stats_FullRPT.pdf.

⁷⁷ Central Bureau of Statistics, "DPR Korea 2008 Population Census: National Report," Pyongyang, DPR Korea, accessed July 15, 2015, http://unstats.un.org/unsd/demographic/sources/census/2010_PHC/North_Korea/Final%20national%20census%20report.pdf.

⁷⁸ Nicholas Eberstadt, *The North Korean Economy* (New Jersey: Transaction Publishers, 2009), 17–52.

Some capacity-building work has been conducted with regards to North Korea's statistical capacities, because, in the words of one of those spearheading a 2013 project, "[c]apacity building in the area of statistics is helpful to governments everywhere because quality data collection leads to informed policy decisions in all areas of development such as agriculture, education, etc."⁷⁹ Enhancing North Korea's statistical capability would be a crucial step toward not only better policy-making within the country, but also toward better informed development cooperation and aid policies.

Therefore, this paper proposes that the international community adopts statistical capacity buildings as one of its areas within development cooperation with North Korea. This policy is relatively non-political: improved statistical capacity is of clear interest to the North Korean government and the international community alike. Such work has already been conducted and would likely be relatively easy and quick to pick up again.

Long-term policy proposal: assistance for improved local governance

Although North Korea is a centrally controlled country, individual provinces have historically had a significant extent of administrative autonomy. In the wake of the famine, provinces were essentially told to manage themselves.⁸⁰ One of the latest developments in this trend is a reform through which individual provinces are now responsible for establishing and maintaining SEZs.⁸¹

This may increase bureaucratic competition in North Korea, as individual provinces battle for SEZ-investments. Similar competition has done much to enhance economic development in countries like China. There, provincial autonomy has been an important key in enabling experiments in different modes of economic governance and reform.⁸² Autonomy of provinces allows countries to try out different forms of governance and reform to see what works best. It encourages competition between provinces to create better conditions for economic growth.

Little is known about local governance in North Korea, but given the dismal state of its economic and administrative institutions, North Korea would likely benefit significantly from assistance in capacity-building for local governance institutions. This paper therefore suggests that such assistance be given in a situation where North Korea explicitly and actually strives to increase provincial autonomy. Assistance should be given with the clear goal of supporting and enhancing provincial autonomy. Such autonomy should lead to institutional competition improving the overall quality of governance in North Korea.

⁷⁹ Carl Bialik, "Statistical Diplomacy in North Korea," *The Numbers Blog*, *Wall Street Journal*, Jan. 18, 2013, accessed July 19, 2015, <http://blogs.wsj.com/numbers/statistical-diplomacy-in-north-korea-1205/>.

⁸⁰ For provincial management of things like food trade and barter, see Noland, "Famine and...".

⁸¹ Abrahamian, "The ABCs ...".

⁸² For more on the role and dynamics of provincial autonomy in China and economic development, see, for example, Gabriella Montinola, Yingyi Qian and Barry R. Weingast, "Federalism, Chinese Style: The Political Basis for Economic Success," *World Politics* 48 (1996, no. 1): 50–81.

Conclusion

This paper aims to spark a more creative debate about development cooperation with North Korea by introducing eight broad suggestions, some of which are realistically possible to implement in a relatively near future, and some that will only be possible in a fairly distant future. Nevertheless, it is important to have an ambitious discussion, because development cooperation with North Korea, like the reunification issue, requires contingency thinking.

North Korea has actually slipped backward in its development cycle, from having come a fairly long way in decreasing poverty and raising human well-being in the 1960s and 1970s, to experiencing a fundamental breakdown of all it had built up in the 1990s. This leaves it a country of development paradoxes. It has a high literacy rate but also severe malnutrition. It is the first fairly urbanized and industrialized country ever to experience famine in peacetime.⁸³

Many of the policy proposals made in this paper concern capacity-building: that is, assistance through knowledge rather than resources. As previously noted, the international community has already channeled massive amounts of funds into North Korea, most of which has gone to nutrition assistance. Such support is necessary in the short run, but in the longer run, much more complex support than food and funds will be necessary. Scholars William Easterly⁸⁴ and Dambisa Moyo⁸⁵ have shown that aid can often hurt more than it helps. When or if North Korea does open up sufficient political space for even the long-run suggestions made in this paper to be viable, the international community must stand ready to assist. However, it must also be ready to stay away, and to remember the Hippocratic Oath of foreign aid: do no harm.

⁸³ Eberstadt, *North Korean Economy*, introduction.

⁸⁴ Easterly has written extensively on the topic. One of his most famous books is William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (London: Penguin Books, 2007).

⁸⁵ Dambisa Moyo, *Dead Aid* (New York: Farrar, Strauss and Giroux, 2010).

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