Daegu’s partnership with Almaty and cooperation for North Korean LGs through the UCLG/UCLG ASPAC

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The city of Daegu and the city of Almaty established the sister city relationship in 1990, two years prior to official diplomatic relationship between the Republic of Korea and the Republic of Kazakhstan.

The two cities have one thing in common: apple. Daegu has been famous for its production of delicious apples. And Almaty, once called as Alma Ata, means “Grandfather of Apple”. This can be a very trivial fact, but somehow it led to linking the two cities.

Over 25 years both cities have cooperated in the fields of medicine, culture & arts, academy and economy. First of all, medical cooperation has been largely implemented by private sector, Keimyung University Dongsan Medical Center. The medical center was established as Jejungwon, a Salvation Hospital, in Daegu in 1899 by Dr. Woodbridge Johnson who had been dispatched to Korea by the United Northern Presbyterian Church in the USA. And since 1995 they have sent their medical team to Kazakhstan, a medical frontier country. For providing better medical service they purchased a building and set up an Almaty Dongsan Medical Clinic. Based on the clinic their volunteers participated in voluntary medical service for Almaty citizens and Korean residents in Almaty every year. And for critical medical cases, they invited the patients to Daegu to have surgery. And the City of Daegu acknowledged their work and supported administratively such as seeking for cooperation from Almaty city hall for smooth customs for their medical equipment and materials at Almaty International Airport. And since 2009 Daegu city also provided some financial support for them to further their work and utilize Almaty Dongsan Medical Clinic as Daegu Medical Service Center. In 2012 as a public-private partnership project, a U-Health Center in Almaty Dongsan Medical Clinic was established. Through this ubiquitous facility Almaty citizens can get Korea’s advanced medical treatment, and local doctors and medical staff can receive updated medical technology and training.

One of the best and efficient ways to build a friendly relationship between the two cities with different backgrounds is cultural exchange. We were invited to the “Day of Almaty” and performed a variety of Korean traditional cultural performance including Hanbok fashion show, fusion music concert of Korea traditional & modern music and Korean traditional dance in 2004, 2007 and 2009. And in return, we also invited Almaty performance team to our citizens’ festivals and their exotic traditional performance was excellent to raise awareness of Almaty as one of our sister cities among our citizens in 2001 and 2008. And celebrating the 2010/2011 Kazakhstan in Korea/Korea in Kazakhstan both cities hosted the large scale of cultural events including concert, exhibition, economic, academic and medical programs.

Also, to enhance Almaty city official’s better understanding on Daegu, we have invited two working level city officials to Daegu International Exchange Forum. It provided them with an opportunity to see, feel Daegu and get to know each other in 2007. Since this exchange program, cooperation between the two cities has been more vitalized.

After fostering good relationship, we tried to seek for economic cooperation. Since 2009 Daegu city has formed trade mission consisting of local small & medium sized companies to find their new business partners in Almaty. Sandwiched between cheap, low-quality Chinese products and expensive, high-quality European ones Daegu companies should find its niche for reasonable priced high-quality goods. And Korea’s good reputation, largely thanks to Hanryu, Korean wave, affects Almaty consumer’s decision, indeed.

Apart from these already mentioned, we have exchanges in academia, attempted to cooperate in the agricultural field, and have supported Korean residents living in Almaty.

In the framework of bilateral relationship sharing various city policies has not been actively implemented. It can be easier to be done in the multilateral framework such as the United Cities and Local Governments (UCLG), an international local government organization.

The UCLG is the biggest international organization for cities, local governments and municipal associations
throughout the world. Founded in 2004 in Paris it has over 1,000 members across 120 countries covering 7 areas including Africa (UCLG Africa), Asia-Pacific (UCLG-AS PAC), Europe (CEMR), Eurasia (UCLG EuroAsia), Middle East and West Asia (UCLG MEWA), Latin America (FLACMA) and North America (UCLG North America). In addition, METROPOLIS representing regions with more than one million population joined the UCLG as well.

In order to reflect the true need of citizens on global issues, the UCLG has been closely working with the UN in various matters such as setting up a new set of the Sustainable Development Goals and agendas of the HABITAT III. It also has a wide range of committees dealing with issues including strategic urban planning, culture, decentralization and local self-government, gender equality, city diplomacy, local finance, peripheral cities, social inclusion, responsible tourism, etc.

Since Daegu is part of the UCLG ASPAC and has been an active member, I would like to focus on how local governments can utilize this organization to strengthen their capacities including North Korean cities. Asian countries have historically complicatedly intertwined each other. For instance, the relationship between the People’s Republic of China and Taiwan, India and Pakistan, and South Korea and North Korea is very rigid and stiff. To overcome this sensitive matter, the UCLG ASPAC founding members agreed to not to use the name of country nor national flag in any document or in any occasion. It also required strongly determined leadership to achieve this goal.

As a result, in 2004, Chinese cities participated in the UCLG ASPAC meeting which was held in Taipei. Chen Haosu, the president of the Chinese People’s Association for Friendship with Foreign Countries (CPAFFC) was elected as the President of the UCLG ASPAC and Ma Ying Jeou, the then Mayor of Taipei supported him. And the All India Institute of Local Self-Government and the Local Council Association of Punjab Pakistan shared its presidency between 2012 and 2014. And with great support of CPAFFAC, UCLG ASPAC Ambassador and Hans Seidel Foundation in Korea, North Korean Cities Federation (KCF) finally joined the UCLG ASPAC and two delegates attended the UCLG ASPAC Congress in Jakarta in 2012. It has not been done in a short period of time, but took about a decade to persuade them to sit down together with South Korean local governments in the same place.

The UCLG ASPAC provides its training sessions combined with statutory meetings twice a year. All types of good practices and policies in the fields of environment, water and sanitary issue, waste treatment, natural disaster- resilient cities, gender equality, urban planning, etc. Regardless its ideology or political belief, any local government who wants to deliver its best service for their citizens can attend this training forum and learn know-how and experience from other local governments. It is one of the best ways for North Korean local government to acquire policies and practices which need for them. It is because even though South Korean local governments have advanced administrative skills and best practices, we are unable to share them with or support them directly. Therefore, I recommend working as a member of an international organization, such as the UCLG ASPAC will be best option for them to strengthen their capacity and develop their city or region in the future.
The current state of the North Korean economy – beyond “panem et circenses”?

Dr. Bernhard Seliger, HSS Korea

1. Introduction – the second phase of Kim Jong-Unts reign

The early years of the Kim Jong-Un reign, 2012 and 2013, might be called a period best characterized by the slogan “panem et circenses”, the old Roman strategy of “bread and games”. Though not beginning then, but already earlier, in the time of the late Kim Jong-II and in the run-up to the 100th birthday of the state’s founder Kim Il-Sung in April 2012, this period was the period of a great change in the cityscape of Pyongyang, of new, for North Korea miraculous entertainment facilities (among them most prominently a water-fun park, a riding club, a shooting club, a renovated and upgraded amusement park, a dolphin show, an upgraded zoo, and in Wonsan, an upgraded children’s holiday home and in Mashikryong near Wonsan a ski resort). It definitely brought improvements for the citizens of Pyongyang, and partly of the other cities of North Korea, but to what extent, cannot easily be measured. A number of (often non-resident) Pyongyang watchers see a growing “middle class”, but, in the absences of exact definitions and measurements, which do not exist in the case of North Korea, it might well be very misleading, and it might be rather spoken of the upper class, or the literal “upper ten thousand” in this case, which seems much more likely, given the state of the economy in the countryside, which houses more than 90 percent of the North Koreans.1

The main rationale of this policy, an overwhelming majority of observers agree, serves to buy the loyalty of the essential group of supporters for the North Korean leadership and its transition. As such, it certainly brought improvements to the life of Pyongyangites and to some

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1 For the first interpretation see prominently Abt (2014) and Frank (2014), for a more skeptical view, seeing the wider middle class much more elementary view, seeing access to rice plus the so-called set of “5 plus 5”, five pieces of furniture (a shoe rack, closet, blanket chest, cupboard, and bookshelf) and five appliances (a television, refrigerator, video machine, fan, and washing machine) as defining for the real middle class, see International News Focus (2013).
extent the rest of Koreans, and, even if these were rather restricted to a small upper class, a
certain trickle-down effect might add advantages, e.g. for service personnel etc. Also, Kim Jong-
Un in various speeches declared the “end of the time of belt-tightening”, which made this policy
a quasi-official goal, which also could be seen in the change of media coverage, e.g. the focus on
happy North Koreans using the new amusement facilities, the invitations of foreign diplomats to
look around the facilities, sometimes even in the presence of leader Kim Jong-Un himself, and
the formerly unheard-of criticism of civil servants, who did not work hard enough to secure these
goals.\footnote{In one case, Kim Jong-Un criticized the civil servants responsible for the Mansudae amusement facilities by pointing out weeds growing at the wayside.}

Then again, 2013 and 2014 saw great changes going clearly against this goal: In 2013, a
major political crisis with South Korea broke out in the first half of the year, leading to the
closure of the Gaesong Industrial Complex (KIC), where 53,000 North Korean workers work for
124 South Korean companies, for half a year, resulting in great income losses also for the North
Korean state. In December 2013, the demise of Jang Song-Thaek, the eminence grise of the
North Korean politics and close friend to China, led to an aggravation of the relations with China,
virtually the only ally of North Korea (at least in terms of much-needed economic assistance to
the country). China is responsible for more than 80 percent of trade with North Korea, and more
than 90 percent of consumer goods, plus indispensable inputs like oil. While North Korea tried to
outbalance the fallout of this crisis, which led to the first dent in North Korea – China trade in a
decade, with a more close relation with Russia, the economic effect of this change was clearly
negative. Despite certain advances to South Korea (the surprise sending of envoys to the Asian
Games in Incheon) and the US (the freeing of three imprisoned US citizens), no improvement of
relations with the two countries took place, none the least due to ongoing military provocations
like violations of UN security council declarations.

These developments often contradicting each other can be explained by a struggle of two
different groups around Kim Jong-Un, doves interested in more trade, better relations to the
outside and the improvement of living conditions, and falcons seeing military power and an iron
fist as the only way to guarantee the survival of North Korea. Obviously, from the contradicting
policies of the past three years, none of these groups has yet been dominating the other. The fight of both has even been enshrined in a new policy doctrine, “byungjin”, the line of simultaneously developing military, nuclear power (falcons) and a strong economy (doves). The announcement of a policy of new special economic zones, of a sharing policy of the state with farmers for the farm output and of liberalized management measures (the so-called May 30 measures) can be traced to the latter, the ongoing military demonstrations, the complete shut-down of foreign relations allegedly due to a potential Ebola risk from November 2014 to March 2015 and the current row over wages in Gaesong Industrial Complex to the former.

The remainder of this paper looks into the signs for a growing upswing in Pyongyang (2.), the essential trade relations with China in section 3 and the policies of special economic zones and the prospects for a more diversified trade in section 4 before a short conclusion.

2. Signs of the upswing - the new cityscape and the new consumption possibilities in Pyongyang

Pyongyang, that is undeniable, experiences a formerly unknown upswing. Cars around the city are ever-increasing in numbers, and, though there are a lot of Chinese-made lorries and trucks and other machines for the construction boom, most of the cars are obviously used as private vehicles. In front of the “forbidden city”, where the functionaries have their apartments, literally hundreds of cars are lined up, and ever increasing is also the number of cars with the “7-27”-number-plate, i.e. presents of the new leader. The formal attachment of these vehicles might still be with an army unit, a party department or elsewhere, but they are essentially used for private transportation. While there is a great number of Chinese car brands visible, notably “Byd”, top-end brands (including Mercedes, BMW, and Volkswagen) have also greatly increased. And the car boom is followed by a boom in gas stations. Owned by a party organization, they are seen by Pyongyangites as a good business, which explains the great numbers of good-looking female service personnel active in any of these stations. There is something like a free, hard-currency-based market for gas. Cars attached to party and governmental institutions, however, seem to be

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3 7-27 stands for the (in the North Korean understanding victorious) end of the Korean war. Before, Kim Jong-il had cars presented to his followers with his birthday (2.16) on the license plate. Overall, there is a whole nomenclatura of different license plates.
forced to use coupons (measured in the unique measurement of kg instead of liters or gallons),
which are slightly more expensive than the free sales on hard currency.

The second sign of the upswing of Pyongyang is the construction boom. Started with the
100-day-campaign and 150-day-campaign of 2010, they are truly reminiscent of a similar boom
accompanying the ascent of Kim Jong-II in the 1980s, the construction of Kwangbok street. And,
using the time-honored instrument of Maoist “mass campaigns”, they also remain true to
socialism in its most antiquated form. Currently, the cityscape of Pyongyang indeed changed in a
remarkable way. The new Mansudae quarter looks modern, is brightly illuminated by night.
While the Mansudae quarter is certainly the most prestigious of all new construction projects, it
is far from being the only one. Everywhere in Pyongyang and in many provincial towns new
construction projects have begun. In particular certain key groups necessary to maintain loyalty
to the leadership, like the professors first of Kim Il-Sung university, then of Kim Chaek
university, and now the scientists of the State Academy of Sciences, are targeted with new
housing. One striking point is that most of them, as far as can be seen from the outside and as far
as North Korea itself tells, are either apartment complexes or service buildings (ranging from
theatres to department stores and restaurants). So, essentially it is furthering consumption, not
investment in nature. And this leads to the next and maybe most striking point: the upswing in
(upscale) consumption possibilities.

The differences from Pyongyang today to that five years ago in terms of consumption
possibilities, and open consumption possibilities, is striking. There always had been a market for
luxury goods in Pyongyang: cognac and whiskey has always been in the market and so have
been other consumption goods: For example, for years there has been a shop of the Swiss watch
maker Tissot and in one place, there has been a typical non-descript Korean building with a
small pharmacy sign. Inside, not only pharmaceuticals (including certain equipment for hospitals,
like infusions etc.) were sold (only against cash, naturally, debunking the myth that medical
treatment in North Korea is free), but on a second floor there was a specialized shop for upscale
frames for glasses, imported from Germany and the US via Hong Kong, and starting with prices
from 250 USD. But, at that time consumption was not displayed with such capitalist fervour like
today.
In the newly renovated or opened department stores like the Kwangbok Department store (where leader Kim Jong-Il made his last public appearance) or the Potonggang Department store (run by the Foreign Trade Ministry) you can be Japanese electronics, German household appliances, Swiss chocolates and expensive toys like electronic bobby cars starting from 300 USD. Still, prices in these shops seem to be high and consumers are not too many. But certainly, it became places where Pyongyang’s higher-to-middle class likes to go, if only for eye-shopping. And, while prices certainly are high, they are low compared internationally, probably related to widespread complaints that the consumption possibilities are much better now, but at the same time people have no money to actually shop. However, it is also true that cash seems to be in Pyongyang less of a problem than before. Prices in the Chinese restaurant incorporated in the Kwangbok Dept. Store have a range up to 120,000 North Korean Won (30 USD at current market prices of April 2012) and people obvious carry this amount around. Even, a sign promising rebates has a rebate for shoppers spending more than one million won at a time. Given the market prices, this seems plausible, but it certainly cannot be reconciled with the figures for nominal monthly wages still sometimes heard (at the level of around 5000 won in 2012). Only a very few domestically produced goods, mainly alcohol, certain foodstuff (like dried fish and fruits), miracle medicines, teas, soft drinks exist. A new cigarette brand was praised by North Koreans as “as good as foreign brands” and obviously there is some interest in substituting expensive foreign goods, but in most cases, there is no home-grown substitute.

A lot has been written on the spectacular rise of the cell-phone industry and its impact on communication in North Korea. While for a long time the focus had been on information inflows from abroad, and on the (im-)possibility of vertical information exchange, the dramatic rise in horizontal communication was the most important feature of the widespread and in its entirety not completely controllable cell-phone use. This is of utmost importance, given the until the early 2010s quite successful strategy of dividing Pyongyang from the rest of the country, the province. Formerly, people living in the province rarely had chances to see Pyongyang and what they saw, on holidays and organized tours, was a capital quite different from their own country life, a real socialist paradise. At the same time, people living in Pyongyang had neither the desire nor the possibility to experience life in the countryside, apart from a few selected tour spots like
Myohyangsan or Nampo West Sea Barrage, Wonsan or Panmunjom. Due to rise of cell-phone use, this artificial divide breaks more and more down and information travels fast and uncontrollable through the country (see Seliger/ Schmidt 2014, Seliger 2012a).

With almost two million cell phones and counting, the diffusion is already high in Pyongyang. Still, it should be pointed out that in comparison to the rest of the world, this is still a very meagre beginning. Cell phone penetration for the least developed countries is at a level of around 60 percent, and two million cell phones would mean a level of less than ten percent for North Korea in a head count, or, given that cell-phones have multiple users, maybe put it at half that rate. But, a beginning is a beginning. More interesting, cellphone use is by now largely consumer driven. While originally, officials were using cellphones, and were using it mainly on official business, by now the use is much more widespread. A large share of students in Kim Il Sung – University are reported to own cell-phones, as do housewives. And, also the rise of consumer-related businesses is growing, for example the sales of cell-phone games (which can be bought at 60 cent a piece, for example at Pyongyang Information Centre’s computer store). The cell-phone story is, however, not a success story of foreign investment. While all the investment came from abroad, from Orascom company from Egypt (and, in Rason, originally from Loxley of Thailand), this company reportedly sits now on a huge pile of paper profits, not convertible into foreign currency.

3. The North Korea – China nexus, or, who or what pays for North Koreans imports?

As it has already been mentioned, China is the most important ally and the most important trading partner for North Korea. Moreover, it is physically, almost the only place where imports can arrive and exports leave. With practically no international air routes besides to China and Vladivostok, and with the railway from Russia bringing only very few goods, if at all, all trade has to be channeled through China. Dandong and its opposite on the North Korean side, Sinuiju, is the lifeline of North Korea. It is telling for the Chinese-North Korean relations, that the new bridge which China built there to enhance trade, is abruptly cut off and fenced off on the North Korean side. North Korea needs China, but at the same time it fears the new information and new ideas coming in by China. While this means that trade grows at less than a possible rate, it
still does grow, and in the time from 2002 to 2012 roughly quadrupled. This is the main explanation for the new upscale consumption outlets in Pyongyang, the imports of high-end consumer goods, perishable food, and sophisticated equipment, e.g. for the water-park, the ski resort or other “health complexes”.

Today, North Korean exports mainly consist of raw materials, and the deals with almost exclusively Chinese partners in the field of raw materials are growing to become a headache and a source of concern for North Korea’s administration. North Korean officials can be overheard grumbling about the fact that most coal mines are exporting to China. Molybdenum, iron ore (from Musan mine) and other raw materials are as well concerned as raw fish, other maritime products and wild fruits and berries collected in the mountains. In 2002, the collected dried fruits, mushrooms, “health herbs” and fish were still the main export item. In that time, slowly the renovation of the North Korean mining industry with the help of China began. North Korea had an important mining industry, first developed by the Japanese in the colonial period and later expanded with the help of Soviet advisors. However, the breakdown of the economy in the early 1990s, mainly a consequence of a lack of energy, meant that pumping systems in the mines did not work properly any more and subsequently many mines were unable to maintain production. The first large-scale renovation was that of the Musan iron ore mine (until today the only Chinese investment by a state-owned enterprise, after a first attempt by a private Chinese company). Others followed and so slowly the renewal of large-scale mining began.

The North Korean grievance seems mainly to be the low price Chinese traders pay compared to South Korean or Japanese traders (which in many cases had been interested in the past), but also the Chinese influence per se and the problem of a lack of domestic resources are mentioned. From a Chinese point of view, steep price discounts are necessary in any deals with North Korea due to the erratic North Korean behavior, high risks of non-delivery, small and outdated sizes of transport entities entailing additional costs. Certainly, the monopsonistic position of China also plays a role in price setting – there are no alternative buyers for most North Korean goods.

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4 For example, usually the Chinese companies at the East coast of China have their own harbours dealing with vessels from 25,000 BRT upwards in a just-on-time logistic system. North Korean vessels of 8,000 or 10,000 BRT do not easily fit in and mean additional adaption cost.
As for other products, e.g. in the field of labor-intensive light industries, like clothing, there is a growing number of ventures, again mainly Chinese, but the number is small. One positive sign is that the size of textile exports by North Korea increased. This is a labor-intensive industrial production predictable for an economy like North Korea which wants to develop. However, essentially imports and construction projects are either paid by raw material imports, or by Chinese credit, which should not be underestimated in size. Both seems to be likely. But at the same time it seems to be not really sustainable. A third important source should be mentioned, namely North Korean labor abroad, which also seems on the rise. In 2013, more than 100,000 labor permits for North Koreans have been issued by China, though in fact at any given time only a few ten thousand workers might be there. Others work in Middle East construction sites, in Russia’s tree logging industry in the Far East, and some are even scattered in Africa or Poland (the only European country still allowing North Korean workers in). This, however, has mixed implications – there are strict limits for North Korea to let workers go out. Defections might
occur (like among loggers in Russia) and also, unwanted information might flow into North Korea (as from Northern Africa during the Arab spring movements).

4. New special economic zones and trade diversification – can it work?

The Special Economic Zones (SEZ) of North Korea have been keenly observed in the past decades. The opening of Gaseong Industrial Complex (GIC) in 2004, the most successful and today only surviving of the many economic cooperation projects from the era of sunshine policy, has been heralded as a potential first step to a market economy. The development of Geumgangsan Tourism Zone and the aborted attempt for a special zone in Sinuiju have been equally seen as steps towards the market (see Seliger 2003, 2006). However, in particular the two inner-Korean projects have been essentially political in nature. Investment was only possible due to a mixture of large-scale state investment in infrastructure and state guarantee of debt of private firms by the South Korean government. And, political trouble brought both projects soon to the brink of closure. GIC closed for several months in 2013 and one, Geumgangsan, seems for now beyond the brink and it is dubious, if it will ever be restored. This does not mean that the zones have had no economic impact. The impact of GIC on the North Korean economy is tremendous, and on the South Korean economy is at least sizable. Moreover, the fact that now around 53.000 North Korean workers work according to the rules of the market, in modern factories enjoying more or less stable supply of raw materials, energy and other utilities, is of utmost importance. While the fact that North Korea is depending more and more on earnings from the zone might be an explanation while this zone has been exempted from the general decline of inter-Korean relations after 2008, might be true. But equally, it might well be true that North Korea cannot afford to let 53.000 of its workers being idle, returning to their hometowns (since by now, many of the workers do not any more come from Gaesong itself) and reporting on the labour conditions in the complex, being incomparably better than in most North Korean factories.

Rason Special Economic Zone has the longest history of all special zones of North Korea, since it was already designated in 1990. Kim Il-Sung himself declared it to be the new “Singapore of the North”, and great hopes were put on the project in Korea as well as internationally, where the Greater Tumen Development Project of UNDP was seen as a possible
complement to the zone. However, for almost fifteen years it stayed dormant and only the planful development of the Chinese Northeast in the 2000s led to new development chances for Rason (see Seliger 2012b). Currently, in particular the finished road network with China and railway plus harbor network with Russia (which leased pier 3 of Rajin harbor and completed renovation in 2014, including outfitting it with modern cranes and independent oil-based energy production) are fueling hopes for a transformation of Rason to a hub for logistics in Northeast Asia, in particular for the 100-million-strong Manchurian region (the Northeastern provinces of China, which have no access to the Pacific). The cooperation with China in the Rason region was a domain of Jang Song-Thaek, and his demise in 2013 put the brakes on the development of the zone. Also, the use of Rason by South Korea until now has only been used in a trial run, and it remains to be seen if the a-political nature of the Russian-leased harbor really holds true, if tensions on the Korean Peninsula rise. Nevertheless, Rason is a possible attraction as well for Chinese as for Korean companies in terms of logistics, and for now Rason is the only special economic zone at least partly driven by economic considerations.

Map: Old and new special economic zones in North Korea
In 2014, North Korea announced the designation of 19 additional special economic zones, some of which had a very particular designation, like the special tourism zone in Wonsan or a high-tech district near Pyongyang. The announcement of these new zones created a lot of attention, since it was seen as a reaffirmation of the wish of North Korea to open up its economy and to interact peacefully with the world – all special economic zones are designated as zones for foreign investment. At a closer look, the zones – at least for the time being – seem to be doomed: there is, beside the most basic designation, no detail rule for any of the zones existing, no investment in infrastructure promised, no additional investment in human resources, also no indication of additional autonomy, for example in visa issues, like in the Rason zone. On a positive note, basically the non-existence of rules means also that investors, should they really be interested, could write their own favorable rules. If these investors, however, will ever arrive, is questionable: The fate of the short-lived Taepoong Investment company, now integrated into the new Ministry of External Economic Relations, shows that North Korea seems to suffer from a lack of a long-term vision on how to develop its external economic relations.5

A glimpse into such a thought could be got by the diplomatic activity of North Korea in 2014, in particular in the wake of the condemnation of North Korea in the UN General Assembly due to its human rights record, based on the findings of the Commission of Inquiry. North Korea tried to avert this condemnation by various means, like sending envoys to certain countries and employing a mixture of pressure and promises. Among them was the idea floated by North Korea to have certain special economic zones “reserved” for certain countries: Gaesong Industrial Complex for South Korea, Rason for Russia, Hwangeumpyo in the Yalu river for China, Wonsan for Japan (due to the historical linkages) and Hamheung to Germany (due to the fact that after the Korean war East Germany led the reconstruction of Hamheung). This strategy, resembling the idea of the Chinese treaty ports in the 19th century, did not achieve its immediate goal to influence nations with regard to the UN resolution. But it is very typical for North Korea in one respect, namely the attempt to deal with any other nation piecemeal, which prevents them from coordinating and exchanging information. If this strategy still can work is questionable – to much the frustrations with North Korea led to interaction and exchanges of its neighbors and

5 Originally, the company was announced with great fanfare, and later it claimed to have secured ten billion USD of investment from China, which, however, never materialized.
adversaries, including China. With regard to this, and the ongoing nuclear policy of North Korea, it might well be that the new zones will remain dormant for a long time, or will eventually be abandoned.

### Table: North Korea’s trade with the world 2011

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<tr>
<td>19</td>
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</tr>
<tr>
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<td>China</td>
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<tr>
<td>26</td>
<td>Cambodia</td>
<td>China</td>
<td>China</td>
</tr>
<tr>
<td>27</td>
<td>Australia</td>
<td>China</td>
<td>China</td>
</tr>
</tbody>
</table>

Table: North Korea’s trade with the world 2011

Source: EU after IMF, World Bank statistics

One of the goals of the new special zones and their possible match with certain foreign nations was also to reduce dependency from China. Currently, North Korea is overwhelmingly dependent on China, and the rest of its trade is difficult to describe, often hinging on one or two major deals. For example, in 2011 the EU 27, India the Republic of Congo and Saudi Arabia were the most important trading partner distantly behind China (taking imports and exports together), with Russia an important import partner and the Dominican Republic and Myanmar an important export partner. This reflects the general low amount of trade with any other country than China. In 2014, trade with Russia grew considerably, but still it is dwarfed by that with China, and this will be the case for a long time to come.
5. **Outlook - what kind of economic system do we talk about in North Korea and what can be expected in the future?**

In 2011/2012, in preparation for the 100th birthday celebration of Kim Il-Sung, Kim Il-Sung square was renovated and, among others, the pictures of Karl Marx and Vladimir I. Lenin were finally removed from the building of the Ministry of Trade (today Ministry of External Economic Relations). They had been put into a museum. But in fact, long before, the breakdown of the Soviet-style centrally-planned economy began. Like in feudal systems, socialist systems grant no complete property rights, but only usage rights to office holders. These usage rights (e.g. for the use of labor, car parks or land) can be used to create private forms of enterprise within nominally state-owned entities. Eventually, this leads to the privatization in particular of profitable parts of enterprises (asset stripping or nomenklatura privatization).

On the microeconomic level, this contributes to unprofitability and the need for ever more subsidies for state-owned enterprises, since only the least productive parts remain public. On the macroeconomic level, this leads to hybridization of the economy. In Central and Eastern Europe as well as some parts of Central Asia, “wild privatization” occurred in particular in the last phase of decline of socialism. China, on the other hand, as well as other Central Asian states experienced a long phase of hybridization and the emergence of new conglomerates in particular from army enterprises. The outcome, however, was very different in terms of macro-economic success in these states. What way will North Korea go? Already now, hybridization through the formation of private enterprises is going on. Today, we have an economy consist over various columns – the party, the military, the people’s economy and the new private economy – but in fact, these are not independent or exact, but fuzzy, distinctions, with large areas overlapping, e.g. military trucks moonlighting as a logistics company. However, as well internal reasons, as the ideological campaign after the purge of Jang Song-Thaek, as external reasons, for example sanctions, prevent a large-scale drive of these enterprises towards freer markets.

The state is put in a difficult situation: by taking away more or less informally privatized economic activities and placing them under the control of the government again, opposition is created. In 2009, the botched currency reform led to form of apology never used before. In the early reign of Kim Jong-Un attempts to put the enterprises of the army under control of the party
or ultimately the government obviously failed. If the state does not intervene, with private enterprise also more information about the outside and greater demand for more consumption will grow. Temporarily, cracking-down on forbidden information, goods from South Korea, and the defection of citizens to South Korea can balance at least partly the inflow of information. All this happens now. But in the medium term, this means that enterprise growth is hampered, and the expected benefits from liberalization cannot be reaped.

This reminds very much of the last two decades of East Germany: here, also, systemic conflict was more fierce than elsewhere, due to the direct comparability of life styles of East and West. And here, also, the East tried to satisfy consumer desires with the consequence of ever-rising subsidies and ever rising debt. In the case of Germany, the West provided a part of the debt and the East became dependent on the West (in particular, through two private credits politically brokered in the early 1980s by Franz-Joseph Strauss). In the case of Korea, the debt might be (explicitly and implicitly) to China, but this became more improbable after the fall of Jang Song-Thaek. In the end, (near-) bankruptcy might loom. At the same time, consumer desires cannot be really fulfilled. Even with subsidized prices, which are applied in some of the department stores, still goods are too expensive for most Pyongyanites. They will not be happy to be restricted to eye-shopping forever, in particular with more information available about consumption in China and South Korea. Therefore, a vicious circle of more subsidies, more inflation, more debt, more demands by consumers might set in and threaten the survival of the government.

This outlook is indeed not very different from that the economy faced already under Kim Jong-Il. There, also, a process of trial-and-error, like the price reform of 2002 and the later reversion of much of the reform in 2005, was driven largely by political rather than economic dynamics, namely the dangerous effects of more opening for regime stability. There is, however, one decisive difference between both situations: Kim Jong-Il was sixty years old, when he rose to power, so his time horizon was rather short or medium-run. Kim Jong-Un came to power in his late twenties and still has a potentially long reign before him. In this situation, it might be much more difficult to stick to the strategy of “muddling through”.

References:

Seliger, Bernhard (2006), “Towards a North Korea Boom? Special Economic Zones in North Korea and their Effects on the North and South Korean Economies,” in: Seliger, Bernhard (with Oh Yean-Cheon, Lee Dalgon, Park Sung-Jo), The Unification Research and Strategy in Korea and Germany: Affinity and Specificity, Seoul: Graduate School of Public Administration, Seoul National University, pp. 93-122
The purpose of this presentation is to demonstrate the position of transition countries in the sectoral structural development of economy, a precondition and an important part of general economic development.

General trends of sectoral development are well-known. The three sector hypothesis is one of the most well-established empirical generalizations in economics. It was developed by Alan Fisher, Colin Clark and Jean Fourastié. According to that, two development stages occur in sectoral structural change after traditional civilizations:

1) Industrialization, in which employment in agriculture is replaced by an industrial one.
2) Tertiarization, when the share of manufacturing industry in employment begins to decrease along with the agricultural sector on the account of the emergence of the service sector.

The increase in the percentage of service industries can be justified by different factors. Two generally recognised explanations can be associated with the works of Baumol and Fuchs. Baumol’s (1967) cost-disease argument explains the increasing share of employment in service sector as well as in GDP by technological stagnation of important areas of this sector, which increases the relative prices of the respective services. By relying on the conception of Maslow’s hierarchy of needs, Fuchs (1968) presented a quantitative principle of tertiarization, which is continually supported empirically as well: the relation of the share of service sector to income per capita follows a logistic curve. In addition, the hypotheses for externalisation and innovation are presented. The first of them explains the increase in the share of services with development in labour division and the fact that the supporting activities of production (foremost logistic) have become independent. The second one sees the reason being the conceptual increase of knowledge-intensive economy, which is related to internationalisation and globalisation, increasing the demand for knowledge-intensive science-developmental but also for marketing services. See the empirical overview by Jorgenson, Timmer (2011).

The two development phases (industrialization and tertiarization) are traceable in the historical development of single countries as well as in comparison between different countries, because the countries have reached different stages in the described process. Empirical studies so far show that despite a certain structural convergence, an important transnational variety has been retained, similarly to a general development level of economy (Sepp 2009; Sepp, Paas, Eerma 2009; Sepp, Kaldaru, Joamets 2014). This article focuses on this variety, whereby we are foremost interested in the position of transition countries when compared to each other as well as compared to other world countries.

Methodologically, our purpose is to group the world countries empirically based on their employment structure and thereafter to explain the position of transition countries. Herewith, we are also trying to advance from the level of the share of single economic sectors to a generalizing latent indicator level, by using primarily discriminant analysis.

We have used year 2011 or closest to the year accessible data from ILOSTAT on the sectoral share of employment, which allows us to identify six economic sectors:

1. Agriculture (hereinafter AGR).
2. Manufacturing (MAN).
3. Construction (CON).
4. Mining and quarrying; Electricity, gas and water supply (MIN).
5. Trade, Transportation, Accommodation and Food, and Business and Administrative Services (TRA).
6. Public Administration, Community, Social and other Services and Activities (PUB).

Preliminary sample has been formed of countries, where economic development has exited from a traditional agricultural stage. We have specifically excluded countries, where the share of agricultural sector in employment was over 40% according to the latest data (2011-2012). Among transition countries, the database is missing data for Turkmenistan and also for Uzbekistan after 1999. Tajikistan and Albania were also excluded, as the proportion of agriculture in employment is still over 50% and 45% accordingly. Altogether, the sample included 76 countries, of which 24 can be considered transition countries.

In order to generalize the structure of employment, the present article applies discriminant analysis. The latter replaces the preliminary share of economic sectors by their linear combination or discriminant function (DF), so as to make the differentiation of countries into specific clusters as clear as possible. The number of clusters can be determined exogenously. In the present work, we have remained with three clusters, which presume two DFs. Table 1 shows the correlation of the original coefficients to the DFs. By way of stronger correlations, we can derive a latent factor or circumstance that distinguishes each cluster redounding in each of the functions (feature of economic structure).

Table 1. Correlation of discriminant functions to original coefficients.

<table>
<thead>
<tr>
<th></th>
<th>DF</th>
<th>Agrarian level</th>
<th>Industrial level</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGR</td>
<td></td>
<td>0.915</td>
<td>-0.261</td>
</tr>
<tr>
<td>TRA</td>
<td></td>
<td>-0.428</td>
<td>-0.391</td>
</tr>
<tr>
<td>MAN</td>
<td></td>
<td>-0.092</td>
<td>0.940</td>
</tr>
<tr>
<td>PUB</td>
<td></td>
<td>-0.347</td>
<td>-0.410</td>
</tr>
<tr>
<td>MIN</td>
<td></td>
<td>0.040</td>
<td>0.372</td>
</tr>
<tr>
<td>CON</td>
<td></td>
<td>-0.031</td>
<td>0.174</td>
</tr>
</tbody>
</table>

Source: Calculations of the author based on data from ILOSTAT.

The first DF describes even up to 96% of the variation of original coefficients, being in strong positive correlation with agricultural sector and in a moderate negative correlation to the general share of service sector (TRA + PUB). The second DF only describes 4% of the general original coefficient variation, but very clearly distinguishes the industrialized countries, where service economy has to that extent a more modest proportion. Hereinafter, the first DF will be named as agrarian level and second as industrial level function. It is also clear that the negative trend of both functions corresponds to service economy development or tertiarization (Figure 1). It must also be added that the share of employment in construction does not in essence associate with indicators generalizing the structure; however, the mining industry and power industry seem to have a moderate part in the formation of industrial level function.

1 For further information, see: http://www.statsoft.com/textbook/discriminant-function-analysis
Figure 1. Location of countries in a “agrarian” and “industrial” discriminant plane.

The DFs found enabled to distinctly differentiate three clusters of countries among the countries analyzed with as similar employment structure as possible, the original coefficient and DF average of which is described in table 2. The size of clusters is respectively 21, 17 and 38 countries. As it can be seen, the first, i.e. the agrarian level DF really does express the bulk of differences of countries and clusters, leaving industrial level only a correcting part. In conclusion, however, each cluster can find its own generalizing name. The first cluster is hereinafter named as the cluster of industrial countries, the second as cluster of agricultural countries and third as cluster of tertiary countries. Herewith, it can be seen that:

1) The marker for agrarian level is certainly not a normal division in the sample, because the average agrarian level indicator of the 17 agricultural countries in the second cluster is a whole 4.5 standard deviation, i.e. sample is largely stretched out towards the agrarian level.
2) The relation between two DFs is non-linear, parabolic to be more exact - the largest degree of industrial level becomes apparent in the countries, where the agrarian level is average. Industrial level is decreasing in the negative area of agrarian level - tertiarization occurs.

Table 2. The average structural indicators of clusters and income.

<table>
<thead>
<tr>
<th>Cluster</th>
<th>Agricultural countries</th>
<th>Industrial countries</th>
<th>Tertiary countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGR</td>
<td>30.5</td>
<td>13.7</td>
<td>4.7</td>
</tr>
</tbody>
</table>
We have also added the average GNI indicators of clusters per capita based on PPP. A clear relation with employment structure emerges. Basically, the income level of industrial countries is twice as high as for agricultural countries and in turn, tertiary countries outpace the industrial countries. The distinction is mainly formed by the difference of agrarian level. The corresponding DF relation to income level is characterized by correlation coefficient -0.77. The correlation coefficient is also negative for industrial level, but only -0.17. Both affirm the fact that with tertiarization, i.e. moving towards tertiary economy comes with an increase in well-being, although the deceleration of the process on the account of retaining the manufacturing industry only means statistically insignificant loss.

Now we can proceed to our main purpose and study the position of transition countries in sectoral structural world (table 3). As in the present conference we are also interested in the position of Korea, we have added the country to the sample as well.

Table 3. Employment structure markers and income in transition countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Cluster</th>
<th>AGR</th>
<th>MAN</th>
<th>TRA+PUB</th>
<th>D1</th>
<th>D2</th>
<th>p1</th>
<th>p2</th>
<th>p3</th>
<th>GNI pC $</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARM</td>
<td>1</td>
<td>38.7</td>
<td>6.6</td>
<td>44.1</td>
<td>6.09</td>
<td>-0.68</td>
<td><strong>1.00</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>7 054</td>
</tr>
<tr>
<td>AZE</td>
<td>1</td>
<td>38</td>
<td>4.8</td>
<td>48.1</td>
<td>6.04</td>
<td>-1.55</td>
<td><strong>1.00</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>14 593</td>
</tr>
<tr>
<td>MNG</td>
<td>1</td>
<td>34</td>
<td>6.3</td>
<td>55.8</td>
<td>5.09</td>
<td>-1.26</td>
<td><strong>1.00</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>6 774</td>
</tr>
<tr>
<td>ROM</td>
<td>1</td>
<td>29.1</td>
<td>18.3</td>
<td>41.7</td>
<td>4.60</td>
<td>1.65</td>
<td><strong>1.00</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>17 071</td>
</tr>
<tr>
<td>KGZ</td>
<td>1</td>
<td>30.1</td>
<td>7.6</td>
<td>48.2</td>
<td>4.45</td>
<td>-0.65</td>
<td><strong>1.00</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>2 610</td>
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<tr>
<td>MOL</td>
<td>1</td>
<td>27.5</td>
<td>10.8</td>
<td>53.5</td>
<td>3.59</td>
<td>-0.46</td>
<td><strong>1.00</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>5 420</td>
</tr>
<tr>
<td>KAZ</td>
<td>1</td>
<td>28.7</td>
<td>7</td>
<td>52.7</td>
<td>3.20</td>
<td>-0.72</td>
<td><strong>0.99</strong></td>
<td>0.01</td>
<td>0.00</td>
<td>17 710</td>
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</table>

GNI per capita based on purchasing power parity (PPP). PPP GNI is gross national income (GNI) converted to international dollars using purchasing power parity rates. An international dollar has the same purchasing power over GNI as a U.S. dollar has in the United States. GNI is the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (compensation of employees and property income) from abroad. Data are in constant 2011 international dollars.
<table>
<thead>
<tr>
<th>Country</th>
<th>Cluster</th>
<th>AGR</th>
<th>MAN</th>
<th>TRA+PUB</th>
<th>D1</th>
<th>D2</th>
<th>p1</th>
<th>p2</th>
<th>p3</th>
<th>GNI</th>
<th>pC $</th>
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<td>SRB</td>
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<td>21.7</td>
<td>17</td>
<td>51.9</td>
<td>2.05</td>
<td>1.22</td>
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<td>0.96</td>
<td>0.00</td>
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<td>10.2</td>
<td>63.7</td>
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<td>0.01</td>
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<td>POL</td>
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<td>12.8</td>
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<td>56.7</td>
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<td>1.49</td>
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<td>23.6</td>
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<td>-0.55</td>
<td>2.07</td>
<td>0.00</td>
<td>0.96</td>
<td>0.04</td>
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<tr>
<td>SLK</td>
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<td>3.2</td>
<td>24.1</td>
<td>59.4</td>
<td>-1.49</td>
<td>2.56</td>
<td>0.00</td>
<td>0.76</td>
<td>0.24</td>
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<td>BGR</td>
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<td>20.8</td>
<td>60.9</td>
<td>-1.50</td>
<td>1.77</td>
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<td>0.54</td>
<td>0.46</td>
<td>14,589</td>
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<tr>
<td>CZE</td>
<td>2</td>
<td>3</td>
<td>25.8</td>
<td>58.8</td>
<td>-1.67</td>
<td>2.90</td>
<td>0.00</td>
<td>0.74</td>
<td>0.26</td>
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<td>66.3</td>
<td>-0.98</td>
<td>0.23</td>
<td>0.00</td>
<td>0.43</td>
<td>0.57</td>
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<td>LVA</td>
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<td>13.8</td>
<td>67.5</td>
<td>-1.29</td>
<td>-0.08</td>
<td>0.00</td>
<td>0.18</td>
<td>0.82</td>
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<td>KOR</td>
<td>3</td>
<td>6.5</td>
<td>16.8</td>
<td>68.8</td>
<td>-1.35</td>
<td>0.03</td>
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<td>HUN</td>
<td>3</td>
<td>4.7</td>
<td>20.9</td>
<td>64.7</td>
<td>-1.75</td>
<td>1.48</td>
<td>0.00</td>
<td>0.29</td>
<td>0.71</td>
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<td>EST</td>
<td>3</td>
<td>4.3</td>
<td>19.1</td>
<td>64.1</td>
<td>-1.80</td>
<td>1.33</td>
<td>0.00</td>
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<td>7.8</td>
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<td>0.85</td>
<td>0.00</td>
<td>0.13</td>
<td>0.87</td>
<td>21,856</td>
<td></td>
</tr>
</tbody>
</table>

Source: Calculations of the author based on data from ILOSTAT.

1. Out of the transition countries observed, countries belonging to agricultural countries are ARM, AZE, MNG, ROM; KGZ, MOL, KAZ (order based on agrarian level function). Discriminant analysis also offers an interesting opportunity to evaluate the probabilities p1-p3, by which each specific country belongs to a cluster. Without a doubt, in this case, all countries belong to the first, i.e. cluster of agricultural countries. The share of agricultural employment here remains mainly above 30%, the proportion of service sector (TRA+PUB), however, stays below half. The indicator for agrarian level as a whole is over three for all of them. In this case, the manufacturing industry has a generally modest proportion (below 10% of employment) and the indicator for industrial level is negative. An exception here is Romania, where the value of industrial level function extends over +1.6 standard deviation. As expected, agricultural countries on average remain below others on income level. The average income level (10047$) for this group of agricultural countries remains a little below of the total level of the first cluster. At the same time, a very large variability within the cluster stands out. The absolute minimum can be found in Kyrgyzstan with 2.6 thousand $. AZE, ROM and KAZ exceed average income level of the cluster by more than 50%. This is probably because of revenues from oil and gas industry, which do not have a substantial effect on the general structure of employment. To obtain a reliable prognosis on the general income level, the productivity of economic sectors would have to be taken into account as well besides employment structure.

2. The second group is industrial countries, where the largest part (11) of transition countries belongs. At the same time, there are three countries here: SLK, CZE and BGR, where distinct features of service economy appear. The last occurs in the agricultural sector in small share (significantly below 10%, agrarian level function ca -1.5). However, the share
of services here reaches up to 60%. This is generally between 50% and 60% in industrial
countries. As for the share of employment in manufacturing industry, CHN barely leads
by 25.9% ahead of CZE (25.8%). Value of industrial level function is over 2 also in SLV.
However, SRB and MKD have a relatively large positive agrarian level. An exception on
its own is Cuba, where industrial level index is altogether negative. Because of vast public
sector, it does not, however, belong among agricultural countries. The variability of
income level is somewhat smaller in this group than in last, reaching from 8.2 thousand
$ in Ukraine up to 28.5 thousand in Slovenia (on average 17.5 thousand). Also leading are
the European Union countries SLK and CZE. Most probably, the different structure of the
manufacturing industry itself in terms of value chain width is behind the different income
levels for industrial countries.

3. The third group of transition countries, but also Korea, in terms of typology belongs to
tertiary countries along with the most developed economies. Here, we see the three Baltic
countries, Hungary and interestingly enough, Russia. The share of services here reaches
up to two thirds. Agrarian level index remains between -1 and -2, whereas industrial level
index is lower from the previous cluster, even negative in Latvia. What is remarkable,
however, is that none of the transition countries and not even Korea belong to the service
cluster with a 100% probability. All show more or less signs of being industrial countries.
With Lithuania, the probability divides practically equally between the corresponding
clusters. The proportion of industrial country in Estonia and Hungary is about a quarter.
Respectively, the average income level (23 thousand $) of the countries analyzed remains
significantly below general average of the cluster of 33.5 thousand $. Only Korea has
come close to it. With the rest of the countries, the income level remains below even to the
more developed industrial countries seen in the last section. To advance to the level of the
wealthiest countries in the world, the agrarian level index should fall below -3 and the
proportion of services should reach 75-80%. This, however, is only possible if increase in
productivity follows in all sectors and especially in the manufacturing industry.

In addition to clusters, we have found a general regression correlation between the found
logarithm income level ln(GNI) and generalizing structural indicators (DF values). It has
become apparent that the relation is not entirely linear and in addition to agrarian level index
D1, the square of the index D1*D1 has also become statistically important (based on
t-criterion), but also the concurrence with the industrial level indicator D1*D2.

The regression equation has therefore taken the form of:
\[ \text{Ln}(\text{GNI})^* = 9.72 - 0.211D1 + 0.015 D1*D1 +0.032 D1*D2, \]
which explains 67% of the dependent variable or income level logarithm variation.

In essence, it tells us that the increase in income level is foremost in correlation with decrease
in agrarian level, whereas the increase is acceleratory, because as the agrarian level increases,
the decrease in income is inhibited. The industrial level, however, is missing an independent
fixed directional influence. Yet it does appear from the equation that if agrarian level and
industrial level variables move in the same direction, this can be associated with higher
income and if they move in opposite directions, it associates with lower income level. This
can be interpreted by having positive industrial level in agricultural countries to increase
income, but in tertiary countries, the positive industrial level of income means a certain
stagnation and relatively lower income level.

Of course the equation only represents a typical or average correlation of the sample between
variables. Only in a few countries, an important deviation from it occurs due to distinctions in
other factors of income. This was partly discussed when analyzing the three clusters. The
largest positive deviations from expected income based on employment structure become
apparent in Azerbaijan and Kazakhstan, for higher income levels in Slovenia and Korea (Figure 2).

![Figure 2. The expected and actual income of transition countries based on employment structure.](image)

On the other hand, the expected income is significantly lower among the agricultural countries in Kyrgyzstan and Moldova, among the industrial countries in Ukraine and among tertiary countries in Bulgaria. The more specific causal analysis of these distinctions must, however, remain the subject for future studies.

References


A Comparison of the South Korean developmental state with Kazakh state capitalism

Discussion Paper

Axel Wölk
State capitalism: Description and Definitions of a Phenomenon

State capitalism is currently gaining global importance. The biggest countries measured by population and territory embarked on a state capitalist course. Apart from China and Russia, countries as diverse as Brazil, Saudi-Arabia, Singapore or the United Arab Emirates (UAE) opted for state capitalism (Economist 2012). As the author will subsequently show, Kazakhstan follows the model of a state capitalist country as well. The same is true for South Korea as a former developmental state. It adopted a state capitalist economic and political order during its catch-up phase from 1961 until approximately 1996.

Owing to its occurrence in regions of considerable geographic, political, economic, social and cultural divergence state capitalism remains a highly elusive phenomenon. There exists no generally accepted definition of state capitalism. Among Western economists this phenomenon is traditionally neglected as it is considered to be intrinsically inferior to market capitalism. Ian Bremmer (2010) formulated the most widely used definition: “It is a system in which the state dominates markets primarily for political gain.” Musacchio / Lazzarini (2014, p. 3-4) define state capitalism in more neutral terms as a system in which the state takes the role as a majority or minority investor.

Evidently, state capitalism is difficult to mould into a theoretical definition. It appears to be more fruitful to establish a list of criteria, which are characteristic of the phenomenon “state capitalism”. First of all, state capitalist countries are endowed with a sufficiently capable bureaucracy that is in general able to implement policy targets. Second, in state capitalism exists an important source of state funding, such as a National Wealth Fund (NWF). This funding serves to a considerable extent as a vehicle for governments to finance their policy goals, for instance by investing into strategic industries. Third, state capitalist economies tend to be more imitator than innovator. To a significant degree they import technology, especially from Western trading partners. Fourth, state capitalist markets are at least partly protected from competition. For instance there are high entry barriers in strategic industries (Djankov / La Porta / Lopez-de-Silanes / Shleifer, 2000, p. 5). Fifth, governments de facto constrain central banks. Monetary policy is not fully shielded from political intervention. Sixth, state-owned enterprises play a highly important role in the economy, occasionally as national champions. Admittedly, their dominance is regularly contained to strategic industries. In such a dual economy in a number of rather minor industries private enterprises take a primary role. Seventh, state capitalist countries utilize a formal or informal state-private sector interface. The state actively coordinates and intervenes into SOEs and the private sector.

With the assistance of these criteria the author formulates the following definition: State capitalism is an order where governments play an active role in the economy through significant degrees of ownership in enterprises and steer the economy by actively interacting with and intervening into the corporate sector.

South Korea as a Developmental State

South Korea was for a long time one of the seven “Asian tigers”. From 1961 to 1986 GDP per capita increased in nominal terms from 110 US$ to 2372 US$ (Wade 1990, p. 35). Chaebols such as Samsung, Hyundai and LG by now tend to dominate globally in some of their respective markets. The author subsequently analyzes South Korea’s catch-up process with the help of the seven criteria illustrated above.
South Korea had a highly acclaimed, capable bureaucracy led by the pilot agency Economic Planning Board (EPB). Under President Park Chung-Hee the government ruled, whereas bureaucracy reigned. In this regard government had strong financial levers in the form of commercial banks, which were state-owned and gave preferential credits to companies that engaged in activities favoured by politicians and bureaucrats. SOEs such as the steel company Posco played a role in the catch-up phase. Privately held conglomerates or chaebols dominated, though. South Korea achieved remarkable success as an imitator and imported Western technology, which an overvalued local currency supported (Amsden 1992, p. 66-67). South Korea progressed systemically from the production of textiles to steel, shipbuilding, cars and ultimately electronics.

In a number of ways South Korean markets were protected, among others due to high import tariffs. Furthermore, owing to subsidized credits for national champions, which were handed out with the aim of export promotion, government permitted the erection of high entrance barriers for newcomers. As a matter of fact the central bank was never really independent during the catch-up period. In May 1962 the independence of the Bank of Korea was considerably reduced. Nevertheless, it managed to provide for macroeconomic stability. Government reserved a key role for deliberation councils, where bureaucrats and private sector representatives exchanged information. By the same token it served the bureaucracy as an important tool for administratively guiding private enterprises into entering preferred industries such as automobiles.

Testing the list of criteria presented above the author comes to the conclusion that South Korea as a developmental state from 1961 to 1996 can be classified as state capitalist.

**The Kazakh model of a Snow Leopard**

Kazakhstan underwent a remarkable transformation from 1991 until today. From 1991 until 2000 GDP collapsed by 30.6% in real terms. Afterwards the country embarked from 2001 until 2010 on a developmental path with a cumulated GDP growth rate of 120.8% (Stark 2012, p. 206-209).

The author now proceeds by analyzing the seven criteria for state capitalism as he has undertaken with regard to South Korea.

Kazakh bureaucracy is traditionally relatively well equipped and rather capable owing to central planning as implemented under Soviet rule. The NWF Samruk-Kazyna actively invests into the economy and is currently endowed with funds of 77 billion US$ (KazPravda 2015). SOEs are primarily active in strategic industries such as energy, mining and banking. In these fields the biggest enterprises of the country conduct their business. For instance since February 2002 KazMunaiGas plays a key role in the oil and gas sector. Prior to 2002 KazOil dominated the oil business and was subsequently merged into KazMunaiGas. Kazakhmys is the Kazakh copper company. In a country that is number ten worldwide in copper production Kazakhmys is therefore an important international player (Nathan 2012, p. 40 and 107).

Kazakhstan is an eager importer of Western technology. This was one key element in the plan of becoming one of the 50 most competitive economies in the world until 2050 (UNDP 2006, p. 32). By now government even intends to become at least number 30 in the same time frame. In Kazakhstan there is a dual economy. On the one hand in strategic industries government strictly protects and regulates enterprises. High entry barriers are clearly discernable. On the other hand in industries with less weight in the supply chain and for GDP,
government to a considerable degree refrains from interventions or strict regulation. Examples are agriculture and retail. Central bank independence exists de jure since January 1993. The National Bank of Kazakhstan has considerable autonomy, but is not free from government pressures (Gürgen et al. 1999, p. 32). Regarding state private sector interaction there is a strong coordination in strategic industries such as mining, energy or banking. These enterprises receive more favourable credit conditions and have far more access to government and bureaucracy than companies from non-strategic sectors. Coordination is hardly formalized and occurs more on the basis of personal exchange. Non-strategic sectors have far more leeway in their commercial decisions and are much less regulated (Vakulchuk 2014, p. 8-9). But this advantage comes at the cost of fewer privileges and less access to the state apparatus.

Briefly analyzing the Kazakh economy the author concludes that all seven criteria for state capitalism are fulfilled. As much as South Korea in its catch-up phase Kazakhstan classifies as state capitalist.

**Theses**

This discussion paper has illustrated that South Korea and Kazakhstan pursued or pursue a state capitalist developmental path. There are similarities as well as discrepancies. Their partly divergent path can prove to be fruitful for learning from each other.

**Lessons from Kazakhstan for a reunited Korea**

- A unified Korea could benefit from choosing a state capitalist development in the North
- Formation of an NWF such as Samruk-Kazyna could prove to be fruitful, especially when investing into projects where social returns surpass private returns
- Creation of a dual economy can be promising, since benefits of a state-led and a market-led development can be combined

**Kazakhstan: A “snow leopard” in the footprints of an "Asian tiger”?**

- A pilot agency such as the South Korean EPB can be institutionalized, advantages are high technical and economic expertise as well as the avoidance of state capture as the result of an elitist “esprit de corps”
- Formation of national champions can trigger efficiency gains, economies of scale and scope and the exploration of new markets
- Deliberation councils such as in South Korea are an option for Kazakhstan. A more formal exchange of information and coordination of private sector activities provides for a level playing field, where newcomers face fewer entry barriers. In this regard Kazakhstan could profit from less reliance on personalized exchange.
- Kazakhstan as a “snow leopard” is well on its way to accomplish its strategy 2050 goal of becoming one of the 30 most competitive countries of the world.
Literature


