

# Can Economic Theory Demystify North Korea?

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*This is particularly important in light of the tendency to describe North Korea as unpredictable, bizarre, and incomprehensible. This is clearly not the case.*

By Ruediger Frank

*The starting point of this paper is the assumption that North Korea is de facto a well-defined nation-state home to a national economy and inhabited by individuals that bear the same basic economic and social characteristics as individuals elsewhere. Despite the obvious specifics of the economic system and institutional structure of the country, standard economic theory should be applicable to the question*



Street in Pyongyang

*North Korean economic development. The article seeks to prove this as broadly as possible, showing that*

*economic theory as diverse as classical and neoclassical, Marxist, Keynesian, institutional, developmentalist, neo-liberal or structuralist, dependency analysis-based and many others,*

## North Korea: (How) Can It Be Understood?

*including regionally centered approaches, can be utilized to explain the North Korean case with useful results, although the latter will inevitably vary depending on the chosen framework. Without arguing*

*against or in favor of any of the available theoretical methods, this article advocates further research on*

*North Korea as another case of development in East Asia, rather than as a mystical exception to the rule*

*North Korea is changing. While there seems to be a certain consensus among academic observers and political analysts on this basic issue, opinion differs strongly on the reasons for and the direction, scale, scope, and implications of the changes. This article seeks to contribute to the debate by arguing that North Korea is in fact just another case of development and can be understood as such.*

From the perspective of state- and aggregate-centred approaches, it is important to note that the Democratic People's Republic of Korea (DPRK) has a permanent population, a defined territory, a government, and the capacity to enter into relations with other states, and thereby meets the four criteria for statehood as set out by article 1 of the Montevideo Convention (Montevideo Convention, 2006). North Korea has been recognized by a large number of other states, including the People's Republic of China, and also "Western" partners such as the European Union, Canada, and Australia; since 1991, it is a member of the United Nations. At the most basic level, North Korea obviously is a state with a national economy, inhabited by individuals who share the same basic characteristics as people anywhere else. To analyze North Korea, it should therefore be possible to utilize tools that have been created as universally applicable meta-theories and models of social science. This is a simple yet important analytical step to make, since it demystifies North Korea by including it in a long chain of established research and provides observers with a relatively solid ground for their attempts to understand the specifics of this highly interesting case.

So far, most attempts at integrating North Korea into standard theoretical models have stopped at transition theory, which involves analysis of the relatively narrow qualitative change from one

regime to another. (Among the notable exceptions is Lee [2002] who applied the Big Push scenario to North Korean economic development.) Whereas the transition approach is highly relevant for understanding North Korea's politico-economic development, it covers only one historically narrow period. Moreover, it implies a qualitative change from one economic or political order to another that is difficult to prove in the DPRK; in fact, it is still unclear whether such a major change has taken place. By moving the analytical framework one level up, i.e. by applying a general approach first, analysis of North Korea becomes more solidly founded and enables research to return to deeper, more precise levels—this time, however, firmly anchored in standard methodology. In other words, North Korea is, first and foremost, an economy and a society. The second step should be to acknowledge that it is developing. The third step would then be to ask this question: Along what lines and in what direction is this development taking place?

The purpose of this article is, very explicitly, not to find the one model that can most effectively be utilized to understand North Korean development, or to make the best prescriptions. Neither is it the intention to explain all aspects of North Korea through a combination of approaches. Rather, by applying a large number of well-established economic theories to North Korea, it will be shown that such an application

is possible and appropriate. Naturally, the results will differ in quality depending on the models applied. The choice of the appropriate methodological framework is, as usual, left to the individual researcher and will be determined by the concrete problem. It is important, however, that the unique and specific characteristics of North Korea, which doubtless exist, be examined in light of one or more of the many available standard frameworks of analysis.

### **What is Development, and Is North Korea Underdeveloped?**



Clothing factory in Pyongyang

Before contrasting the North Korean case with a number of economic theories, a brief definition of development (or underdevelopment) is in order. Development is a relative, comparative concept. Based on a number of indicators, a classification of countries is made according to the degree to which they have reached the highest available (or imaginable) standard. With a focus on economics, underdeveloped or Less Developed Countries (LDCs) are typically characterized by the following features: a low per capita income; a

high population growth rate; large-scale unemployment, underemployment, and disguised employment; low productivity; extensive poverty; highly unequal income distribution; predominance of agriculture in the national economy; and a low level of foreign trade (Ghatak, 2003: 1-20). Dissatisfaction with these indicators has led to the inclusion of other, non-economic factors. The Human Development Index (HDI), created by the UNDP in 1990, is one answer to the demand for a more eclectic indicator of development. It focuses not only on GDP per capita, but also on life expectancy, adult literacy rate, and school enrolment. However, GDP, and particularly per capita GDP, remains one of the most important indicators, making the question of development a major concern of economists.

From this quantitative perspective, despite a general lack of reliable data, North Korea sends mixed signals. North Korea is not among the 177 countries listed in the 2004 HDI; however, the DPRK is classified by the UNDP as a developing country (UNDP, 2005: 281). While per capita income and productivity are indeed low, there is no high population growth rate and no predominance of agriculture in the national economy (around 30%). We can further expect the obviously low productivity to hide a significant amount of disguised unemployment. On the other hand, the level of education is assumed to be high, and despite all

shortcomings, the population appears to have access to basic health services. The picture that would be created by following the UNDP's indicators is therefore mixed: adult literacy rate (95-98%, source: UNDP) and school enrolment are high, whereas life expectancy has reportedly been dropping [1] and GDP per capita is assumed to be low. [2]

### Standard Economic Theory and its Application to North Korea



Farm workers

Interest in development is at least as old as economic theory. When Adam Smith started his famous inquiry into the Wealth of Nations “to explain in what has consisted the revenue of the great body of the people” (Smith, 1776), he did more than lay the foundation for classical economics. It is a small step from “revenue” and “wealth” to “output” and “development”. Classical economists imply that the state can limit the scope of the individual's actions, but not their underlying motivations—which is an important

argument for those who emphasize the need to establish a certain economic and political order as a condition “sine qua non” for development. Neoclassical economists, building on this approach, enlarged Smith's concept of “value” and assumed that firms maximize their profits, as individuals maximize their utility. [3] Choice is made rationally according to those motivations, but is usually constrained. Resources are scarce and distributed among alternative ends (Caporaso and Levine, 1996: 81). States or concepts of states (only) differ in so far as they allow or prevent an efficient resource allocation.

North Korea fits well into this picture. In North Korea, too, resources are scarce, individuals try to maximize their utility, and an allocation of resources takes place. The individual's rational choice is influenced by a number of country-specific factors, hence the aggregate result of individual economic activity—or the aggregate output—is below optimal levels, and the resource allocation process is inefficient. A neoclassical or liberal economist would start from here, looking for the limiting factors on the micro level and trying to find ways to remove them. The debate would then focus on the question of (quantitative) reform versus (qualitative) regime change, and on the details of both options, leading directly to transition/transformation theory.

Another classical economist, Karl Marx,

attempted to transcend the limitations of individual- and state-centered approaches and developed a class-based concept (Marx and Engels, 1983). Ownership or non-ownership of the means of production, and the broader concept of relations of production, determine the individual's position in society. Despite the progressive role of the bourgeoisie in its early stage of existence, in the long run development would only be possible if the limits of class antagonism were overcome through revolution in a society. Marx emphasized the existence of a universal path of development that is governed by natural or "objective" laws, which we can at best ascertain, but by no means affect or alter through individual action (Hahn, 1968).

Marx's theory has been applied in socialist countries such as North Korea as a rationale for replacing existing—in fact, often just emerging—capitalist economic orders with autocratic political systems and centrally planned economies based on state ownership.

However, this approach neglects Marx's basically positive perspective on development as necessarily passing through stages. He argued that capitalism was an important and necessary stage in the development of a society, one that cannot simply be skipped. Accordingly, even from a Marxist point of view, the underdevelopment of the North

Korean economy can be understood. First and

implicitly, in any country a mature capitalist market economy had to exist for a prolonged period before capitalism would itself create the various contradictions that finally would cause its collapse and result in transition to socialism. Lenin (1972) was the first to break this rule for pragmatic reasons by establishing a socialist order in a country that had barely left feudalism behind. Others followed, including Mao Zedong and Kim Il-sung, arguing that the model had to be altered to match the concrete conditions in their countries. In this view, revolution would make it possible to advance directly to socialism in the absence of mature capitalist development. Interestingly, this clearly runs counter to Marx's claim of having created a meta-theory based on the discovery of objective, "natural" laws—although it is exactly this "scientific approach" that has been constantly cited in socialist countries as a major source of system legitimization. Against this background, it could be argued that North Korea is underdeveloped not because it followed Marx's model, but because it did not do so. In fact, there is not much to "follow"; Marx mainly interpreted development and made predictions, not normative prescriptions.

Keynesian economists emphasize aggregates and argue that macroeconomic trends can override microeconomics; they focus on the demand side rather than on output (Balaam and Veseth, 1996). Recognizing the heavy cost of market failure and



rejecting the idea of a general trend towards equilibrium, Keynesian economists suggest a targeted state intervention in the process of resource allocation through an active fiscal policy to balance, via a counter-cyclical policy, amplitudes in demand. Development depends on the ability of the state to prevent a collapse of the economy. From this perspective, the North Korean state on one hand plays too big a role; it should give up direct control, utilize indirect fiscal policy instead, and give the economy the necessary space to increase the aggregate demand and thereby foster development. On the other hand, the North Korean state seems to lack the basic arsenal of information and tools for efficient macro-management of the economy. Such a Keynesian approach would therefore lead to suggestions on reforms to improve, among others, state efficiency.

Other economists (Williamson, 1998; North, 1992) emphasize the role of transaction or “institutional” costs, including expenses for gathering information, bargaining, policing and enforcement. The relevance of this concept is not limited to capitalist economies. In a non-transparent, inefficient, centrally administered bureaucratic socialist economy the costs of a transaction can be so restrictively high that the transaction itself does not take place. A transaction economist would suggest, among other things, that to increase its output, North Korea would have to guarantee property rights

and reduce transaction costs by improving access to information, cutting red tape, monetizing the economy, etc. A transformation of the economic institutions of North Korea would be the logical consequence.

Olson (1965) points at the power of well-organized interest groups to capture the state that regulates the economy, and to enforce an inefficient economic structure. Focusing on political institutions, we would have to look for influential interest groups in North Korea, on the role they play in economic development, and for ways to break their power monopoly. Establishing a pluralist political order would, from this perspective, change the operating environment for dominant power groups and thereby help solve the problem of low output.

Principal-agent theory (Jensen and Meckling, 1976) points to the asymmetric distribution of information between the agent and the principal, limited rationality, and opportunism. The agent can pursue its own interests while pretending to serve the principal. The solution would be the creation of cost-efficient control mechanisms, i.e. the creation of a pluralist political order, and the creation of incentives that link the agent’s interest with those of the principal. Understanding North Korea as a typical agency problem, we would regard the people as the principal and the leadership as the agent; the latter utilizes its superior information to pursue its own interests

while using propaganda to create the impression that it acts on behalf of the people. The moral hazard for the elite to disregard the majority's interests is particularly high if the asymmetry of information is big, control mechanisms are weak, and incentives to fulfill the contract—i.e., to act in the majority's interest—are low. Accordingly, reforms would focus on reducing the information asymmetry by increasing transparency, on strengthening the people's control over the state, and to more closely connecting the well-being of the elite with that of the majority.

This brief overview of some major models of economic thinking is incomplete, but sufficient to show how, with relatively little effort, application of each of these approaches to North Korea is possible. In most cases, it would lead to the demand for economic and political reforms towards a more liberal and more pluralistic order. This is also the consequence of the application of a number of more specific theories of economic development, as will be undertaken in the following section.

### **North Korea from the Perspective of Development Economics**



Market in Pyongyang

If the standard theories of economics are indeed applicable to North Korea—and as demonstrated above, there is no reason why that should not be the case—what could be done to support economic growth in that country, and how are the recent economic measures to be interpreted normatively against that background? In other words, what can development economics tell us about the future of North Korea?

A clear answer is complicated, if not impossible to give. Not only is there no single opinion on the question of development; the empirical data that are required as a precondition to applying most methodological approaches are absent or of dubious quality. However, once we agree on the fact that North Korea is a national economy and North Koreans as individuals are ordinary economic beings, we can at least refer to the many existing attempts at answering the very basic question of development elsewhere in the world.

Among developmentalist economists in the 1950s and 1960s, there was a broad consensus that development was a relatively easy task. They believed that industrialization would automatically lead to prosperity. This industrialization could be brought about by massive, although not lasting, state intervention. Markets were perceived as means to realizing the end of economic development; they were not ends in themselves. The developmentalists further shared Keynes' opinion that economic problems arise from a lack of aggregate demand, and not from a lack of resources (Cypher and Dietz, 2004: 129).

Based on these concepts, Paul Rosenstein-Rodan (1961) developed his theory of the Big Push. He believed that at times, there needs to be a strong and targeted investment in core areas such as social overhead capital (SOC) to kick-start growth, and to unearth the hidden potential which he believed existed in less-developed regions. This investment would trigger a synergetic chain reaction across sectors. However, the benefits of this process would not be limited to the one who started it, but rather take on the character of positive externalities—a good for which consumers don't pay the producer. Accordingly, he expected less of an incentive for private investors to initiate the Big Push. In such a setting, the market would only lead to sub-optimal levels of investment. The economy would be caught in a low-level

equilibrium trap, requiring the state to take the lead.

The application of these ideas to North Korea shows that the economy indeed had its Big Pushes. The first one occurred during the Japanese colonial period; in the 1930s and early 1940s, in particular, heavy and chemical industries and infrastructure such as transportation and communication facilities were constructed on a massive scale and the already well-developed educational system was further expanded (McNamara, 1990). The next stage of massive investment came after the Korean War, when political considerations led the socialist camp to make considerable contributions to North Korean reconstruction, including a significant enlargement of its industrial base (see Frank, 1996). The results of these state-directed investment waves were indeed remarkable; although there are slight variations concerning the exact period, there seems to be a consensus in the literature that North Korea was economically stronger than South Korea at least until the late 1960s (Martin, 2004). The absence of markets in North Korea would have to be regarded as the main reason why the long-term results of the Big Pushes in both parts of Korea were so different; while the effects of these gigantic efforts abated in the North and resulted in stagnation, they ignited a chain reaction in the South and created dynamic development.



An important question in the theoretical debate was whether the Big Push should take place on a broad scale or only in a few pioneering sectors. Rosenstein-Rodan (1961) argued that given low incomes and a low savings rate in LDCs, only a balanced investment in many sectors would create the market for the other sectors' products, keeping the growth process alive. Albert Hirschman (1958) advocated the deliberate unbalancing of the economy, creating disequilibrium situations; he argued that resources in LDCs were usually limited in scale and would not allow for a broad scope of investment. He expected that emerging overcapacities coupled with higher revenue in a few sectors would speed up the development process in other sectors.

If interpreted from this perspective, North Korea has followed an unbalanced growth strategy, focusing on a few sectors such as heavy and chemical industry—as did South Korea in the early 1970s. The results, however, have been very different. A major component in Hirschman's ideas, private investment, has so far been missing in North Korea. The typical vertical integration of a socialist economy (see Kornai, 1992) has prevented or limited the spill-over effects of growth impulses to other sectors.

Later in his career, Hirschman (1981) criticized his own work and developed the theory of antagonistic growth: due to a scarcity of

resources, investing too heavily in one sector might not only leave no new resources for other sectors, but even siphon off old resources from other sectors, thereby leaving them worse off and inducing negative growth. This provides another possible explanation for the economic downturn in North Korea despite a relatively high starting level after 1945 (see Woo, 1991) and subsequent massive investments in a few industries. An inquiry into North Korean development would start with the search for the reasons why an unbalanced growth strategy has worked in the South but did not in the North, and conclusions for a reform process that creates favorable conditions for success.

Nurkse (1953) was concerned with the effects of foreign trade. He cautioned that increased income through exports would not necessarily be used for re-investment; rather, it could inspire the import of new products, thereby bleeding the country. He advocated state intervention through fiscal policies and government-operated development banks to prevent the outflow of funds and to support import-substitution. Nurkse's "export pessimism" provides an objective method to interpret the effects of the North Korean elite's spending on expensive and unproductive imported consumer goods.

Nurkse's concerns might indeed apply to the DPRK: scarce resources are unproductively wasted for luxury goods and prestige projects,

instead of finding their way into productive investments. Whereas criticism of this behavior is frequent, it is often based on intuition and rarely connected to economic theory.

Similar to David Ricardo and extending Nurkse's argument, Lewis (1954) in his study of labor supply assumed that rich landowners and monopolists in LDCs would spend their money on unproductive consumption. Accordingly, he suggested not only levying high taxes on high incomes, but also supporting industrialists who he expected to reinvest their income productively. The latter has been done very successfully in South Korea, where the industrial conglomerates (*jaebeo*) were utilized as "private agencies of public purpose" (Woo, 1991: 176). At first glance, it seems odd to criticize the spending behavior of private landowners and monopolists in a socialist country where they don't exist by definition; however, in reality, there are indeed individuals with far-reaching rights of disposal, such as party or military leaders, and members of the Kim family. Applying Lewis's suggestion coupled with the South Korean experience to reality in North Korea, one could think of large industries that are de facto privately managed—for example, in the context of the Military First Policy, by ranking military officers (see Frank, 2003).

Despite the severe criticisms it faced, Walt Rostow's linear "stages of growth" theory had a

significant impact on the debate in developmental economics. Although he explicitly distanced himself from Marx by calling his own book a "non-Communist manifesto" (Rostow, 1960), he, too, proposed a universal interpretation of history and one predicated on stages of growth, [4]

Based on his research on European development, Rostow suggested that all national economies sooner or later pass through the same stages, from traditional society to the age of mass consumption. The key stage was the "take-off". First, the pre-scientific and mainly agricultural traditional society had to experience a sweeping destruction and see the emergence of new professions such as banking and entrepreneurship, as well as investment in infrastructure to "gather the forces" required for take-off. This would be the case when the following simultaneous conditions were met: a rise in the rate of productive investment to over 10 percent of national income; the development of one or more substantial manufacturing sectors with a high rate of growth; and the existence or quick emergence of a political, social and institutional framework which "exploits the impulses to expansion" (Rostow, 1960: 39). The take-off stage would furthermore witness a sweeping reallocation of resources to build up or modernize what Rostow regarded as the "matrix for industrial growth": social overhead capital, agriculture, and foreign-exchange-earning

sectors.

A one-on-one application of Rostow's stage model to most countries, including North Korea, is problematic; however, there are some important points that deserve mention. Among them is the need to destroy what could be called the traditional institutional structure (more details on institutionalism below); in fact, this would correspond with the concept of a revolution, or even the basic spirit of the South Korean *saemaeu* (New Village) Movement under Park Chung-hee, who emphasized the need for Korea to change its old habits—to “crack the shell of backwardness”—and characterized the movement as “the national task symbolic of our modernization goals in the 1970s” (Park, 1974: 175). This was repeated over two decades later by the democratic South Korean President Kim Young-sam (1997: 129f.), who stated, “If we are to stand at the center of the world in an age of boundless competition, we must reform our backward systems, ways of thinking and customs”. In 1973 North Korea launched its Three Revolutions (technical, cultural, and ideological) movement, which can be interpreted as an analogous attempt to provide the institutional foundation for development. The concrete content of this program is country-specific; however, the fact that such an effort was made corresponds well with a number of models as well as with other country cases.

Like Marx, Rostow detected formative moments in development, when transitions from one qualitative state to another occur very quickly, based on the accumulation of quantitative changes. This concept could be helpful in understanding the often hesitant approach to reforms by the North Korean leadership: educated in Marxism, and having witnessed the processes in Eastern Europe, it is keenly aware of the risks of triggering a major transformation through a relatively small quantitative “adjustment”.

Positioning North Korea within the stage model is difficult. One could argue that North Korea already had its take-off (see Big Push), but that this process was stifled by an inappropriate institutional setting. Alternatively, North Korea could be seen as still being in the second, pre-take-off stage of accumulating the necessary forces. In the latter case, with the right institutional setting and enough external support, dynamic economic growth would be anticipated as part of the process of inter-Korean reconciliation and rapprochement. If compared to the standard, i.e. predominantly agricultural developing economy, North Korea stands out as already industrialized; improved efficiency through modernization is needed. This is, however, hardly a new insight; the Chinese discovered the same problem under Deng Xiaoping in 1979 (Four Modernizations).

An interesting detail in Rostow's theory is that "reactive nationalism" (Cypher and Dietz, 2004: 151) ignites modernization. This factor is clearly present in North Korea. As Harrison (2002: 8) argues, "The psychological cement that holds North Korea together is nationalism . . .", which he classifies as being "inspirational and uplifting" (ibid.: 18). If *juche*, often viewed as a uniquely North Korean ideology, is seen in this context, it could easily fit into concepts of development—supported by Jorganson's (1996) definition of *juche* as a "culture-specific ethnic nationalism".

Furthermore, Rostow's model, as Marx's, carries an implication that has very powerfully (and controversially) been repeated by Francis Fukuyama (1992): The thesis that there is an end point in development. There is, naturally, disagreement over what this point is. Marx calls it "communism", Rostow "the age of mass consumption", and Fukuyama "Western liberal democracy". What all three authors have in common is the idea of the existence of such a final stage of development. Research on North Korea will inevitably be influenced by the individual researcher's stance on this issue. A subscriber to Fukuyama's theory will normatively categorize North Korea as being "wrong", conclude that the country (including the regime) needs to be changed, and feel confident in doing the right thing by actively importing the Western model. This perspective

would introduce "forced regime change," as advocated by the Bush administration of the United States, as one option in the total number of North Korea development theories.

Based on their observations in Latin America, structuralists such as Raúl Prebisch (1950) doubted that relatively small changes such as foreign aid or investment increases could initiate a Big Push or a take-off. They argued that without sweeping changes within the affected societies, such impulses might even strengthen backward economic frameworks. The basic argument of structuralism is the structural and institutional difference between central developed countries and peripheral developing countries, calling into question Adam Smith's "harmony of interests" as well as David Ricardo's theory of comparative advantages and free trade. According to this view, the world is divided into peripheral and central nations. The Prebisch-Singer Hypothesis, based on

Engel's Law [5], suggests that the export prices for primary products fall faster than export prices for manufactured goods (Lutz, 1999). As a consequence, the underdeveloped periphery has to produce more to import a stable quantity of industrial goods, while the industrialized center could, with the same amount of exports, finance the import of more primary goods. Without an active policy, center and periphery would constantly drift apart, rather than converge.

Prebisch called for changes in the economic structure of the developing country in order to substitute imports, starting with simple, less capital-intensive consumer goods, and to change the economic structure of the developing country by increasing exports of manufactured goods and reducing the export of primary goods. Import substitution would stabilize the national economy and let technology diffuse into the primary sector, thereby making it more efficient and productive. Such a policy demanded a protection of the domestic market by tariffs etc. and called for an active role of the state in allocating public resources, including state planning and “guidance of private economic activities” (Prebisch, 1984: 180). Structuralists like Singer (1949) were strong supporters of foreign aid, in any form.



Fertilizer aid from South Korea

The latter has been the subject of a heated debate with regard to North Korea. Haggard and Noland (2005) have argued that this aid should

be provided only on strict conditionality, while others such as myself (Frank 2005c) have insisted that the inflow of aid will, among other things, have the effect of strengthening domestic demand and thereby contribute to overall development regardless of who the primary beneficiaries are. In late October 2005, North Korea repeated its calls for development assistance (AFP, Oct. 31, 2005); from Singer’s perspective, a positive answer to these requests would indeed support development. Critics of the structuralist perspective on trade have pointed out that exports of primary products, too, can strengthen domestic demand and thereby positively contribute to development (Lewis, 1950). Rather than condemning the primary sector per se, an emphasis on the export of such products should be avoided where international competition is high and the income elasticity of demand is low. This often applies to primary products, but is neither limited to nor true for all of them. However, the structuralist demand to concentrate on industry instead of primary products corresponds well with the North Korean decision of late 2005 to give up the agriculture-centered reform policy and to shift focus to the generation of exports through industrial production (Hankook Ilbo, 2005-11-30). With regard to the take-off or Big Push issue, the argument that without sweeping changes within the society, such impulses might even strengthen backward economic frameworks provides an explanation for the current underdevelopment of



North Korea despite a number of industrialization pushes.

Institutionalism is a theory that is of particularly high attractiveness for area studies, because it attempts to incorporate culture, which is often treated as an exogenous variable by economics, into an economic model of explaining human behavior. Institutionalists believe that the institutions of an economy, the regular behaviour of individuals which follows certain patterns (Hodgson, 1994), the rules of the game in a society (North, 1992), or “the forms of production, ownership, work processes, and ideologies which combine to create an economy and society” (Cypher and Dietz, 2004: 171) are the proper subjects for economic analysis.

Clarence E. Ayres (1951) was looking for a mega-theory of development that would be applicable to both developed and developing economies alike. He placed a great emphasis on technology; for Ayres, technological progress (broadly defined) and economic development were virtually synonymous. The dichotomous opposite of technological dynamism was “ceremonialism”, as he called it. Ceremonialism imposes a curb on human creativity; in essence, it is any binding behavior (or traditional institution) that tends to thwart the forward progress that technology imparts. In all societies, ceremonial and technological forces are at work and compete; the outcome determines the pace

and direction of development of that society, and economic development is the consequence of the successful triumph of technology over ceremonial behavior. Successful development starts with the reconstruction of adverse institutional structures. Among the five ways in which ceremonialism intrudes on any society, Ayres (quoted in Cypher and Dietz, 2004: 172-173) identified “a social system of indoctrination which emotionally conditions individuals to accept the dominant ideology, mores and class and social stratification”.

The latter strikingly resembles North Korea’s heavy focus on ideological training. It is no coincidence that Kim Jong-il (1995) emphasized, “The most serious lesson of the collapse of socialism in several countries is that the corruption of socialism begins with ideological corruption, and that a breakdown on the ideological front results in the crumbling of all socialism’s fronts and ends in the total ruin of socialism . . . Giving priority to ideological work is essential for accomplishing socialism.” Ayres would argue that the explicit priority on ideological work is essential for supporting ceremonialism and thereby for preventing development.

The view of ceremonialism as an integral part of the development equation corresponds well with other institutionalist mainstays such as transaction cost theory, the emphasis on property

rights, and the idea that in reality, there are restrictions to the theoretically available number of behavioural options (Richter and Furubotn, 1999). Not everything is possible everywhere; decisions are often made according to rules dictated by ceremonialism, not necessarily by neoclassic economic rationality. This perspective would help to explain why, despite underdevelopment and even famine as well as strong external pressure, North Korea still exists under an almost unchanged political system. The absence of a strong anti-state movement in North Korea appears to be highly irrational for many external observers, who explain it by invoking heavy state suppression.



Distribution of rice

However, the actual reason is subtler and can be approached with the terminology of institutionalism: the state has obviously been able to utilize traditional institutions as well as to create and strengthen new ones that stifle dynamic elements in North Korean society and provide legitimacy to a government that is not very successful economically.

Institutionalism shows that fighting ceremonialism—i.e. transforming the value structure of North Korean society—is an enormously important, if not crucial, task for the future. Such an institutional change needs time and cannot be triggered directly, but rather has to be supported through indirect means such as a monetization of North Korean society. The institutionalist perspective provides a rationale for a long-term perspective and is a methodological tool to integrate the historical experience, the cultural tradition and decades of deliberate institution-building by state propaganda into a concept of North Korean development.

Gunnar Myrdal (1957) agreed with the structuralist argument that in the absence of counteracting policies, inequalities would tend to increase, both internationally and within a country. He expected a global polarization through one-sided growth, since economic success tends to be cumulative. [6] According to Myrdal, a great advantage of developed countries was the strong state, which could intervene and either redistribute wealth or engage in industrial targeting. In developing countries, he argued, the state is often captured by the elite. Myrdal concluded that to make a positive change in developing countries, radical reconstruction of attitudes and institutions was necessary, including land reform, anti-corruption campaigns, and political reform. From this

perspective, North Korea is doing well in terms of resisting full-fledged liberalization; however, the non-participatory, non-pluralist political system makes it easy for the elite to capture the state and to turn it into an instrument of their own interests, which from the viewpoint of the national economy are inefficient.

Whereas most of the theories discussed above are based on liberal ideas, which naturally challenge the current North Korean economic order, we would expect dependency theory with its embedded criticism of liberal capitalism to be less critical of the North Korean model. This is, however, not necessarily the case. Dependency theory builds on Prebisch's model of the center (the cause) and periphery (the effect). Developing countries were seen as part of a global process, in which they merely provide the inputs for the wealth of the developed countries. They were often seen as stuck in stagnation, or what Andre Gunder Frank (1969) called the "development of underdevelopment". The reasons for the difficulties of developing countries were not to be sought domestically, but abroad. It appears that a similar approach has indeed been utilized by the North Korean leadership to explain their country's obvious and indisputable economic hardships.

Lack of consumer goods was blamed on the embargo policy, and the concentration of the economy on unproductive military goods has

been justified by external threats to the national sovereignty and independence. The *juche* ideology with its emphasis on self-sustainability is the expression of a deep mistrust in international partnership, in particular with "big countries", by which North Korea is surrounded. South Korea is often described in North Korean propaganda as a typical victim of neo-colonial international and economic relations.

Paul Baran (1957), a Marxist dependency analyst, argued that there was an "economic surplus", which he defined as the amount of resources, actual or potential, which a society has at its disposal after the society's basic needs for food, shelter, clothing and human companionship have been met. Economic growth or development would depend on the size and the efficiency of utilization of this surplus. Similar to Myrdal, he argued that the state in underdeveloped countries was not able to ensure such efficiency, since it would be captured by domestic capitalists or foreign investors, and regarded socialism as the only way out of poverty for developing countries. North Korea is obviously not able to manage the economic surplus efficiently, despite its allegedly socialist economic order. Was Baran wrong? Probably; however, North Korea might rather be interpreted as a case of a government captured by particular interests, although the latter are neither domestic capitalists nor foreign investors. This corresponds with the suggestion made above

that socialism has in reality never existed in North Korea. However, the strong emphasis on independence in North Korea shows a great sensibility with regard to the question of cooperating with countries from the “center”. Instead of merely ridiculing *juche*, one could see it as a not very successful attempt to ensure development while avoiding dependency.

Not all dependency analysts were Marxists. Fernando Henrique Cardoso, who later in his career became president of Brazil (1995-2002), did not regard the situation of developing countries as hopeless (Cardoso and Faletto, 1979). He opposed the demands for a revolutionary change of the global political and economic system, and argued that a smartly operating state could extract enough inputs from the transnational companies to develop the country. Cardoso assumed that the governments of developing countries, often authoritarian and not responsive to the needs of their population, nevertheless have some kind of negotiating power vis-à-vis the transnational corporations which exploit the country, since the latter need the customers in these countries to sell their products. The resulting cooperation would translate into a certain growth and even raise the standards of living. He saw a chance for mutual benefit in the relationship between center and periphery.

With regard to North Korea, Cardoso’s views provide an interesting perspective, in particular

on the often surprisingly successful dealings of the state with foreigners, although the latter are, so far, usually state and not private actors. Furthermore, opening

North Korea for economic cooperation with the outside world would, by this logic, increase Pyongyang’s negotiating power rather than weakening it. In addition to the already existing tools for political pressure, North Korea would then possess means of economic pressure, too. The case of Hyundai Asan is particularly telling in this regard.

The company has, since the year 1998, been engaged in the Geumgang Mountain tourism project, and aims at expanding the scope of this business to the newly created tourist zone around Gaeseong. From the very outset, the tourism project appeared to be a money-losing business for Hyundai—and a cash cow for North Korea. While Hyundai’s fixed investment was relatively small in the case of Mt. Geumgang, the situation is different with Gaeseong, which includes a huge industrial zone. An attempt by North Korea to increase its relative power over Hyundai by inviting Lotte (Yonhap News, Oct. 13, 2005) to compete for the tourism project failed in 2005, yet this might have set the tone for the future of doing private business in North Korea.

Monetarism and neo-liberalism are relatively recent concepts for development. They first gained prominence in the UK (Thatcher) and the

USA (Reagan) in the 1980s as an expression of the dissatisfaction with Keynesianism. Neoliberals look for state failure rather than for ways to correct market failure (monopolies, externalities); they regard the state as the source of inefficiency and the market as the source of efficiency. Neoliberals did not restrict their suggestions to money supply, as monetarists did (Friedman, 2002). Economists such as Bauer (1984) insisted that Smith's invisible hand did indeed function and rejected the necessity for active instruments such as Big Push, SOC investments, etc. Bauer made culture, ethnicity, and race responsible for success or failure of development. Neoliberals criticized the state for three mistakes: the public sector has become over-extended in the economy; the public sector has over-emphasized capital formation and mega-investment projects; and the public sector has caused the proliferation of economically distorting controls in the economy that create incentives for inefficient production and ineffective economic structures. Despite this obvious distaste regarding state interference with market forces, Cypher and Dietz (2004: 199) point at the fact that "Neoliberals typically regard foreign aid and technical assistance as extremely important instruments of influence which can be utilized to impose their policies on less-developed nations or risk foregoing such assistance."

This corresponds well with a remark by North Korea's leader Kim Jong-il, who in 1997 stated,

"The so-called 'prescriptions' that the imperialists are propagating around the world are neither good for the development of other nations nor 'ingenious plans' to activate the economy of other countries and ensure national reconciliation; these are the schemes to embellish themselves and gain their profit in this process." (Kim, 1997)

Kim Jong-il is not alone in opposing the application of neoliberal prescriptions to developing countries. Friedrich List (1922), a German economist, criticized a similar approach already in the early 19th century. He regarded free trade as the veil behind which the British state ruthlessly pursued its own national interests and exploited its particular advantages. Shapiro and Taylor (1990: 866) use the same argument with regard to the United States, where they discovered a significant degree of protectionism and dirigisme in earlier stages of the economy's development. Chomsky (1991) expressed it even more bluntly: "the economic doctrines preached by the powerful are intended for others, so they can be more efficiently robbed and exploited". Accordingly, many developing countries "tend to see free trade as a weapon used by dominant players to open up their societies to resource exploitation, foreign investment, access to raw materials and the repatriation of profits (Burchill, 2001: 54).

Neoclassical attacks against dirigisme prompted



a number of works with particular reference to Asia, such as Johnson (1982) on Japan, Amsden (1989) on Korea, and Wade (1990) on Taiwan. These authors, acknowledging successful cases of economic development, shared the neoliberal dissatisfaction with dependency theory, but on the other hand argued that the state had indeed played an important role in development.

This “developmental state” (Wade, 1990) implemented land reform, controlled the financial system, pursued macroeconomic stability to attract long-term investment, engaged in industrial policy with import substitution and export promotion, had a focus on agriculture and the living conditions in rural areas, and supported growing incomes and standards of living while simultaneously suppressing social organizations.

While the Asian Crisis of 1997 has raised doubts about the sustainability of the developmental state, the remarkable results of countries such as Taiwan and South Korea are undisputed. For North Korea, this means first of all that development is possible.

Moreover, a democratic political order is not necessarily a precondition for development, although it might well be among its long-term consequences.

#### **Is North Korea Different Because It Is In Asia?**



There are theories that indeed suggest a distinct Asian model of economic development, characterized by abundant human resources, organizational capital, and a smaller emphasis on capital- and resource-intensive industries if compared to European economic development (see Pomeranz, 2005; quoting Sugihara, 2000). Culture, values, or institutions—defined as “the rules of the game in a society” (North, 1992)—have been seen as an important variable; in fact, a country’s development has been regarded as a function of its institutions. The fact that politicians enthusiastically supported this view suggests that the underlying motivation for these claims was political, and a response by Asian leaders to the perceived neo-colonial attempt by the West, led by the USA, to impose its system upon their countries. The discussion thereby reminds one of Friedrich List’s argument: “It [the culture of America, RF] makes the hopeful assumption that all men are equal, that people all over the world are the same. They are not . . .” (Lee Kuan Yew, quoted in Zakaria, 1994). He later softened this statement, but still insisted on the difference in the institutional

setting: “I don’t think there is an Asian model as such. But

Asian societies are unlike Western ones.” (ibid.). This view has been supported by leaders from Malaysia and Japan (Mahathir and Ishihara, 1995): “For Westerners to think we cannot make progress unless we become like them is absurd . . . In short, basic modes of thought—the outlook that shapes the individual and society—in the East are dissimilar to those in the West”.

The “Asian values” approach has far-reaching consequences. In essence, it suggests that none of the theories and models briefly identified above (and many others that have not been mentioned here) are universally valid, since that they apply only to selected cases. Accordingly, there have been many critics of the “Asian Model”, including Asian leaders such as Kim Dae-jung, who in 1997 became South Korea’s president. He strongly opposed the particularist view and emphasized the universal nature of certain basic values: “Culture is not necessarily our destiny. Democracy is” (Kim, 1994). One of the most prominent critics among economists was Paul Krugman (1994), who insisted that the Asian Miracle—built on the notion of the “otherness” of Asia—was in fact a myth. Moreover, he pointed to the surprising similarities between the “slick exuberance” of the Asian boom and the less shiny Soviet Union of the 1950s. Growth, Krugman argued, was in both cases achieved

through an astonishing mobilization of resources, i.e., through extensive rather than intensive growth. He further doubted that there was an “Asian system” at all, pointing at the great differences between the cases of Japan and Singapore. He went so far as to suggest that eventually and inevitably, Asian growth would face the reality of the law of diminishing returns. He concluded: “If there is a secret to Asian growth, it is simply deferred gratification, the willingness to sacrifice current satisfaction for future gain” (Krugman, 1994).

This debate was, however, neither new nor limited to Asian nations that had chosen the “capitalist” way of development. It is indeed remarkable that a similar discussion has already been led, decades ago, by communist leaders in East Asia, although based on different motivations. Following Lenin’s attempt at justifying a deviation from Marx’s orthodoxy by hinting at the specific conditions in his country, Mao Zedong emphasized the Chinese road to socialism (Yechury, 1999), which, for very pragmatic reasons, focused on the peasants and not on the workers. His idea of a specific Chinese way has been repeated, refined and expanded by leaders such as Deng Xiaoping (1979), who emphasized that “China’s socialism had its own characteristics ever since the founding of the People’s Republic”, and Jiang Zemin (2002), who urged that “An important objective . . . is to develop socialist democracy with Chinese

characteristics . . . in pushing forward reform of the political system, China must proceed from its own conditions and unswervingly stick to its own political road . . . China will never copy the Western political systems.” These ideas are reflected in the preamble of the current Chinese constitution: “The basic task of the nation is to concentrate its efforts on socialist modernization along the road of Chinese-style socialism.”

North Korea has been part of that discussion since early on. In a speech in December 1955, later much publicized, Kim Il-sung stated, “Some people say, either the Soviet or the Chinese way is the best. But isn’t it time that we create our own method?” (Kim, 1973). The background was the attempt to distance himself from the dangerous developments in the Soviet Union after the 20th Party Congress while avoiding an explicit break of the vital alliance with Moscow. Kim Jong-il (1990) repeated the argument to disconnect his country from the reforms that were shaking Eastern Europe: “Our socialism is different from the socialism of the European countries”. The underlying rationale of all these statements is not of a philosophical or theoretical nature; it is highly pragmatic. It reflects the effort by a country to proceed along a flexible and in many respects reactive path to development while for political and ideological reasons claiming to follow the safe road of orthodoxy. This becomes obvious when Kim Jong-il urges,

“Things are not what they used to be in the 1960s. So no one should follow the way people used to do things in the past . . . We should make constant efforts to renew the landscape to replace the one which was formed in the past, to meet the requirements of the new era” (Kim Jong-il, 2001).

There are other examples of such flexibility. While in 1990, Kim Jong-il firmly held to the traditional principle that “the market economy is incompatible with socialism” (Kim Jong-il, 1990), twelve years later, with the reforms of July 2002, he sanctioned the introduction of a Chinese-style dual economy (see Frank, 2005b). The semi-official *People’s Korea* (2002) wrote: “Kim Jong-il . . . points to the fact that foreign trade should be conducted in accordance with the mechanism and principles of capitalism”. Eventually, North Korea even seems prepared to give up its working-class based concept of society: “In the past, it was recognized as an unbreakable formula in socialist politics to put forth the working class. However, the theory and formula that was generated one and a half centuries ago cannot be applicable to today’s reality . . . Nation is [positioned] over class and stratum, and the fatherland is over idea and ideology.” (Rodong Sinmun, 2003). The latter sentence could be interpreted as officially bringing North Korea back to what it always has been: A nation-state with a national economy, national interests, and the desire to acquire as much power as possible

to pursue this interest. This is not “North Korean” or “Asian”: according to neorealist or structuralist theories of International Relations, it is just universal (Burchill et al., 2001). The various attempts by North Korea to extract aid from its friends and enemies can be interpreted as signs of its “normalness”: the desire by the regime to secure its stability, and by the elite to expand its power and wealth. This strong and, as the neoclassics claim, universal desire to maximize utility finds its reflection in a very pragmatic approach to South Korea, which for decades was supposed to be North Korea’s main adversary: “It is most important now for all Koreans to love the country and nation, lead a genuine life as members of the Korean nation and devote their all to the common aim of the nation, transcending the different systems created temporarily owing to national division, as well as different ideas and ideals, different political views and religions and different classes and strata” (Kim Jong-il, 1997).

In many respects, North Korea, although not directly, shares the position of such conservative and anti-Communist voices as Mahathir of Malaysia, Ishihara of Japan, and Lee of Singapore. In addition to the “our style” paradigm as mentioned above, there are more similarities concerning their views of society. Lee Kuan Yew (1994) explained, “The fundamental difference between Western concepts of society and government and East Asian concepts is that

Eastern societies believe that the individual exists in the context of his family. He is not pristine and separate”. Four years before, Kim Jong-il had emphasized how important the collectivist idea was in his country: “Collectivism constitutes the basic condition for strengthening the might of the social community. Man can play his creative role to the full only within the social collective. His creative ability to transform nature and society is brought into full play only when people form a single social community and develop collective cooperation” (Kim, 1990).

One notable difference between North Korea and many former allies from Eastern Europe is that it still officially exists as a socialist country with a one-party dictatorship. However, even in this respect, it is far from alone. China, Cuba, Vietnam, and Laos are also among those who have so far survived the wave of collapses of the early 1990s (for Eastern European transformation, see Segert, 2002 and Kern, 1992; for Vietnam, see McCargo, 2004; for China, see Heberer, 2003). Even a superficial analysis of the many different cases in Eastern Europe and Asia shows that there is not just one single way to proceed, and so far we cannot be sure if there is any way to succeed. From the perspective of socialist one-party states, it appears that gradual reform, although with different speeds, was the choice of most (see Blanchart, 1998). A “big bang” in the true sense of the word has in fact only taken place in Eastern Germany, where its

effects were bolstered by the West German social security system (see Klinger, 1998). However, there are distinguishable stages and policy measures in the context of generally gradual approaches to transformation, which we could call “little bangs” or “small shocks”. The changes in Vietnam, in particular the reforms in agriculture in December 1987 and the comprehensive reform package after 1989 (*doi moi*) with its sharp increase in interest rates, stabilized money supply, currency devaluation, foreign trade liberalization and deregulation of the domestic economy, were such a limited macroeconomic shock therapy (Ronnas, 2001: 2). The reforms in China involved a sequence of bold approaches, too, but taken by stages. In late 1978 the contract responsibility system in agriculture was introduced (farmers were thereafter responsible for family farms, and they could sell their crops on the open market after fulfilling quotas set by the village); township and village enterprises were established to spearhead expansive rural industry; and Special Economic Zones were created to expand exports. Another far-reaching decision was price reform in 1988, which ended up as a great failure that led right to the Tiananmen massacre of 1989 (see Kane, 1989; Lardy, 1993; Zhang, 2000).

Vietnam and China are interesting cases because the changes were not induced as a result of state failure. In both countries, they were implemented and carried through by a system that still

functioned effectively. The same is true for North Korea, although the signals being sent by the leadership are mixed and seem to be subject to a certain evolution. On September 9, 1998, the *Rodong Sinmun* declared, “It is a foolish daydream to try to revive the economy by introducing foreign capital, not relying on one’s own strength”. The same editorial went on: “We have nothing to reform and open”. Six years later, I was invited to Pyongyang to give a presentation entitled “How to Attract and Retain Foreign Direct Investment” at the Workshop on Economic Reform and the Development of Economic Relations between the EU and the DPRK. China, too, for many years had insisted on undertaking only “adjustments”, a mere “supplementary role of the market”, and preserving “the principles of socialism” (Zhou, 1992). Such claims have played an important role in stabilizing the domestic political environment; the fact that the North Korean leadership does not enthusiastically embrace the idea of rapid and massive qualitative change does not necessarily mean that such a development is impossible.

The absence of a spectacular transition does not imply that no development has taken place. On the contrary, North Korea in 2006 is not the same as it was in 1990, with respect to its ideology, its leadership, or its economy (see Frank, 2005b). The monetization of the economy is proceeding quickly; private initiative is increasingly



sanctioned, although it is still limited. Foreign direct investment is allowed and promoted, and exchanges with foreigners are rising. The volume of foreign trade grows, and projects are underway to rehabilitate North Korea's SOC, including transportation, communication, and higher education.

### The Alleged "Otherness" of North Korea: A Myth



Internet cafe in Pyongyang

The country is obviously developing, much as any other. The specific institutional setting in North Korea, defined by its natural conditions and historic experience, influences the direction, the pace, and the scope of that development, and provides it with a unique shape. Sustainability can be questioned, as well as the efficiency of the chosen path. However, the basic laws which shape that development are universal, they are known, and have been discussed among academics and policy makers for decades. There is nothing mystical about North Korea; it is just a

highly untransparent case of ordinary development—as easy or as hard to understand as any other. It can be expected that the closer the institutional structure in North Korea comes to the international mainstream, the easier it will get to integrate this case into standard theoretical models and to compare it with other examples.

With a strong military leadership, a well educated and disciplined workforce, a low GDP and nationalism as the overarching force of integration, North Korea reminds one in many ways of South Korea at the beginning of the 1960s (for an excellent description, see Woo, 1991). Seoul had, under Syngman Rhee, implemented an often-overlooked institutional build-up and import substituting strategy, before shifting to export promotion and later a Big Push scenario under Park Chung-hee. The time may not yet have come to describe North Korea as a developmental state. However, there were two decisive factors behind Park's success that could well be of relevance to the DPRK: External inputs of significant amounts of capital at crucial points of economic development (normalization with Japan in 1965, the Vietnam War around 1967-1972, and the First Oil Shock after 1973), and the combination of state-directed economic planning and guidance with the vigour and energy of private entrepreneurship (*jaebeo*). It would be a short step from the *seongun* (Military First) policy to the creation of large industrial conglomerates, owned and managed by military

officers but responsible to the central planning authorities in Pyongyang. The talks with Japan about normalization are stalled, but not canceled; a solution of the nuclear issue will very likely involve significant amounts of development assistance; and South Korea is ready to lend a helping hand. The external political environment will be as crucial as markets and sources of finance and technology. A diplomatic normalization with Washington could obviously have important implications for North Korea's development.

This article has raised more questions than it could answer. The intention was to show that, with little effort, many well known and widely taught economic theories can fruitfully be applied to a country that, mainly because of its lack of transparency, easily leads observers into the trap of treating it as extraordinary and abnormal.

China will most likely continue to stand out as the great example of development via transformation from socialism to the market economy, as Japan will remain the primary textbook case of the post-1945 developmental state. However, South Korea, too, has played a prominent role in the debate between opposing theories of development. Both liberal neoclassical economists (Balassa, 1981; Krueger, 1983; World Bank, 1993) and supporters of a stronger role for the state (such as Amsden, 1989) have seen the

South Korean case as a proof of their theoretical convictions. It is not hard to imagine that after the most dynamic and yet only roughly understood stages of the process are over, North Korea's case, too, will attract great international academic interest—as an integral part of the debate on development, not as the great exception.

*The author would like to thank the Korea Foundation and the Graduate School of International Studies of Korea University for its vital support of the research that led to this paper, as well as anonymous reviewers for their helpful comments.*

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## Notes

[1] The CIA World Factbook gives 71.3 years for average North Korean life expectancy; the UNDP's 2004 Human Development Report provides 63.1 years (UNDP, 2004).

[2] Again, the CIA World Factbook and the UNDP provide different numbers; the former provides a GDP per capita of US\$1,800, while the Human Development Report 2004 lists North

Korea among the countries with US\$735 or less GNI per capita.

[3] Remarkably, “profits” are explicitly, and positively, mentioned in the 1998 DPRK Constitution (Article 33).

[4] Rostow’s image of the final stage of development strikingly recalls a Communist utopia: “A subsequent period where the production is largely for the purpose of consumption, with relatively little concern for the need to further build production capabilities. Society is now devoted to the pleasures of consumer choice, the pursuit of security, and the enjoyments of art and leisure” (Cypher and Dietz, 2004: 153).

[5] With a given set of tastes and preferences, as income rises, the *proportion* of income spent on food falls, even if *actual* expenditure on food rises. In other words, the income elasticity of demand for food is less than 1.

[6] Koreans, like members of many other cultures, have a proverb to express this: *bu-ik-bu, bin-ik-bin* (the rich get richer, the poor get poorer).

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