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## Pyongyang's Failed Currency Reform

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**Marcus Noland, Deputy Director and Senior Fellow at the Peterson Institute for International Economics and Senior Fellow at the East-West Center, notes that in North Korea's recent surprise confiscatory currency reform "enormous limits were placed on North Koreans' ability to convert cash holdings, in effect wiping out considerable household savings and the working capital of many private entrepreneurs."**

On November 30, 2009, North Korea launched a surprise confiscatory currency reform aimed at cracking down on burgeoning private markets and reviving socialism. The move predictably set off chaos, and now it appears that the government is in retreat, acquiescing in the reopening of markets. The open question is what impact this episode may have for North Korea's looming leadership transition.

The North Korean economy marketized under duress during the 1990s, as the state was no longer able to fulfill its obligations under the old centrally planned system. At the time, small-scale social units—households, work units, local government offices, and party organs—and even small-scale military units began acting entrepreneurially to survive. This marketization from below received an enormous push during the famine period of the mid-1990s when perhaps 600,000-1 million people, or roughly 3-5 percent of the pre-crisis population, died.

The regime is extraordinarily insecure with the domestic political implications of economic change. At times it has acquiesced in ratifying the facts on the ground, while at other times it has sought to reverse the process. The trend over the past five years has been largely negative, and the recent confiscatory currency reform could be interpreted as the latest in a series of moves designed to reassert state control over the economy.

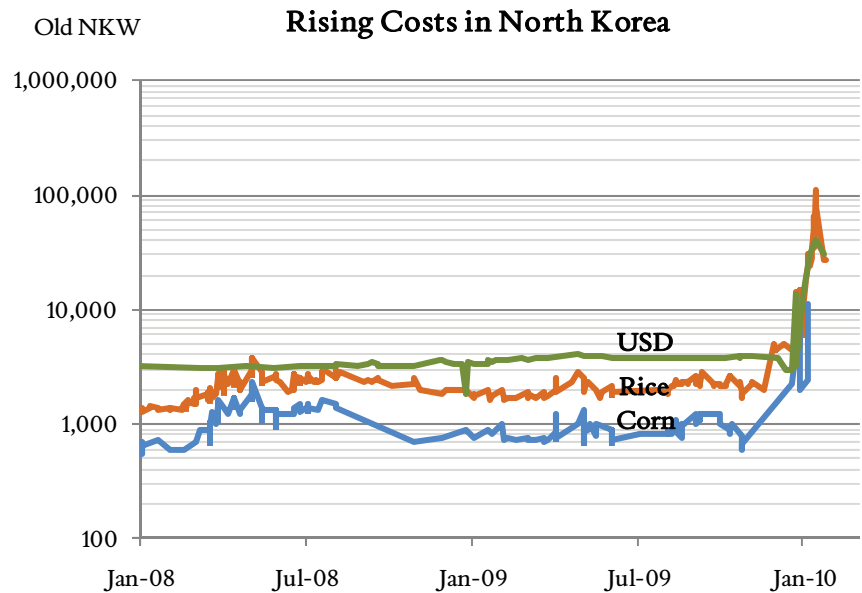
In principle, currency reforms are not a bad thing. Governments often use them to signal after a period of high inflation that the bad days are in the past and that the government will pursue more responsible macroeconomic policies in the future. Typically, a government issues a new currency with a number of decimal places or zeroes removed, often linking the nominal value of the new currency to a well-known currency such as the dollar or the euro. In recent years, countries such as Turkey, Romania, and Ghana have implemented such reforms.

The North Korean case is significantly different from the conventional case in that the move was sprung on the populace without warning, and, most critically, enormous limits were placed on North Koreans' ability to convert cash holdings, in effect wiping out considerable household savings and the working capital of many private entrepreneurs. Citizens were instructed that they had one week to convert a limited amount of their old currency to the new currency at a rate of 100:1 (i.e., a hundred old won would be worth one new won). The limit would not finance much more than a 50-kilogram sack of rice at the prevailing retail prices.



“Some reports emerging from the diaspora network of North Korean refugees indicated that the policy was being undertaken in the name of Kim Jong-eun, the North Korean leader’s third son and purported successor, and was meant to signal his emergence as a major political figure. Now, it is an open question whether the fiasco has damaged his succession prospects in what is beginning to look increasingly like a nuclear-capable failing state.”

The announcement set off panic buying as people rushed to dump soon-to-be-worthless currency, buying foreign exchange or any physical good that could preserve value. As the value of the North Korean won collapsed on the black market, the government issued further edicts banning the use of foreign currency, establishing official prices for goods, and limiting the hours of markets and products that could be legally traded.



Note: The scale is logarithmic.

Source: Marcus Noland/PIIE

As social opposition to these moves began to manifest itself, the government was forced to backtrack, offering compensatory wage increases, sometimes paying workers at the old wage rates in the new currency, amounting to a hundred-fold increase in money income. The result has been a literal disintegration of the market, as traders, intimidated by the changing rules of the game, withheld supply, reportedly forcing some citizens to resort to barter.

Reports—difficult if not impossible to confirm—have emerged of civil disobedience, protests, and even physical attacks on government officials trying to enforce the tightened restrictions. In the latest twist, the government appears to be in retreat—easing restrictions on markets and, according to some reports, scapegoating Pak Nam-gi, the Korean Workers’ Party Director of Finance, for the failed policy.

The politics of the episode clearly leave many questions unanswered. Despite the fact that the reform was the year’s single biggest economic event, it went unmentioned in the traditional New Year’s Day joint editorial of several official publications. Some reports emerging from the diaspora network of North Korean refugees indicated that the policy was being undertaken in the name of Kim Jong-eun, the North Korean leader’s third son and purported successor, and was meant to signal his emergence as a major political figure. Now, it is an open question whether the fiasco has damaged his succession prospects in what is beginning to look increasingly like a nuclear-capable failing state.

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