



## TIME FOR NORTH KOREA TO JOIN THE IMF

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Will North Korea become the 190<sup>th</sup> member of the International Monetary Fund? When I asked South Korean President Moon Jae-in during his recent appearance at the Council on Foreign Relations, he [replied](#): “I’ve confirmed that the North Korean side has the will to engage in reform and opening by joining several international organizations such as the IMF and World Bank.” This would be a momentous step for North Korea, having fundamental implications on whether – after 30 years of false hopes – this time is different in that the North will accept international norms of behavior.

External monitoring and verification will be an essential element in achieving US and South Korea denuclearization policy objectives. North Korea’s reward for denuclearization would be a brighter future, something that both the US and South Korea have pledged to support. But success in economic development will also require transparency, external monitoring, and scrutiny. North Korea’s timely entry into the IMF would signal that this time is indeed different, complementing in the areas of economic and financial policy, the high degree of transparency that North Korea will have to commit to in a denuclearization process.

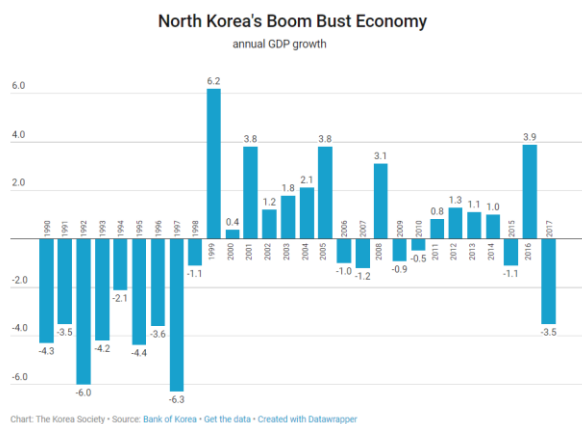
The two textbook cases of successful economic transition in East Asia – the People’s Republic of China’s Opening and Reform Policy adopted in 1978

and the Socialist Democratic Republic of Vietnam’s Doi Moi Policy adopted in 1986 – saw both governments succeed in activating membership within a year or two of initiating economic reforms. For the states that emerged from the collapse of the Soviet Union in late 1991, IMF membership was even quicker. The Russian Federation joined within six months, and most former Soviet Republics joined within a year in 1992.

IMF assistance would begin with the provision of technical advice, not only in improving and standardizing data standards and dissemination, but also in advising on how to develop functional systems and institutions. That process will be laborious, however, especially given the North’s informational black box. Vietnam’s financial system is, for example, still held back by weak transparency, supervision, and regulation even after 30 years of Doi Moi and active relations with the IMF.

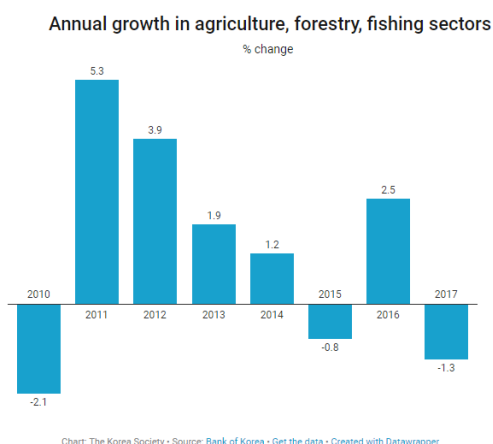
The possibility of lending from the IMF would come much later, once data transparency improved sufficiently and policies were conducive to the IMF’s support. Moreover, President Moon premised his response at CFR by saying that support from the international financial institutions would only come after “complete denuclearization of North Korea or substantive progress in an irreversible way in terms of denuclearization” was achieved.

North Korea remains a very poor country and is trapped in low-growth dynamics. Although the North’s economic performance has showed some signs of improvement in the six years since Chairman Kim Jung Un assumed leadership, it continues to be held back by the shallowness of internal reform and is now hemmed in by sweeping international sanctions. Because of this, North Korea faces a future of stagnation at best. Following a relatively good run during the period of South Korea’s Sunshine Policy from 1998 to 2008, the North’s economy has since fallen into up-down cycles, with economic growth contracting 3.5 percent in 2017, according to the South’s Bank of Korea.



The North's economic policy has often relied on forced work campaigns that boost labor input, but cannot sustainably boost economic performance. This is because of the lack of capital formation to drive investment-led growth in a system without creditor rights and the absence of a functional deposit-based banking system.

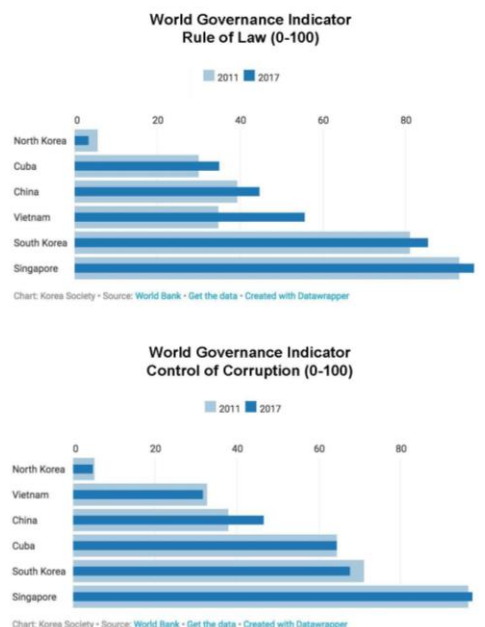
In addition, despite the introduction of incentives aimed at boosting household farming, output in the agriculture, forestry, and fishing sectors [decreased](#) by 1.3 percent in 2017, and crop production [decreased](#) by 4.7 percent. Further, over 10 million North Koreans were [undernourished](#) in 2017, according to the UN World Food Program (WFP). The situation continues, with the FAO [reporting](#) production shortfalls for 2018 resulting in most households experiencing, “borderline or poor food consumption rates.”



Economic history teaches us that sustainable growth depends on institutional development. Involvement

by the IMF and other international financial institutions in North Korea's economic development would provide an opportunity for the North to improve its policy capabilities and institutional structures, and thereby its economic performance. Free markets and good governance drive prosperity, in which political leaders are accountable and citizens have a voice. In contrast, North Korea's economic institutions are not inclusive and are not supported by the rule of law with secure property rights. Moreover, the North's leadership cult of personality evidently fosters corrupt patronage networks. Surveys by the World Bank show the extreme weaknesses of North Korea's political and economic institutions.

#### North Korea in Need of Governance Improvement



South Korea has proposed that the first step in North Korea's economic transition and development should focus on infrastructure. The ROK seeks to establish a rail and road transportation corridor through North Korea to Russia, China, and even Europe, at a \$63 billion cost estimated by Citibank. To help put that in context, that is one and a half times South Korea's defense budget for 2019.

The IMF could play a critical role here, too, if North Korea denuclearizes. South Korea is willing to take the lead in financing the North's economic development, but it will be a long and costly process.

This raises political risks from domestic opposition to the diversion of taxpayer money from growing social welfare demands in a rapidly aging population. In addition, the South's younger generation is wary of economic engagement with the North, being more concerned with their own economic prospects in an economy with high youth unemployment.

To address the North's infrastructure deficit, multilateral development banks could chip in, easing the burden on South Korea. The World Bank, Asian Development Bank, European Investment Bank, and even the new Beijing-based Asian Infrastructure Investment Bank (AIIB) could possibly offer sizable capital inflows on relatively favorable terms along with the technical expertise to ensure efficiency of investment. But they all require that a borrowing member country first join the IMF.

IMF membership would provide a signal that fundamental economic change – at last – is beginning in North Korea. And then the hard work begins. North Korea's bright future would hinge on its ability – and willingness – to sustain politically difficult reforms and convince the international financial institutions that it is creditworthy. Ultimately, the peace and prosperity of the Korean Peninsula depends on denuclearization and internal economic reforms. The odds of success on both fronts would be greatly enhanced by external verification and monitoring.

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