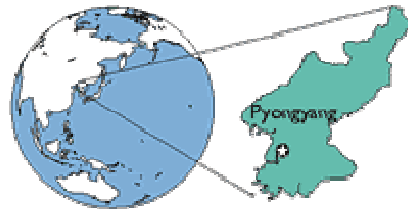


COUNTRY REVIEW

North Korea



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EULER HERMES COUNTRY RISK GRADE: D

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

COUNTRY PROFILE

Capital city:	Pyongyang
GDP:	USD 28,200 mn (2009e; official exchange rate)
Population:	23.9 mn (2009e)
GDP per capita:	USD 1,180 (2009e; official exchange rate)
Currency:	North Korean won (KPW)
Form of state:	Communist state, authoritarian one-party rule
Head of government:	KIM Jong-il, National Defence Commission Chairman (since 1994)
Next elections:	March 2014 (rubberstamp Supreme People's Assembly, SPA)

North Korea is considered a failed state and economy. The country is one of the world's most centrally directed and least open economies and the ruling communist regime has only taken very tentative steps to reduce the country's self-imposed isolation. Domestic politics are opaque. Kim Jong-il followed his late father as National Defence Commission (NDC) chairman (the highest executive post) in 1994 without opposition and was most recently re-elected in April 2009 by a rubberstamp Supreme People's Assembly.

As a clear succession process has not been established, several indications of a poor health of the ageing Kim Jong-il over the past years have raised questions over the political future of the state. In a rare convention of the ruling Workers' Party of Korea (WPK) in September 2010, Kim Jong-il's third son, Kim Jong-un, was named a four-star general and appointed to two top party posts. And both Kims appeared together in early October at a large military parade, open to foreign media, marking the 65th anniversary of the founding of the WPK. This is widely seen as the beginning of a gradual transfer of power. At the previous WPK convention in 1980, Kim Jong-il had been groomed as successor to his father whom he followed 14 years later. However, the politically inexperienced Kim Jong-un, who is reportedly around 27 years of age, may have less time to prepare for the country's top post. And there may be doubts among the elite that Kim Jong-un will be able to head a country which has known only strong, absolutist leadership, as any weakness or uncertainty could expose the regime's underlying fragility. The military remains the most powerful institution and wields a veto over policy. Were Kim Jong-il to die suddenly, it cannot be ruled out that a military regime under the NDC would take over. Overall, the eventually upcoming leadership transition creates some uncertainty over continued political stability, with potential geo-political implications.

North Korea's international relations have always been very poor and have more recently deteriorated further. China, which took the role of the country's patron after the collapse of the Soviet Union in 1991, may be an exception. Although political relations between China and North Korea appear to have suffered cracks over the past four years owing to a number of critical actions by the latter—for instance the conduct of nuclear tests in October 2006 and May 2009 as well as the killing of three Chinese by a North Korean border guard in June 2010—economic ties between the two countries appear to have strengthened. Six-nation talks among North and South Korea, China, Japan, Russia and the US on the North's nuclear disarmament have been on-again, off-again since 2003, frequently interrupted by North Korea violating earlier made agreements. The latest such incident was the North's second nuclear test in May 2009 which resulted in fresh UN sanctions and caused a new low point in its international relations. Since the painfully slow step-by-step approach of the six-nation talks have in effect achieved little, they may not be resumed any time soon. North Korea has played a game of cat and mouse for many years and it now appears unlikely that it will surrender its sole real bargaining strength at any price. Moreover, tensions between North and South Korea have also risen since the hawkish administration of President Lee Myung-bak took office in the South in early 2008. President Lee has not appreciated the "sunshine" policy designed by his two predecessors to relieve tensions between the two countries and has instead taken a hard line stance. Provocative actions, mainly by the North, have resumed. In 2009, the North conducted the already mentioned nuclear test as well as several missile tests and in November warships of both sides exchanged fire. Recently, the North seized Southern assets at a tourist resort, Mount Kumgang, which together with the Kaesong Industrial Complex (KIC), a commonly run industrial park in the North, was one of the core achievements of the "sunshine" policy. The latest and most serious provocation by North Korea was the alleged sinking of a South Korean naval vessel, Cheonan, in March 2010, causing 46 deaths. After a—somewhat controversial—international investigation has declared North Korea responsible for the sinking, the South Korean government announced retaliatory measures in May and referred the issue to the UN Security Council (UNSC). An enraged North Korea, which strongly denies any role in the

sinking, has responded by severing all ties with the South and by upping its customary aggressive rhetoric. The days of the KIC may also be numbered now. Meanwhile, the UNSC has denounced the sinking but fell short of blaming North Korea, largely due to China's objections. But the US has underscored its support for South Korea, announcing new sanctions against the North and conducting large military exercises with the South in July 2010. Nonetheless, although the probability of significant military escalation may have increased somewhat, outright military conflict between the two Koreas appears still less likely in the near term.

Economic data on North Korea is scarce and mainly provided by South Korea's central bank, the Bank of Korea (BoK). After rapid industrialisation until 1970, decades of stagnation and famine followed. Perennial food shortages have led to a critical situation and it is estimated that famine has killed about 2 million people or roughly 10% of the population since 1995. Severe floods led to the contraction of the agriculture, fishery and forestry sector (accounting for about 23% of GDP) by 9.4% in 2007, aggravating food shortages once again. Severe famine in 2008 was averted thanks to food aid shipments, but aid has largely dried up since mid-2009 owing to renewed UN sanctions in response to the nuclear test. The industrial capital stock is heavily degenerated as a result of years of underinvestment and shortages of spare parts. Large-scale military spending divests resources needed for investment and civilian consumption. Energy shortages are frequent. According to the BoK, real GDP contracted by 0.9% in 2009, the third annual drop in four years. Although GDP per capita is estimated at almost USD1,200 at the official exchange rate, income inequality is extreme as the military runs a separate economy, eradicating any benefits to the people. In 2002, the government permitted some private farming and private "farmers' markets" to sell a wide range of goods, but since 2005, it has reversed most of these policies. Overall, the economy has to be regarded as dysfunctional and an opening up of North Korea is unlikely in the near future, signifying that economic conditions are highly likely to deteriorate further.

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