

The Changing Structure of Economic Cooperation between China and North Korea

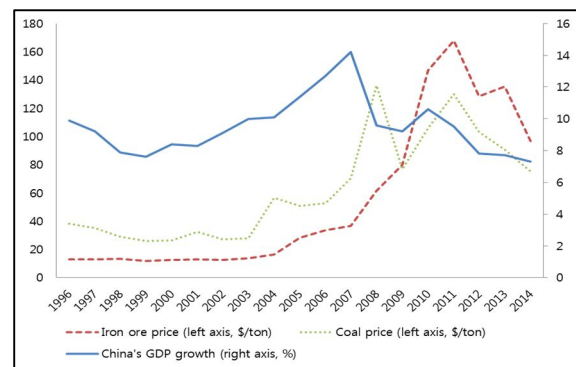
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I. Shift in the Chinese Economic Landscape

The Chinese economy has been slowing down since 2007. Since the deceleration of the hyper-infrastructure building process, China's import of raw materials worldwide has also decreased, which has led to falling raw material prices. China's GDP growth peaked in 2007 and began to drop ever since, save a brief increase in 2010. In 2014 its GDP growth rate was 7.3 percent, still a considerable number, but obviously not as significant as its previous two-digit, rapid growth period. Such a decrease in China's GDP growth rate has been reflected in the fall of global coal and iron ore prices (figure 1). Compounding this trend is the global financial crisis, during which global demand for iron and steel dramatically declined, causing a drop in exports of China's iron and steel companies. This in turn has led to lower demand for overall raw materials in China, in particular iron ore, which was previously needed by growing iron and steel manufacturers.

Figure 1. China's GDP growth and raw material prices



Data: China's GDP growth from the World Bank. Raw material prices from Index mundi

China's economic slowdown has been both a result of and a reason for the stagnant world economy as a whole, but it especially has big ramifications for North Korea, which is highly dependent on China as its trading partner, with over 90 percent of imports and exports being traded with China in recent years. For example, North Korea's exports to China decreased in 2014 compared to the previous year, and the items that contributed to this fall were iron ore and anthracite, traditionally the two main export items from North Korea to China. Such a

trend has continued on to early 2016, and this trend has not been limited only to North Korea. For example, Vietnam's anthracite export to China in April 2016 has seen a 30 percent decrease from that of April 2015. Australia's iron ore export to China in April 2016 has seen a 14 percent decrease from that of April 2015.

China has also witnessed major migrations occurring from less-developed rural regions to affluent cities, especially among young generations attempting to find better job opportunities. Consequently, China's Northeastern region has been suffering from labor shortage, especially young labor. This trend has been compounded by China's rising wages, which incentivizes businesses to look for cheaper labor.

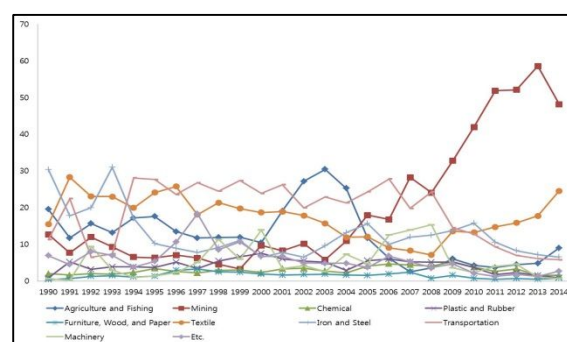
II. Changing Structure of Economic Cooperation between North Korea and China

China's shifting economic circumstances have been impacting the structure of its economic cooperation with North Korea, as shown in trade data between the two countries. Chinese customs data displays categories that indicate different types of trade. Processing trade denotes items that are subject to reduced tariff rates, since they will be used in a contracted agreement between businesses in both countries. For example, if a garment firm in China signed a contract agreement with a textile or garment factory in North Korea under the condition that the raw materials would be provided by the Chinese firm, then those raw materials imported into North Korea for processing, as well as the value-added product exported back to China, will be subject to re-

duced or no duty. Therefore, even if small, the gradual increase of processing trade share indicates an intensification of vertical integration between the two countries. In terms of North Korea's exports to China, processing trade has increased drastically beginning from 2009, although there was a slight decrease in 2015. Processing trade has also increased incrementally in North Korea's imports from China.

Such trends indicate a changing structure of economic cooperation between North Korea and China. A closer look into the composition of trade between the two countries, North Korea's export share in mining products (HS code 25~27, 68) increased drastically since the late 2000s, and peaked in 2013 at about 60 percent, but fell 10 percentage points in 2014. In contrast, North Korea's export share in textiles (HS codes 50~67) has grown drastically from less than 10 percent in the late 2000s to over 24 percent in 2014, acquiring the second-largest share among the broader HS code 2 digit categories (figure 2).

Figure 2. North Korea's export share by sector

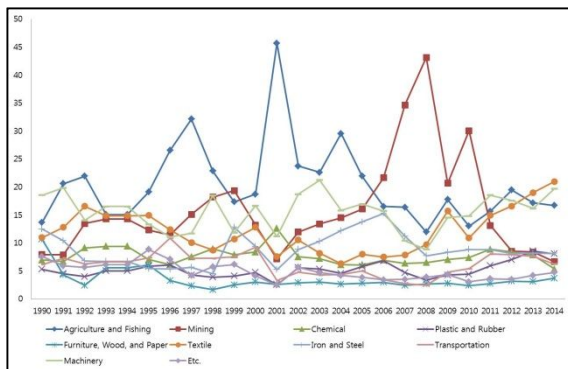


Data: CHOI Jangho and IM So Jeong, 2016, "The evolution of Economic Cooperation between North Korea and China at the Border Area" (unpublished)

In terms of North Korea's imports, their share

in the mining sector (HS codes 25~27, 68) has also plummeted since 2010, whereas textile share has incrementally increased since the mid-2000s. Agriculture and fishing (HS codes 1~24, 41~43) and machinery (HS codes 84, 85) shares have consistently maintained a 15~20 percent level (figure 3).

Figure 3. North Korea's import share by sector



Data: CHOI Jangho and IM So Jeong, 2016, "The evolution of Economic Cooperation between North Korea and China at the Border Area" (unpublished)

Such trends reveal that minerals, or raw materials, are now becoming relatively less important compared to recent years in North Korea's trade, of which trade with China comprises more than 80 percent. Instead, the share of textile products in both import and export has been growing gradually.

All these trends combined – the growing share of textiles, decline in mineral share in trade, and increase of processing trade - give us a glimpse into the shifting structure of economic cooperation between North Korea and China. Whereas in the past, North Korea's main trade items were concentrated in raw materials, primarily iron ore and anthracite, their relative importance has been decreasing while more and more emphasis is placed on

textile trade, which indicates the development of a production sharing network, shown in the growing share of trade categorized under processing trade between the two countries.

This also indicates how China may be utilizing North Korea's cheap labor in the form of outsourcing certain manufacturing procedures, especially those that are labor intensive, for instance in the garment and textile industry. The rising traffic of textile products between borders, especially in the form of processing trade, points to this trend.

Economic cooperation between the two countries does not stop short at the manufacturing sector. Intricate webs of division of labor are occurring in the service sector as well. Overseas labor dispatch from North Korea has been ongoing for decades, since the late 1960s, but since the early 2000s, it has been documented that there is a growing number of North Korean workers in restaurants, light industrial sectors, and IT industries in China. Chinese businesses are not only utilizing cheap labor within North Korea through outsourcing, but are also directly employing cheap and disciplined labor from North Korea.

Tourism is one of the newest industries that North Korea has been developing as a means to earn foreign currency, and China's role in the recent growth of tourism in North Korea is evident. China has interests in the development of North Korean tourism, since there are positive external effects from people traveling through China – either through Beijing or through the northeastern provinces, to enter North Korea. Chinese travel agencies therefore hoard tourists, acting as brokers, while the North Korean side provides logistical support during the actual tour. There are at least 30 Chinese travel agencies that are authorized by the North Korean government to engage in

this business, but there are far more sub-agencies that do business under these major authorized agencies, marketing tourism to Chinese people as well as foreigners who seek the thrill of visiting an obscure, cult-like destination.

III. Policy Recommendations

On the one hand, North Korea and China's deepening economic cooperation may facilitate North Korea's marketization and opening up. In 2002, the North Korean government, through the July 1st measures, officially allowed a certain level of marketization in its domestic economy. In the 2010s, as its economic cooperation with China deepened, there were a series of legal institutionalization efforts, upon the request of China as a condition for deciding on investment in North Korea. North Korea's increasingly frequent business interaction with China is gradually leading to the expansion of market activity, institutional reforms, and opening up of North Korea's economy.

On the other hand, the intensification of economic cooperation between the two countries may also result in North Korea's over-dependence on the Chinese economy. China also has interests in its northeast region with an aim to tackle major problems such as the stagnant economy, and the dearth of young and quality labor resulting from mass migration and an ageing population. China may also outsource its pollution-causing industries such as textile dying and leather processing to North Korea, due to its growing environmental concerns. If North Korea's interaction with the outside world is predominantly concentrated in China, which is already evident in its trade relations, it will give China significant lever-

age in the international arena when it comes to negotiating or prodding North Korea toward a desirable direction. It may also result in the alienation of the inter-Korean relationship, which will have ramifications in the possible event of unification.

North Korea's over-dependence on the Chinese economy is by no means a product of natural economic phenomena, but instead is heavily impacted by political decisions. Less economic interaction with other countries like South Korea or Japan has intensified the isolated relationship between China and North Korea. In the short term, such isolation will persist due to multilateral and bilateral sanctions prompted by North Korea's nuclear armament attempts. In the long term, however, assuming that the nuclear issue attenuates, there may be some room for South Korea's involvement in economic cooperation, for example in possible joint ventures between China and the two Koreas in the Rason area. This, of course, is impossible unless the political situation resolves. **KIEP**