

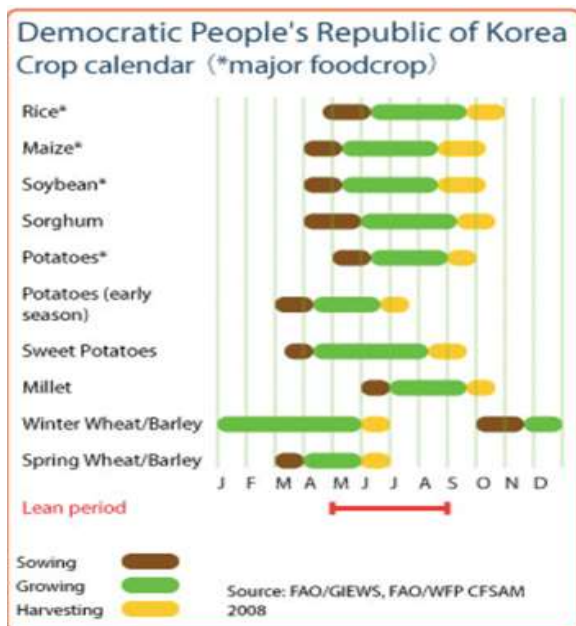
The Last Frontier Market – North Korea Faces New Food Famine

By - Lars Henriksson, Senior Research Fellow; Co-Head, Frontier Asia Consulting

North Korea faces a new food famine this winter. The expected fall in crop production will be the worst since Kim Jong-Un became leader. A sustained famine could test the stability of his regime. Squeezed by new import restrictions induced by international enforcement of a tough UN sanctions regime, against the backdrop of a stalled nuclear negotiation with the US, a crippling heatwave, a shortage of fertilizers and the lack of farm equipment, North Korean fall crop harvests could fall by up to 20%. A new food famine in late 2018/ early 2019 is very likely unless UN sanctions are lifted, or China, Russia or others provide massive food aid to the beleaguered regime. North Korea's precarious food balance may mollify its hard foreign policy stance at the US denuclearization talks and possibly produce a major foreign policy win for the Trump administration before the November mid-term elections.

Agriculture accounts for 22% of North Korea's GDP, employs between 37% and 40% of the population. With a mere 22% of the total land area of North Korea arable, an imminent crop failure will have serious consequences for regime stability if no headway is made on US sanctions talks.

The likely crop failure this fall will hit the country's west coast which shares a border with China much more significantly than the rest of the country, and may see an upsurge of refugee inflows into China. The west coast of the country is the country's 'bread basket,' accounting for 17% of available land. The country's main food crops: rice, maize, potatoes, wheat and barley are all likely to be badly affected by the ongoing heatwave as they are harvested each year between August and October.¹



Further complicating the North Korean food situation is the poor quality seeds and proper fertilizers (made even harder by the strict oil import quota under the UN-sanctions enacted in November 2017). Frequent droughts and flooding do not help either. Additionally environmental degradation, deforestation and economic mismanagement have conspired to stagnate crop yields over the past decade. With little economic incentives most North Korean farms are run as socialist farm cooperatives where each household rely on a small plot of land – about 100 sq. m – to grow vegetables for their own consumption but also rear rabbits, pigs, goats and poultry to supplement household nutrition and income. The lack of economic incentives leads to massive inefficiencies and waste. The waste is staggering. A 2014 UN FAO study found that post-harvest loss of rice, maize, and wheat & barley, was 15.6%, 16.7%, and 16.4% of total production respectively.

North Korea's food insecurity situation is so grave that the World Food Program (WFP) and its The Global Hunger Index (GHI) classifies the country as 'serious' with a rating of 28.2% of population going hungry, contrasted with India 31.4%, Sudan 35.5%, Chad 43.5% and Central African Republic 50.8% (the latter three labeled 'alarming'/extremely alarming'). Since 1995 WFP has regularly provide food aid and other assistance to North Korea.

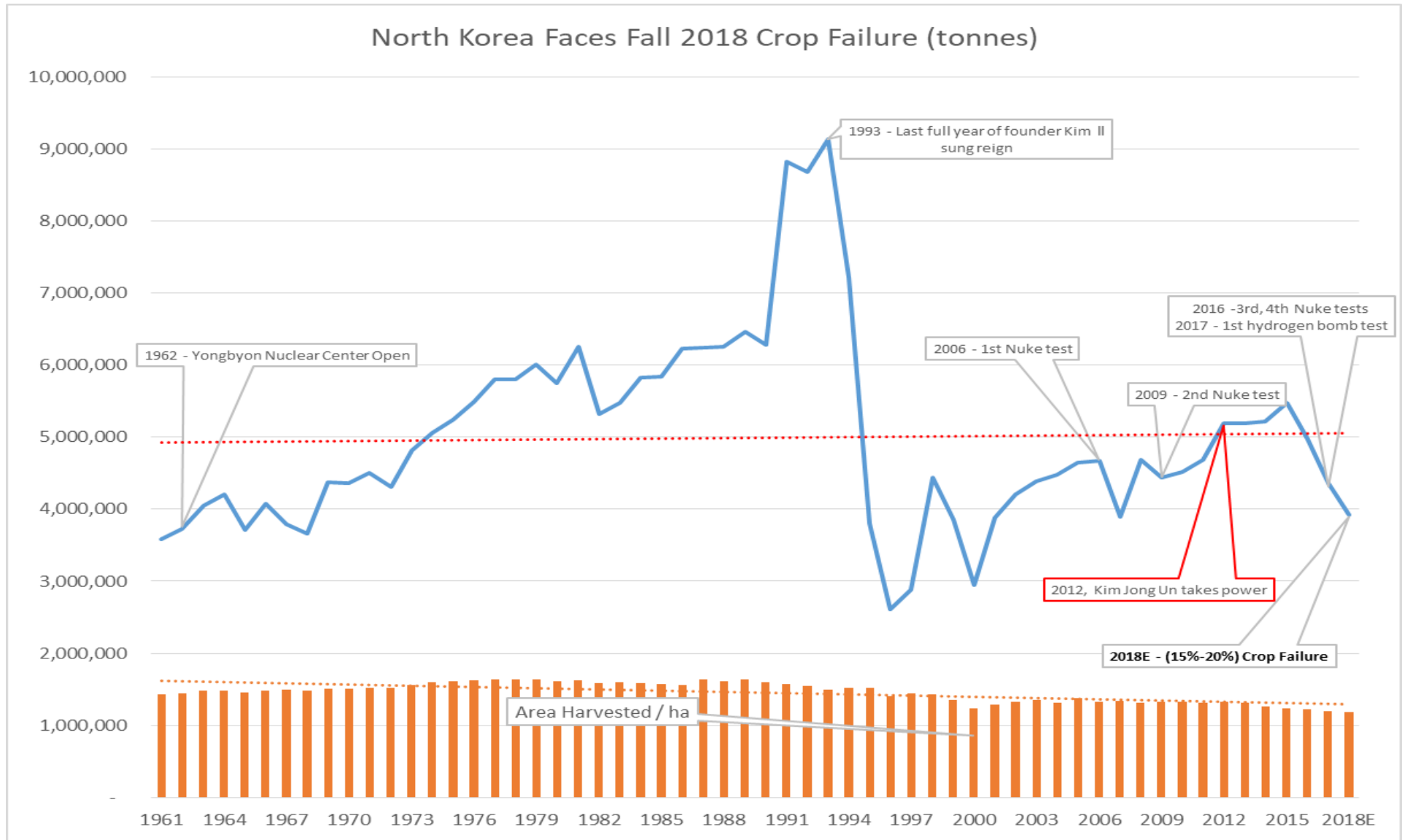
The shortcoming of the agriculture sector is also visible in the trade sector. FAO's Food Security Indicators shows that North Korea 'average dietary requirement supply adequacy' is just 88% - on the same level as Somalia (Eastern Africa average 92% and world average 120%). Such shortfall ought to be met by ample food imports. That is not the case. The value of food imports as percentage of merchandise exports is 11% (in 2013, latest available data) vs. 25% for Eastern Africa 11% - which is way below the 31% for low-income economies/frontier markets. Another way to illustrate the shortcoming is compare with South Korea, which shares the same geographical and meteorological conditions, its southern neighbor imports 70% of its food needs.

In 2017, most of North Korea's grain import came from China and increased three times, according to Chinese customs data. Wheat (81,653 tons) was the biggest import, followed corn (57,887 tons) and rice (35,408 tons). Corn imports jumped 16 times to 31, 235 tons, and flour imports which stood at 7,000 tons increased 12 times from previous year.

Furthermore unregistered barter trade with China helps to mask the true size of imported agriculture products. However the heavy trading sanction regimes levied on North Korea and stricter border controls are making increased agriculture imports challenging at the moment.

Strong military link

The North Korean military is called upon during labor-intensive planting and harvest periods to assist farmers. The North Korean military, the fourth largest in the world in manpower size, possesses the limited gasoline supplies and heavy machinery available. Thus military capabilities are significantly constrained during March-April and August-September months each year.



Source: FAO/ DaMina Advisors

South Korea/Japan land reform model

Without doubt the North Korean agriculture sector stands at a crucial juncture where major reforms are needed if the country is to maintain social stability. There has been some economic policy tinkering but a thorough reform package is yet to be unveiled. A Post US nuclear deal will give impetus to new economic reforms within the country.

The most likely pathway is to follow in the footsteps of South Korea and Japan on land reform. Following the end of WW2, South Korea introduced the first land reform, which involved putting a cap on rent charged to farm tenants to 1/3 of annual yield. In 1948 the government transferred farmland expropriated from the Japanese government and Japanese private owners to tenants where a cap was put on the land per tenant. The acquired land was sold to the farm tenants on generous terms. In 1950 a new Land Reform Act meant that government and government-vested lands (such as owned by absent landlords) were redistributed at similar generous terms.

The land reform led to former owners transformed into entrepreneurs who would start businesses in the manufacturing sectors the government had earmarked as having best potential. The government also offered low interest loans for them getting into business.

The land was distributed to recipients under strict conditions, such as they would actively farm the land. And recipients of land could only sell or donate the land after they paid it off, and government could take the land back if the owners failed to meet regular payments. A similar reform scheme was enacted in Japan during the same period. Farmers used their land as collateral for bad loans, selected the crops cultivated, mechanized and applied fertilizers, which pushed up the yields/profitability that helped them free up family members/children to join other industries/study which oiled the fast paced economic growth of North Asia through 1950-80s.

September 24 Harvest Festival will signal whether a famine is afoot or not

To better gauge internal North Korean sentiment around food security ahead of the winter, two major upcoming events will signal whether the food insecurity situation within the country is nearing a critical point or not. The National Day on September 9, (which also marks 70-years anniversary of the nation), and the Harvest Festival on September 24, (one of the country's most cherished festivals) will see the regime signal the level of concern within North Korea over social stability. The regime may well push to sign a final denuclearization deal with the US by then. A sustained famine could severely challenge the stability of the Kim jong-Un led regime.

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To schedule in-depth Q&A on North Korea's potential future investment opportunities/ risks

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