

The Rajin-Sonbong Free Economic & Trade Zone (RSFETZ) : Transport Expansion Needs and Financing Perspectives

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1 . Introduction

Multitudes of papers have dealt with the institutional changes that took place in the Rajin—Sonbong Free Economic Trade Zone (hereafter RSFETZ), a special export processing zone established in Hamkyongbuk-do(the northeastern province of North Korea) in December 1991.²⁾ Choe Sang-Chuel (1992) studied the issue of acute transportation shortages in the North Korean economy. Michael P.Lavellee (1997) examined the transportation infrastructure and development potential of the Tumen River Economic Development Area (hereafter TREDA) as a future transportation hub of Northeast Asia. However, to the best of my knowledge, no paper discussed the current status of transportation infrastructure of the RSFETZ in close association with the financing possibilities of the related investments.

This paper is a modest attempt to fill in this gap. It attempts first to examine the current status of the zone, then assesses the politico-economic feasibility of the alternative sources of financing investment expansion in the zone.

2 . Transport Infrastructure and FDI Inflow into the RSFETZ

(1) Current Status of Infrastructure of the RSFETZ

1) Railways

Before discussing the prospects of financing the infrastructural investments in the RSFETZ, we first need to examine the current status of transportation shortages of the zone. North Korea since early 1990s has actually strived to improve the transportation

[Key Words]

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infrastructure in Hamkyongbuk-do. North Korea put US\$19 million for the expansion of transportation and tourism, from the total US\$37 million investment expenditure earmarked for the RSFETZ from 1992 to 1996, in order to make transport networks along the border more efficient.

Its efforts were focused on the modernization of the inland railway system, which accounts for over 70% of total inland transportation volume handled in the province. The renovation of the local circular railway network around province, which stretches 218 km from Chongjin to Rajin, Sonbong, Saetpyol and finally to Onsong, was one of the province's major achievements. In addition, the Hamkyongbuk-do railway authorities also completed the electrification of the 168 km of railway network in October 1997, while conducting new investments to build the Namyang Railway Marshalling Yard, which will handle the transfer of 20–40 ft. containers from vehicles to the train bound for Rajin. Despite all these efforts, however, it is safe to say that the local railway network in the zone is still so backward and inefficient that it suffers from chronic transport bottlenecks and tensions.

2) Roads

Road condition is no better than that of railway system. Most of local roads are not paved properly, nor are they linked efficiently with each other. This, combined with the shortages of transportation means, results in the transportation difficulties in the cross-border trade with neighboring province of Jilin, China, and the supply bottlenecks in the RSFETZ. The reopening of the Quanhe Bridge in October 1995 relieved the tension to a certain degrees by linking Wonjong-li of North Korea with Quanhe of Hunchun, Jilin Province.³⁾

Local road network was also improved. A 50 km road was built between Wonjong-li and Sonbong, the existing roads between Rajin and Wonjong-li were paved, and major town roads in the Rajin-Sonbong City were reconstructed in a bid to improve the local road transportation linkage.⁴⁾

3) Ports, Harbors and Ancillary Facilities

The RSFETZ has a few good harbors such as Rajin, Sonbong, Woongsang, and Chongjin, which do not freeze over during the winter. In particular, Rajin has natural breakwaters like Socho and Daecho islands. Since early 1990s North Korean authorities have accelerated their efforts to develop Rajin into a modern container port that can handle the 40-ft. container transit cargo bound for the Yanbian Autonomous Prefecture, while planning to develop Sonbong into a port specializing in the import of crude oil.

However, domestic or foreign investment conducted to achieve such an aim has been

negligible. The only major achievement made thus far is the construction of a Rajin fertilizer terminal through an equity joint venture agreement between Russia and Japan. And it is hard to expect any further increase in the Primorsky province's investments in the zone, when considering the domestic financial difficulties of Russia culminated by the recent announcement of the moratorium (August 17th 1998) and also due to the Russian ports' competing relationship with the ports of Rajin and Sonbong.

(2) FDI Inflow into the Zone

Having mentioned the notorious conditions of the transport infrastructure in the RSFETZ, we may now be able to say that North Korea needs to consider the search for fresh capital to expand infrastructural investments in the zone. One of the most oft-spoken ways of financing the modernization of the backward, insufficient transport sector of the zone is to attract foreign capital, notably foreign direct investment (FDI) from overseas.

Indeed, the North Korean authorities made serious efforts to this direction. They have improved the legal and institutional investment environments of the zone to a substantial degree, while increasing the proportion of the in-budget construction investment expenditure allocated to the zone since 1991. At the same time, the central government of North Korea as well as the local authorities held a few occasions of investment promotional seminars and fora with the assistance of international organizations such as UNIDO and UNDP to promote FDI into the zone.

The first forum took place in the Yanbian Autonomous Prefecture (China) in 1995. The Yanbian Investment Forum, in which South Korean businessmen could not participate due to North-South political conflicts, attracted 430 foreign investors and business people and led to the conclusion of 142 agreements and letters of intent for FDI with an estimated valuation of US\$ 600 million.⁹ Extensive follow-up work by local authorities and companies resulted in nearly 100 of these projects being finalized and approved during 1997.

The second investment promotion forum was held in Sonbong in mid-September 1996 in the RSFETZ with the operational and financial support of UNIDO and the Tumen Secretariat, with financial assistance from UNDP. Approximately 460 foreign visitors attended the forum. A US\$ 268 million worth of FDI contracts were concluded, the largest of which US\$ 28 million committed by Thailand Loxley telecommunication consortium. In addition, eleven partnerships were signed in the form of the Memoranda of Agreements.

However, as one can see in Table 1, the RSFETZ's record of attracting foreign capital is the poorest of all the three alternative destinations. The sum total of accumulated FDI attracted into the zone until 1996 (US\$37.9 million) falls far short of the one year record of

Hunchun, China. Moreover, most of the letters of intent negotiated and signed were concentrated in investments in hotels and tourist facilities with only a fraction of the investment funds channeled into transport sector that has low profit margins but high risks.⁶⁾

More importantly, of the US\$350 million contracted in the Rajin-Sonbong International Investment and Business Forum in September 1996, only 20 projects with a combined value of over US\$ 35 million materialized. Such a low realization ratio of 6.36% reflects foreign investors' deep disappointment over the improvement of institutional and infrastructural environments of the zone.

(Table 1) Actual and Forecast Inflow of FDI into the Tumen River Economic Development Area(TREDA)

Unit:million US\$;percentage share

Area (Country)	Actually Realized Figures					Forecast Figures	
	Accumul. Amt. until Dec. 1993	During 1994	During 1995	During 1996	Accumulated Amt. until the 1996 Year-end	Accumulated Amt. until the 1997 Year-end	Accumulated Amt. until the 1998 Year-end
RSFTZ (DPRK)	0.54 (0.19)	1.34 (2.1)	5.0 (3.8)	31.0 (14.3)	37.88 (6)	100.0 (9)	200.0 (17)
Yanbian Prefecture (PRC)	98.29 (34.3)	60.69 (94.9)	78.3 (59.3)	133.9 (62.0)	371.18 (52)	450.0 (50)	550.0 (48)
Primorsky Territory (Russia)	187.40 (65.5)	1.87 (2.9)	48.8 (36.9)	51.2 (23.7)	289.27 (42)	350.0 (41)	400.0 (35)
Total TREDA	286.23 (100.0)	63.90 (100.0)	132.1 (100.0)	216.1 (100.0)	698.33 (100.0)	900.0 (100)	1,150 (100)

Source : Information by UNDP Beijing Office ; 1997-1998 figures are forecast by the UNDP Tumen Secretariat,Oct.1997.

(3) Sources of the Poor Record

Having witnessed the lower-than-expected realization ratio of contracted investment, North Korean authorities blamed the U.S. embargo imposed on North Korean products as the major culprit.⁷ Such a perception, however, is divorced from the law of the market.

Although the U.S. embargo is one of major political hurdles to the increased flow of FDI into the zone, more immediate sources of the poor performance are price fixing practice, irrational tax structure, and the rigidities of the North Korean economic system. In particular, unreasonably low level of transport prices (e.g. fares and usage fees) prohibit any long-term infrastructural investments in transportation sector, which, by nature, require huge amount of capital over long gestation periods. This implies that in the absence of sufficient economic and policy incentives, foreign investors would be reluctant to get started with risky infrastructural investment in North Korea.

Secondly, and more importantly, the North Korea's grandiose infrastructure plans lack the essential details of the financing scheme. Foreign investors, fraught with insufficient economic incentive and scarce economic data, could not analyze the economic feasibility of infrastructure projects. International financial institutions have become also skeptical about the prospects of the RSFETZ plan. This, coupled with the politico-economic uncertainties, led to the under-fulfilment of FDI attraction target.

(4) Adjustment of Scale and Scope of Investment Projects

Having witnessed the foreign investors' withering interest in the RSFETZ, the North Korean government changed its strategy in 1996 to readjust the scale and scope of transport investment projects. At the Northeast Asian Economic Conference held at Nikata in the fall of 1996, Kim Eungryo, vice chairman of the Foreign Economic Cooperation Council, revealed that given the tight budget constraints, it would have to minimize the new infrastructural investment, while making the most of the existing facilities in the development of the RSFETZ. He also stressed that a priority should be placed upon the economically feasible projects in transit transportation, tourism, etc.⁸

3. Alternative Available Sources of Financing Transport Investment in the Zone

Then what kind of alternative available sources does North Korea have in financing the expansion of transport investment in the RSFETZ? The alternatives one can think of are following five options: first, increase in China's assistance and FDI; secondly, relaxation of

trade embargo by the U.S.; third, receipt of reparation fund from Japan; fourth, the use of soft loans from the ADB/IBRD, and, finally South Korea's investment participation.

(1) Chinese Assistance and FDI

With regard to the first option, it is clear that China, particularly the land-locked Jilin province, would enjoy the greatest benefit out of reaching out into the East sea. From the Chinese stand point, shipping goods through Rajin port is more economical than the alternative of shipping them to other Chinese and Russian ports through an overcrowded Chinese rail system. This is particularly true for goods originating in or destined for Japan or South Korea. This is the reason why the Chinese government has participated so actively in the conferences and meetings related to the TRADP. The dispatch of large Chinese delegation to the 1996 Rajin-Sonbong Forum is just an example.⁹⁾

However, the progress of transportation expansion in the RSFETZ was very slow. Jilin Province thus felt great frustration over the fact that no substantial improvement was made with regard to the modernization of the transport infrastructure of the zone over the last 7 years. The existing insufficient, underdeveloped road network could not meet sufficiently the fast growth of the cross-border trade volume between the Chinese border cities (Yanji and Hunchun) and the Rajin-Sonbong Zone (including Chongjin).

Thus the Jilin provincial government, with the backing of the Chinese central government, began to financially support certain essential transportation projects of North Korea to bring tangible benefits to them. As a matter of fact, the Jilin provincial government since 1995 has supplied cement and steel products, on an on-and-off basis, to North Korea to expedite the construction work of the road between Hunchun and Rajin. The problem is, however, that Chinese financial assistance is not reliable or sustainable from the viewpoint of North Korean authorities.

(2) Relaxation of Trade Embargo and the U.S. Investment

The second alternative open to the North Korean government is to urge the U.S. government to relax or lift trade embargo imposed on them. North Korea considers that lifting of the U.S. trade embargo before the normalization of full diplomatic link would result in the growth of U.S. investment in the zone, which would in turn work as a pipeline to induce other countries' investments.

Such a presumption, however, is predicated on the assumption that the U.S. congress assesses the human rights situation of North Korea in a very affirmative way. The recent successful completion in April 1999 of the Geneva talk over the inspection of the Youngbyon

underground nuclear facilities may support such a presumption.

However, the lifting or relaxation of trade embargo is no easy option at this stage. The U.S. congress has deep-rooted suspicion about the North Korean government which more often than not breaches the international agreement. This hampers the U.S. multinational firms from participating in the North Korean infrastructural investment projects.

(3) Reparation Fund from Japan

The third long-term alternative, although uncertain, is to use a reparation fund that may be given from Japan. This option is only possible if and when both Koreas agree to enter into a full diplomatic relationship. Marcus Noland and Gordon Flake (1997) said that if Japan provided compensation to North Korea for post-colonial claims at the same level it provided the South, the amount would be US\$ 12 billion over ten years in 1995 dollars. They also said if the World Bank were to provide North Korea a level of funding similar to its program for the Palestinians, it would amount to US\$ 4.4 billion per year.

However, this option is not workable, either. The reason is that the Japanese government is at odds with North Korea over various political issues, which include the alleged kidnapping of Japanese students and the North Korea's repeated experimentation with the launch of long-range missile over their territory.

(4) Use of Soft Loans from ADB/IBRD

The fourth avenue open to North Korea is to obtain soft-term loans from international financial institutions including the ADB and the World Bank. If North Korea had such a luck to join them, then they may be forced to publicize economic data/statistics in order to obtain any financial support from the organizations. This will help international investors to compute costs/benefits of the RSFETZ projects.

This option, however, is not viable, either. The reason is that prior to joining the ADB, North Korea must first join the IBRD, the membership into which in turn presupposes North Korea's joining the IMF. However, the position of the U. S., major stakeholder of the ADB/IBRD opposition, is adamantly negative or at best acquiescent. There is no strong evidence at this stage that the U.S. Congress has the intention of repealing its classification of North Korea as a 'terrorist state' if the Geneva talks comes to a successful conclusion. The U.S. Treasury is also strongly opposed to any lending to North Korea at the present stage.¹⁰

(5) South Korea's Investment Participation

Given this situation, the most awkward yet only available option left to North Korea is to utilize capital and technology from the South. Thus far, Pyongyang, with strong pride about the superiority and sustainability of socialism, refused any massive investment participation by the South Korean firms in their social overhead capital.

However, having witnessed the collapse and disintegration of the Soviet Union and also in the face of acute domestic economic difficulties, the North Korean leadership appears to have become more anxious than before about keeping their political system intact from the possible peaceful subversion attempts waged by the South under the disguise of economic cooperation. Such cautiousness is reflected in their periodical switch of hard- and soft-line attitude towards the South.

Difficulties exist in the South, too. Despite the proactive engagement policy initiative undertaken by the Kim Daejung government, South Korean firms want to stand aloof in their transport investments in the North. The absence of investment protection agreement or guarantees is major source of such caution. In addition, North Korea's intermittent infiltration attempts have thrown a cold blanket over the on-going talk over the constructive engagement with the North. In fact, the Southern firms decided not to attend the Rajin-Sonbong Forum in September 1996 due to the occurrence of a submarine incident.

Many western and Japanese firms, however, tend to consider the South Korean involvement as a pre-condition for, or a testbed to, their main investment in the Stalinist country. Without the Seoul's substantial investment commitment to the basic industry and social overhead capital of North Korea, it is too risky to go into the RSFETZ.

4 . Conclusion

In the above, we have studied the current status and concomitant expansion needs of transportation investment in the RSFETZ, and the North Korean efforts to attract FDI, then finally discussed various alternative financing sources of infrastructural investments.

We have found that the U.S. suspicion of North Korea's breach of the Geneva Accord hampers the early lifting of trade embargo imposed upon North Korea, and that North Korea's joining the ADB or IBRD is also a remote possibility. In addition, as the prospects of establishing diplomatic links with Japan and the U.S. are still considered uncertain, it is hard at this stage to expect North Korea to obtain reparation fund from Japan or see an increase in U. S. investment in their soil.

Given such unfavorable situation, North Korea may have to adopt two-track strategy: on the one hand, they may redouble their efforts to establish diplomatic links with the U.S. and Japan; on the other hand they may also increase civilian contacts with the South in trade, investment, and tourism so as to draw the attention of the U.S. and Japan and also to direct the international investors' attention to the secluded zone of Rajin-Sonbong. The North Korean government's signing of the Mt. Kumkang project with the Hyundai group, South Korean multinational conglomerate, may be construed as a step towards this direction.

As a matter of fact, there is a growing evidence that North Korea has begun to see the South under the leadership of Kim Daejung from a more pragmatic perspective, escaping from their over-indulgence in 'Juche' ideology, insistence of economic self-reliance, and persistent worries about their systemic security. If the sightseeing program proves to be successful, then it will provide a favorable atmosphere for South Korea's businessmen to conduct small-scale infrastructural investments in the RSFETZ. The recent conclusion of the Geneva talk concerning the inspection of Keumchang-li underground nuclear facilities may also contribute to the formation of favorable environment for foreign direct investment by South Korean investors.

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- 2) For the institutional aspects of the TREDAs and the RSFETZ, see M. Clifford (1993), M. Clifford *et. al.* (1992), M.J.Valencia (1996), M.Noland and F.L. Gordon (1997), N.Cowee (1998), Icksoo Kim (1994a; 1994b; 1994c; 1995b; 1995d), KIEP ed. (1994), UNDP(1997a; 1997b), to name a few. For the comparative analysis of the differing positions of the countries interested in the TRADPs, please refer to Icksoo Kim (1994d; 1995a).
- 3) The Quanhe bridge was closed in 1953 by the North Korean authorities since it was crippled during the Korean War by the heavy bombardment. Another source of the closure was for security reasons.
- 4) The Chinese side is building another 50 km of a first class road linking Wonjong-li to Hunchun.
- 5) UNDP (1997), "Tumen Secretariat Analysis ...," p.5.
- 6) 4; Other investment deals include the setup of a bank branch, and manufacturing sector, specifically wood processing, oil refining, paper-making, seafood processing, building materials and toy production.
- 7) After the KAL explosion incident, U.S categorized North Korea as a terrorist nation.
- 8) By economically feasible projects, he also referred to the manufacturing industries which would bring immediate benefits in terms of employment and hard currency acquisition.
- 9) The Chinese delegation to the Forum was reported to number 160 of the total 450 foreign participants. The Hong Kong's Emperor Group was responsible for two thirds of the monetary value of the contracts signed in the 1996 Forum.
- 10) The U. S. Treasury has no sympathy for the economic plight of North Korea, which Treasury considers got themselves into its serious food shortage and economic trouble. Hence, the U. S. Treasury did not even support any type of ADB relationship with North Korea, including an informal dialogue to collect data and assess its economy. See *KEI Executive Summary*, no. 9606-12, June 5 1996, p.1.