

A Harbinger of Marketization? Special Economic Zones in North Korea*

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Abstracts

This paper reviews a series of attempts made by North Korea to cope with the changes in international economic situations for last two decades in vain except the help of Chinese ties. Furthermore, it presents a reluctant conclusion that ever since withdrawal of North Korea from the NPT, external would-be investors have been discouraged, and the amount of foreign investment inflow has been drastically reduced. Moreover, the current issues surrounding nuclear dispute also plays negative roles in the process of establishing special zones in North Korea, which made the supportive South Korea government's economic aids almost sole efforts.

Keywords : Special Economic Zones, North Korea, NPT

I . Introduction

It is a well-proven fact that economic growth is an absolutely important pre-requisite for improving economic welfare and reducing eventual proverty in an economy. It is also a well-founded truism that in order to attain economic growth the two most important

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production factors, skilled labour and fixed capital formation, should be put into production process. A poor economy is usually characterized by lack of both skilled labour and fixed capital formation. Because of lack of both of these two factors, growth cannot be achieved and, accordingly, the economy does not possess a capacity to achieve fixed capital formation and to train labour. This is a typical aspect of vicious cycle of poverty usually observed from a poor economy.

Some specific and concrete measures should be adopted in order to break a link in the loop of vicious cycle of poverty. One of the most important measures traditionally employed in East Asia and elsewhere in the world is establishment of special economic zones or free trade areas, which could be used as an instrument to invite foreign capital and technology. In the early period of economic growth, South Korea established the so-called 'bonded areas' in Changwon and Masan area in the 1960's. This is not an exception in case of People's Republic of China (PRC). Special economic zones in Shonzon(深川), Zuhai(珠海), Shantow(仙頭) and Siamon(廈門) in China, established in 1980, with a scheme of inviting foreign capital and technology were a good example of economic success, which proves that current Chinese economic growth has been originated from these zones. Average GDP growth rates in these zones reached more than three times of the average overall GDP growth rate of 9 percent in the two decades of 1980's and 1990's. Particularly the establishment of Pudong(浦東) economic zone in Shanghai in 1990 accelerated economic growth in China in recent years.

It is a historical fact that in order to attain industrialization in Europe and America after the Industrial Revolution, it took more than a century, primarily because the industrialization had to solely rely on endogenous capital and technology. Some countries are still lagging behind in economic development and experiencing rampant wide-spread poverty due to reluctance to open their economies and refusing to establish special economic zones. Of course, there are pros

and cons about opening economy and establishing economic zones. As it was aptly mentioned, "Opening windows will not only bring in cool breeze but also flies and mosquitos."

II. A Brief Sketch of North Korean Economic Background

As it is already indicated in the constitution of Democratic People's Republic of Korea (DPRK, North Korea), the economic system is based on a rigid Stalinistic principle of Socialism. All of means of production are nationally owned, and, therefore, employment of labour force is also realized through central planning. Only recently after realization of foreign exchange rate from 2.11 to 150 Won per U.S. dollar, a fragile and slow sign of marketization is appearing in North Korea. However, most of important industries are still operated under the central plan, and foreign trade is also conducted by state enterprises. Consecutive mismanagement of economy, in particular, failure of agricultural sector management has caused extensive famine in North Korea, and large outflux of migration out of North Korea has eventually brought international attention.

North Korea enacted the so-called 'Joint Management Act' only in 1984 under a scheme of inducing foreign capital into the North Korean economy (Yoon). However, as the so-called 'Juche' ideology clearly reveals, the North Korean economy has fundamentally based on self-help and self-identity spirit and was reluctant to be influenced by foreign economic interference. With absence of market, the entire operation of the economy was entrusted to a few governing heads of party cadre and bureaucrats, who did not necessarily possess expertise and knowledge of the economy.

With collapse of socialist economies in Europe and elsewhere, the North Korean economic situation was further exacerbated, mainly due

to termination of economic cooperation between North Korea and other European socialist economies. Perhaps, China was and still is only remaining economy, which is economically and politically friendly to North Korea. Even though China is a large giant economy itself, it cannot permanently be a feeding hand to the always hungry and starving mouth of the North Korean economy.

The presidential election in 1997 in South Korea had produced a regime, which was extremely supportive to North Korea, and the presidential election in 2002 in South Korea again resulted in a similar regime. But the growing suspicion against the North Korean regime after publicization of nuclear issues in North Korea has become a great hinderance to continued economic support of South Korea. Except a few liberal politicians and academia, there is a strong and wide-spread consensus among majority of people in South Korea that a unilateral economic support to North Korea does not help to dissolve the current dispute and ultimate issue of the Korean penninsular unification.

III. Special Economic Zones in North Korea¹⁾

After the enactment of Joint Management Law in 1984, North Korea achieved foreign capital investment contracts reaching approximately 150 million U.S. dollars up to 1990. However, most of business operations under foreign capital investment encountered unfavorable economic environment and excessive state interferences and eventually discontinued their operations in North Korea.

In 1991, North Korea decided to establish a free economic trade area in Najin and Sunbong area in the northeastern part of the country. Najin/Sunbong area is geographically isolated area near to

1) Much of information about the Special Economic Zones of North Korea is obtained from Korea Exim Bank, *Bodo Jaryo* (Public Report), 29 November 2002.

Russian and Chinese borders. It is not difficult to conjecture that the area was intentionally selected to insulate the economic zone from ordinary North Korean people. Contrary to North Korea's ambitious plan of inviting 4.7 billion U.S. dollar foreign investment during the planned period of 1999 through 2010 into the area, only 88 million U.S. dollar foreign investment was contracted up to 1998, and there has been very limited and negligible foreign investment contracted in the ensuing years. It seems apparent that the Najin/Sunbong project is a complete failure.

In the year 2000, the Asian and Pacific Peace Commission, representing North Korea, and Hyundai Corporation basically agreed to establish an industrial zone in Kaesung, and in the year 2002, the North Korean government enacted a law called 'Kaesung Industrial Zone Act of DPRK' to provide a legal basis for the project. The agreement basically plans to establish an industry complex of 8 million pyungs (One pyung is approximately equivalent to 3.24 square meters) and a supporting city of 12 million pyung in Pyunghwa-ri, Panmoon-gun, Kaesung city by 2008. The project aims at a three-stage development, beginning from light manufacturing industries and gradually up-grading to technology intensive industries such as electronics and information related manufacturing.

Again in September 2002, the Standing Committee of the Supreme People's Soviet, DPRK enacted 'Basic Law concerning Shincuijoo Special Administrative Zone', and in the same month the External Economic Cooperation Promotion Commission, representing North Korea, and the Dutch Europe-Asia Trade Corporation reached an agreement for joint operations in the zone.

The Special Administrative Zone is to be located in Shincuijoo city including three counties of Euijoo, Yomjoo and Chulsan. Shincuijoo Special Zone is authorized to enjoy autonomous status in legislation, administration and judiciary operations, and the central government would not, in principle, interfere with the affairs of the Special Zone

except national defense and diplomatic matters. Except the laws concerning nationality, national emblem, national flag, national anthem, territory and national security, no laws of North Korea will apply to the Special Zone.

The Shineuijoo Special Administrative Zone is planned to develop international finance, international trade and commerce, manufacturing industries, advanced technology industries, recreation, and tourism under the land lease contract covering the 50-year period up to 2052. The Special Zone is also authorized to establish and operate an independent monetary and fiscal system and policy. Private ownership of property and the right to inherit privately owned property are also authorized in the zone. However, the central government retains the basic authority to appoint the minister of the zone, to approve aggregate investment plans, to order revision of decisions made by the legislative body and to approve other related matters.

Beginning from September 1998, the Hyundai Corporation has maintained a close cooperation in promoting tourism in Keumkang-san area with a total investment reaching 200 million U.S. dollars. Even though this project is somewhat different from special economic zone in many aspects, the impact of the project to North Korea in terms of foreign exchange acquisition would be similar.

IV. Evaluation and Prospect

South Korea's trade with North Korea started in a manner of triangular trade with a neutral country involved in-between. This method of indirect trade was maintained until 1980's, and direct trade without involving a third party only began recently. The items imported from North Korea were mineral ore and agricultural product mostly, which were supplied to domestic firms in South Korea or

exported to other foreign countries after re-processing. Because of chronic deficit of foreign exchange in North Korea, North Korea could not import very much from South Korea and, therefore, a natural consequence was the idea of establishing special economic zones.

Najin/Sunbong Special Economic Zone was the first attempt by North Korea for the purpose. However, it is generally agreed among the concerned scholars and observers that the project is a complete failure. The major factors that contributed to the failure may be summed up as follow (Tongil Yonkuwon, 2002b).

First, the location of the Najin/Sunbong is extremely isolated both in terms of geographical distance and economic relations with other area. The area is only close to Russian Maritime Province and North Eastern Chinese Provinces, which could not play a role of primary markets for the zone. Social overhead capital formation, which should have been preceded, was lacking and other infrastructure was almost negligible. Accordingly, cost involved in transportation and communication would be too enormous to be borne by foreign investors. In order to improve and newly install required infrastructure, United Nations Development Programme, in cooperation with China and Russia initiated the so-called Tumen Regional Economic Development Project, TREDP, which, however, could not realize any visible achievement. Again, the North Korea government has not shown any active intention to invest internally in the formation of infrastructure. Investment through the Asian Development Bank or the World Bank was neither possible since North Korea was not a member of these institutions (is not a member still).

Second, no detailed legal and administrative blue print was made in the beginning, and haphazardous interventions were frequently made by the authority, which discouraged foreign investors' will.

Third, the North Korean authority has been very staunch to insulate the zone from other domestic areas by constructing high fences surrounding the zone area. A large portion of initial investment was

squandered in this fence construction. Without having a close network with domestic industries, no linkage effect would be expected and, therefore, there would be no channel to promote domestic national economy.

Fourth, the North Korean operation partners were designated by the North Korean authority in plural, from which one could be selected without necessarily considering business expertise and qualities of the candidates. Because of this policy, political consideration usually dominated over business priorities, and inevitable conflicts occurred between two partners of projects.

Fifth, tax reduction and tariff redemption originally provided in the law were hardly practiced, and various hindrances and bureaucratic red tapes made administrative procedures almost impossible to enjoy the promised benefit. Furthermore, labour cost in terms of wage and productivity was higher than other special economic zone in China and Vietnam, and rent charged per square meter was also higher than China.

Sixth, the control on foreign exchange remittance was also restrictive and free transaction of foreign exchange was severely curtailed in practice, eventually causing withdrawal of ING bank from the zone in 1999. Without having an efficient banking institution to support the project financially, it would be entirely impossible to accomplish the planned target.

In sum, because of the lack of predictability and transparency of the government policy, it must have been very difficult for investing firms to design and implement a long-run business strategy. Perhaps, the volatility of policy implementation by North Korean authority seems to be originated from two withstanding political views of liberalist and orthodox camps in North Korea.

Kaesung and Shineuijoo zones have just started (Tongil Yonkuwon, 2002a). It is perhaps very hard to predict how these projects will end up in future. Yang Bin, the first minister designated by the North Korean authority was, unfortunately for North Korea, arrested by

Chinese authority, and the operation of the Shineuijoo zone was from the very beginning unexpectedly thwarted. The Dutch Europe Asian Corporation, the head of which is Yang Bin and which also was the main investor/partner must have been discouraged both in terms of morale and willingness to invest.

In order to make a successful case out of future operations of special economic zones in North Korea, it seems to be absolutely necessary to fulfill the following conditions.

First, North Korea will have to strictly separate economic operations from political considerations as the case in China has so far shown. Economic operations always have to be based on market mechanism without being intervened by political ideology.

Second, Kaesung and Shineuijoo should effectively be connected to not only international markets but also domestic markets both in terms of supply of product and acquisition of input materials. Particularly, a full-fledged access to domestic and international labour markets are an absolute pre-requisite for sound operations of the zones. An idealistic minimum wage system should not be enforced.

Third, the North Korean authority should do its best in supporting investment in infrastructure and social overhead capital formation as well as in providing various administrative services voluntarily. High rent will also have to be lowered to the level charged in neighboring countries. Free transaction of foreign exchange should also be guaranteed both legally and in practice.

Finally, market principles should be closely observed at least in the special economic zones. Political ideology and market operation should be treated as two independent and separate entities.

V. Concluding Remarks

Ever since withdrawal of North Korea from the Non-proliferation

Treaty, NPT, external would-be investors have been discouraged, and the amount of foreign investment inflow has also been drastically reduced. Moreover, the current issues surrounding nuclear dispute also plays negative roles in the process of establishing special economic zones in North Korea.

Because of negative attitudes of the United States, Japan and European Union toward North Korea, it is easily predicted that the short-term impact of the Special Economic Zone in North Korea on the East Asian economies seems to be negligible and almost nil. In order to achieve what Chinese and Vietnamese economies did in the past decades, North Korea has to step forward with new courageous wide strides.

With growing regionalism elsewhere in the world, the East Asian economies should also be substantially integrated by achieving free trade and economic cooperation in the region and eliminating various barriers socially, politically and economically. This situation is particularly needed in case of less developed economies including North Korea and Mongolia. In this respect, initiatives from China, Japan and South Korea are crucially important.

◆ *References* ◆

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