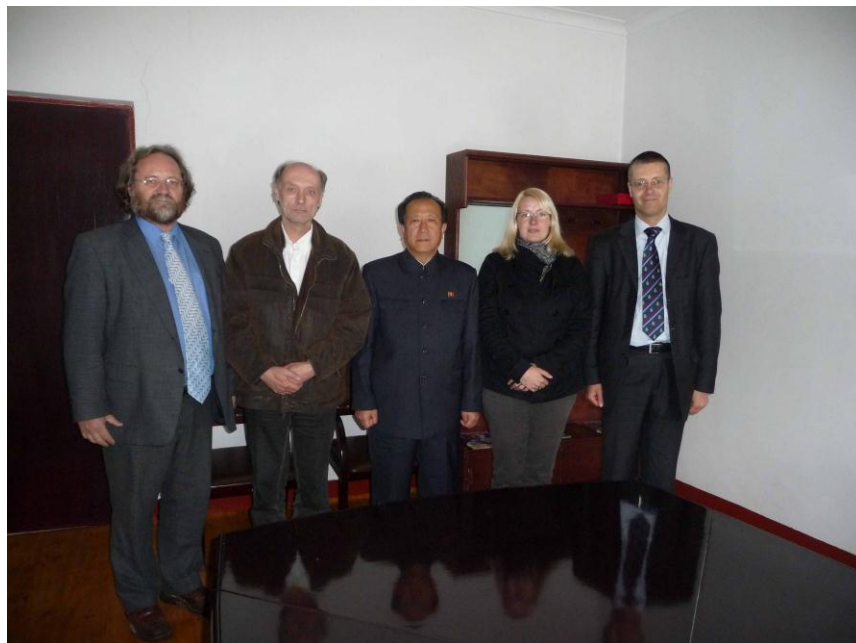


**INTRODUCTION TO  
NORTH KOREA'S RASON ECONOMIC TRADE ZONE**

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The government of North Korea has long recognized that the economy of North Korea has been stagnant while the economies of neighboring nations have flourished. If the DPRK indeed desires to commence the transition from a command economy to a market economy based upon the template developed by Deng Xiaoping, Rason is clearly the transformative point that must be observed.

On the surface, the Rason Economic and Trade Zone appears to be North Korea's primary attempt to initiate this transition from a command economy to a market economy. At the first China Jilin-Northeast Asia Investment and Trade Expo in September of 2005, the Vice Chairman of the Port Authority of Rason City, Mr. **Chae Song Hak** (pictured below [in May 2010 with a German delegation](#)) outlined the program to potential investors. Several basic outlines of the zone follow, juxtaposing Chae's bullish report in Jilin (a PDF of which can be consulted [here](#)) with more recent information.



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### Zone Specifications and Capacity

The total area included in this zone in the Rajin-Sonbong region is 469 square kilometers while the area deemed “suitable for development” totals 185 square kilometers. The estimated population living within the zone numbers 170,000. The zone is proximate to China's Jilin province along with the Far East region of Russia.

Rajin port is serviced by railways to both Tumen in Yanbian Korean autonomous prefecture in China and [Khasan](#) in Russia with both standard-gauge and wider-gauge tracks, such that Russian freight can arrive at the port without the need to change railcars. The ice-free port provides year round access to Japan, Southeast Asia, and beyond.

Rajin port is also linked to [Wonjong](#) via a 9 meter-wide road built in 2004-05. A 20 million ton capacity oil refinery exists near Sonbong port along with a heavy oil power plant with a generating capacity of 200,000 kilowatts. The zone also provides a 156 km coastline with an abundance of seafood resources (a “seafood processing center” was among the desired goals of development). A 50,000 circuit telecommunications network comprising both conventional and mobile phone capability has also been installed. In addition, Cholju Reservoir, located 20 km away, has a capacity of 20 million cubic meters of water.

The Rajin port has a 4 million ton cargo handling capacity, the Sonbong port has a 2 million ton oil processing capacity and the Ungsang port has a timber handling capacity of 6 million cubic meters.

### Future Development Objectives

The stated objectives of the North Korean government are to develop the zone into “a base for preferential trade, transportation of goods in transit and export processing.” To facilitate these goals, large increases in the cargo handling capacity for goods in transit are envisioned such as the repair and modernization of the railway from Rajin to Tumen. The Rajin port could be expanded to handle 100 million tons of cargo.

A plan exists for the construction of a modern 67 km highway from Wonjong (near Hunchun, China) to Rajin port. This would increase the export processing capabilities of the port.

Enticements to Attract Foreign Direct Investment

The government suggests that the zone contains a well educated workforce along with low labor rates. A [report by Cheng Gang, a Huanqiu Shibao reporter who visited Rason in December 2010](#), notes that foreign language majors from Pyongyang were well-represented in the special zone. The Rajin Business School has been established within the Rajin University of Marine Transport to provide business development and management resources.

Foreign investors are able to establish wholly foreign-owned enterprises or joint ventures in the zone. Tariffs apply only to goods brought into the zone for sale and lower tariff rates exist compared to rates imposed outside of the zone. Foreign investors are allowed to repatriate all of their profits and capital gains along with all of the funds received from the sale of their business free from tax. The income rate in the zone, as stated in the 2005 report, was slated at 14% of net profit. Foreign invested businesses in the production and service sectors in operation for more than ten years were said to be entitled to full exemption from income tax for three years from the first profitable year for production sector businesses and one year for service sector businesses along with a reduction of 50% for the following two years. For foreign-invested businesses engaged in infrastructure development totaling at least 30 million Euros, a four year income tax exemption accompanied by a reduction of 50% for the following three years has been granted.

Foreign investors will be able to invest in land parcels for up to 50 years at reduced rates. Also, when foreign investors reinvest the profits from their business which has been in operation for more than five years, the full amount of income tax paid on the amount reinvested will be refunded.

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Cellular phone users in North Korea currently number more than one million. One official claimed that the overwhelming majority of urban households have at least one cell phone.<sup>1</sup>

On October 13, 2011, the ceremonial first running of a trial train between Rajin and Khasan in Russia occurred.<sup>2</sup> The 54 km (34 mile) rail line from Russia's eastern border town of Khasan to a container terminal in Rajin will be used to export Russian coal and to import goods from South Korea and other Asian countries. It is envisioned that the container terminal will operate at full capacity, 200,000 20-foot equivalent units (TEU), in 2013.<sup>3</sup> The cost of the railway project has been estimated to be approximately 200 million U.S. dollars of which at least 70 million U.S. dollars was to have been paid by the Russian government.<sup>4</sup>

### Factors Detrimental to Attracting Foreign Direct Investment

Property rights are protected, although the government maintains the right to confiscate the investors' property through the payment of compensation.

In the document presented at the trade exposition in September of 2005, seven preferential investment opportunities have been listed. However, the third point states, "...with regard to the protection of property rights, the Government does not nationalize or confiscate the property of foreign investors, and if it has to nationalize or confiscate it for unavoidable reasons, it will compensate absolutely for it."

Naturally, confiscating property for "unavoidable" reasons and compensating "absolutely" for this property are not components of a preferential investment opportunity. Foreign investors require very specific and very limited conditions under which their property could be nationalized. The compensation package to be provided in this situation must be clearly detailed. If investors are not able to ascertain the probability and impact that such an action would have upon their investments, they will not be able to

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<sup>1</sup> ["Choson Exchange October Trip Findings."](#) *Choson Exchange*, Nov 7, 2011.

<sup>2</sup> ["Russia - Rajin \(Rason\) Railway Completion,"](#) North Korea Economy Watch, update 8, Oct 13, 2011.

<sup>3</sup> *Ibid*, updated 7; see also Reuters, Sept 15, 2011.

<sup>4</sup> *Ibid*, update 5; see also *Donga Ilbo*, Oct 6, 2008.

complete a cost-benefit analysis. Consequently, most private investors would be very hesitant to invest even if high returns could be generated.

The problems associated with investing in North Korea over the past two decades are well documented. An article published in July of 2011 states:

“While transnational economic cooperation and exchanges among neighboring countries have become a regional trend around the world, the cross-border economic development of North Korea and China raises questions, considering the North’s unpredictable behavior and economic policy advocating self-reliance. This led to Japan’s eight failed investment attempts in the North during the 1990s, a bitter experience replicated by most South Korean enterprises that have invested in the North since the late 1990s. Outstanding cases are the Mt. Kumgan tourism program and the Kaesong joint industrial parks.”<sup>5</sup>

#### Current Status of Rason Economic Trade Zone

At the Rajin Port, a 30,000 metric ton coal storage warehouse has been constructed at Pier 1 by Chinese companies. In five shipments last year, 80,000 metric tons had been moved through the facility. However, Pier 2, which had been designated to handle container shipments, is currently dormant. Pier 3 is being utilized by a Swiss company to ship manganese and talc out of the region.<sup>6</sup>

The Ungsang Port remains dormant apart from the occasional fishing boat. The Sonbong Port has two pipes, 63 cm in diameter, connecting the port to a storage facility at “Victory Petrochemical.” However, the Sonbong Power plant, originally designed to take fuel oil from Victory Petrochemical as feedstock and generate power to feed back to Victory, operates intermittently since the economics of running the plant are unfavorable. Consequently, the 800 workers employed at Sonbong Power are idle most of the time.

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<sup>5</sup> “Progress in North Korea - China Economic Cooperation,” *Yonhap Views*, July 1, 2011.

<sup>6</sup> “Choson Exchange October Trip Findings,” *Choson Exchange*, Nov 7, 2011.

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The "Victory Chemical Plant" is currently idle and would require over 500 million U.S. dollars in investment to become competitive.<sup>7</sup>

China recently agreed to provide electricity to the Rason special economic zone. The project involves laying high-voltage power distribution lines between the Chinese border city of Hunchun and the city of Rajin along with the construction of a thermal power plant in Rason. The construction of the power lines is scheduled to begin soon while final agreement with respect to the power plant will occur sometime in the future.<sup>8</sup>

In September of 2011, the tax bureau of Rason city set the minimum monthly wage at 80 USD in the Rajin-Sonbong (Rason) Economic and Trade Zone. Although this is 25% higher than the minimum wage in Kaesong Industrial Complex (KIC), it is less than half of the minimum monthly wage of 167 USD in China.<sup>9</sup> Since the minimum wage may have been set below the minimum wage established by market forces, investors are not likely to be too concerned.

The current highway construction project connecting Rajin with Wonjung in China had been expected to open in October of 2011. In the meantime, Chinese cargo trucks have been delivering a variety of Chinese consumer goods to the Rason Free Trade Market along dirt roads from Wonjung. The market is a 13-year-old experiment in small-scale capitalism which has been so successful that the Chinese managing company, the Tianyu Group, is planning to expand the crowded 54,000 square foot market to 320,000 square feet.<sup>10</sup>

When Tianyu Vice Director Zheng Zhexi arrived in 1997 to establish the market, people were hesitant to get involved. Now Tianyu does not have the space to approve even a fraction of the applications from prospective vendors. Zhang states that ordinary people's sense and awareness of the market, along with their views

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<sup>7</sup> Ibid.

<sup>8</sup> "Details on the Rason SEZ Emerging," *Korea Times*, Sept 13, 2011.

<sup>9</sup> "Rajin – Songbong Minimum Wage Set at 80 Dollars," *Institute of Far Eastern Studies* (IFES), Sept 21, 2011.

<sup>10</sup> "North Korea Encourages Investment in Rajin-Sonbong (Rason) Economic and Trade Zone," IFES, Sept 16, 2011.

on the economy, have all changed dramatically. Zheng stated that, “The policy environment has been improving continuously. It is moving towards a market economy.” One example of this transition to the market economy in Rason can be seen at an office located in one corner of the market with a sign in English reading “Foreign Exchange”. The currency is exchanged at the market rate of one Chinese Renminbi to 350 North Korean won rather than at the official rate of one Chinese Renminbi to 15 won.

[Yanbian Tianyu International Trading Company](#) [天宇集团], a company affiliated with the Chinese state that also has interests in the Musan mine, has expanded operations significantly in other areas including the construction of a casino, a hospital, a bread factory, and a telecommunications building. It is currently constructing a cement factory and operates two iron mines.

#### Future Outlook for North Korea’s Rason Economic Trade Zone

There is little doubt that the Rason Economic Trade Zone has enormous potential. China is keen on developing the North Korean port as a key component of its grand vision of constructing a transport network stretching from the Indian Ocean to the North Pacific. China’s own ports in the region have already reached full capacity. China has publicly stated that it is willing to spend one billion dollars to develop port facilities, build railroads connecting the port to China and improve existing infrastructure such as highways. China intends to utilize their investments in North Korea’s ports and railroads to extend its own infrastructure for export and import purposes. China has made similar investments in Burma, Vietnam, and Bangladesh.<sup>11</sup>

Russia envisions using the new railway to Rason as a way of connecting the population centers in Russia and beyond with the Pacific Rim nations. With the completion of the rail link from Khasan to Rajin, there is now a 10,000 kilometer railway across the breadth of Russia. The route may become a major transportation line, challenging ocean routes through the Suez

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<sup>11</sup> North Korea Economy Watch, Ibid, update 1, Jan 27, 2008.

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Canal and reducing travel time by fifty percent and cutting costs by up to seventy five percent.<sup>12</sup>

In order for North Korea to fully capitalize on these enormous opportunities, North Korea will need capitalism. The government of North Korea can easily utilize the templates provided by post-Mao China in order to orchestrate a successful transition from a command economy to a market economy.

Based on the suggestions presented earlier in this report, some simple changes could be implemented to attract foreign investment into the Rason Economic Trade Zone. North Korea must demonstrate that market forces and the rule of law will be consistently applied in Rason.

The North Korean government has the opportunity to establish a successful Rason Economic Trade Zone as their own template for the successful implementation of free trade zones in other regions as well as the transformation of their entire economy from a command economy into a market economy.

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<sup>12</sup> North Korea Economy Watch, *ibid* (excerpting Bloomberg's original post on Oct. 25, 2006).