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# A Convergence of Interests: Prospects for Rason Special Economic Zone

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## Abstract

Rason, North Korea's Special Economic Zone located in the far Northeast of the country, is undergoing change at a pace unseen in its twenty-year existence. Its history has been one of insufficient support, both from leadership in Pyongyang and from external actors. Now, however, amid political transition in North Korea, reform and reoganization has taken place in the SEZ, while at the same time China has included Rason in its ambitious plans to develop its Northeastern province of Jilin. These changes demonstrate Pyongyang's increasing need to reach out to foreign investors to reinvigorate its economy. They also point toward China's desire to develop its Northeast region and promote stability while increasing its leverage over North Korea's economic growth. Despite the myriad challenges facing both the SEZ and North Korea's economy, these factors give Rason better prospects for development than we have seen before.


## Introduction

In 1991, the same year that the world watched the dissolution of the Soviet Union, the Democratic People's Republic of Korea (DPRK or North Korea) established Rason as a Special Economic Zone (SEZ): one that could be a hub for export-processing and transportation. This caused considerable excitement for long-time North Korea watchers. Rason hinted that even if Pyongyang didn't go the way of the Eastern European socialist governments, perhaps Chinese-style reforms could be expected. Instead, Pyongyang's resistance to change has proven remarkably strong, even as its economy ground to a crawl and its people suffered through famine. Rason, meanwhile, languished in the far Northeast, its minimal development a symbol of the leadership's enduring opposition to opening up.

Several factors contributed to Rason's two decade-long inertia including disinterested neighbors, lack of international co-ordination and not least, Pyongyang's ambivalence. Now, however, China's twin concerns about its geopolitical influence and Jilin province's development have aligned with a new Pyongyang leadership that can no longer rely on *songun* (military-first) alone for its legitimacy and must make some attempt to improve the economy. This harmony of interests gives Rason prospects for change and growth that have not existed since its creation in 1991. Indeed, long-discussed and delayed projects are finally being implemented along with practical administrative changes.

## Historical Impediments to Growth in Rason

Pyongyang, like Beijing before it, has identified Special Economic Zones as a means to experiment with economic reforms in a manner that is controllable, regional and, above all, containable. Both countries' leaders recognize that a swift marketization of the economy could jeopardize their positions of power. Beijing's gradual marketization, however, has proceeded with remarkable success: The model of the first SEZ at Shenzhen has been replicated all over the country, with its endemic influences allowed to penetrate the broader economy and society as a whole.

This was not replicated in North Korea for several reasons. First, with the important exception of Chongryon Japanese Koreans, North Korea could not rely on an ethnic diaspora to invest in the SEZ, as China did. In the mid-1980's almost 80% of investment in China came from overseas Chinese.[1] Overseas Koreans, far fewer in number and less dispersed than their Chinese counterparts, were much more easily attracted by South Korea's rather more normal investment conditions.

Economic competition with the South also has a political component that constrains Pyongyang in a way that has never fettered Beijing. This was (and remains) the fear that should reforms in Rason (or anywhere else) become uncontrollable,

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North Korea's citizens would lose faith in the revolutionary Democratic People's Republic's raison d'être and begin calling for reunification on Seoul's terms. Andrei Lankov calls this concern "a rational and well-informed assessment of North Korea's domestic and international situation."[2] After all, the influence of even an isolated SEZ cannot be fully geographically contained, as inputs and outputs spill into the regions around it.

The pressure from this direct competitor for legitimacy south of the DMZ has led to a deep ambivalence about Rason in particular and economic reform in general, reflected not only in Pyongyang's lack of investment in Rason during the 1990s, but also in its halting attempts to reform and then undo reforms in the 2000s. Perhaps realizing that some form of marketization was unavoidable following the breakdown of the Public Distribution System, Pyongyang enacted reforms in 2002. These reforms, though dramatic by North Korean standards, essentially tried to allow market activities while maintaining a degree of central control. The authorities did, however, grant greater freedom for state-owned enterprises, allowing them to set their own prices as well as introducing incentives for efficiency. They also legitimized "Jangmadangs" (trader's markets) by providing covered spaces, licenses and rental fees, both official and otherwise.

In 2005, however, those reforms were undone and greater restrictions were placed on international communication and market activities in general. The knowledge of international norms and transactions could not be taken away, though, nor could the experience of participating in money-earning activities be forgotten. As pre-2005 economic freedoms crept back into society, conservative forces in Pyongyang made one more attempt to return to North Korean orthodoxy through the 2009 currency reform. This failed to both diminish market activity and revive the public distribution system.

Compounding Pyongyang's suspicion of the SEZ it had created was a lack of interest internationally. This was manifested through the perpetually moribund Tumen River Area Development Programme (TRADP), a project run by the United Nations Development Programme (UNDP). This project sought to embrace and shape a post-Cold War Northeast Asia with a hugely ambitious and equally vague vision. It imagined a 20-year, $30 billion plan to modernize and integrate a vast region that included North-east China, Mongolia, North Korea and Eastern Russia, with Rason as a hub.[3] However, from the beginning it suffered from a lack of interest from member nations: funding, communications and staffing have all been problems. High-level officials did not participate and plans were not well formulated.[4]

The TRADP very quickly turned into little more than a talk shop: a 2007 UNDP evaluation report concluded that financing remained a key issue as no one country displayed a commitment to take ownership of the project.[5] It is important to remember that during the 1990s China was focused on developing its populated coastal regions and managing the takeover of Hong Kong, Japan was slipping into 'the lost decade', Russia's transitional economy was in turmoil, North Korea was descending into a food crisis and South Korea spent the latter part of the decade dealing with the aftermath of the Asian Financial Crisis. There was precious little interest or capacity to spare on developing the TRADP or Rason.

TRADP was rebranded in 2005 as the Greater Tumen Initiative (GTI), ostensibly as a means to transfer operational control from the UN to member states, but cooperation has continued to prove elusive despite Northeast Asia's generally favorable economic conditions. One evaluation concluded that the project would be "unsustainable" if the UN were to fully cede leadership.[6] The GTI continues to make plans with little relevance or mechanisms for implementation and with unrealistic goals such as increasing international tourism in the zone 10-15% or increasing cross-border trade by 10-15% by 2015.[7]

South Korea's role in North Korea's development will be crucial in the future, with a somewhat tenuous but growing foundation laid during the heyday of the Sunshine Policy. South Korean interest in economic engagement with North Korea grew in the early 2000s, but has been focused on the Kaesong Industrial Complex and the embattled Kumgangsan Tourist Zone. For a variety of reasons, there has been little government or private sector interest in Rason.

## A Confluence of Interests

### North Korea's Leadership

There are several indications that North Korea is developing a greater seriousness about investment, international trade and economic management. This stems from a key problem facing the new generation of leadership: how can they ask their citizenry to endure privation under the Songun banner, when the ultimate justification for that ideology – a nuclear arsenal - has already been attained? Ultimately, military-first asked its people to sacrifice material wellbeing in the name of national defense. It is not an ideology that inspires hope; the suffering that North Koreans involuntarily associate with it cannot be endured forever. The new government will have to demonstrate some other kinds of success to its people if it has any hope of capturing or retaining their loyalties.

Indeed, an observation of domestic propaganda reveals that a more hopeful message focused on improving quality of life has become increasingly and rather overtly conveyed. Kim Jong-il's last couple of years of on-the-spot guidance tours demonstrated a renewed emphasis on economic issues. Following North Korea's nuclear test in 2006, Kim's visits to military sites relative to economic ones began to drop. The year 2010 saw the fewest visits to military sites since he succeeded his father.[8] In fact, visits to economic sites outstripped military ones by 58 to 33 that year (through December 6th).[9] In 2011, similar attention was paid to economic sites.

The first major event in North Korea after Kim Jong-il's funeral was a January 3rd rally in Pyongyang, which was focused on economic issues. Slogans included "Light Industry First-ism" and "The People's Lives Upward!"[10] Also, in the several weeks immediately after Kim's death, North Korea's media stressed that Kim Jong--un's succession drew upon the inheritance of *juche* ideals to a greater degree than on *songun*.[11]

Also worth noting is the tenure of the New Year Joint Editorial, which is published by Pyongyang's top three newspapers and communicates the state's goals for the upcoming year. As the year's key piece of domestic propaganda, its content is very carefully thought out. There is always some element of economic instruction and admonition, but the editorial has traditionally revolved around military and revolutionary themes. In 2010, however, the editorial emphasized "a radical turn in the people's standard of living" by focusing on light industry and agriculture. The catchy title for 2011 was "Bring about a Decisive Turn in the Improvement of the People's Standard of Living and the Building of a Great, Prosperous and Powerful Country by Accelerating the Development of Light Industry Once Again This Year."

Again, the focus was on quality of life and economic growth, with revolution and military matters taking a backseat.[12] (2012 broke this trend – Kim Jong-il's death resulted in a hastily written piece, focusing on continuity and succession. We'll never see the editorial that was originally planned.) All this propaganda contains both explicit and implicit promises to the public about their economic wellbeing that were relatively absent for most of the Kim Jong-il era.

Propaganda can be dismissed as being without real value. However, concrete steps taken among Pyongyang's very top elites also demonstrate a greater focus on economic management. Starting in 2009, two investment groups came to the fore. First, the Daepung International Investment Group was re-purposed along the lines of a holding company model and paired with the newly created State Development Bank as a vehicle for attracting foreign direct investment. Individuals on the National Defence Committee have been linked to the Daepung Group as has Kim Jong-il's erstwhile confidant Jon Il-Chun, who is reportedly the Director of Office 39, a murky but influential international trade and finance organization.

The same year, North Korea formed the Joint Venture and Investment Committee, a governmental office tasked with attracting and regulating foreign investment in the DPRK. The reins of this organization were handed to Ri Chol, who, among other roles, has helped manage Kim Jong-il's foreign assets and mind his children while they studied in Switzerland. It is thought that his stewardship of the JVIC was a reward for brokering the deal that brought Orascom to North Korea.

Other investment groups have been folded into these two umbrella organizations even as rumors spread of attempts to set up new ones – with different patrons from the top of Pyongyang's hierarchy. This centralization and competition suggests that elites recognize that participating in and controlling foreign investment and trade will become ever more important for securing influence in the future.[13] It also suggests that the military is decreasing in relevance as a path for advancement.

As these reorganizations were developing, the DPRK passed a "corporate law" in the fall of 2010, just over a month after Kim Jong-un was introduced at the Party Conference in September. Under the new law, corporations are defined and receive autonomy in many areas, though sales and wage mechanisms are decided by the state.[14]

While still unwilling to truly open the economy, it seems apparent that North Korea's elites are turning to economic development, growth in light industry and trade and investment to define the new era of governance. The creation of investment organs and national laws relating to corporate activity attest to this and coincide with material and legal changes in Rason as well.

### Jilin's Development – The "Changjitu" Plan

The other side of the story is how external economic actors view Rason; North Korea's willpower alone cannot conquer an unfavorable external environment, despite propaganda rhetoric to the contrary. Fortunately for Pyongyang, both Beijing and Jilin province have both the interest and capacity to push for Rason's development. Where the vague, overly broad and ultimately ineffective Tumen River Development Programme failed, China's Changjitu Development Plan is having an impact.

In 2009, Beijing approved a locally formulated development plan called "Changjitu", an abbreviation of Changchun-Jilin-Tumen. This is an ambitious yet focused program for developing a province that has lagged behind the development of China's coastal regions. Jilin's Gross Domestic Product in 2008 was about $100 million. This is roughly double North Korea's GDP, though Jilin's population of 27 million is almost exactly the same. Under the Changjitu plan, Jilin's GDP is to double 2008's level by 2012 and to quadruple 2008's level by 2020.[15]

In order to achieve this rapid growth, Beijing has invested in all manner of infrastructure. A high-speed rail connecting Changchun and Jilin, the province's two major cities, began operating in early 2011. Construction is underway to extend the line to Hunchun, near the border, and is supposed to begin running in 2012. Changjitu's motorways have been expanded and upgraded, now crisscrossing the region. One of these motorways leads to a large new customs and immigration facility in Quanhe. Across a newly refurbished bridge – entirely Chinese financed - sits North Korea's Wonjong-ri customs house.

Part of the plan includes creating regional financial infrastructure. Locally based financial institutions such as banks, local financial holding companies, and financial leasing firms are to be created to support the growth of targeted industries.[16] These industries include automobile and parts manufacturing, petrochemicals, agricultural products, electronics, pharmaceuticals, medical equipment, metallurgy and tourism.[17]

Changjitu's planners have from the very start imagined the use of Rason's port as an integral part of its development, as an outlet for finished goods and raw materials for both international and domestic markets. In January 2011, Hunchun Mining Group, one of the province's most significant mining operations, conducted a test run of some 20,000 tons of coal from Hunchun to the Shanghai-Pudong port. Despite the lack of a paved road at that time, the usual transportation time of 11 days to Shanghai was cut to 3 days. With upgrades to Rason's infrastructure underway, Hunchun Mining Group is planning to increase its output from 5.6 million tons to 13.5 million tons in 2012.[18] Essentially, the grandiose plans for Jilin simply do not work without continued, guaranteed access to Rason.

The Changjitu plan and its relationship to Rason are also very much in congruence with Beijing's geostrategic goals for the Korean peninsula. China hopes above all to reduce the possibility of events that might jeopardize its own rapid economic growth. Beijing, frustrated by its inability to prevent North Korea's nuclear tests, has effectively decided it needs more leverage over its erstwhile co-combatant. Encouraging economic reliance on China during a period where South Korea and Japan have written themselves out of the story can only give Beijing greater influence in Pyongyang's decision-making.

Encouraging economic ties with North Korea not only increases leverage over its neighbor, but should also reduce the frequency of food shortages, while sheltering Pyongyang from the effects of sanctions. If reducing North Korean provocations is a core concern of Beijing's, preventing an absolute and sudden collapse is its primary one. Improving her ally's food and attendant human security issues through economic exchange is an indirect means of accomplishing this. Bonding Jilin's economy to Rason's serves all of these interests and will help stabilize North Korea's Northeastern provinces, the most impoverished and vulnerable.

## Recent Developments

Rason is undergoing changes that are manifestly different from anything previously observed. Pyongyang's lack of initial commitment to its SEZ was perhaps most visible in its failure to pave the road from the Chinese border to the port. The unwillingness to invest in the road, port, or power plant reflected Pyongyang's reluctance to really let Rason become an international trading hub and a large-scale experiment in attracting foreign direct investment.

Now, however, infrastructure upgrades are taking place, the most conspicuous of which is the construction of a paved highway linking Rajin and Sonbong to the border crossing at Wonjong. If anything over the last twenty years has symbolized Pyongyang's failure to move forward on Rason, it was the dusty, bumpy road that connected the SEZ to China. As poor as North Korea may be, building a 30-some kilometer road is certainly within its capacity. (Far more so, say, than upgrading a decaying power plant.) Now, however, the road is almost fully paved, with work beginning in the spring of 2011 and "90% complete" by November. Four Chinese companies, making use of both Korean and Chinese laborers, oversaw construction, which was entirely paid for by the Chinese. Whether the funding came from the firms involved in exchange for tolling rights or concessions or whether it is from central or provincial Chinese government subsidies is not entirely clear. Whatever the case may be, the road is absolutely fundamental to any further development, because the incentive to invest heavily in factories or port facilities is low if there is no capacity to transport products and materials easily and quickly.

Despite this, Rason's port facilities have seen some limited upgrades in recent years. Out of three ports, the primary one is Rajin. Rajin port is 9.8 meters deep and has three piers and nine berths. Chinese companies have leased the use of the 1st pier for coal and the 2nd for containers. The head of the Port's Foreign Affairs Department, Kim Chun-il, claimed there was an agreement with Chinese companies to build two more piers at a depth of 15 meters. This would allow for some of the biggest New Panamax class ships to dock, increasing economies of scale for transport beyond Japan and South Korea all the way to the Americas. While this seems consistent with Jilin provinces' development goals, it has proved impossible to confirm the details of this agreement. Most crucially, it remains unknown whether a finished contract has been signed and whether there is a timeline for construction.

A Russian company signed a 49-year lease for the 3rd pier in 2008, for which they agreed to invest approximately 1 billion US dollars. For the first 17 years of the lease they will collect 100% of the port fees on that pier. After that, fees will be split 70%-30% (in favor of the Russians) until the end of the lease period. Rajin port has 11 DPRK-owned cranes with a capacity of five tons, five Russian-owned ones with a capacity of 10 tons and also two Russian-owned ones with a capacity of 30 tons.

Another issue is the chronic power shortages that plague Rason, not unlike most of North Korea. Along with transportation infrastructure, electrical power is any special economic zone's most rudimentary necessity. Resolution of this issue, therefore, would represent a great deal in terms of Rason's validity as an export-processing zone. After years of negotiations, promises, and rumored agreements, progress here is finally underway: in November 2011, work began on electricity transmission lines that will link Rason to power plants in Yanbian Autonomous prefecture in Jilin,[19] The cost of electricity will be set at Chinese prices and payment will be made through the new Golden Triangle Bank in Rajin. This will give Chinese investors confidence that prices will be consistent. Moreover, this agreement gives China effective control of one of the commanding heights of Rason's economic future.

The imperative point to recognize is that for 20 years such construction has been talked about, promised, and reported upon. North Korea may be a place where commitments, memorandums of understanding, and contracts go to die, but now, for the first time in Rason's history, there is tangible movement taking place on key infrastructure projects. It is difficult to overstate what this means for the zone. For the first time, Chinese finance and expertise are combining with North Korean acquiescence to create a Rason with the basic capacities of a modern free economic zone.

Also, 2010 saw legal changes in Rason that wrested it from the provincial government and granted more local autonomy. Rason is now the responsibility of the Joint Venture and Investment Committee in Pyongyang but is administered by the Economic Cooperation Bureau, a semi-autonomous organization under the City People's Committee. One official stated that 80% of decision-making is now made locally while only the most important decisions require consultation with Pyongyang. It was also explained that individual companies are free to negotiate and conclude deals with their foreign partners autonomously, before seeking final approval from the government.[20] Foreigners with long-term experience in Rason note that decisions do appear to be made with greater speed and flexibility than in the past. Moreover, it is said there is less suspicion and greater openness in local attitudes towards foreigners.

Finally, it should also be noted that Rason's administrators appear to be increasingly talented, pragmatic individuals. Many come from Pyongyang's top universities and have studied or worked abroad and have a better grasp of international business than in earlier years. The Vice-mayor, Hwang Chol Nam, seems particularly impressive in both his language skills and his understanding of technical and market issues. Anecdotes suggest that Rason is no longer seen as a place of exile, but rather a place where incentives to succeed exist and personal career advancement is possible.

### Remaining Issues

It would be remiss to ignore the multitude of constraints facing Rason, however. The environment in the DPRK remains challenging and while Rason is freer than most places in the country, it still operates under a political system that is essentially trying to balance the need to revive the economy with a desire to retain as much central control as possible.

This political uncertainty is the ultimate impediment to development in Rason and elsewhere. North Korea has, after all, rolled back previous reforms in the past. When feeling relatively confident about its economic and agricultural situation, Pyongyang has tried to move back towards orthodoxy as in 2005, with repeals of the 2002 economic reforms, and in 2009, with the unsuccessful currency reform. If investors are not confident in Pyongyang's commitment to maintaining Rason as a functioning platform for free trade and investment, they will be wary about committing assets that might be jeopardized by a change in Pyongyang's political winds.

The uncertainty over the application of law is a worry as well. Stories abound of conflicts over contracts, assets confiscations and done deals coming undone. Rason's managers need to realize that this will have to change if they hope to attract investment from sources other than China. As we have seen, Chinese control over key parts of Rason's infrastructure is increasing. If we begin to see bigger Chinese enterprises investing in Rason, this may be a sign that that leverage is sufficiently counterbalancing concerns over the DPRK's irregular legal environment. Investors from elsewhere, whose governments do not have their hands on such levers, will likely continue to stay away.

Communication remains an issue. Rason's administrators currently do not have email access, though there are rumors that it is on the way in 2012. Even so, it seems unlikely that most of them will be allowed individual email addresses – a prerequisite for operating businesses at the normal pace of the 21st century. And while roughly 1/5 of all adults in Rason have mobile phones – exceptionally high by North Korean standards – foreigners in the zone cannot be on the same network and cannot call their Korean partners. (They can apparently both call landlines, however.) Calling internationally from the zone remains highly restricted, making business very, very slow by today's standards. However, Rason administrators claim that starting sometime in 2012, foreigners will have access to Internet and international telephony from certain hotels.

Finally, while infrastructure projects are underway, there is still much work to be done. As promising as developments at Rajin Port have been, they remain ultimately quite minimal. The crane system they employ can only handle six moves per hour (the number of crates that can be unloaded in an hour). This is slow compared to many regional ports (17-25 moves per hour) and positively somnambulant compared to the world's most efficient ports (over 40 moves per hour). Rason's two other ports, Sonbong and Unsang, are dedicated to transporting crude oil and lumber respectively. They are both too shallow for heavy use and lie in significant states of disrepair, largely unused.

Ultimately, what investors seek are efficiency in logistics and consistency in the enforcement of rules and regulations. Rason's infrastructure upgrades are beginning to address the former; Pyongyang has yet to show commitment to the latter.

## Conclusion

Beijing intends to bond Rason's economy to Jilin's, making them impossible to separate without risking instability and loss on both sides. The upgrades to transport networks both in Jilin and Rason and the impending resolution of Rason's power shortage indicate a seriousness of purpose that has not previously been evident. Furthermore, Chinese control of key utilities, especially the power supply, increases Rason's dependence on its northern neighbor.

Pyongyang's acquiescence to economic engagement and recent legal reforms give Rason the best administrative environment it has ever had. A shrewd yet realistic management team is in place and operating with greater autonomy than ever before. Pyongyang's increasing need to create economic success stories and China's commitment suggest Rason will develop quickly over the coming years. This doesn't mean we can expect Rason and the DPRK to follow a trajectory of reform along the lines of Shenzhen and China before it. It does mean, however, that Rason's relative importance both as a locus of experimentation and as a generator of wealth in North Korea's economy will increase in the coming years.

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