

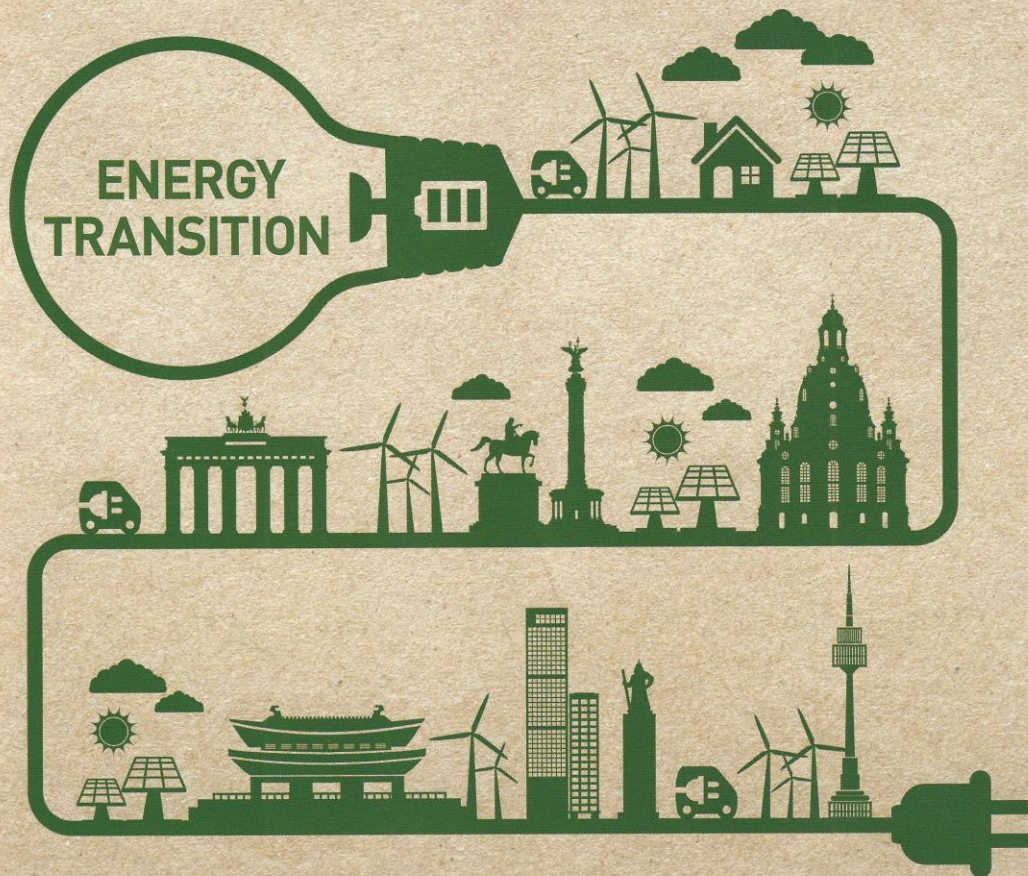
2nd Quarter

2019, No.80

German Energy Transition
Korea's Roadmap to Energy Transition
Advance Customs Valuation Arrangement
Special Economic Zones in North Korea

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Special Economic Zones in North Korea



The Hungnam SEZ in Hamheung - just a green field © Bernhard Seliger

When in 2015 a German delegation was invited by North Korea to look into investment possibilities in Hamheung, South Hamgyong province, they also visited a nearby power plant. Looking at the facility, they were stumped by the fact that the plant was running a Siemens turbine - built in 1932 under Japanese colonial rule! This was a great sign for longevity of German engineering - but it also was a sign of what was and is wrong with the North Korean economy. Not knowing economic depreciation (as opposed to the physical wear and tear), all equipment is run until it literally breaks down. The capital stock of the country is aged, and public infrastructure, in particular in the industrial cities of the East coast (Wonsan, Hamheung, Chongjin) is worn out. In most of the rural areas, it simply does not exist. No wonder then, that North Korea did not invite the delegation to invest in one of the giant, but aged chemical industry plants of Hamheung, but rather offered access to greenfield investment, namely the Heungnam Special Economic Zone, one of more than 20 zones now existing in the country. The spot for greenfield investment was exactly this -

a green field. No tarred road, no electricity, no water, no site development: just a green field. How in this situation, absent a site development operator, any investment could happen, the North Korean officials could not really explain.

While investment in North Korea is currently impossible for a number of reasons, foremost the simple fact that sanctions prevent companies from any investment, it is legitimate and necessary for companies to prospect into the future. What chances will there be for investment once North Korea opens up or even gets unified with the South? The peace overtures of the last two years, precarious as they are, even more kindled interest in this kind of question. Looking closer at the North Korean economy, it becomes evident that, while there still are remnants of socialist style central planning, today a highly idiosyncratic hybrid economic systems mixing elements of market and plan exists. And the designation of Special Economic Zones (SEZ) is certainly the potentially most interesting development with respect to potential foreign investment.

The history of SEZ in North Korea dates back to 1991, when the two remote counties of Rajin and Sonbong were merged into the Rason Special Economic Zone. Located at the border to China and Russia and equipped with an ice-free harbor, the zone seemed ideally located as a potential logistics hub of the future: far from the dangerous Southern border, close to the neighbors and with one attractive feature, the ice-free harbor, neither of the neighbors had. Though the original idea to create a "Singapore of the North" quickly evaporated and for ten years progress on the zone was very slow, ironically until today Rason SEZ is the only zone, where real progress in terms of foreign involvement, overwhelmingly through Chinese investment and trade, can be seen. While in the first years of its existence, Rason was mainly famous for a casino-hotel, the Emperor (now Imperial) hotel built by a Hong Kong tycoon, with the Chinese development of the former "rust belt", the three Northeastern provinces Heilonggang, Liaoning and Jilin, from the late 2000s also the interest in Rason rekindled, since these provinces lacked a harbor connection to the Pacific. China built a motorway and high-speed train to Hunchun, and also substituted the 48 km dirt track between the border post Wonjong and Rajin in the Rason SEZ with a modern road. Russia, which under Putin's presidency did not want to stand by, negotiated the long-term lease of pier 3 of Rason harbor and equipped it with an autonomous oil power plant and modern cranes as well as modernized the railway tracks from the border to Rajin harbor to accommodate Russian railway carts.

In November 2015, North Korea claimed that there were 150 foreign invested firms in the zone, including 4 equity joint ventures, 30 contractual joint ventures, 103 foreign companies and 13 representative offices of foreign companies. Tourism by Chinese operators and small-scale border trade were blooming and business people from the Yanbian autonomous Korean Prefecture in China could even enter the zone in their own cars. At the same time, the zone exported workers to the nearby Chinese cities of Hunchun, Yanji and Tumen, where they

were sought after as reliable, cheap labor in textile, seafood processing and other companies. The development of the nuclear program and sanctions, however, for the time being stopped that development; joint ventures became outlawed, though many seem to have only formally changed ownership, the Russian pier since two years did not ship any coal (the main bulk export for which it was thought) or other goods, and for one year even tourism came to a halt. With the thawing of relations between North and South from 2018, tourism and small-scale border trade rebounded; but all kind of larger-scale investment is still illegal. Where there were once several Chinese banks, including subsidiaries of Chinese giants like the China Construction Bank, only one local bank, Golden Triangle bank, survived.

But Rason did not remain the only SEZ in North Korea. During the time of the Sunshine policy of the Kim Dae-Jung administration in South Korea, the Kaesong Industrial Complex (KIC) and the Kumgangsan tourism zone started. KIC became actually the largest such enterprise in the North, with up to 54.000 North Korean workers employed in South Korean companies, but ultimately it became another victim of the nuclearization of North Korea in 2016. Already in 2008, after the death of a tourist, Kumgangsan tourism zone had been closed. Also with China, various attempts to create special zones were started. In 2002, a zone was declared in Sinuiju, opposite the Chinese border town of Dandong, through which the overwhelming part of imports enter North Korea. Probably due to Chinese displeasure with the selection of the place and the potential manager, a shady Chinese business man, the plan never came to fruition. Also other attempts in 2011 for two zones on islands in the Yalu river, Hwanggumpyong and Wiwha, were not very successful. Under the new rule of Kim Jong-Un, SEZ policy accelerated. Though overshadowed by the nuclear armament dispute, North Korea enacted quite comprehensive SEZ legislation for Rason and other SEZ. In 2013 and 2014, 19 economic development districts (focusing on industry,



The three piers of Rajin harbor in Rason Special Economic Zone. While the right-hand Russian pier with modern cranes is practically idle since two years, the middle pier used by North Korea itself still shows heaps of coal; probably for (basically prohibited) export. © Bernhard Seliger

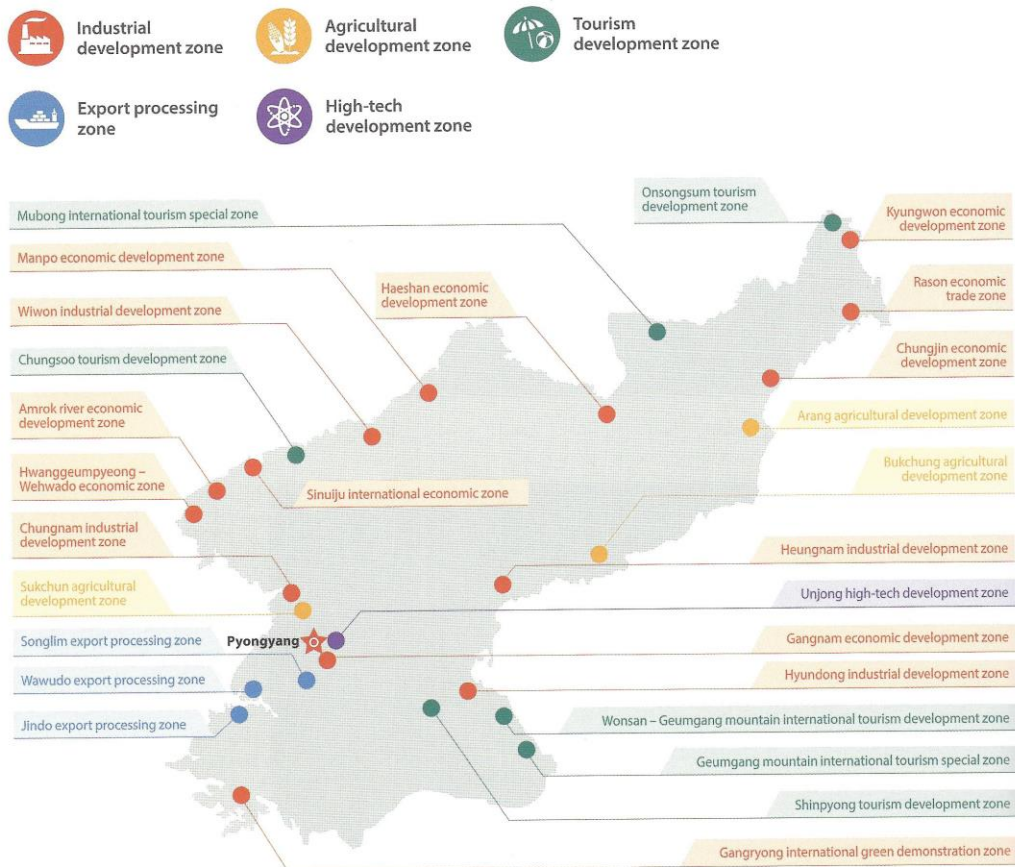
North Korea

agriculture, tourism, technology and export processing) were designated and in 2017 two more were added, one of them in Pyongyang.

What makes these zones different from the rest of the country? While the first SEZ obviously tried to create controlled, closed islands of economic trial areas strongly disconnected from the rest of the country (in border areas fenced off from the rest of the country and only to be accessed with difficulty from inside the country or on islands in the river), the new economic development zones under Kim Jong-Un seem to be quite equally spread around the country. Ironically, until today they had almost zero success, mostly due to the sanctions, but

also, as Peter Ward, an economic analyst for NK News service observes, since the rest of the country becomes more and more similar to the SEZ. As one North Korean official once in private said, "every part of the country can become an SEZ, once there is investment"... Rules in North Korea are not fixed, but can be bended according to economic needs. Tragically, beside that flexibility, North Korea direly lacks a track record of successful foreign investment in SEZ or elsewhere. Instead, all larger investment projects - like Pyongyang Motors built by the "Unification Church" or Orascom, the Egyptian-owned cell-phone business - ran into economic difficulties, after initial investment was done.

Special Economic Zones in North Korea



Source: Chosonminjuui Inmingongwhaguk chuyokyongjechidaereul, Pyongyang 2018.

Currently, the focus of North Korea is in particular on the development of a new tourism zone in Wonsan, Kalma beach resort, which is as of yet one of the few non-sanctioned areas. However, also no foreign investment has been possible there as well, and earlier investment seminars for the zone came to nothing. Even if sanctions are lifted one day, North Korea still has to go a long, long way before it becomes attractive for serious foreign investment. Then, however, trading opportunities, investment in raw material mining, export processing, everything is possible.

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Laws changed or newly introduced for SEZ. While legal change is impressive, it is not as important as a track record of functioning investment in SEZ, which is still lacking.

Source: own compilation after North Korean sources

DPRK Foreign Economy Arbitration Act
DPRK Customs Act
DPRK Entry and Exit Act
DPRK Trade Act
DPRK Import & Export Commodity Inspection Act
DPRK Copyright Act
DPRK Trade Mark Act
DPRK Environmental Protection Act
DPRK Economic Development Zone (EDZ) Act
EDZ Management Agency Operation Regulation
EDZ Business Establishment Operation Regulation
EDZ Development Regulation
EDZ Labor Regulation
EDZ Environmental Protection Regulation
Rason Special Economic Trade Zone (SEZ) Business Establishment Operation Regulation
Rason SEZ Development Regulation
Rason SEZ Foreign Investment Company Labor Regulation
Rason SEZ Road Traffic Act
Rason SEZ Peoples' Security Regulation

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