

Foreign Investment in the DPRK

A 38 North Interview

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TRANSCRIPT

Part I: Foreign Investment in North Korea

Bradley Babson: This is an important time to be talking about foreign investment in North Korea because North Korea has for many years identified 2012 as the time when it will be demonstrating it is both a strong *and* a prosperous country. We had focused a lot in recent weeks on the missile tests and the issues of whether or not North Korea is in fact a strong country, and there's been a lot of focus on the famine and other problems facing the general population about how prosperous a country it is. But there's no question that North Korea sees the special economic zones on the China border as providing an opportunity to attract foreign investment in a way that has not been achieved in the past and to begin turning the corner to allow them and for their people to believe that prosperity is just around the corner.

Part II: Special Economic Zones

BB: Special economic zone in Rason has been around since the early 1990s and it's been through a number of iterations of legal documents to try to attract foreign investors. It's been not very successful through the 1990s and the early part of this decade but more recently, China and Russia have become very interested in taking an advantage of the port in the Rason area to be able to transfer goods in and out of landlocked China and in and out of Russia, particularly during the winter months when the Russian ports are icebound. So that the combination of Chinese and Russian interests in the Rason port and the opportunity to develop industries that can provide some value added processing on goods coming in or out of that port, creates a new window of opportunity for North Korea driven by the self interest of China and Russia- not only by the desires of North Korea to attract investment. Most of the trade that comes between China and North Korea comes on the western side of North Korea in the Dandong area, which is a very vibrant economic area of China. So the potential for having an economic zone on the western area that is more directly linked to the mainstream of the North Korean economy has some real potential value for North Korea in a very different way than Rason, which is quite remote from the mainstream of the North Korean economy. North Korea has rather ambitious ideas about how much investment they can attract and what they would do with it. They've never been very successful in translating those ideas into reality. I think the hope this time is that they will be able to get more attraction in getting investors willing to come in to invest they way that has been successful y done in the Kaesong project with South Korea. If they're successful, then it means that North Korea will have better control over what kind of investment is taking place, more centralized approval processes, they've put in place good institutional mechanisms for

making decisions at the local level in the management of the zones using local authorities and special boards to solve problems as they come up. And I think that that reflects a seriousness of intent to do it better this time than they have in the past. The benefit for North Korea would be attracting investment, getting the returns to the country of those investments, both from revenues that would flow from taxes as well as the potential for new products and access to technology that could help stimulate the domestic economy, particularly if they allow backward linkages into the domestic economy to provide not just labor but also other inputs into production in the zones. That would certainly help develop the North Korean economy beyond the zones itself.

Part III: New SEZ Laws

BB: There are some important aspects of these laws which I think are important new developments for North Korea. One is providing 50 year leases for land and also property management rights and flexibility, particularly when it comes to hiring North Korean labor and setting wages, being able to get access to finance in multiple currencies, having preferential tax incentives for investment, also tariff and customs waivers to allow inputs to come across the border for production to reduce the cost to the production process. And there are new dispute mechanisms that have been put in place for both the economic zones that are more robust than what has ever been allowed in the past. I think one of the interesting aspects of the new laws that apply both to Rason and to the western zone is that not just Chinese but nationals of other countries, including explicitly Koreans not resident inside DPRK, are allowed to invest in these zones. That's a kind of a sign that South Korean investors in these zones would be welcome and again the question is whether there will be the interest on the South Korea side for that type of relationship. But it does create an opening for a more regional approach to investment and integration of North Korea economically, than simply relying on bilateral relations between China and North Korea.

Part IV: Gauging Kim Jong Un's Commitment

BB: The that the laws were published in English on the 17th of March, I think is a signal that the new regime is looking to these laws as one of the mechanisms for advancing their aspirations to bring prosperity to the North Korean people. It's also, I think, noteworthy that in his first speech on the 15th of March, Kim Jong Un was willing to make a pledge to the people that they would never have to tighten their belts again. That sets a marker of expectation that somehow the economy is going to be a high priority for this new regime and the delivering for the people, not just for the pocket book of the elite in Pyongyang, is going to be part of the agenda. The zones are clearly one aspect of that. The other development that occurred during that week that is important was the decision and the announcement that the Cabinet would be given primary responsibility for managing an economic development strategy in a more integrated way than in the past, and that the technocrats in the government would be given more support and authority to find a "realistic way to develop the economy". And I think that that signals that there is more likely to be a more rational economic development policy than we've seen in recent years when we've seen various efforts to roll back to old style socialist economic management that had failed, and continuing inflation which undermines the efforts to develop the economy. So I think that this new administration looks like they're willing to give the technocrats another chance to see what they can do.

Part V: What to Watch For

BB: I think as we look ahead over the next months on the way the North Korean economy develops, there are a few important markers to keep an eye out for. One is the streamlining of institutional authorities for attracting and for approving foreign investment. We've had different parts of the system, in effect, competing with each other. I think the key one there is Taypong Investment Group, which had been operating independently of the Cabinet, and we have the joint venture and investment committee under the Cabinet. I expect to see some kind of an integration of these two organizations that would make it a lot easier for investors to know who they're dealing with, how to get decisions made, and more of a one stop shop approach to getting approvals from Pyongyang for projects inside North Korea, particularly inside these enterprise zones. I think the other big issue is going to be whether there the new economic team that is being put in place in Pyongyang, which includes a new finance minister, are willing to try to get a more integrated approach to economic strategy and supervision of the financial system. One of the big faults of the 2002-2003 reform effort was they did not really focus on the institutions that would be necessary to support a more liberal economic policy. Just changing prices doesn't do the job. It's very important to develop the banking system, develop the public finance system, taxes, insurance, more flexible property and land and labor markets. These are all areas where if North Korea was willing to lighten up, and allow more flexible economic practices and more support for evolution of market economic dynamics, that things could become more interesting in terms of the domestic economy and how it evolves over the coming years.