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**Report on Rason Special Economic Zone,
Democratic People's Republic of Korea
CE2011-001**

Andray Abrahamian

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www.chosonexchange.org



For additional comments, please email andray.abra@chosonexchange.org

Introduction

Rason Special Economic Zone is an area carved out of North Hamgyong Province in the far Northeast of the Democratic People's Republic of Korea, bordering both China and Russia. Rason, an amalgamation of the names of the area's two biggest cities, Rajin and Sonbong, has been a legal entity since 1991 and could theoretically be a vibrant hub for both logistics and export processing. It has an abundant, cheap and well educated labor force as well as the region's northernmost year-round ice-free port. Yet despite these advantages, Rason has struggled to reach its potential in the face of Pyongyang's ambivalence about free trade zones, domestic politics and difficult geopolitical circumstances. For years, various plans, agreements and memoranda of understanding with regards to investment in transportation, power generation, factory building and other infrastructure development projects have been talked about but with little to show for it.

Recently, however, activity is afoot. Roadwork on the thoroughfare between Rason and China has begun in earnest, as well as work on the railway link to Russia. These projects – like many others - have been talked about for some time, but are now underway with deadlines set for both before the end of 2011. Several of the SEZ's management have spent time abroad and appear motivated and pragmatic in their understanding of Rason's challenges as well as advantages. Since 2010 they have been given greater autonomy in practical decision-making from Pyongyang.

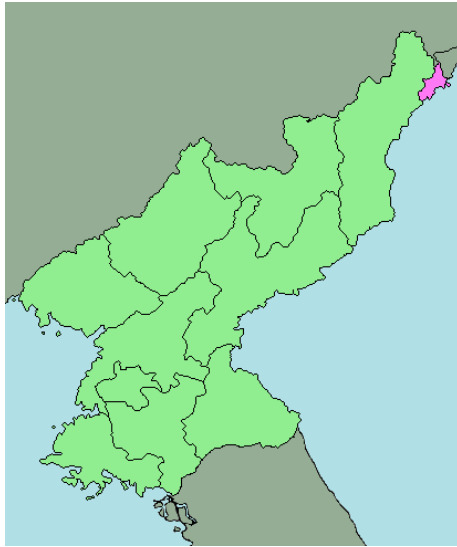
Choson Exchange, accompanying Hanns Seidel Foundation, traveled to Rason in August 2011 to attend the 1st Rason Trade Fair and explore training needs for company managers and SEZ administrators. This report is based on interviews with local officials and businesspeople. Choson Exchange would like to express our deep gratitude to Hanns Seidel Foundation for its support and to Rason's Economic Cooperation Bureau for the invitation and hospitality.

Andray Abrahamian
Executive Director, Choson Exchange

1. Organizational Structure: More Local Autonomy

Rason is administered under the Economic Cooperation Bureau, a semi-autonomous organization under the city government, but also under the Joint Venture and Investment Committee (JVIC), which is based in Pyongyang. One official stated that 80% of decision-making is taken locally and 20% in 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.

We could not ascertain the exact fault-lines in local vs. central administrative decision-making. One official noted that JVIC “are the generals, we are the soldiers,” perhaps referring to the division between crafting strategy and specifics in attracting Investments. The latest amendment to the Law of the Democratic



Rason's Location in the DPRK

People's Republic of Korea on the Rason Economic and Trade Zone (Sept. 27, 2010) grants nearly complete autonomy in attracting and managing investments. Foreign investors noted that in practice local autonomy had increased over the last year, increasing the speed and efficiency by which actions can be taken. Bigger deals must, it appears, still be referred to Pyongyang, while less important decisions remain local.

2. Port Facilities

Rajin port, built 80 years ago, is 9.8 m deep and has 3 piers and 9 berths. The port generally handles ships that weigh between 30,000 and 40,000 tons. However, at a depth of nearly 10 meters, much bigger post-panamax ships, able to carry 10,000 TEU (Twenty-foot equivalent), could be accommodated by the ports.

The 1st pier is used by Chinese for coal and the 2nd for containers. A Russian company has a 49 year-lease for the 3rd pier, starting from 2008, for which they invested 1 Billion US Dollars, according to the Head of the Port's Foreign Affairs Department, Kim Chun Il. 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. This gives an incentive for speedier development and use when the foreign half of the joint venture will collect greater remuneration.

Kim also stated that Chinese investors plan to start building two more piers with a depth of 15 meters in 2012, the contract for which is already signed. This, when completed, would allow for some of the biggest New Panamax class ships to dock, increasing economies of scale for transport beyond Japan and South Korea to the Americas. It would still be too small, however, for ultra-large container vessels or “Super-Post-Panamax” class, which are over 14,000 TEU. A timeline was not given.

Rason has three ports. Rajin port, the largest, has multiple uses and a capacity of 3.5 million tons of cargo, though the most it has seen in any year has been 750,000 tons. Unsang port is a specialized timber port with 600,000 tons capacity. Sonbong port is used exclusively for oil and has 250,000 tons capacity. They are all within a few kilometers of each other.

The main Rajin port has at total of 18 cranes: 11 DPRK-owned ones with a capacity of 5 tons, 5 Russian-owned ones with a capacity of 10 tons, and 2 more Russian-owned ones with a capacity of 30 tons.

Unloading of a 50-foot container takes 10 min, a standard 20-foot container also takes 10 min. This works out to about 6 moves per hour. Bigger ports, such as those in Southeast Asia or North America, can handle 17-25 moves per hour. The speediest ports, such as Singapore or Rotterdam operate in excess of 40 moves per hour. Crane efficiency will need to be improved as capacity increases.

2. Rail and Road Links Upgrade Projects

There is a modern-looking electrical overhead power system for the train line to Russia. Tracks are currently being widened to match Russia's gauge, while keeping the thinner international standard used by Korea and China. This will allow Russian trains to go straight through rather than change carriages at the border.

Chinese workers, in the employ of four construction companies, have been brought into Rason to work on the road. North Korean civilians and military have also been mobilized and at any time there are hundreds of workers engaged in the construction projects which stretches from the border to Sonbong.

Work began in May of 2011 with a stated deadline of November. While the road has been widened and leveled, paving had not begun as of August. In order to meet the deadline, officials and businesspeople spoke of closing the road to traffic completely for up to a month – probably the whole of October – and re-diverting traffic. There is great incentive to complete the road before the harsh winter rolls in: ice and snow would damage the work already completed if it remains unpaved and most of the Chinese workers are living in tents, which would be terribly burdensome through the winter months.

3. Plans to Increase Energy Output

Currently, 20,000 kw/h is generated by Sonbong coal burning power plant, the lone power plant in the region. Costs are currently 0.06 Euros per kw/h. The Vice-mayor of Rason, Mr. Hwang Nam Chol, stated there is a plan to import Chinese electricity, generated by coal. A Chinese power company will build the lines and transport the electricity through a joint venture supply company. The new supplies will be at Chinese prices, paid back through the new Golden Triangle Bank. An agreement exists, although there is no contract yet and Rason administrators said they are waiting for Chinese government approval for the export license. The first stage of development will supply 80,000 kw/h, by the end of next year. Then, an increasable amount according to demand will be generated, to a maximum of 600,000 kw/h.



Construction on the Rajin branch of Golden Triangle Bank

Journalists traveling in early September, however, were told that there was a plan to build a new coal-fired power plant actually in the SEZ, also capable of generating 600,000 kw/h¹. Both seem to be on the table, but neither seem locked down.

There is also a small “stand-alone” or island grid in the zone. A four-turbine wind power plant was built by an partially American joint-venture capable of generating 95 Kw/h. It has been connected to a Chinese-backed hydro plant through a 26 km transmission line. This island grid is not connected to national or regional grids.

4. Banking Services Remain Minimal

Multiple investors and officials cited rumors that China Construction Bank will be setting up a branch to facilitate transactions for Chinese companies, but this was difficult to confirm. Golden Triangle Bank, originally founded in 1996 to deal with Rason-related transactions, is constructing a seven-story building in

¹ <http://www.reuters.com/article/2011/08/31/korea-north-investment-idUSL4E7JU2W620110831>

Rajin. One investor told us that in the past it was not possible to transfer money to Rason from Pyongyang's main Golden Triangle Branch, which is where international funds must be transferred. Instead, cash had to be brought up by car. Upon completion, transfers between Pyongyang and Rason should be possible. The new branch will also have the capability for companies to remit abroad.

5. Communication Remains Limited

Direct communication between foreigners and their partners in Rason remains difficult. Most contact has to be done through a representative in Yanji. International calling is nonexistent. Group emails do exist for administrators and managers in Rason, but they are unreliable. At some point in 2012, both international calling and individual email is expected to be permitted, though exactly when is unclear. "The sooner, the better," one administrator said.

A local cellular phone network exists, constructed and administered by a Thai company, Loxley-Pacific, under a separate contract from the Orascom-Koryolink agreement that covers Pyongyang and other parts of the DPRK. Foreigners cannot yet own and use a phone on the network.

6. Cost and Availability of Labour

According to local statistics, Rason has an effective labor force of 103,000 people out of a population of 198,000. Approximately 62% of its residents are between the ages of 16 and 59, according to a presentation given at the 1st Rason International Trade Fair. Training institutions include Rajin University of Marine Transport, Sonbong University of Agriculture, a commercial college, and smaller vocational schools. One official in attendance stated that the Korean side of any joint venture would be responsible for training workers, unless otherwise agreed.

One foreign investor calculated that the cost of textile assembly is about 30% cheaper than in Northeast China, not factoring transportation costs. One shoe factory, for example, produces 245 pairs of boots per day, made by the 35 workers. Production cost is 25 RMB per pair. Reports have recently surfaced claiming that a minimum wage of \$80 USD per month has been set in the SEZ².

² <http://english.yonhapnews.co.kr/northkorea/2011/09/08/20/0401000000AEN20110908004000315F.HTML>