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The State and Prospects of the Rajin-Sonbong Free Economic and Trade Zone in the Democratic People's Republic of Korea (DPRK)

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At the end of 1991, the government of the DPRK proclaimed that the area surrounding the cities Rajin and Sonbong would become a free economic and trade zone (Decision No. 74 of the DPRK Administration Council). The zone lies along the Tumen River Triangle, which marks the border between the three riparian countries: the DPRK, China, and Russia. Several reasons caused the DPRK government to change the negative stance it had held since 1984 on establishing the free economic and trade zone, including the limits on its economic development caused by its ineffective mobilization strategy, the success of China' s open economic policy, and the disruption of trade with the former USSR from the end of 1980s. The Rajin-Sonbong free economic and trade zone will function primarily as an international cargo transit point, handling large volumes of transit goods shipped to and from foreign countries, particularly the Northeast Asian countries. Its second function will be to serve as a manufacturing center whose main activity will be the processing of exports. Third, the zone will become an international tourist area.

Foreign businesses are free to conduct economic and trade activities without restriction or control under the special regulations established by the state.

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Institutes, companies, enterprises, and other economic bodies from foreign countries are allowed to establish all types of businesses (not only equity and contractual joint ventures but also wholly foreign-owned enterprises) anywhere within the zone and to set up representative offices to conduct economic and trade activities.

Foreign investment is permitted in every sector, including industry, transport, telecommunications, science and technology, tourism, finance, banking, and commerce. The zone particularly encourages investment in export-processing enterprises that are aimed at overseas markets. Within the zone, foreign-investment enterprises can freely choose their management methods.

The corporate income tax rate is 14 percent in the free economic and trade zone, which is 11 percent lower than in other areas of the DPRK. Especially encouraged enterprises are granted a reduction of up to 10 percent in their income tax. In addition, every enterprise is exempted from income tax for three years from the year in which profits begin to accrue and is entitled to a reduction of up to 50 percent in income tax for the following two years.

A foreign investor may lease land in the zone for up to fifty years and employ the required labor force to develop the land. Also, the right to use land granted to the investor may be inherited by or transferred to a third party. In addition, foreign investors are permitted to bring raw materials, semi-finished goods, and parts for assembly into the zone duty-free, and process and assemble them in the zone for subsequent export or processing outside the zone.

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The overseas repatriation of profits earned legally from business activities and other legitimate revenues, as well as of assets invested and the proceeds from their sale, is permissible and tax-free. Visa-free entry is permitted for foreign nationals who come to the zone, and the Rajin, Sonbong, and Chongjin ports are free trade ports where people and vessels from any country may enter and leave.

Of course, the central government has placed in the free economic and trade zone various managerial systems and administrative measures that differ from other parts of the country. For example, the scale of production and the price of goods within the zone will be determined by the forces of supply and demand within the market. Therefore, successful economic reform in the zone will bring about markets for building and land, consumer commodities, and producer goods as well as capital labor markets.

For the development of the zone, foreign direct investment (FDI) is given priority over loans. This is based on the idea that FDI brings not only funds but also technology, business management skills, and market extension techniques, while foreign loans only provide funds. Changing economic conditions in China and the DPRK' s heavy dependence on Russian loans have also affected the DPRK' s preference for FDI. In the early stages of development, investments in real estate, tourism, traffic, transportation, commerce, and services have been relatively high, but are slowly decreasing. The industrial sector in the early stages is mostly comprised of labor-intensive companies such as electricity, electronics, textiles, and clothing, due to of DPRK' s low production cost compared to rising wages and labor shortages in these companies' home countries.

It is extremely risky for foreign companies other than Korean companies to enter the DPRK prior to the establishment of official diplomatic relations. However, Korean companies have not necessarily expanded their businesses into the DPRK for purely economic reasons (low wages, sufficient labor supply, and market opening). Sentiments concerning family and race are also a major reason for the entry of Korean companies.

Thus the main form of investment in the Rajin-Sonbong zone is Korean capital, including Korean-Japanese capital. Korean investment is crucial to the DPRK, just as much as Hong Kong and Taiwanese capital is to the sustained development of China.

At least in the early stage, the social welfare payments and the total wage bill (foreign currency) of the foreign-capital companies are paid to the government sector, which then pays salaries to the workers of foreign-capital companies with DPRK currency. Foreign-capital companies have high import/export reliance ratios in their early stages, but such reliance is gradually decreasing. This suggests that the procurement rate for raw and intermediate materials in the DPRK domestic market by foreign-capital companies is increasing. I predict the international balance of payments by foreign-capital companies in the zone to be in the deficit until the year 2010.

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Most foreign-capital companies want to enter DPRK as a 100- percent independently owned company. Because enterprises with 100 percent foreign ownership run into much friction with the DPRK government, at least in the early stages, some companies are opting for a merged-type ownership with the DPRK. However, merged-type companies do not operate for long, because the business management systems are quite different between partners.

The average age and education level of employees in the DPRK are high relative to those of China. The average age of employees is approximately 20 years old, and most workers have completed a high-school-level education. Because labor distribution is controlled by the government, wholly foreign-capital companies recruit laborers through indirect hiring. Gradually, however, the hiring rights of labor go to the company. Thus direct hiring will eventually increase.

Working conditions and education and training programs are basically the same as those in China. Workdays tend to be long and holidays tend to be few. Despite laborious working conditions, the absence rate is low since nonattendance is linked directly to pay. Since the production processes of foreign-capital companies that enter the zone usually involve only simple assembly, most companies do not offer skill-developing training, educational programs, or facilities. Thus companies' educational programs focus on on-the-job training (OJT).

In foreign-capital companies, the management of technology is performed generally by foreigners. However, because of cost reasons companies are decreasing the number of foreign-skilled laborers, teaching the skills to domestic workers as early as possible.

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Foreign-capital companies are offering job-rotation only to workers that appear likely to stay for a long time. With regard to promotion, an ability-oriented system is preferred to a seniority system; wages are paid based on ability and productivity. In comparing the power of middle-level managers, most foreign-capital companies offer them not only leadership but also the rights of decision for tardiness, absence, home leave, and personnel (hiring/firing).

Because it is not easy for a foreign manager to understand the different systems, customs, and values of DPRK in the early stage, most foreign-capital companies produce expert products. In this case, if these companies procure most of their machines and technology in the DPRK, the products are not competitive enough for the export market. Thus, foreign-capital companies depend entirely on imports for their production facilities, technology, and raw materials. However, this situation will improve as the industrialization of the DPRK progresses and foreign-capital companies set up their material factories in the DPRK.

The average monthly wage of ordinary laborers is about $80. This is relatively higher than that of China. Therefore, companies should not come to the free economic and trade zone solely because of low wages.

The levels of recreation facilities, factories, and the working environment in foreign-capital companies are a bit higher than those of DPRK companies.

Labor productivity is generally 60 to 70 percent of that of the foreign companies' home countries. This low productivity in DPRK results from: (1) the small number of skilled laborers, (2) the prevalence of equalitarianism (or communistic values), (3) the low educational level, and (4) the lack of management skills. Despite low productivity in DPRK, foreign-capital companies will realize profits because of low wages.

Under those situations, the transfer of advanced technology and management skills, as well as inter-industry related effects that DPRK expects to achieve through the free economic and trade zone, is proving difficult to realize.

However, foreign-capital companies that enter the zone function early on as connection points in the triangular relationship that consists of the Rajin-Sonbong free economic and trade zone, the DPRK' s internal areas, and the Republic of Korea (ROK). Through joint efforts, the free economic and trade zone and ROK are integrating gradually, at least on an economic level. In light of the fast-approaching unification of the Korean peninsula, this integration is a valuable achievement. In the long run, such efforts are expected to contribute to the strengthening and expansion of the East Asian economy and ASEAN. This structural change, which transforms the DPRK economy from a national to an international economic framework, will be a landmark in the history of the DPRK economy. EKR