

The Consequences of the Rajin-Sonbong Region's Market Economy on North Korea's Economic Structure: A Comparison with China's Economic Free Zone

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If the development of a special economic zone is realized while maintaining North Korea's political and economic stability, then the process of shifting to a market economy in this region will spread rapidly. The most significant and distinctive change brought about by the special economic zone is the concept of ownership and the economic management system.

As the development of the Rajin-Sonbong free economic and trade zone is being realized, it is expected that real estate firms will be liberalized to purchase and sell factories, warehouses, buildings, land, etc. In addition, a vast array of ownership relationships will be established.

In managing a special economic zone, the state must involve itself only in implementing long-term plans, introducing important projects, and issuing construction permits. All the other economic activities must be left to the market mechanism. Furthermore, a consumer goods market, production goods market, capital market, labor market, etc. will be created by the formation of a special economic zone.

From a long-run perspective, the market economy of the special economic zone is expected to induce North Korea's current system to adopt market principles, creating an economic bloc run by the logic of the market. It is also forecasted that when North Korea gains practical experience of a market economy system it

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will immensely contribute to reforming the current planned economy system.

Introduction to the Problem

In December of 1991 the North Korean government declared the Rajin-Sonbong region of the North Ham-Kyung Province to be a “free economic and trade zone” (hereafter referred to as a special economic zone). The primary motive for establishing the special economic zone was the importation of Western capital and technology as a means of activating the economy. The change in North Korea’s economic policy towards opening up to the West was its way of achieving modernization and industrialization. Given the context, the establishment of a special economic zone can be interpreted as North Korea’s first step in deviating from its past economic development model which emphasized autonomy and independence.

In this paper, we deal with numerous critical issues of the special economic zone, including mapping out the details of ownership and an economic management system, and how it should be operated, organized, and formed. Additionally, the paper will shed light on the impact the special economic zone will have on the development of North Korea’s present socialist economy.

The issues North Korea will face concerning its special economic zone will be analyzed by comparing it to China’s experience, it being a pioneer in the field of special economic zones. The primary reason for conducting a comparative study with China’s case is that both China and North Korea have basically implemented a special economic zone which retains the fundamentals of a socialist economy, while adopting some characteristics of a special zone for export promotion. In other words, North Korea’s special economic zone is fundamentally different from other special economic zones practiced by most capitalist economies.

Changes in the Form of Ownership and the Economic Management System

The most distinctive change brought about by the special economic zone policy is how the formation of ownership and the economic management system will change. The North Korean government's official stance is for the special economic zone to operate under the auspices of capitalism, completely separate from the internal economy. This being the case, the most fundamental difference between the internal economy of traditional socialism and the special economic zone is the ownership structure and the economic management system.

The Changes in Ownership Structure

If the special economic zone is based on the law legalizing the leasing of land that officially went into effect on September 7, 1994, then it will be possible to rent land (including buildings and the appurtenances) through tenders or public auctions. Although the state will still retain ownership of the land, the selling and purchasing of the right to use the land will be permitted. Accordingly, with the emergence of real estate companies, the buying and selling of real estate will actively develop. It is expected that the buying and selling of factories, warehouses, buildings, houses, land, etc. will be liberalized. The buying and selling of real estate is likely to take on the following characteristics.

In the case of houses, their market prices are expected to be determined largely by foreign enterprises and foreigners. North Koreans who are not officially registered with the government, as well as foreigners, are not eligible to receive state housing. Therefore, they will need to reside in company-owned houses purchased at market prices. Additionally, there will be many cases where foreigners (in particular North Korean immigrants) will purchase homes for their North Korean relatives or for speculative purposes. As development progresses, companies and individuals, who will have moved from other regions to the special economic zone, will increasingly partake in the purchasing

and renting of individual houses.

The buying and selling of the rights to use the homes owned by state enterprises or by the municipal government is also expected to gain momentum. Furthermore, the buying, selling, and renting of buildings and land will similarly be liberalized.

In examining the types of changes the ownership structure of land and buildings will undergo in the Rajin-Sonbong region, it is instructive to review the temporary land management provision that was enacted in the Shenzhen special economic zone of China in November of 1981. Due to this provision the real estate industry was revitalized, making the real estate industry responsible for 17.6% of total production of third tier industries in the Shenzhen region in 1993. Interestingly, 80% of real estate purchases and sales were transactions made by private individuals.

Changes in the Economic Management System

A fundamental principle for operating a special economic zone is to focus on the market mechanism rather than on a planned economy. In other words, the state needs to be involved only in initiating a long-term plan, introducing important projects, and issuing construction permits. Also, the materials the government needs to supply to the special economic zone, such as energy, should be incorporated in the government's plan. All other factors should be determined by the market.

(1) Consumer Goods Market

In order to improve the citizens' standard of living and income levels, the government needs to strive to establish a consumer goods market. Typical of such efforts are the activation of distribution channels and price reforms.

Article 22 of the Democratic People's Republic of Korea Free Economic and Trade Zone Law states that, "product prices within the zone should be determined in accordance with the buyer and seller of the product. And the prices of some daily necessities shall be determined by the government." In the special economic zone the pricing system will be different from that of other regions in North Korea. In other words, other areas, except for the special

economic zone, will be run according to the principles of a planned economy where the government determines and fixes prices. The case for the special economic zone is completely different. Gradually, price fixing will shift towards the market mechanism and the local government will be responsible only for determining the prices of a minimum number of necessities (important products). The prices of everything else will be determined independently and depend on the activities of economic agents.

More specifically, as stated by Article 22 of the Free Economic and Trade Zone Law, only the prices of bare necessities will be determined by the government. Other products, at first, will be subject to a floating price system where companies are allowed to change the price within the range predetermined by the local government. When the floating price system achieves relative stability, then prices will be completely left to be determined by the supply and demand of the market.

In the event that the price management system reform is successful, then the special economic zone's price system will shift from a system where both the state price and market price coexist to a single product-single price system. Furthermore, as the economy takes on more and more characteristics of a market economy, the role of the government will be restricted to monitoring and managing product prices determined by market forces.

(2) Production Goods Market

In a planned economy production goods are basically not considered commodities, and accordingly they are not allowed to be distributed in the market. Although the objective of the production goods regulation is to get them distributed to areas throughout the country, the demand for production goods will increase in the special economic zone as development occurs and large scale equipment investments are being made. In order to meet the growing demand for production goods, the government will need to import production goods either from other domestic regions or from abroad. If this is the case, there will be a large

price discrepancy among those distributed by the state, those taken from the domestic supply, and those imported from abroad. Consequently, the production goods market is likely to undergo mass confusion. In order to prevent such confusion and obtain stability in the supply and demand of production goods in the special economic zone, it is vital that a market mechanism for production goods be executed. Thus, there is no other alternative than to allow prices to be determined by the market.

(3) Capital Market

In a planned economy, the government adopts a system where profits and taxes from state enterprises all accrue to the central and local governments' finances. However, in the special economic zone financial institutions will take on a more significant role than the financial authorities. Each company, in order to overcome the limited capability of the financial authority, will have to borrow capital from banks or other foreign financial institutions. In fact, Article 32 of the Democratic People's Republic of Korea Free Economic and Trade Zone Law stipulates that, "foreign invested companies or foreigners are eligible to receive capital loans from North Korean or foreign financial institutions."

Additionally, financial institutions other than banks are expected to be established, such as investment trust firms, leasing firms, securities firms, insurance companies, etc. Their main services will include trust loans, investment, and leasing, but they will also provide services concerning domestic or foreign investment guarantees, real estate, securities, and business consulting.

Among these institutions, the establishment of securities firms will draw the most attention. This is because one of the central issues the financial market of the special economic zone faces is how to effectively utilize the small amount of capital that the residents retain from their minimal savings for investment purposes.

Another critical factor that cannot be omitted from the capital market is the foreign currency market. As it stands, foreign currencies and the North Korean Won have not achieved a

stabilized exchange rate, resulting in a substantial amount of foreign currency and North Korean Won appearing in the black market. This is a crucial problem with which the government's foreign exchange management system will be confronted. Accordingly, as the advancement of the special economic zone materializes, the foreign exchange control center must be prepared to meet the demands of both the consumers and suppliers of foreign currencies. Actually, Article 34 of the Free Economic and Trade Zone Law states that, "foreign invested companies and foreigners in pre-specified locations within the special zone can engage in the buying and selling of foreign stocks and bonds."

(4) Labor Market

Before the establishment of the special economic zone, the distribution and management of labor was controlled by the government. Therefore, companies are issued their labor supply through the labor management authorities, making it impossible for labor to move freely.

However, in the special economic zone, where pluralistic ownership exists and where the labor movement between companies with different ownership structures occurs, new problems will emerge such as maintaining the principles of a welfare society by guaranteeing wages, and an insufficiency in the labor supply, especially skilled labor. Under the present circumstances, it would be difficult for the government to solve these problems according to its present system of coordination and control. The government has no choice but to allow the establishment of an independent and liberalized labor market within the special economic zone.

The Significance of the Market Economy in the Special Economic Zone

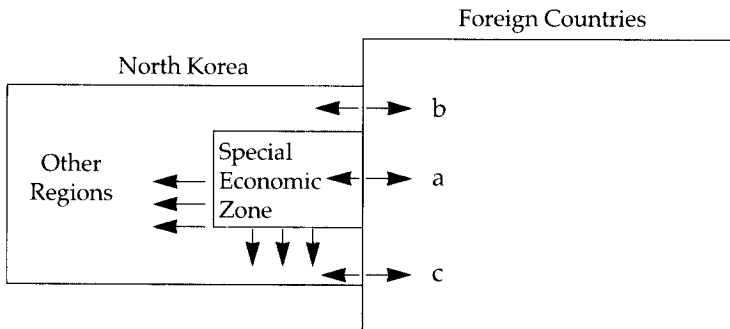
The effects the market economy of the special economic zone has on the North Korean economy are significant in two distinctive aspects. They are the significance of the special economic zone serving as a medium for the establishment of a new

economic bloc, and the significance of using the special economic zone as an experiment for structural reform of the system.

The Special Economic Zone as a Medium for a New Form of an Economic Bloc

As mentioned previously, as the policies of the special economic zone materializes, other domestic companies are expected to actively move into the zone. This inflow of domestic companies, in turn, will play an important role in helping attract foreign enterprises to the zone. More importantly, through these companies the transfer of advanced technologies, management skills, etc. of foreign companies will spread to all regions of the country. (Refer to <Figure 1>)

<Figure 1> The Tripartite Relationship Among the Special Economic Zone, Other Domestic Regions, and Foreign Countries



a: the most accessible route between North Korea and foreign countries
 b, c: less accessible routes

In addition, the development of the special economic zone will depend heavily upon other regions in securing agricultural products and construction materials. Also, in terms of labor supply, the zone will have to recruit more technicians and other labor from other regions, as the present population of 135,000 is expected to increase to one million.

In the long-run, the exchange of people and goods through the special economic zone can eventually lead to the creation of a regional economic bloc. The formation of an economic bloc, in turn, is expected to have a profound effect on the existing North Korean economic structure. The establishment of such a broad economic bloc that transcends existing administrative units signifies it is subject to market principles. In this respect, the special economic zone will play a prominent role as a mediator in establishing for the first time an economic bloc dictated by market principles.

The Special Economic Zone as an Experiment for System Reform

The gradual expansion of the principles of a market economy in the Rajin-Sonbong area can serve as an experimental case of reform for the North Korean economic structure, just as China's special economic zone had done.

Needless to say, the North Korean's official stance does not proclaim the Rajin-Sonbong region as an experiment for reform, because such a statement would be equivalent to admitting to the failures of their present economic system. By declaring the region an experiment for structural reform, it would present an image of the people's dissatisfaction with the current system. However, if the region is successfully operated, then the accumulated experience can gradually lead to the implementation of a structural reform program. North Korean leaders are well aware of the fact that structural reform is the only means by which they can solve their economic problems.

Conclusion

We have examined the expected changes in ownership forms and the economic management system within the Rajin-Sonbong Free Economic and Trade Zone. In its early stages of opening and reform, in order to ensure the region's stability, there may be a reluctance to reveal the blueprint of its plan to the external public. China also showed such reluctance during its early development period.

However, as development continues with the government's strong commitment to reform and opening, there must be a shift towards a market economy system in the ownership structure and economic management system. Additionally, with the spread of a market economy system, it will not only expand economic exchange and cooperation between North and South Korea, but also promote further interactions between North Korea and the rest of the world. In short, North Korea, by utilizing its special economic zone as a starting point for economic structural reform, will eventually join the international, global economy. ■