

STRATEGIES FOR INVESTING IN NORTH KOREA

Chung-Kyun Kim
(jkkim@hri.co.kr)

Based on North Korea's investment conditions and cases of the South's investment attempts, this article tries to analyze promising locations, industries, and investment methods.

With the arrival of the 21st century, a new atmosphere has emerged on the Korean peninsula. The inter-Korean summit held in June was the key event, bringing a mood of reconciliation and cooperation that has not been seen since the nation's division 55 years ago. The South-North summit is expected to be a starting point for shaking off the remnants of the Cold War and establishing peace on the peninsula.

After the summit, the most prominent issue has been South-North economic cooperation. The private sector-led cooperation efforts started with the present regime can only have a limited effect. For cooperation to expand, certain conditions should be fulfilled, such as legal and institutional mechanisms or formation of infrastructure. Of course, these issues should be faced by the involved parties of the South and North. However, opportunities for expanding economic cooperation have not been provided because of North Korea's reluctance to meet with the South. But after the summit it is expected that this difficulty will gradually be resolved.

With the opening of a new chapter in South-North economic cooperation, what are the investment strategies for South Korean firms? Based on North Korea's investment conditions and cases of the South's investment attempts, this article tries to analyze promising locations, industries, and investment methods.

Promising locations for investment

In selecting a location for investment, firms should consider the investing in the following sites.

From the North Korean perspective, where considerations of the harmful effects of opening to the political system are a large factor, coastal areas are probably preferable to inland areas.

First, coastal city areas that are near ports would be good locations. In the past, foreign firms investing in China mainly entered through coastal cities because of economic advantages such as ease of transportation, plentiful labor pool, and the use of industrial facilities. From the North Korean perspective, where considerations of the harmful effects of opening to the political system are a large factor, coastal areas are probably preferable to inland areas.

Another type of location is an area with a pre-existing industrial base. Industrial facilities in North Korea are currently in extremely poor condition and will be almost impossible to use. Despite this however, these regions will have some experience and mind-set in working in their given industries, and hiring workers in their respective fields will also be possible.

A third possible location would be one where the North could easily accommodate investment. From the view of North Korea, which is sensitive to the potential harm in

opening its economy, the country will prefer the South to invest in relatively “safe” regions. For example, the North would probably not approve of investment near military bases without a special reason.

Fourth, the region should have economic linkages with neighboring countries. Good examples are locations that can support North Korea’s industrial areas in special economic zones or that can act as ports due to their proximity to neighboring countries. In particular, areas that have convenient transportation because they are near national borders should be considered. In the past, China increased the effectiveness of its special economic zones by putting them in locations that have economic linkages with neighboring countries.

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A final consideration is ease of attracting personnel. Large cities that have a lot of universities or higher learning facilities are advantageous in this light.

Possible Regions

Pyongyang-Nampo Region: This region is North Korea’s capital region and South Koreans have already invested here. Its concentration of higher learning institutions gives the region an edge in personnel. The region also has a high population density, which gives it good potential as a market after its living standards rise.

Shinuiju Region: 80-90% of North Korea’s commerce passes through the Shinuiju region. It is North Korea’s international port of entry and is near China. This region is currently the most recommended to South Korean firms by the North. Shinuiju is divided into north (which is near China) and south.

Wonsan-Hamhung Region: Compared to other regions, the industrial base of Wonsan-Hamhung is focused on heavy industries. Therefore, in the first stage of economic cooperation which will center on light industries, this region will not be a priority site. Overall, the east coast region is less open than the west coast, and investment conditions are relatively poor.

Haeju-Kaesong Region: Because of its proximity to South Korea, investors in this region will be able to save on transportation costs and use South Korean energy. However, the location also has a high concentration of military bases, and from North Korea’s perspective, it will not be a good investment site.

Rajin-Songbong Region: North Korea previously designated this region as a special economic zone and tried to promote economic exchange. However, because of poor infrastructure, lack of an industrial base, and weak legal mechanisms, the region failed to attract foreign investment. It may have potential as a site for transportation or tourism investment.

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In light of the above conditions, the most promising regions for development seem to be the Pyongyang-Nampo and Shinuiju regions.

Table 1. Regional Rating of Investment Conditions

Economic Region	Social Overhead Capital	Industrial Base	Openness	External Linkages - Efficiency (by land)	Market Scale and Prospects	Prospects for Development
Shinuiji	B	B	A	A	B	A
Rajin-Sonbong	C	C	A	B	C	B
Pyongyang-Nampo	B	A	A	B	A	A
Wonsan-Hamhung	B	A	B	B	B	B
Haeju-Kaesong	C	C	C (A)	C (A)	B	C (A)

Note: 1) The ratings are relative and based on the authors opinion. A: Favorable B: Average C: Poor

2) The (A) ratings for the Haeju-Kaesong region would apply if North Korea allowed construction of industrial sites on the west coast.

Promising industries for investment

Industries should bring limited contact with outsiders and should also bring in foreign funds.

Industries for investment in North Korea should fit several criteria. First, they should have little effect on the North Korean system. Industries should bring limited contact with outsiders and should also bring in foreign funds. Potential industries include consignment manufacturing (such as electronics: phones, computer components, and TVs, software development, clothing, footwear, leather goods, toys, and bags), tourism, and transportation.

A second criteria is ease of attracting foreign funds. Industries should allow the earning of foreign funds with North Korea's existing resources (human and tourism resources). Consignment manufacturing, tourism, and software-related industries are promising in this respect.

Thirdly, industries that are needed for North Korea's economic recovery should be considered. These industries include agriculture, infrastructure, daily necessities (eg. clothing, toothpaste, toothbrushes, soap, and footwear), food products (eg. sugar, seasonings, and bread), and raw materials (eg. recycled goods).

Fourth, industries should be those included in the North Korean support efforts mentioned by President Kim in his Berlin Declaration. These include agricultural improvement industries (eg. fertilizer, agricultural equipment, seeds, and agricultural vinyl), and infrastructure (eg. energy, ports, railways, and roads).

Method and strategy of investment

In the early stage of investment, joint ventures are preferable to individual efforts by companies.

In the early stage of investment, joint ventures are preferable to individual efforts by companies. In particular, industrial areas in special economic zones will be the best method.

Considering North Korea's poor investment conditions and the fact that the situation will not improve greatly in the short term, small or medium sized firms should avoid entering ventures on their own. Few firms that have attempted consignment manufacturing or direct investment in North Korea have realized profits.

There are several types of joint ventures that can be considered.

One is a joint venture between large conglomerates and small or medium sized companies. In this scenario, small or medium companies can take advantage of a large conglomerate's knowledge of North Korea, and the time and costs associated with investment will be reduced. In addition, if such a joint venture takes place in an industrial site within a special economic zone, the site's management could help solve any problems that may arise.

A second type of venture is joint investment by firms from the same region. For example, firms from Pusan could form a "Pusan Regional Investment Group" or Taejon firms could form a "Taejon Regional Investment Group". In this case, firms could build an image for their respective regions in North Korea, and any problems could be tackled jointly by the regional group. In addition, regional groups should invest in industrial sites in special economic zones.

Thirdly, joint investment among firms in the same industry is possible. In this case, it is possible for firms to jointly create an image for their industry, and face problems together. Firms adopting this method should also try to invest in special industrial sites.

A fourth method is for firms to jointly invest with companies that already have entered North Korea. This method would allow new firms to save time and reduce risk by taking advantage of their predecessors' business experience and human networks.

Finally, Korean firms could pursue joint ventures with foreign firms. One possibility is joint investment with Chinese firms which already have experience in North Korean ventures. This method would reduce risk but domestic firms would have to investigate the reliability of their partners. Firms that already have relations with Chinese companies should examine this method.

In conclusion, the most promising investment method is to invest in industrial areas (special economic zones). Industrial areas (special economic zones) refer to areas that have social overhead capital, and legal and institutional mechanisms (eg. remittances, free passage of employees, or various preferential measures such as tax breaks). Such areas would operate on a different system than the rest of North Korea, and would guarantee the freedom of business activity. Small or medium sized firms, besides investing in industrial areas, should invest jointly with other firms from the same region or industry. Such an approach would allow them to solve problems and arrange transportation cooperatively. **VIP**

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