

# DPRK's Special Economic Zone Policies: Recent Development and Future Challenges

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## 1. Background and Progress

Three years since its announcement in 2013, the DPRK's Special Economic Zone policy has begun to take real shape. In his New Year's address, Kim Jong Un declared that the development of Special Economic Zones including the Wonsan-Mt. Kumgang International Tourism Zone (Mt. Kumgang Special Tourist Zone) would gain momentum, while an institutional and legal framework is being drawn up in the form of 14 new regulations (668 provisions), to be enacted to implement effective policy measures including infrastructure establishment and SEZ tax breaks. Efforts to invite foreign

capital are also gaining pace, as seen in the discussion of economic cooperation with Russia centered on SEZs near the DPRK-Russia border, investment briefings in China's Northeast region and the DPRK's Mt. Kumgang, and discussions on jointly developing special tourist zones on the DPRK-China border.

To be exact, the DPRK's SEZ policy is not a recent initiative. Headed by the designation of the Rason SEZ as a special zone in 1991, four central SEZs have been added to the list in the 2000s; since Kim Jong Un took power, one central SEZ and 19 regional SEZs were newly established.

This can be considered as the North Korean equivalent of China's opening up policy, characterized by a gradual shift from the establishment of SEZs and the designation of open cities for foreign investment, and expansion of the strategy to include broader regions across the country.<sup>1</sup> The establishment of regional SEZs is a foreign economic policy aligned with transition of economic policy on the domestic front, examples being the "6.28 Measures", "regional economic development" and "business autonomy", all of which can be classified under decentralization. Put simply, SEZ policy is emerging as a key economic policy under the Kim Jong Un regime.

SEZ development typically proceeds with the Rason and Mt. Kumgang SEZs – the two central SEZs that represent twin pillars – in the lead, with regional SEZs following suit by borrowing and tailoring the development plans of central SEZs. These zones are subject to preferential measures including tax breaks; such as on income tax (25 percent  $\Rightarrow$  14 percent for SEZs) and corporate income such as

tariffs or share dividends. In addition, high-quality but cheap labor also serves as a major investment stimulus for foreign investors. Efforts to attract foreign capital have become more aggressive in large-scale infrastructure projects, evidenced in the lower burden on foreign investors through the practice of BOT (Build-Operate-Transfer) methods. Interestingly, the Kaesong Industrial Complex and the Mt. Kumgang Special Tourist Zone are being actively referred to as successful examples, probably in an attempt to apply DPRK's experiences with South Korea in attracting Chinese and Russian investment and developing other regions across the country.

## 2. Core Projects in Major SEZs

### A. Central SEZs – Rason Special Economic Zone, Wonsan-Mt. Kumgang International Tourism Zone

At the center of focus since Kim Jong Un took power, the Rason SEZ is seeking to induce investment from China and Russia as an effort to develop the Chinese Northeast and Russian Far East regions; the ultimate goal is to transform the area into Northeast Asia's logistics, transport and tourist hub. Due to its historical, geographic and ethnic proximity, China's Northeast region is engaged in active economic cooperation with the DPRK. Rajin Port, situated in the Rason SEZ, is receiving particular attention along with Russia's Zarubino Port as an outlet to the sea from Jilin and Heilongjiang Provinces. Meanwhile, Russia is diversifying its economic cooperation with neighboring Rason SEZ, in line with the extension of the DPRK-Russia relationship from political friendship to economic cooperation. This can be witnessed in Russia's investment, development and long-term lease of Rajin Port's Pier 1 and Piers 3-5, growing in-

1 The 6 central SEZs are Rason SEZ, Kaesong Industrial Complex, Mt. Kumgang Special Tourist Zone, Sinuiju International Economic Zone, Hwanggumpyong and Wihwa Islands Economic Zone, Mubong (Mt. Baekdu) Special International Tourism Zone; the 19 regional SEZs include 3 in North Hamgyong (Chongjin Economic Development Zone, Orang Agricultural Development Zone, Onsong Island Tourism Development Zone), 2 in South Hamgyong (Pukchong Agricultural Development Zone, Hungnam Industrial Development Zone), 1 in Ryanggang (Hyesan Economic Development Zone), 2 in Chagang (Manpo Economic Development Zone, Wiwon Industrial Development Zone), 2 in North Pyongan (Amrok River Economic Development Zone, Chongsu Tourist Development Zone), 1 in Gangwon (Hyondong Industrial Development Zone), 1 in South Hwanghae (Kangryong International Green Demonstration Zone), 2 in South Pyongan (Chongnam Industrial Development Zone, Sukchon Agricultural Development Zone), 2 in North Hwanghae (Songrim Export Processing Zone, Sinpyong Tourism Development Zone), 1 in Pyeongyang (Unjong High-Tech Development Zone), 2 in Nampo (Wando Export Processing Zone, Jindo Export Processing Zone); by function, 12 are single-purpose industrial, agricultural, tourism and export zones, while 4 are multi-purpose.

vestment in Rason by private businesses in China's Northeast, and Russia's construction of power lines in the Rason SEZ to supply standby power from the Far East - a clear sign of China and Russia finding more diverse channels in approaching Rason. Furthermore, the newly established North Pole Route and

use of the new route crossing the Arctic Circle have added importance to Rason's geopolitical position, making it likely that Rason and the Far East will witness greater cooperation beyond the economic arena into military, political, and sociocultural sectors.

**TABLE 1. Key SEZ Policies**

Category	Highlights	
Basic Principles	1. Development in stages 2. Diversification in attracting foreign capital 3. Protection of the environment 4. Rational use of resources (i.e. land) 5. Enhanced global competitiveness in production and services 6. Guarantee benefits and convenience in business activities, and also social benefits 7. Ensuring sustainable, balanced development of SEZs	
Establishment and Operational Principles	<ul style="list-style-type: none"> <li>- SEZ establishment and operation to be aligned with national economic development strategies, and favorable toward international economic cooperation and exchanges</li> <li>- Maintain certain distance from national economy, technology development and residents, and prevent access or damage to state-protected areas</li> <li>- SEZ management authority divided between national and regional authorities; central SEZ authority responsible for the establishment.</li> <li>- SEZs to be supervised and managed by the central SEZ authority and Provisional People's Committees at the provincial or municipal (city) level</li> </ul>	
Business-related advantages	Guarantee business management	- Guarantee rights of and benefits for investing businesses; ensure free business activities
	Preferential policies for business activities	<ul style="list-style-type: none"> <li>- Freedom with respect to establishing, dividing and managing businesses</li> <li>- Preferential policies on land, labor, tax revenues</li> <li>- Additional benefits on investments involving infrastructure construction, high technology and global competitiveness</li> <li>- Priority in selection of prime land and tax breaks for long-term land use</li> <li>- Full income tax refund for businesses reinvesting in the same area</li> </ul>
	Income tax breaks	<ul style="list-style-type: none"> <li>- 14% discount on SEZ corporate income tax, 10% discount on national priority areas (25% for foreign businesses in non-SEZ regions)</li> <li>- Corporate income tax cuts for businesses that operate over a decade in SEZs</li> <li>- 50% income tax cuts on reinvestments for businesses with a 5+ year SEZ history based on margin reinvestments and new business launching</li> </ul>
	Import tax breaks	- 10% tax cuts on share dividends, interest, leases, patent imports (20% in non-SEZ regions)
	Benefits for priority businesses	- Priority offers for business management rights in tourism and accommodation sectors, tax benefits for infrastructure and social service facilities operation
Others	SEZ tariff benefits	- Non-tariff benefits and free import/exports: 1. SEZ construction material and support for commissioned processing, entrepot and compensation trade 2. Business product exports 3. Daily supplies necessary for business activities, nationally regulated support
	<ul style="list-style-type: none"> <li>- SEZ land lease available for up to 50 years, right to lease can be sold after lease termination</li> <li>- Freedom to carry foreign currency, generate legal profit and remit income</li> </ul>	

Source: LIM Ho Yeol and KIM Junyoung (2015).

The Mt. Kumgang Special Tourist Zone is likewise being given greater consideration under the Kim Jong Un regime as a development zone focusing on tourism. As a major source of the DPRK's foreign currency, tourism is an area towards which the DPRK devotes much care and attention. The Mt. Kumgang Zone is a site for a gamut of tourist-related infrastructure and facilities construction, and has established itself as the core area for a broader development plan that includes neighboring regional special zones. However, there is a low probability of foreign capital being secured for actual development, and even if this happens, doubts remain on whether any revenue will be generated through efficient operations within the zone.

### **B. Regional SEZs - Waudu Export Processing Zone, Chongjin Economic Development Zone**

The regional SEZs with highest growth potential are the Waudu Export Processing Zone, neighboring the DPRK's largest trade port Nampo, and the Chongjin Economic Development Zone, which is situated near Chongjin port, which comes in second.

The Waudu Export Processing Zone is a promising candidate as an export base to China, thanks to its accessibility to China's coastal cities - Dalian, Weihai, Shanghai, Tianjin - and its top-class infrastructure by DPRK standards, as well as its proximity to labor-rich Pyongyang.

As for the Chongjin Economic Development Zone, its position as the central city of North Hamgyong Province and its endowment of good infrastructure, expectations are that its frequent exchanges with China, Russia and Japan will help it become a logistics hub. However, since the regional SEZs are still in

their planning stages, it will be a long time before construction begins.

## **3. Subsequent Steps**

The DPRK government's determination toward SEZ development is remarkably strong, but at the same time is faced with sizable challenges. Learning from China's SEZ examples, it is evident that clear vision, revenue-securing mechanisms for investors, safeguard measures for protection of property rights, and successful case examples at the corporate level, are necessary. Another prerequisite would be a control measure against illegal acts by foreign businesses, by setting accounting standards and tax systems for those operating in the DPRK. In light of the recent drop in investment capacity following the economic slowdown in Northeast China and the Russian economic crisis, it is also critical to identify long-term investors. And since the mobilization of domestic capital is essential in support of the SEZs, the above endeavors will have to be accompanied by systematic efforts toward improving the financial system - realigning the fiscal and financial systems of the central and local governments, as well as founding new commercial banks.

The Korean government should focus on the long term when formulating cooperative measures with SEZs in the DPRK. If inter-Korean relations improve, a new model for economic cooperation could be built around the DPRK SEZs. Some examples would be the development of a logistics and passenger route including Rason following the establishment of the new North Pole Route; linking the Mt. Kumgang Special Zone and the Pyeong Chang 2018 Winter Olympic & Paralympic Games; utilization of the Waudu Export Processing Zone after the Korea-China

FTA is settled, and so forth. Finally, as China's transnational development initiative "One Belt, One Road" is implemented and the establishment of the Asian Infrastructure Investment Bank (AIIB) gains speed, the collective wisdom and cooperation of the two Koreas, China and Russia on Northeast Asian infrastructure, including in the DPRK, becomes more important. With this in mind, the Korean government should take a more forward-looking stance toward Northeast Asian development, in line with the launch of the AIIB.

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