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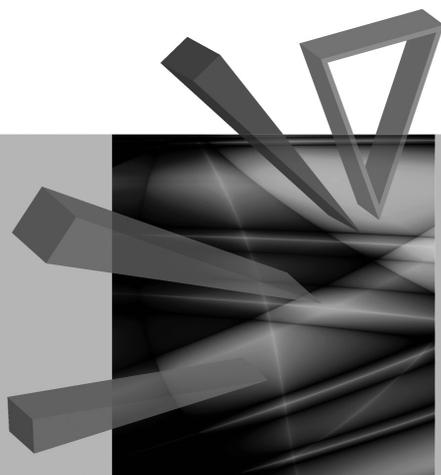
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Clusters, Networks and Markets in the Asia-Pacific Region



edited by

Anna H. Jankowiak

Szymon Mazurek

Bogusława Skulska



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Copy-editing: Agnieszka Flasińska

Layout: Barbara Łopusiewicz

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Contents

Introduction	7
Ken-ichi Ando: The dynamics of the industrial cluster facing the foreign expansion of the home multinationals, the changes of the automotive sector in Aichi and their reasons.....	9
Sebastian Bobowski: Knowledge cluster initiatives by MEXT – case of Tokai Region Nanotechnology Manufacturing Cluster in Japan.....	27
Anna H. Jankowiak: Micro, small and medium enterprises clusters and the regional development – case of India.....	41
Szymon Mazurek: Clusters in India as an instrument for enhancing the innovation, productivity and competitiveness of micro and small enterprises.....	50
Tomasz Bieliński: Development of internet social networks in China as a chance for European software developers.....	61
Günter Heiduk, Agnieszka McCaleb: Production, innovation, information networks in Asia: The role of institutions.....	72
Marta Najda-Janoszka, Karolina Nessel: Has the economic liberalization changed Filipino business networks? A case study of a small travel agency.....	83
Chris Weston: North Korea and its special economic zones: Re-establishing networks with the world economy?.....	93
Marta Wincewicz-Bosy: Networks of economic entities related to horse racing exemplified by the Japan Racing Association (JRA).....	109
Anna Żyła: The international production networks as a factor of growing investment attractiveness of ASEAN countries.....	119
Marcin Jałowicki: China’s luxury products market.....	130
Karolina Klupś-Orłowska: People’s Republic of China as a new direction for luxury goods brands producers based on the example of activity of Louis Vuitton Moët Hennessy.....	140
Karolina Łopacińska: The Chinese management model regarding enterprise competitiveness on the international market.....	150
Thanh Nguyen: Vietnamese fishing communities: Which solution between geographic advantage and conflicts over territorial sovereignty?.....	161

Streszczenia

Ken-ichi Ando: Klastry przemysłowe w kraju macierzystym korporacji transnarodowych na przykładzie japońskiego sektora motoryzacyjnego.....	26
Sebastian Bobowski: Inicjatywa klastra wiedzy MEXT – przykład klastra nanotechnologicznego regionu Tokai w Japonii.....	40
Anna H. Jankowiak: Klastry mikro, małych i średnich przedsiębiorstw a rozwój regionalny – przypadek Indii.....	49
Szymon Mazurek: Klastry w Indiach jako instrument wspierania innowacyjności i konkurencyjności małych i średnich przedsiębiorstw.....	60
Tomasz Bieliński: Rozwój internetowych sieci społecznościowych w Chinach jako możliwość rozwoju dla europejskich producentów oprogramowania.....	71
Günter Heiduk, Agnieszka McCaleb: Sieci produkcji, innowacji i informacji w Azji: rola instytucji.....	81
Marta Najda-Janoszka, Karolina Nessel: Czy liberalizacja ekonomiczna zmieniła filipińskie sieci biznesowe? Studium przypadku małego biura podróży	92
Chris Weston: Korea Północna i jej specjalne strefy ekonomiczne: nowe sieci powiązań z globalną ekonomią?.....	108
Marta Wincewicz-Bosy: Sieci podmiotów gospodarczych wyścigów konnych na przykładzie Japan Racing Association (JRA)	118
Anna Żyła: Międzynarodowe sieci produkcji jako czynnik wzrostu atrakcyjności inwestycyjnej krajów należących do ASEAN.....	129
Marcin Jałowicki: Rynek dóbr luksusowych w Chinach.....	139
Karolina Klupś-Orłowska: Chiny jako nowy kierunek ekspansji producentów dóbr luksusowych na przykładzie działań Louis Vuitton Moët Hennessy	149
Karolina Łopacińska: Chiński model zarządzania w aspekcie konkurencyjności przedsiębiorstw na rynku międzynarodowym.....	160
Thanh Nguyen: Wietnamskie społeczności rybackie: przewagi geograficzne i konflikty czy suwerenność terytorialna?	168

Chris Weston

Warsaw School of Economics

NORTH KOREA AND ITS SPECIAL ECONOMIC ZONES: RE-ESTABLISHING NETWORKS WITH THE WORLD ECONOMY?

Abstract: Since the 1990s, North Korea has sought to re-establish its network of commercial and economic relations with its near neighbours through the creation of Special Economic Zones (SEZs). The paper will look at the definition of “network” in the context of these relations with its neighbours and, in particular, with South Korea. The paper will consider the extent to which the SEZs have succeeded or not, through generating positive externalities, and the particular factors, both internal and external, that have affected their progress to date. At the heart of the paper is consideration of whether the SEZs constitute an opportunity or threat to North Korea and whether the authorities’ preference for foreign aid rather than foreign capital for pursuing its relations has served to diminish the effectiveness of the SEZ-based network of relations.

Keywords: network, externalities, special economic zones, North Korea, foreign investment, reindustrialisation.

1. Introduction

The purpose of this paper is to examine North Korea’s attempts to re-establish its network of non-aid related, commercial and economic relations with the outside world through the creation of Special Economic Zones (SEZs). As defined:¹ a network is “a hybrid type of governance structure consisting of independent actors that have a mutual interest and coordinate their activities to some extent. The actors in a network can have legal, economic, financial or personal relationships.”

A central (economic) benefit from establishing a network is the generation of positive externalities. Externalities are economic side effects not addressed by the market and consequently not reflected in the prices. In the context of SEZs, for example, we would observe a number of such positive externalities: with foreign

¹ J. Groenewegen et al., *Institutional Economics: An Introduction*, Palgrave Macmillan, UK, 2010, p. 374.

investment comes access to technology, management skills and enhanced human capital. The latter may include training in new technical skills, knowledge of “best practices” as well as engendering new modes of thinking about, but not limited to, business problems and how to address. There are also the benefits derived from “clustering effects” whereby around a foreign company will gather local suppliers and providers of goods and services who will also enhance their products and skills, and so on.

In this paper, we will look closely whether the above definition met the reality of the SEZs in North Korea and particularly pertinent, whether “mutual interest” actually existed in the relations established. Furthermore, the term “non-aid” should also be viewed with some caution in the underlying paper. The term is introduced to seek to exclude from the discussion that aid which has been provided historically over the period of the existence of North Korea as a separate state by its allies, China and the USSR (now the Russian Federation for the purposes of current relations) as well as by South Korea, Japan and the USA.

By “outside world” we mean primarily with its near neighbours: South Korea, China and Russia. The relations with these countries will be viewed, in turn, in their historical context in the first section.

The paper shall then move onto a description of the various principal SEZs as they exist: Rason with the Russian Federation; Keasong Industrial Complex in conjunction with South Korea; and a number of other SEZs with the People’s Republic of China. This might appear to have the flavour of a consultant’s “Investment in North Korea” report but seeks to provide some basic details on each as well as identifying common themes and issues.

The paper then seeks to examine the SEZs in the light of the evolving attitudes of the DPRK authorities. I will summarise these attitudes briefly here as follows:

- “Benign skepticism”: 1980s,
- “Anything goes”: 1991–1997,
- “Opportunistic anxiety”: 1998–.

These attitudes were to an extent an outcome of historical and cultural experience (as noted in earlier section), ideology (which is not explored here fully due to space constraints, but is examined through the very narrow prism of the leadership and its (half hearted) legislative efforts and, to borrow from an UK prime minister,² “Events”). The latter sometimes served to push the concept of SEZs along e.g., the fall of the Soviet Union and the growing *détente* with South Korea in the late 1990s, but also served to hinder their development at critical junctures. Of note is the interaction of various factors and influences on the evolution of SEZs in North Korea.

² When asked what he most feared as a politician, Harold Macmillan would respond in his Edwardian drawl: “Events, dear boy, events!”

2. Historical context

South Korea. The end of the Second World War saw the Korean peninsula divided by the victorious powers, the USA and the USSR, along the 38th parallel. It is important to note that Korea had been, as a whole, under the occupation of Japan from 1910 to 1945 with South Korea serving predominantly as the agricultural food basket for the country as well as Japan itself while the North was heavily industrialised and served as an essential component in the Japanese military-industrial complex.³ Following the Korean War of 1950–1953, both north and south underwent considerable reconstruction – with the North carried out under the auspices of China and the USSR, and achieving its own economic miracle in restoring its heavy industry base. From the mid to late 1960s, the fortunes of both sides then sharply diverged as the South underwent its own industrialisation and achieved significant growth thereafter.

The USSR (and its successor, the Russian Federation). As noted above, the USSR was intimately involved in the creation of North Korea.⁴ It remained throughout, despite some ups and downs arising from Sino-Soviet split, a firm supporter of the regime. Soviet economic assistance to North Korea was considerable: it supplied experts from both the USSR and friendly countries to help construct and run major industries – according to P. Mceachern,⁵ post 1953, Moscow provided assistance in constructing 93 heavy industrial factories in the country; it supplied crude oil at subsidized prices and spare parts for free; and it bought goods from the country at prices above their worth as another form of subsidy. It is interesting to note that, notwithstanding their close economic relations, North Korea rejected the chance to join the Comecon, preferring to concentrate on developing its own heavy industry base as part of its own emphasis on establishing its defence capabilities. The collapse of the USSR in 1990–1991, which led to the removal of subsidies and aid constituted a significant economic shock to North Korea – bilateral trade fell from US \$ 2.56 billion in 1990 to US \$ 0.14 billion in 1994 and industrial output in the state sector fell by around a half between 1990 and 2000.⁶

China. Aside from providing considerable military assistance to North Korea in the war of 1950–1953 thus enabling the regime's survival, China was to play a

³ E. Brun, J. Hersh, *Socialist Korea: A case study in the strategy of economic development*, *Monthly Review Press*, USA, 1976, p. 57: "In Korea, the alliance of Japanese finance capital with militarism was complete"; A. Lankov, *The Real North Korea: Life and Politics in the Failed Stalinist Utopia*, Oxford University Press, Oxford 2013, p. 69.

⁴ See A. Lankov, *From Stalin to Kim Il Sung: The Formation of North Korea 1945–50*, Hurst, London 2002.

⁵ P. Mceachern, *Inside the Red Box: North Korea's Post Totalitarian Politics*, Columbia University Press, New York 2010, p. 67.

⁶ A. Lankov, *The Real North Korea...*, pp. 76, 77; P. Mceachern, *op. cit.*, p. 192, estimates a loss of 80–90% of industrial capacity in the 1990s.

substantial role in the country's reconstruction. According to K. Oh and R.C. Hassig,⁷ Chinese volunteers provided 5 million days of labour in the post-1953 period up to their withdrawal in 1957. To prevent the risk of the regime's collapse in the wake of the withdrawal of Soviet assistance in 1990–1991, China stepped in to provide considerable assistance, which accounted for 70–90% of North Korea's energy aid and one-third of its food aid.⁸

As will be seen, the SEZs can be viewed in the context of reactions to both events internally and externally, and an attempt (half-hearted in retrospect) to re-establish economic relations with its near neighbours.

3. Rajin – Sonbong Special Economic Zone (Rason SEZ)⁹

The Rason SEZ, comprising 621 km², is located in the far northeast of the Democratic People's Republic of Korea ("DPRK" or "North Korea") along the Tumen river, bordering on both China and the Russian Federation (a map of this and other SEZs is set out overleaf – Figure 1). The zone was located within a larger area designated by the UN Development Programme in 1990 as an international development area. It has been a legal entity since 1991. The region has an abundant, cheap and (reasonably) well educated workforce as well as the region's northernmost year-round, ice-free port of Rajin (or Najin in map under South Korean spelling).

Despite its early establishment (Sinuiji was established in 2002 and Kaesong Industrial Complex in 2003/4), the Rason SEZ has been subject to several "stop-go's" through either foreign investor disinterest or poor infrastructure or second thoughts by the North Koreans on the benefits of opening up, or even a combination of all of the above. It therefore never really realized its full potential as a result. In 1991–1992, there was talk of foreign parties investing up to US \$ 2 billion – the DPRK envisaged a 3-stage infrastructure development between 1993 and 2010 of up to US \$ 3.3 billion, but by 2000, the total volume of foreign investment amounted to just US \$ 35 million.

A single lane connected Rajin to Sonbong while a "magnet" to attract Chinese tourists through the opening of a casino failed as the Chinese government demanded its closure following a number of scandals involving embezzlement of monies. The

⁷ K. Oh, R.C. Hassig, *North Korea: Through the Looking Glass*, Brookings, Washington, DC, 2000, p. 156.

⁸ P. Mceachern, *op. cit.*, p. 70.

⁹ See A. Abrahamian, *Report on Rason Special Economic Zone*, September 2011, Choson Exchange, <http://chosonexchange.org/wp-content/uploads/2011/09/Choson-Exchange-Rason-Report-August.pdf>; A Lankov, *The Real North Korea...*, pp. 170, 171; K. Oh, R.C. Hassig, *op. cit.*, p. 64; K.-A. Park, S. Snyder (Eds.), *North Korea in Transition: Politics, Economy, and Society*, Rowman & Littlefield, Lanham, MD, 2013, p. 227; D. Thompson, *Silent Partners: Chinese Joint Ventures in North Korea*, February 2011, http://uskoreainstitute.org/wp-content/uploads/2011/02/USKI_Report_Silent-Partners_DrewThompson_020311.pdf, pp. 4, 25, 26, 31–41.



Figure 1. Map of North Korea showing principal Special Economic Zones (Hwanggumphyong-Wihwa Islands located in vicinity of Sinuiju)

DPRK sought to exercise greater control over what vendors could sell in the zone while there were few efforts undertaken to coordinate the development with China and Russia.

However, since late 2010, there has been renewed interest in the zone with greater autonomy being granted through an amendment to the Law of the DPRK on the Rason Economic and Trade Zone. The Chinese provincial governments of Jilin and Liaoning (which abut North Korea) had invested in their own infrastructure in anticipation of increased commerce with the DPRK and to take advantage of the Rajin port. The three northeastern Chinese provinces are landlocked so the nearest Chinese port to ship goods overseas from these provinces is either Dandong or Dalian – almost 1,000 km away.

In particular, the Rajin port, which has 3 terminals and 5 piers, has attracted a significant amount of foreign interest. In December 2010, a Chinese company signed a Memorandum of Understanding¹⁰ to invest up to US \$ 2 billion in the port, the Musan Iron Mine (Asia's largest open-pit mine) and to construct a power plant.

¹⁰ Note a MOU is not a binding contract – more a detailed letter of intent. We shall see if the MOU is followed through on.

Chuangli Group obtained the right of exclusive use of Pier No 1 and it is reported that the Chinese will construct a further two piers. A Russian company owns a further pier and has invested, it is believed, up to US \$ 1 billion.

There are also rail and road upgrade projects – including a widening of tracks to match Russia’s gauge.

As part of the wider engagement of Chinese business in North Korea, there is also a plan to develop in the region 4 major industrial complexes consisting of a storage, logistics and distribution centre, as well as projects in clothing, food manufacturing, petrochemicals, cars, machinery, shipbuilding and high-tech.

A key component of the above plans is the desire, particularly by Chinese companies, to avail themselves of the relatively cheap labour offered by North Korea. This has come to the fore more recently in the light of increased employment costs in China. It has been estimated that the cost of textile assembly is around 30% cheaper than in northeast China. The port facility of Rajin represents however both an opportunity as well as a weak link given the urgent need to upgrade and enhance North Korea’s inadequate infrastructure. While Chinese companies may be willing to do business and extend their business network into the DPRK, the considerable outlays required for infrastructure, particularly in respect of transport, may yet temper their eagerness to enjoy this competitive advantage.

4. Sinuiju Special Administrative Zone (SAZ)¹¹

The Sinuiju SAZ was established under the basic Law of SAZs in September 2002 alongside the Kaesung Industrial Complex (see below) and the Mount Kumgang Tourist Resort Zone. Sinuiju is a border city with China in the northwest (see Figure 1).

On the face of it, this SAZ represented a singularly bold move by the characteristically ultra North Korean leadership. The project leadership was handed to Yang Bin, a Chinese businessman with Dutch citizenship – reputedly China’s second richest man. Yang Bin’s intention was to create a “Macau of the North” and to establish a casino – again a “magnet” for Chinese tourism. Shortly after the plans were announced, Yang was arrested and jailed by the Chinese authorities for tax evasion. It is understood that the North Koreans had not discussed with the Chinese theirs, and Yang’s, plans for Sinuiju and had attracted China’s ire for pursuing a plan that might have infringed on the interests of China’s northeastern cities.

In 2011, it was announced that a Special Economic Zone in Sinuiju would be relaunched.

¹¹ A. Lankov, *The Real North Korea...*, pp. 171, 172; K.-A. Park, S. Snyder (Eds.), *op. cit.*, p. 227; V. Cha, *North Korea: The Impossible State*, Bodley Head, London 2012, pp. 137, 138.

5. The Kaesong Industrial Complex (KIC)¹²

This is an industrial park located in the DPRK near to the demilitarized zone between the DPRK and the Republic of Korea (“ROK” or “South Korea”), 106 miles south of Pyongyang and just 43 miles north of Seoul. As at the end of March 2013, when tensions between the DPRK and South Korea led to its closure, it employed 54,000 North Korean workers (plus 1,000 South Koreans) at 123 South Korean operated factories. In 2010, around US \$ 1.4 billion, or 76% of total intra Korean trade, was conducted through the KIC.

The KIC was the product of the “Sunshine polices” conducted by the South Korean President Kim Dae-Jung (1998–2003) and his successor, Roh Moo-Hyan (2003–2008) as part of the process to re-engage with the DPRK in the light of reduced tensions following the 1994 nuclear agreement. Indeed, it might be argued that the KIC represented a major (and probably, the most successful) element of drawing North Korea into the network of commercial relations which had been disrupted by the partition of the Korean peninsula following the Second World War.

According to Cha, Kim Jong-Il had previously sought to persuade Chung Juyung, the founding Chairman of Hyundai, the largest South Korean conglomerate, and a native of North Korea, to invest in Sinuiju in northwest Korea. Hyundai had carried out a feasibility project on Sinuiju but had failed to establish a business case and in 1998 had opted instead for the KIC project.

Groundbreaking occurred in June 2003 and again in April 2004. The start-up costs amounted to US \$ 374 million, of which 40% was borne by Hyundai and the balance by the South Korean government. At present, the KIC has much of the infrastructure, e.g. electrical facilities, to enable the completion of a first stage site of 800 acres that would employ around 100,000 North Korean workers in 300 firms. The project master plan envisaged, on completion, a build out to 6,000 acres of industrial space and a further 6,000 acres of supporting zone with shops, residential areas and tourism & recreation facilities, with 2,000 firms, 500,000 North Korean workers and US \$ 20 billion per annum in products.

South Korean companies receive incentives from the South Korean government, including low interest loans, guarantees and political risk insurance, as well as reduced corporate tax rates. The KIC is a duty-free zone with no restrictions on the use of foreign currency or credit cards; no visa are required.

Over half of production of the KIC is represented by textiles and clothes with a further 20% each generated by electronic products as well as by metals & machinery. The South Korean firms involved in the KIC are substantially only small and medium sized entities.

¹² See M.E. Manyin, R.K. Nanto, *The Kaesong North-South Korean Industrial Complex*, 18 April 2011, Congressional Research Service; A. Lankov, *The Real North Korea...*, pp. 165, 167–170; K.-A. Park S. Snyder (Eds.), *op. cit.*, p. 158; V. Cha, *op. cit.*, pp. 145–147; see Hope glimmered where North and South met, *International Herald Tribune*, 6 May 2013, for details on March 2013 data.

Roh's successor as President, Lee Myung-Bak, cancelled a number of inter-Korean cooperation projects, including a major expansion of the KIC, as he sought to link such projects to progress on denuclearization and human rights. Despite tensions over the years, including the sinking of a South Korean naval vessel and North Korean shelling of a South Korean island,¹³ the KIC remained open until recently.

Its closure in April 2013¹⁴ therefore came as a surprise given an assumption that "no matter what," the DPRK would seek to keep the complex open as it stood to forego almost US \$ 90 million in hard currency funding it derived from the South Korean as "employer" of the North Korean workforce.¹⁵

6. Hwanggumpyang and Wihwa Islands¹⁶

These are located in the northwest on the Yalu river near to Sinuiju and opposite the Chinese border city of Dandong. Despite a technical assessment by Chinese that the Hwanggumpyang island was prone to flooding and therefore it would be doubtful if any economic benefits would be derived, plans were proceeded to further enhance Chinese-DPRK economic relations.

Ground-breaking took place in May 2011 and a lease for the use of the Hwanggumpyang island for 50 years was granted to the Chinese (with an option to extend for a further 50). The Supreme People's Assembly issued a Decision of Development in June 2011.

The islands are to serve as a hub for light industry and, in particular, software outsourcing. It is envisaged that four major industrial complexes will be built for information, tourism and culture, modern protected agriculture and food processing, and light manufacturing.

7. Evolving attitudes and events affecting the SEZs

As noted earlier, these can be outlined as follows:

- "Benign skepticism": 1980s,
- "Anything goes": 1991–1997,
- "Opportunistic anxiety": 1998–.

¹³ The sinking of the *Cheonan* took place on 26 March 2010; the shelling of the western island of Yeonpyeong in November 2010.

¹⁴ See: S.A. Snyder, Kaesong closure and US-South Korea Summit, *Asia Unbound*, Council for Foreign Relations, <http://blogs.cfr.org/asia/2013/05/02/kaesong-closure-and-the-u-s-south-korea-summit/> (retrieved 4.06.2013).

¹⁵ See: North Korea seeks talks with firms at idled site, *Wall Street Journal*, 29 May 2013. The KIC reopened in mid September 2013.

¹⁶ K.-A. Park, S. Snyder (Eds.), pp. 227, 228.

North Korea's approach to SEZs can be viewed through Kim Jong Il's own statements. In 1982,¹⁷ he noted in his treatise *On the Juche idea*: "Building an independent national economy on the principle of self-reliance does not mean building an economy in isolation. An independent economy is opposed to foreign economic domination and subjugation; but it does not rule out international economic cooperation." At the time, Kim Jong Il served as the ideological chief on behalf of his then ruling father, Kim Il Sung. The wording used suggested a modest move to permit such networks but it was hardly a ringing endorsement of the concept, as being pursued wholeheartedly by the Chinese under Deng Xiaoping. Nevertheless, in September 1984, an Equity Joint Venture Act, based on China's own legislation, was passed.

But as we have seen, no SEZs were pursued as the leadership's inherent caution held sway. While the ideological basis for such a concept had been provided, the prevailing mood was of a "wait and see.. The decade of the 1980s for North Korea became one of near stasis as the recourse to large scale projects suggested an element of malaise in the higher leadership circles – a search for a legacy by a leader who had been in power for almost 40 years or perhaps a North Korean form of "bread and circuses" for the populace.¹⁸

The 1990s opened with the demise of the Eastern bloc and the fall of the Soviet Union. With the USSR's insistence on a cash payment basis from 1990–1991, the DPRK could no longer avoid to import one million tons of oil per annum that had been previously provided for free by the USSR or the spare parts necessary for Soviet built factories that accounted for 40% of DPRK's industrial products.¹⁹ Bilateral trade with the USSR fell from US \$ 2.56 billion in 1990 to US \$ 0.14 billion in 1994. Or put another way, trade with the USSR had accounted for 50% of North Korea's trade volume but in the 1990s, this fell to just 3%.²⁰ Trade with China also became subject to a cash only basis. The North Korean economy faced near collapse.

The adverse circumstances faced by the regime would lead to a search for alternatives – an "Anything goes" attitude arose. At first sight, the above-mentioned Equity Joint Venture act had represented a breakthrough but it was not until 1992 that the constitutional grounds for such an act were explicitly provided for through Articles 16 and 37 of the constitution. That said, the Rason SEZ was announced by the Cabinet prior to the 1992 constitutional amendment reflecting a speedy attempt

¹⁷ A. Buzo, *The Guerilla Dynasty: Politics and Leadership in North Korea*, IB Taurus, London 1999, p141

¹⁸ For example, in 1989, North Korea chose to hold the World Festival of Youth & Students, which required spending of over US\$ 4.5 billion. Perhaps even a combination of both with a Keynes style public works programme to address mounting unemployment?

¹⁹ K. Oh, R.C. Hassig, *op. cit.*, p. 155.

²⁰ J.L. Fuqua, *Korean Unification: Inevitable Challenges*, Potomac Books, Washington, DC, 2011, p. 55.

to move on an avenue for foreign investment with its near trading partners. However, Russia was undergoing the pains of market transformation – undoubtedly viewed with deep unease by the DPRK, while China was itself growing increasingly integrated with the global economy and concentrating on attracting its own foreign investment.

A further series of shocks, including the death of Kim Il Sung in 1994, followed by three years official mourning by his son and successor, Kim Jong Il; and a further shock (or subset of shocks) took place between 1995 and 1997 when extreme weather in the form of devastating floods and drought struck the country in quick succession. Many people died in the ensuing famine as the grain supply fell by a half – the exact number of victims is not known but some estimates place the numbers in several hundred thousand; other estimates place the victims at over a million. Given the leadership transition and the series of disasters, policy innovation would not rank high among the priorities of the regime. But notwithstanding, the constitutional grounds for establishing SEZs was added to Article 37 in 1998. However, all cabinet decisions, Supreme People Assembly laws, acts and constitutional amendments were (and still are) however “trumped” by Article 11 which states that the “DPRK shall conduct **all** activities under the leadership of the Workers Party of Korea” [bold emphasis added].²¹

The warming of relations with South Korea in the late 1990s, as encouraged by the then Clinton administration, would lead to progress in the area of SEZs. For example, the Kaesong Industrial Complex arose out of the “Sunshine policy” as well as reduced tensions in the 1990s. The North Korean government had proceeded with the 7/1 reforms in 2002 which, inter alia, also promoted SEZs. However ongoing tensions – particularly post 2008, led to a slowdown in the expanded development of the KIC and the resort by the North Korean authorities in late 2010 to seek to expand the Rason SEZ in conjunction with China and Russia, the announcement of relaunching the Sinuiju SEZ in 2011 as well as proceeding with the Hwanggumpyang island development – the latter two projects with China.

That said, questions remain as to whether the recent moves will amount to anything concrete in terms of enhancing the network of relationships. As has been observed, the Rason SEZ was launched with much fanfare in 1991 but led to few concrete investments notwithstanding Chinese interest in developing better ties with the northeast. While there have been moves by the Russians and Chinese to develop the Rajin port itself, there still remain substantial infrastructure investments to be undertaken to realize the benefits from the port. The North Koreans appear to wish to wait for foreign investors to undertake the (significant) financial commitments

²¹ P.H. Park, *The Dynamics of Change in North Korea*, Kyungnam University Press, Seoul 2009, pp. 45, 46, 52, 54. Thus a proposed replacement of “rule of man” by “rule of law” appeared in *form* while the *substance* remained unchanged.

required. This might have taken place if the warmer relations with the Japanese had led to a resolution of outstanding issues arising from the Japanese colonial occupation pre 1945. Such a resolution would have entailed significant Japanese aid in the form of infrastructure construction by Japanese firms. This however was stymied by “events” in the form of a burgeoning scandal arising from North Korean disclosures of it kidnapping Japanese citizens from their mainland and spiriting them to North Korea for intelligence purposes. The Japanese populace was outraged and assistance for reconstruction was accordingly blocked.

We can therefore observe the most recent phase of North Korean attitudes, as embodied in the phrase “Opportunistic anxiety.” The regime could foresee the *opportunities* of infrastructure upgrade, cash inflows to government, significant foreign investment (by historical comparison) and other network effects. But there was also *anxiety* over other externalities arising – the exposure of its citizens to “best practices” of the South Koreans, – constituting an alternative path of development from that pursued by North Korea, as well as behaviours and attitudes adopted by the Russians and particularly the Chinese, who had pursued their own path of “market socialism.”

The *opportunities* can be demonstrated by the Kaesong Industrial Complex (as well as the Mount Kumgang Tourist Resort Zone²²) which required substantial investment outlays by the South Korean government and Hyundai – we have seen the KIC investment was US \$ 400 million while the tourist resort zone investment amounted to US \$ 1.4 billion. Given the amounts involved and their significance to the SEZ projects, it might be argued that the “dividing line” between what constituted “aid” and did not, had become considerably blurred.

Indeed, the regime demonstrated a marked preference for aid rather than foreign capital – the latter described in a party organ as “like opium,”²³ for the purposes of re-establishing its network with its neighbours and other countries, e.g. the USA and Japan. According to Fuqua,²⁴ between 1998 and 2003 South Korea had provided US \$ 1.2 billion of food, fertilizer and other aid. Between 1998 and 2008, North Korea ranked third for receiving international food assistance after Ethiopia and Bangladesh.

²² I have not dealt with this tourist complex built by Hyundai as it is not a SEZ. That said, it represented another form of network established between the two Koreas which was of mutual interest: South Koreans visited a region closed to them since 1953 while the North Koreans generated sizeable tourism revenues of US\$ 80–85 million per annum. It closed in July 2008 when DRPK guards shot dead a female tourist inadvertently trespassing in a restricted beach area.

²³ K. Oh, R.C. Hassig, *op. cit.*, p. 79.

²⁴ J.L. Fuqua, *op. cit.*, pp. 8, 52. For details of the US and South Korean aid to DPRK, see K.-A. Park, S. Snyder (Eds.), *op. cit.*, Tables 6.2 & 6.3, pp. 134, 135. For details of international assistance pre 1998, see S.-Ch. Kim, *North Korea under Kim Jong Il: From Consolidation to Systemic Dissonance*, State University of New York Press, Albany 2006, Table 1.2, p. 22; see also chapter 6 re “Political Economy of Aid” in S. Haggard, M. Noland, *Famine in North Korea: Markets, Aid and Reform*, Columbia University Press, New York 2007.

Another facet of the KIC serving as quasi aid was the increased *sensitivity* of the regime to claims, surely not without some foundation, that the regime substantially benefited from this SEZ as the North Korean employees' wages and other fees were paid directly to the government in the DPRK which, after making certain deductions, paid over the net (and much reduced) amount to its citizens. Such claims as well as heightened tensions (see next paragraph) with the West and South Korea arising from a series of incidents and testing of missiles and nuclear bombs, fed into the regime's *anxiety* which would lead to the closure of the KIC for the better part of five months during 2013.

The ongoing tensions²⁵ – particularly post 2008, also led to a slowdown in the expanded development of the KIC and the resort by the North Korean authorities in late 2010 to seek to expand the Rason SEZ in conjunction with China and Russia, the announcement of relaunching the Sinuiju SEZ in 2011 as well as proceeding with the Hwanggumpyang island development – the latter two projects with China.

Thus, SEZs had become less an instrument in developing network relations to further economic objectives than a “hostage” to the frictions arising from North Korea's increasingly fraught external relations and events. This was also likely “aided and abetted” by manoeuvring at the highest levels of the regime. We have seen that any progress in the Equity Joint Venture act and SEZs was “placed on hold” as Kim Jong Il sought to solidify his position in the leadership after 1994. Given the reliance on the military to ensure this process went smoothly, it would be hard to imagine innovative policies to open the country to foreign (and therefore, according to the KPA's worldview, malign) influence to have taken place. Fast forward to 2010 and 2011, when Kim Jong Un was being positioned to take over from an ailing Kim Jong Il, we can observe a near symmetry of events to that in 1994 – heightened tensions leading to questions over SEZs.

One area to highlight is the military's involvement in the area of SEZs. It might be argued that such involvement was likely to ensure the military might *benefit* directly from such arrangements or, at least, obtain their tacit support. One example being the Tae'pung Investment Group, which was close to the top organ, the National Defence Commission, headed by Kim Jong Il (and now, Kim Jong Un), and which would serve as a means to generate foreign investment. This group effectively became defunct given the wide ranging sanctions by the US and UN against bodies and individuals linked to the nuclear and ballistic missile programmes. Increased sanctions have made the search for western foreign investment and particularly South Korean linked SEZs almost impossible to pursue.

²⁵ The sinking of the *Cheonan* took place on 26 March 2010; the shelling of the western island of Yeonpyeong in November 2010. More recently, nuclear and missile tests prompted strong international action that culminated in the (temporary) closure of KIC. See also North Korean posturing, picking up steam, *The Economist*, 21–27 September 2013.

8. The DPRK's External Trade position²⁶

North Korea had experienced minimal dependence on external trade, which amounted to 10% of GDP. That said, trade volumes experienced annual growth of 11% between 2000 and 2010, compared with average growth in GNI of just 2%. The country increased its trade dependence with China where trade increased from just US \$ 610 million in 1991 to US \$ 3.5 billion in 2010. The 2000s also saw increased trade between North and South Korea. Taken together, DPRK's trade with China and South Korea accounted for 88% of total trade in 2010.

This trade had a number of consequences: firstly, North Korea's trade deficit increased from an average of US \$ 490 million between 1990 and 1999, to US \$ 1.04 billion between 2000 and 2010. The trade surplus with South Korea (arising principally from exports from the KIC to South Korea – in 2010, around US \$ 1.4 billion, or 76% of total intra Korean trade, was conducted through the KIC) was being employed to meet a considerable trade deficit with China.

Thus, the KIC had become, irrespective of the leadership's intentions or desires, an important element of the DPRK's economy given it generated a surplus to settle an increasing trade deficit with its largest neighbour, China. Irrespective of ideology and the primacy of politics, the DPRK had encountered the power of economics to affect its decision making and calculus of foreign relations. To avoid *tributary state* status, it would need to reopen the KIC and engage with South Korea on SEZs and reopening the Kumgang resort after all.

9. Other issues arising

At the onset, it was noted that the inclusion in the definition of “mutual” might require qualification. In the instance of China post 1978, we can observe the opening of the country to Foreign Direct Investment did lead to the parties on all sides enjoying “mutual interest.” From the Chinese side, it attracted long overdue investment, access to technology, management and skills, while, broadly speaking, both western companies and consumers reaped considerable benefit from respectively reduced costs and lower prices for goods. China had developed its network by re-entering the global economy in conjunction with foreign companies and investors.

This cannot be said in the case of North Korea. In contradistinction to China, there was (and is) an absence of a Vision-Strategy-Policy-Action continuum, as exemplified in China's case by the top level support of Deng Xiaoping, the Go Mu trip, the Four Modernisations and the opening of zones in Guangdong and Fujian.

²⁶ See Ministry of Unification, *2012 Understanding North Korea*, Institute for Unification Education, Seoul, pp. 192–198.

As E.F. Vogel noted:²⁷ “Within three decades after Guangdong and Fujian were granted special status, Chinese exports had multiplied over one hundred times, from less than US \$ 10 billion per annum in 1978 to US \$ 1 trillion, with more than one-third from Guangdong. In 1978 there were virtually no factories in Guangdong with modern assembly lines.”

Indeed the absence of concrete support from the Kims, poorly designed legislation, inadequate infrastructure and an inability to maintain relations with South Korea, had sharply restricted any benefits to be derived from positive externalities through establishing networks with its neighbours.

As can also be seen from the KIC (where over half of firms and products are textile related) and potential Chinese interest in Rason for textiles, it remained a curious facet of the SEZs (and of the DPRK’s economic trajectory) that, despite the DPRK being one of the most industrialized countries in East Asia in 1945, it had been forced to retrace the steps of industrialization taken by other countries, e.g. the UK in the late 18th and 19th century,²⁸ through involvement in the textile industry.

10. Conclusion

As can be summarised, the attempts to open the North Korean economy have “ebbed and flowed” in the light of both internal and external events, as reflected in the changing attitudes ranging from “benign skepticism”, i.e., “we won’t actively oppose although we remain unconvinced of its applicability” to “opportunistic anxiety” reflecting concerns that the social costs to the regime of opening up DPRK would outweigh any financial benefits. In essence, SEZs have been marked by a spectrum of regime attitudes ranging from indifference to deep concern, without registering much warmth for positive effects.

Following a visit to China in 2010, Kim was to state:²⁹ “Relying on external forces to find ways for better living is a manifestation of a selfish perspective that only takes one’s own well being into account, regardless of what happens to future generations. The Party is firmly determined to build a strong economy based on the principles of self-reliance and *juche* ideology, without delving into sycophancy and reliance on external powers.”

This statement, as well as his position in 1982, neatly bookend the period when SEZs were being explored by the regime, with the latter reflecting a summing up of North Korea’s overall experience with SEZs to date. For, together with infrastructure problems cited above (a further impediment to networks being established), a key issue affecting the realization of benefits through networks in SEZs remains the

²⁷ E.F. Vogel, *Deng Xiaoping and the Transformation of China*, Harvard University Press, Cambridge, MA, 2011, p. 406.

²⁸ E. Hobsbawm, *Industry and Empire*, Penguin, London 1999.

²⁹ Ministry of Unification, *op. cit.*, p. 169.

ideology (or set of beliefs) held by the government who have been undecided as to whether such benefits derived therefrom outweigh the costs of their maintaining control.³⁰ Economists are familiar with government intervention to counteract negative externalities e.g. pollution, but in North Korea's case, such intervention is present to thwart positive externalities given beliefs over the costs of exposing the masses to other ways of living, information and knowledge. As J. Groenewegen noted:³¹ "Governments may have several motives to want to have control over certain goods and these can be related to...power motives."

It therefore remains an open question as to whether Kim Jong Il's successor³² will adopt a different route. The North Korean top leadership's preference for "no strings attached" aid, notwithstanding increased resistance by its neighbours and other countries to provide, and the increasing preference of the population to look after themselves through the informal/black markets suggest that SEZs may not yet represent the primary means of achieving a network relationship with its neighbours that can bring substantial, mutual, economic benefits for all.

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³⁰ See A. Lankov, *op. cit.*, p. 220 – he views KIC as particular threat to regime given employees' exposure to South Koreans working in SEZ.

³¹ J. Groenewegen et al., *op. cit.*, p. 100.

³² Kim Jong Il died in December 2011 and was succeeded by his son, Kim Jong Un.

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KOREA PÓLNOCNA I JEJ SPECJALNE STREFY EKONOMICZNE: NOWE SIECI POWIĄZAŃ Z GLOBALNĄ EKONOMIĄ?

Streszczenie: Począwszy od lat 90. XX wieku, Korea Północna, poprzez tworzenie specjalnych stref ekonomicznych, dążyła do kształtowania sieci handlowych i relacji ekonomicznych ze swoimi najbliższymi sąsiadami. Celem artykułu jest przedstawienie zagadnienia sieci w kontekście relacji Korei Północnej z jej sąsiadami, szczególnie z Koreą Południową. Artykuł przedstawia czynniki mające wpływ na tworzenie sieci, sukcesy i porażki tego procesu oraz ich rozwój.

Słowa kluczowe: Korea Północna, specjalne strefy ekonomiczne, efekty zewnętrzne.