

Asia's next capitalist domino

As the Korean express rumbles into the small town of Sinuijo, on the North Korean border with China, soldiers and North Korean officials in green and grey uniforms briskly board the train. With painstaking attention they search the compartments, interrogating passengers on the reasons for their journey. A few wary Eastern Europeans hide bags under the seats. The bags contain cigarettes, spare parts, and other goods that are either expensive or hard to obtain in North Korea's closed and fraying economy.

Outside, local people on the platform are herded by an armed guard to compartments farther down the train. This restriction — like so many others in this avowedly Marxist country — is aimed at separating the North Koreans from foreigners, lest their vision of the *people's paradise* be blurred by western propaganda.

But while the vestiges of communism continue to dominate this nation of 22 million people, the fundamentals that have supported North Korea for more than four decades are irrevocably changing.

In February, the standing committee of the Supreme People's Assembly adopted the law on external economic contracts, which consists of 42 articles and is aimed at attracting foreign capital and technology. It followed the revamp of the legal system and the introduction of sweeping measures designed to lure western institutions into North Korea. "There is no doubt that the country is opening up," says Ian Davies, manager at the United Nations Industrial Development Organization (UNIDO) in Beijing. "While the old collective farm will continue, I believe you will see a move towards the Chinese economic model."

Seven hundred kilometres to the north-east of the capital, beyond some of the most magnificent landscapes in the country, the foundations are already being laid for a free economic

Its popular image is of a nuclear-armed xenophobe, but North Korea is quietly courting foreign investors.

One aim is to prop up its bankrupt economy. The other is to maintain its communist rulers' hold on power

BY BEN DAVIES IN
PYONGYANG, BEIJING
AND HONG KONG

and trade zone. The Rajin-Sonbong administrative area already contains basic ports, railways and a spattering of factories. Over the next 15 years, the Committee for the Promotion of External Economic Cooperation aims to transform it into a major regional shipping, trading and manufacturing zone emulating the success of Hong Kong and Shenzhen.

Even more surprising, North Korea, a country some suspect foolhardy enough to start a war with the US-backed South over its suspected nuclear weapons building programme, is welcoming a small number of foreign institutions. At the end of February, Peregrine Investment announced plans to open a joint venture bank with the state-run Daesong Bank. The new bank, to be called Peregrine-Daesong Development Bank, will be involved in commercial banking and direct investment.

Weeks earlier, ING Bank also signed an agreement with the Korea Foreign Insurance Co to establish the first international joint-venture bank in the Rajin-Sonbong free economic and trade zone. The new bank, which will have a paid in capital of US\$2 million, is expected to open its doors before the end of June, subject to final approval from the authorities. Initially it will concentrate on trade finance, international payments services, working capital finance and project finance. "We are a specialist in emerging markets and we believe it important to be in North Korea at the outset," says Jan Bosma, general manager of ING Bank in Seoul.

ING Bank and Peregrine are not the only western companies exploring the *other* Korea. Multinationals such as BHP Australia, AT&T, Shell, Ciba-Geigy, Coca-Cola, Pepsico and General Motors have all held high-level talks aimed at evaluating business prospects in North Korea. Almost all the South Korean *chaebol* and plenty of other smaller companies have visited Pyongyang to look at business opportunities following the November signing of a frame-

work agreement between the US and North Korea, to resolve the nuclear issue. And in May, their forays were given new hope when the government in Seoul approved two projects by South Korean companies to manufacture in the north.

Since 1993, Euro-Asian Business Consultancy has been promoting joint ventures in North Korea as part of a pan-North Asia consultancy service. "There is interest from foreign investors, although it is relatively early days," says Peter Blythe, who recently joined the three-man Pyongyang operation following the departure of Stephen Cox, the former representative. "Up till now the North Koreans have had very little experience, so they are still feeling their way."

In one of the latest ventures, Deutsche Clearing-und Countertrade, a German consortium of banks, manufacturers and traders, is said to have signed a clearing

"They want the money but they also want to pull the strings"

agreement with the North Korean Committee for the Promotion of International Trade. The deal coincides with a decision by Thai Central Steel to purchase 300,000 tons of steel from North Korea as part of another counter-trade agreement.

The shift from central planning is striking given the rigid ideology imposed by Kim Il Sung, whose pictures loom everywhere as a reminder. And though gradual, the move towards capitalism may prove irreversible. The Committee for Foreign Economic Cooperation estimates that foreign companies have committed

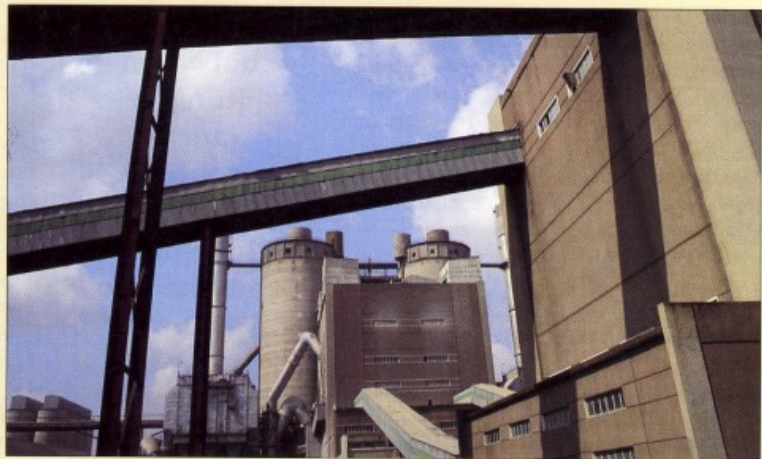
to invest US\$200 million and actually invested US\$40 million in the Rajin-Sonbong Zone as of April 1995. Though the figures may be inflated, and though many companies are likely to postpone making an investment decision given the uncertainties, the trend toward investing in North Korea is increasing.

Communist showpiece

Like a colossus, the Sangwan cement factory rises up from the flat rice fields south of Pyongyang, a concrete structure that stands incongruously amid the lush scenery. Beyond the entry gate, manned by armed women soldiers, giant plaques cling to the grey conveyor belts, extolling the virtues of *Great Leader* Kim Il Sung and *Dear Leader* Kim Jong Il. Over a megaphone, a voice congratulates workers who have surpassed the monthly targets set by the central planning department.

The Sangwan factory is not just a sprawling monument to communism. It is also a showcase of efficiency and advanced technology. Inside the closely guarded control centre, four men operate a computerized system that runs the factory. The equipment, acquired from Germany, Denmark and France, has made the factory the second largest producer in North Korea.

The factory employs just 200 people to produce two million tons of cement a year for domestic consumption. "This is one of the most advanced factories in North Korea," says



REN DAVIES

The North in action

Djeung In-Hyeun, a factory official called upon to guide visiting businessmen.

Though it is something of a showpiece, the factory has many of the hallmarks of industry in North Korea. Workers are set monthly targets by the central planning committee and awarded bonuses for surpassing them. And while wages are low — from W110 to W191 (US\$55 to US\$95.50) a month — free housing and education boosts living standards.

The conditions are worse in other factories. In the district of Nampo, west of Pyongyang, few of the factories appear to be running. And while western

allegations of starvation are almost universally dismissed as pure fabrication, the half-finished construction sites along the new four-lane highway are evidence enough of the country's lack of cash.

Indeed, while vast amounts of money have been spent to build monuments to Kim-Il Sung and *juche*, the chronic lack of foreign exchange and low industrial productivity continue to dog the country. If nothing else, they serve as a reminder of the conditions that provoked the backlash in other communist countries, and which could similarly propel the *people's paradise* into a capitalist haven.



In need of investment

North Korea's change of course has been dictated by its poverty and international isolation. Since the collapse of Comecon and the demise of barter trade with its major trading partners, North Korea's economy has foundered. In 1993 and 1994, GDP is estimated to have declined at 4% a year on the back of a sharp fall in trade with Russia and China. And while large shopping centres continue to stock a variety of electronic goods, and Mercedes Benz cars still drive through the capital, the shortage of spare parts has left many factories idle.

Moreover, its traditional supporters Russia and China are said to have increased the pressure on Pyongyang to develop a less vociferous relationship with the west, following their lead. "They have little choice but to open up," says Marc Faber, managing director of Marc Faber and Co, an investment management firm in Hong Kong. "The young Kim wants to modernize the country. The army wants to buy new weapons. To do that, they need money."

In the centre of Pyongyang, the unfinished Ryugyong Hotel is perhaps the most fitting symbol of how badly North Korea needs money. When it was begun in 1989, the hotel was intended to be the biggest in the world with 3,000 rooms and six revolving restaurants. Today, the crane on top of the hotel is at a standstill and the windows are bricked up. Diplomats claim that completion of the 105-storey property has been delayed by lack of funds. Others say that the pyramid-shaped structure is gradually sinking, and may have to be destroyed

before it collapses.

Elsewhere in this showcase capital city, contradictions abound. Pyongyang has one of the most expensive and efficient underground railway systems in the world, but many people are too poor to use it. It has a magnificent assembly hall costing US\$100 million, but senators only meet there twice a year. Even in the model schools, attended by the top cadres and children of senior officials, smiling children play magnificent piano pieces, but on closer inspection are unable to read the score that they make a show of following.

Still, North Koreans save their highest expression of pride for Kim Il Sung, the leader who oversaw the rebuilding of their country at the end of the Japanese and Korean wars. Yet despite their public demonstration of loyalty, officials are privately revising Kim's teachings on *juche* (self-reliance) in an attempt to make his philosophy more economically viable. "I remember having lunch with Kim Il Sung in 1991," says Oei Hong Leong, chairman and chief executive of China Strategic Investment. "In those days, even to mention the word reform was a crime." Nowadays, not only is the word reform mentioned at party meetings; senior officials are being sent to China to study its economic liberalization programme. Indeed, while the weekly *Pyongyang Times* still talks of *American imperialists* and *South Korean puppets*, officials are privately being called upon to fill North Korea's empty larder. "American businessmen are not the enemy," insists one North Korean official in

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Pyongyang's golden triangle

Surrounded by barbed-wire fences and stunning scenery, the Rajin-Sonbong free economic and trade zone is the most poignant symbol of the new forces driving North Korea's pseudo-Marxist ideology. Not only does it offer special tax breaks and profit repatriation to foreign enterprises. It is also open to investors from any country, including *American imperialists* and *South Korean Puppets*.

However, the zone, known as the *golden triangle*, has yet to acquire infrastructure or enough foreign investors. And it remains closed to the majority of North Koreans who, it is feared, will get shocked by the capi-

talist actions of their great leaders.

"The place looks sterile," says Ian Davies, manager of the United Nations Industrial Development Organization in Beijing. "There are no bicycles, no free markets. It is as if you were in China in 1979."

That has not stemmed the ambitions of the zone's architects. Under stage 1 of the master plan (1993-1995), railways, roads and ports will be rebuilt and upgraded. That will be followed by the construction of export processing centres and international transit cargo facilities from 1996 to 2000. By 2010, the master plan envisages the creation of a modern international trade centre able to serve all of north-east Asia.

To make the plans a reality, North Korea is inviting foreigners to participate in contractual and equity joint venture projects, including the US\$1.5-billion expansion of the Rajin Sea Port, installation of turbine generators, and construction of a US\$147-million fully

equipped telecoms centre. Foreigners may also establish joint ventures with some 68 local companies including the Sinhung Industrial Park Sock Factory, the Sonbong Township Ceramics Factory, and various other electronic component factories elsewhere in the zone.

"By the 21st century, north-east Asia will be one of the most powerful economic forces in the world," says one local official. "And unlike Vladivostok, which is closed for four months of the year, the Rajin-Sonbong zone will be at the crossroads."

For now, North Korea's capitalist experiment is confined to the closely controlled enclave surrounded by 80 kilometres of barbed wire. Few people believe the genie can be kept in the bottle. However, while the Rajin-Sonbong Zone is still to take off, it is likely to represent the only way forward for this hermit kingdom.

Pyongyang. "The enemy is the American government that wants to rule the world."

The obstacles to North Korea attracting and keeping foreign investment are many. One of the most formidable is political. Almost nine months after the death of Kim Il Sung, his son and anointed successor, Kim Jong Il, has yet to assume power. The speculations are that a leadership struggle is preventing it happening.

In any case, North Korea has few of the certainties offered by most emerging and all developed economies. It has almost no investment laws and no real banking system. It is technically in default of an estimated US\$2 billion in loans that it secured from western banks in the 1970s. Despite magnificent feats of engineering in the capital and in a few model factories, its infrastructure and technology remain extremely basic. There is a widely held suspicion that North Korea's rulers want funds to keep their rigid system afloat, but are not prepared to make concessions. "They want the money, but they also want to pull the strings," says one foreign businessman who has accompanied a delegation to the Rajin-Sonbong free economic and trade zone. "They don't seem to understand that they can't have something for nothing."

Another concern is how long a political system built on personality cults, repression and secrecy will last — and how it will go if it does. A bigger concern is how willing North Korea's

rulers are to go to war over their suspected nuclear building programme. In recent weeks, tensions along the demilitarized zone dividing the two Koreas have increased with both sides trading insults and occasionally even bullets.

That situation has already put off investors who see greater potential and significantly smaller risks in other emerging markets. But it has failed to deter others. Earlier this year, North East Asia Corp, a Hong Kong-registered company, announced it would build a soft drinks plant in the Rajin-Sonbong free trade zone and hold talks on constructing an airport in the same area. Shell is making studies which could lead to the setting up of storage facilities for petroleum products, which could be re-exported to north-east China. Even some US companies who have visited North Korea since

November have shown strong interest to do business in that country, although they need the go-ahead of their government. "In the longer term I am certainly optimistic [about North Korea]," says Ludo Drybooms, a Belgian diamond dealer who has been active in the country for seven years. "But change will come slowly."

For the foreign companies prepared to take the long-term view, North Korea has its attractions. It is rich in minerals including coal, gold, nickel, lead, zinc, iron ore and diamonds. It exports cement, steel plates, iron bars and pellets to South-east Asia and porcelain ware, marble and iron ore to the Russian Federation, Cuba, China and Japan.

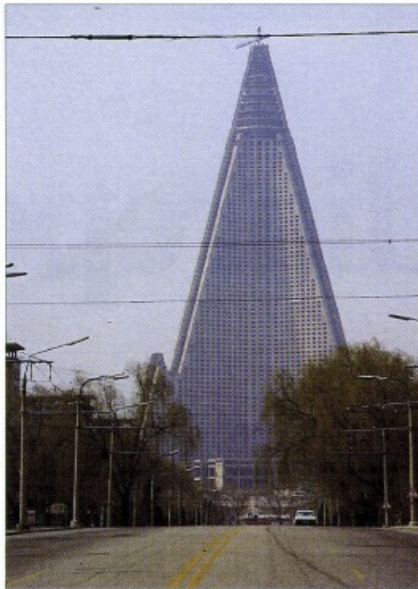
"In the longer term I am certainly optimistic about North Korea. But change will come slowly"

It also has industries. Most of these are poorly equipped, underfunded, badly managed and use equipment that are often short of parts. But in the long term, North Korea could become a thriving exporter and market for foreign goods once it is able to attract capital and new technology. "North Korea offers the industrial base and minerals which the south lacks," says John Alsbury, executive director of Brown & Williamson in Seoul. "With 70 million people and with access to technology, a unified Korea could be a very potent force in the region."

The country's strategic position next to Russia and north-east China, along with its ports and railways could also pave the way for a new transport hub incorporating the Tumen River Basin. According to a report by the Committee for the Promotion of External Economic Cooperation, projects soon to get under way in the nascent Rajin-Sonbong free economic and trade zone will include a US\$1.5-billion expansion of the Rajin Port and a US\$59-million investment in the Hoeryong-Haksong Railway. The government, with the support of a US\$2-million grant from the United Nations Industrial Development Organization, hopes that these and other large infrastructure projects will attract western capital.

The biggest impetus to development is likely to come from North Korea's increased economic links with the South. Since July 1953, when the Korean Peninsula was divided at the end of the Korean War, both countries have called for reunification based on different conditions. Few diplomats expect an acceptable compromise in the short to medium term. What they believe is that the recent increase in direct trade between the two countries — along with the prospects of direct investment — could lead to closer economic and political ties. "There is no way that the North and South will sit down tomorrow and reunify. That is impossible," says Faber, who compares the situation to that between Taiwan and China. "On the other hand, it is quite realistic to assume that over the next five years we will see some form of economic unification."

For now, most investors prefer to buy North Korean debt than invest in ventures which could take years to pay dividends. But the dream of a reunited Korea and the North's cheap production base, skilled labour and similar language are drawing South Korean companies. In a well-documented trip in 1992, Daewoo chairman Kim Woo Choong went to Pyongyang to discuss a number of joint ventures. The talks led to the establishment of a US\$5.1 million clothes-manufacturing plant in the city of Nampo, which was approved by the South Korean au-



The 105-storey demolition site?

BEN DAVIES

thorities last month.

Other *chaebol* have followed suit under an agreement that allows businessmen — but not ordinary citizens — to visit the North. Since November, Samsung, Hyundai and LG are said to have held talks with North Korean officials for the establishment of production facilities in the Rajin-Sonbong trade zone. The talks have spurred hopes of a new wave of investment. But these hopes have been dashed by the South Korean government, which wants to stop all direct investment going north until the nuclear issue is resolved. "It's the late-night knock on the door — and the [admonition] thou shalt not invest in North Korea," says one senior official monitoring the situation in Seoul. "The central bank, the planning board, the reunification board — they are all stopping it."

But neither South Korea's politicians nor Pyongyang's old guard can turn back the clock as North Korea moves inexorably away from Marxism. Already, South Korean companies are investing through third countries such as Hong Kong and Singapore. Two-way trade between North and South has also risen significantly, according to the Unification Ministry, reaching US\$54 million in the first quarter of 1995. And once the South Korean companies are seen moving in, others are likely to follow suit. "I don't think you will ever see a wall of money," says Davies at UNIDO. "But there is cheap labour and there are resources [in North Korea]."

The strength of the forces that have combined to push North Korea on the road to capitalism, far from declining, is likely to increase as eastern Europe, Russia and China continue to pursue free-market reforms and reap the benefits they bring. And the more the North Koreans hear about the prosperity enjoyed by the people in the south, so will the pressure for change increase. The North will of course self-destruct if it wages war over its suspected nuclear programme. But most diplomats doubt it will happen, seeing North Korea's hard-line policy as a bargaining chip that it uses to secure loans and aid.

Indeed, a picture of what North Korea's future could look like may be glimpsed south of Pyongyang, beyond the demilitarized zone that marks the rugged mountain border, one of the most fortified areas in the world. It is a picture that must represent a nightmare for the power brokers in Pyongyang. They could loosen the reins and risk the sort of backlash that has occurred in some countries in eastern Europe. Or they could hold on to the rigid power structure and watch the system crumble. For foreign investors too there is a tough decision to make: either get in there early and take the long-term view, or risk missing out on Asia's next capitalist domino. **am**