

The Russian Far East Economy: The Current Situation and Potential for Development

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As the end of the 20th century approaches, the economic and political situation is changing substantially in the Pacific region as a whole as well as in Northeast Asia. The economic prosperity of Japan, South Korea, Hong Kong, Taiwan, and Singapore, and successful market reforms in Thailand, Malaysia, China, and Vietnam provide a very strong stimulus for Russia and the Russian Far East. Northeast Asia is moving to fulfill its destiny in the 21st century. The question is whether the Russian Far East will join this dynamic region? The answer will depend on the decisiveness of regional and federal authorities regarding market reforms which must be synchronized with the modernization of the economic structure of Northeast Asia.

From the very beginning of the liberalization process, the Russian public and many analysts, particularly those in the West were certain that the positive results of "shock reform" would come quickly. The long and deep crisis in the Russian economy was an unpleasant surprise for everybody. And now the crisis has reached all sectors of the economy, especially material production (Table 1).

Table 1 Social and Economic Indicators in Russia, 1992-1995 (percent)

Indicators	1992	1993	1994	1995 First quarter
Gross Domestic Product	81	88	85	95
Industrial Production	82	86	79	95.5
Agricultural Production	91	96	91	89
Investments	60	88	74	76
Retail Trade	97	102	100.1	90
Services	82	70	64	86
Share of population with an average income below the poverty level	31.5	24.4	30.4	31

Sources: Osnovnye pokazateli socialno-ekonomicheskogo polozheniya i khoda dkonomicheskoy reformy v Rossiiskoy Federatsii v 1 kvartale 1995 goda.- Moscow: Goskomstat RF, 1995; Socialno-ekonomicheskoe polozhenie Rossii, Janvar-may 1995 goda. - Moscow: Goskomstat, 1995.

enterprises. Approximately eight billion dollars are needed to fulfill this program. The program is based on a new concept of economic and social development in the Far East. The basics of this program is the fundamental reconstruction of economic infrastructure in the Far East, geared towards increasing the openness of this region for mutually beneficial cooperation with the countries of the Pacific Rim. This New Economic Policy in the Russian Far East concentrates on developing financial and material resources with the active participation of the local administration, and the stimulation of local business activities, including the creation of joint ventures. The objectives are to reconstruct the economy and to foster the production of competitive goods.

In view of the importance of attracting foreign investment, the administrations of the region have created a favorable environment for foreign investment. For this purpose tax privileges have been granted. In Khabarovsk krai, in certain production sectors and for hotels, newly founded joint ventures with a share of foreign investment greater than 30%, branches of foreign companies, and companies which are wholly foreign owned are exempt from the profit tax for two years. Joint ventures with a share of foreign investment amounting to more than five million U.S. dollars, and operating in the development of mineral deposits and in transportation construction projects are exempt from the profit tax for three years. Exemption from the profit tax means a tax reduction of 22%. Another step taken to attract foreign investors has been the creation of free economic zones. The best results have been achieved in the free economic zone of Nakhodka, where work began in 1990. In Amurskaya oblast, a new international economic zone, called Blagoveshenskii Haihe, has been created for increased cooperation and development.

The prospects for improvement of the Far Eastern economy also hinge on Russian participation in international projects such as the Tumen River Area Development Programme. Local government leaders in Northeast Asia have participated actively in conferences in the Russian Far East. Such a conference was held in Khabarovsk in September 1995, and was very successful. And in May of this year, Khabarovsk will host the first Far Eastern International Investment Conference.

Manipulation of fiscal instruments was a factor in the resulting economic depression. Every year the Russian government promised macroeconomic stabilization. But the decrease in production proved to be much deeper than the governmental stabilization program. In 1995, there was a crisis in the financial sector. But the most dangerous situation is in the investment sphere. Investments underpin economic activity in general as well as any possible structural adjustments. Thus it is very difficult to believe that a quick restructuring of Russian production is possible.

Even the positive growth rates in industrial output and GDP are not encouraging. The physical growth in some industries in 1995 does not mean a general improvement in the economic situation because this growth is more a result of current fluctuations in foreign market demand than of general stabilization. Very often, production dynamics can be explained by unpredictable changes in bank account balances in different enterprises. For example, some enterprises suddenly receive money from the government or other enterprises for previously provided commodities or services. These enterprises then provoke new demand. Because of the scale of economic depression in Russia, even such small increases of production to satisfy this new demand influences the statistics.

One of the major reasons for economic destabilization in Russia is the financial crisis brought by nonpayments. In 1994 the share of suppliers' total debts was 17% of GDP and the share of overdue debts—9.2%; 68% of all enterprises had overdue customer debts and 61% of enterprises had overdue debts to suppliers. More than two-thirds of all economic actors are nearly bankrupt. Federal anti-inflation regulations relied mainly on decreased money supply as its main instrument. This provoked the appearance of so-called "artificial money," i.e., firm-to-firm debts. Commercial banks became involved and the federal government began to use this "money" to address the budget deficit. Since 1994, the problem of a double money market became the main feature of the Russian economic crisis. In the 1960s and 1970s, the South Korean economy faced the same problem. But in the case of Korea, "artificial money" was officially introduced into the money market by the Government and was regulated by it. In Russia, "artificial money" was illegally introduced into the economy by commercial firms and governmental enterprises. And the Government is using this money to solve budget problems, while refusing to regulate "artificial money" turnover, or to guarantee the stability of the payment system. Debts are moving from one production cycle to another and capital accumulation for the modernization of the technology and production system has become very difficult. From the very beginning of radical economic reform in Russia, the financial crisis and the reduction of "real"

money supply caused a substantial reduction in demand. This result was inevitable due to the general logic of Russian economic reform. But the basic idea was to balance supply and demand. However, the situation is now out of control.

By 1995, the demand-supply balance had changed drastically. By 1991 this balance was supported by an enormous shadow personal demand estimated at 128 billion rubles. In 1991, Pavlov's price reform, the first real step towards future price liberalization in 1992, provoked a consumer shock which resulted in an increase of money supply in the consumer market. The dramatic intervention of the "shadow demand" in the consumer market increased demand in comparison with supply. As a result, in 1991, imports exceeded exports. After the price liberalization in 1992, consumer demand was reduced by nearly twice and general supply exceeded final demand. Because of this, the trade balance changed. Producers tried to compensate the reduced internal demand by increasing sales in foreign markets. Though the level of personal income gradually increased in 1993 and 1994, supply exceeded demand. But in 1994 and 1995 supply decreased more than demand. The most serious gap was in the production of consumer goods. The general decrease of consumer good output in 1994 was estimated at 26% in comparison with a 21% decrease in industry as a whole. Because of this, the share of imports in the domestic consumer market increased. Though the general trade balance remained positive, domestic consumer demand began to reorient toward imported goods. The share of imported goods in the Russian consumer market was estimated in 1994 as 33%, in comparison with 29% in 1993. From a macroeconomic point of view, export-oriented industries were trying to compensate for the reduction of domestic demand for their products by increasing exports—but without substantial success. And domestic industries which tried to compete with imported goods were unsuccessful.

The correct strategy in this situation would have been to support export-oriented industries and to help producers of consumer goods to compete with imported goods. Instead, the strategy used by the Russian federal government can be described as "support of traders by imported goods." This policy is the same as that in 1992, but then the objective was to compensate the deficit of commodities in the domestic market by intervention from abroad. In 1994 and 1995 the only reason for such a strategy was the desire to increase revenues through the customs duties and the desire to demonstrate to the IMF that the ruble had stabilized as a product of general economic stabilization.

The main element of this new financial policy is the revaluation of the Russian ruble. From January 1992 until January 1996 the exchange rate of

the ruble to the U.S. dollar increased 46 times. At the same time, consumer prices increased 1,100 times, wholesale prices increased 1,035 times, and the cost of cargo transportation increased 2,882 times. In mid-1995, the federal government and the central bank decided to install a so-called "exchange-channel" (i.e., 4,200-4,900 rubles per 1 U.S. dollar). Yet since January 1996, these limits have increased to 5,200 rubles per 1 U.S. dollar. This decree means that the Russian government has made the revaluation of the ruble their official economic policy. And this policy has now become one of the main factors that is destabilizing the Russian economy.

Export-oriented industries suffer from this high exchange rate in that their competitiveness and profitability in the domestic market are reduced. At the same time, the effectiveness of imports has been increasing since 1992. As a result, instead of the official strategy of protecting national producers, prices of imported commodities have been reduced and domestic output has declined. Devaluation of the ruble might be a logical option in this situation but it would not be politically feasible. Although the present economic strategy led to the victory of the opposition parties in the last parliamentary election, there has been no indication that the government's economic policy will be changed.

Other changes in the strategy of economic reform are focused on money supply and credit policy. Indeed, it is these two sectors that have been the primary cause of the current financial crisis. The high interest rate in commercial banks is based on "expensive money" and the high price of money is based on the monetary regulations of the central bank and the government.

The increase of producers' prices has been much greater than the growth of money supply. This situation provokes a greater money deficit and the growth of debts. The result is a recession in production. At the same time the growth rate of M1 and consumer prices are the same (Table 2). It means that supplying money remains the only way of covering the demand for payment for the consumer market. Thus while inflation in the consumer market is fueled by the supply of money, decreases in the credit and budget systems limits economic activities as a whole. It is impossible to solve both problems simultaneously, i.e., to stimulate the production system and limit inflation in the consumer market. It is therefore necessary to prioritize goals. The central government decided that the number one goal is to limit consumer inflation. However, political events in Russia have proven this decision wrong. Indeed, the methods of economic regulation have not led to general economic stability but rather to permanent stagnation. Thus the current economic regulations have to be changed both in theory and practice. Without such changes it will be almost impossible to resolve the economic crisis or political transition back to a national-communism.

Table 2 Money Supply and Price Dynamics (percent)

	1992	1993	1994
1. Growth rate of money supply (M2)	770	520	280
2. Growth rate of producers' prices	2,050	990	510
3. 2/1	266	190	182
4. Growth rate of consumer prices	2,610	940	315
5. Growth rate of cash (M1)	1,619	720	210
6. 4/5	154	137	150

Source: *Rossia v tsifrah*, 1995, pp. 170, 187, 195.

THE RUSSIAN FAR EAST

Up to now, economic reform in the Russian Far East displays more antimarket characteristics than market entrepreneurship. The main problems of 1994 were continual decline of production, particularly in industry, and a drastic increase in unemployment. Eighteen months ago, these problems were seen as part of a radical cure for the Russian economy. The government intended to increase the efficiency of production and promote structural adjustments to curb inflation. But at least the economic situation in 1995 was not as bad as that in 1991-1994.

Nevertheless, there have not been any real changes in economic structure, and economic stability is now the same as two years ago. The only change has been in the price structure as a result of uneven increases in output prices because of different declining rates of industrial output. The industrial recession in this region at the beginning of 1995 became very dangerous (Table 3). In 1994, the industrial output in the Russian Far East declined by 40% in comparison with that of 1989. During the first half of 1995 the recession continued, though at a lower rate (1992—15.7%, 1993—16.3%, 1994—20.8%, first half of 1995—5.6%).

In some territories such as Primorsky, Sakhalin, Yakutia, and Kamchatka, production slightly increased in comparison with 1994. This was mainly due to export-oriented industries such as fisheries, coal, gold, diamonds, and timber. This was part of the attempt to use favorable foreign markets to compensate for decreasing domestic demand. And it indicates that a regional export sector can improve the region's economic situation. An important condition for these attempts was the adoption of new approaches to the organization of export industries in the second phase of privatization.

Table 3 Industrial Growth Rate in the Russian Far East, 1991-1995
(percent)

	1991	1992	1993	1994	1995*
Russia	92.0	81.2	83.8	79.0	—
Far East	97.3	84.3	83.7	79.2	94.4
Republic of Sakha (Yakutia)	92.0	79.0	94.9	101.0	101.4
Primorsky Krai	96.3	90.3	83.4	74.5	101.2
Khabarovsk Krai	98.8	88.3	78.1	63.1	78.0
Amur Territory	93.6	84.3	84.4	80.1	80.9
Kamchatka Territory	92.1	65.0	85.3	73.2	115.2
Magadan Territory	96.9	92.7	87.3	91.0	72.9
Sakhalin Territory	103.1	85.7	86.3	77.6	111.2

Note: * = January-June 1995, compared with January-June 1994.

Sources: *Ekonomi Dalnego Vostoka: Reforma i Krisis*. Ed. by P.A. Minakir. Khabarovsk-Vladivostok: Dalnauka, 1994. *Socialno-Ekonomicheskoe polozenie Rossii, 1994*. Moscow: Roskomstat, 1995. Materials of the Representation of the Ministry of Economy of the Russian Federation in the Far East.

Since 1994, privatization has become the main feature of radical economic reform in Russia. Actually, during 1993, the privatization process was already proceeding rapidly and privatization was the hallmark of economic life in the region. Many governmental enterprises in trade, industry and construction were privatized, modernized and transformed into public companies. In 1994, this process began its first phase, i.e., to persuade the populace to believe that privatization will solve all problems in the economy and society, e.g., the financial crisis, decreased final demand, structural adjustments, and the budget deficit. In fact, conversion of state property to public companies as well as privatization itself have been making legal the illegal distribution of government property among criminals, bureaucratic and party officials. This is only very slightly connected with the general macroeconomic strategy of reform.

Government enterprises, which have been privatized, receive few additional resources or special opportunities. And they have lost the illusion of support from the government. In the Russian Far East, the difficulties of former state enterprises are caused mainly by a drastic change in cost structure. The most popular request of former governmental enterprises as well as the local administration is for a change in prices of transportation, electricity and fuel, or the granting of special subsidies to their enterprises. This need was in response to major changes in the price

structure. In 1993, the price structure began to float up to the international price structure. But structural changes in the price system were not followed by a change in the production structure. As a result, production costs of fuel, electricity, transportation, communication and financial services began to increase rapidly. However, the growing production costs were not compensated by an increase in the value of production. Instead, decreasing production output caused production costs to soar. That was why, in 1995, small private enterprises founded in 1993-1994 coalesced and government regulation and support were extended to export industries. Yet high production costs cannot be regulated by the general methods and mechanisms used in the radical economic reform.

There are also local sources of inflation of production costs in the Russian Far East. For example, this region produces a large portion of semi-manufactured products. And the energy sector is out of balance in that 20% of the coal and 90% of the oil used to produce more than 80% of the electricity are imported from interior Russia. Not least, the region continues to suffer from its geographical separation from European Russia and Siberia. These problems will continue to be crucial factors in the region's economic dynamics.

The share of total consumers' debts in regional industrial output is 31.6% and the share of debts to suppliers is 29%. Every month, the total debt to workers and banks is increasing. Debts to workers in monthly wages increased from 24% in 1993 to 38% in 1994. The real amount of debts is much higher because the data do not include debts in the budget. By June 1995 the total debt of the Russian Far East was estimated at about 14 trillion rubles.

Since 1992, the Russian Far East has attempted to reorient its financial and commercial transactions towards the Pacific and other international markets. This was possible because of the general liberalization of foreign trade in Russia. The development of international cooperation partly compensated for the reduction in the domestic market in 1992. And in 1993, the macroeconomic situation in the Far East was also stabilized to some extent by this factor (Table 4). Yet since 1994, international activities have suffered from financial and customs regulations.

Results of industrial development in 1995 show that the extraction sector, as usual, was the only stabilizing force in the Far Eastern economy. Regional economic stabilization thus depends on structural adjustments. And the latter depends on the regional and national financial environment, particularly the accumulation of capital.

In 1994-1995, the financial situation in the Far East remained grim. The national financial and budget crisis seriously afflicted Far Eastern enterprises. The number of unprofitable enterprises grew and for producers

in the Russian Far East, the financial situation was more serious than in Russia as a whole because of the higher production costs in energy, transportation and salaries. In 1992 the share of unprofitable industrial enterprises in the Far East exceeded the national average by 6.8 percent. But in 1994 this number increased to 16.5 percent. The central government's effort to create universal conditions for all enterprises without taking into account regional differentiation practically excluded any possibility of creating a stable financial base in the Far East.

Table 4 Dynamics of Foreign Trade and Macroeconomic Indicators (percent)

	Russia		Far East		
	1993	1994	1993	1994	1995*
Exports	1.4	8.0	18.4	-25.7	21.0
Imports	-25.0	8.0	2.0	-44.0	—
Industrial Production	-16.2	-21.0	-16.3	-20.8	-5.6
Investments	-15.0	-26.0	-30.0	-46.6	-27.5

Note: * = January-June 1995, compared with January-June 1994.

Sources: Socialno-ekonomicheskoe polozenie Rossii. 1994. Moscow: Roskomstat, 1995; Materials of the Ministry of Economy of the Russian Federation in the Far East; P.A. Minakir, The Russian Far East in Northeast Asia. Paper presented at the Fifth Northeast Asia Economic Forum, Niigata, 1995.

Before economic reform, when the Far East received subsidies and investments from the central budget, the national income produced by the region was less than what it used (Table 5). When the central government stopped almost all investment, the situation changed. Thus the financial position of the region depends greatly on its relations with Moscow and changes in the region are predicated on real changes in the national economic policy and implementation of real regional policies. Since the very beginning of economic reform, the federal government has been opposed to the implementation of any unique regional policy. It has thus failed to develop clear and understandable criteria for incentives and to delineate possibilities for individual regions in accordance with their potential and perspective.

In mid-1995, pursuant to Presidential Decree and Governmental Order, the Ministry of Economy began to prepare a new edition of the Long-Term Program of the Economic Development of the Far East and Zabaykalje, to

2005. It will be the fifth program for this region. In the first draft of this program, which was discussed on October 13 in Khabarovsk by the Association of Economic Relations of the Far East and Zabaykalje, a new attempt was made to place the Russian Far East within a framework of a domestic division of labor and at the same time to integrate its economy with the Northeast Asian market. But the program does not suggest sufficient modifications of the market regulation mechanism or special stimuli to develop international economic cooperation. The future of this program may be similar to the famous "Gorbachev's Program until 2000," in which an attempt was also made to solve all current regional problems by central budget financing. This may be the last program of its kind. Chances are that this program will fail. Then the government may realize that it is necessary to change inter-regional economic relations and to allow real integration with the international market. The federal economic policy must include real incentives for the Far East to promote its international economic activities.

Table 5 Produced and Used National Income in the Russian Far East, 1992 (billion rubles)

	Produced National Income (PNI)	Used National Income (UNI)	PNI/UNI (%)
Far East	725.3	677.1	107.1
Sakha Republic	143.6	155.1	92.6
Khabarovsk Krai	144.6	123.9	116.7
Primorsky Krai	209.1	173.2	120.7
Amur Oblast	78.1	73.3	106.5
Kamchat Oblast	27.9	26.8	104.1
Magadan Oblast	82.2	63.7	129.0
Sakhalin Oblast	39.8	61.1	65.1

Source: Osnovnye pokazately socialno-ekonomicheskogo polozhenia i khoda ekonomicheskoy reformy v regionakh Dalnevostochnogo ekonomicheskogo rayona Rossiiskoy Federatsii. Moscow, 1994.

The Rajin-Sonbong Free Economic and Trade Zone, and the Policy of the Government of the Democratic People's Republic of Korea

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In previous sessions of the Northeast Asia Economic Forum, development of the Tumen River area has been a priority issue in the promotion of regional economic cooperation and exchange. This project also contributes to and supports the establishment of the DPRK's Rajin-Sonbong Free Economic and Trade Zone (FETZ) which is an important part of the Tumen River Area Development Programme. At a time when there is a strengthening of regional economic cooperation and exchange in Northeast Asia, and the focus on the Tumen River area, the Government of the DPRK, following the far-sighted initiatives of the Great Leader Comrade Kim Il Sung, declared Rajin-Sonbong City a FETZ in December 1991 and began its development. This decision was part of the DPRK's policy to actively contribute to the expansion and development of economic cooperation and exchanges in Northeast Asia by making maximum use of its geopolitical advantages.

There is a great difference in the level of economic development in countries in Northeast Asia due to the special sociopolitical situation and natural geographical conditions. Regional economic cooperation and exchange can ameliorate these differences and improve infrastructure such as ports and rail so as to ensure free movement of raw materials, capital and persons between the countries in the region.

The Rajin-Sonbong Zone is adjacent to Hunchun, China, and Khassan in the Russian Federation, and faces Japan across the East Sea of Korea. It is only 130 km by land and 485 miles by sea from Hunchun to Niigata through the port of Rajin. The distances via Dalian are 1,300 km and 1,070 miles respectively, 10 times further by land and two times further by sea. For these reasons the Zone is a gateway for multi-modal transportation by sea and land and a transit center for the facilitation of movement of capital, technology, materials and people between the countries in the region. If 100 million tons of cargo were transported per year on a 10,000-ton ship, companies utilizing this route would save approximately \$500 million due

to reduction of transportation distance and time. The full utilization of the port will also increase Northeast Asia's transportation capacity and the volume of exports and imports between Northeast Asia and other regions will grow accordingly. Given that the total volume of exports and imports by Northeast China, Russian Far East and Mongolia is expected to be more than 300 million tons in the near future, the geopolitical importance of the Rajin-Sonbong FETZ will increase. Thus the DPRK Government took into full consideration the role to be played by the zone in the overall development of Northeast Asia.

The DPRK Government has approved the masterplan for the zone which foresees it becoming an international cargo transit center, an international center of finance and tourism, and a manufacturing zone focusing on export processing by making maximum use of the natural, geographical and geopolitical advantages of the area. Under this masterplan, development will be undertaken in 2 phases: phase I up to the year 2000, and phase II from 2001 to 2010. During the first phase, existing infrastructure including the seaport, railways, roads and telecommunications will be utilized to the maximum and improved and upgraded to enhance the role of the zone as an international cargo transit center. At the same time, efforts will be made to create and improve the investment climate. During the second phase, efforts will focus on continued improvement and completion of the infrastructure network and development of the zone as an export processing base, a financial center and an international tourist resort. The ultimate goal for the zone is to make it a comprehensive, international center of economic exchange and trade for the 21st century.

To make the zone a first-class transit cargo center, the ports of Rajin and Sonbong inside the zone, and the port of Chongjin, a free trade port near the zone, will be modernized to handle a total annual capacity of 100 million tons. As the capacities of the ports increase, the capacities of the railway and road networks connected to the ports will be increased to 50-60 million tons and 30-40 million tons respectively.

The zone will also be developed as a comprehensive export processing zone. Over 50 existing factories and enterprises will be rebuilt and modernized through joint ventures to convert them into export processing factories. At the same time, the construction of industrial areas specializing in different sectors will be initiated and, in the long term, ten or more modern industrial areas will be established in the zone including light industry, and electronics, automation and automobile industries.

To make the zone an international center of financial services for the region, the DPRK Government will also allow joint ventures in banking, including offshore banking and wholly foreign-owned enterprises. Further, since the zone and its surrounding areas are well-known for their beautiful

coasts and are adjacent to China and Russia, the DPRK Government is also planning to construct modern hotels, recreational facilities, shopping areas and other service facilities and promote international tourism inside or through the zone. Tourists will be able to enter the zone without visas, facilitating their passage through the territory of the DPRK to China or Russia.

With regard to the creation of a favorable investment climate, the DPRK government has reviewed experiences gained and lessons learned by various countries in establishing and operating their free economic zones and, on this basis, is intent on providing conditions for investment and economic activities which are more favorable than those in other free economic zones, while at the same time seeking to establish an economic order which has become customary practice throughout the world. Since the declaration of the Rajin-Sonbong FETZ, the DPRK Government has drafted and promulgated over 30 laws and regulations relating to foreign investment with a view to creating a legal framework for investors from any country to come and carry out economic activities without limitations. The DPRK Government has promulgated the Law on Foreign Investment, which is the basic law stipulating the policy of the DPRK Government with regard to attraction of foreign investors, and, on this basis, has developed laws governing contractual and equity joint ventures and wholly foreign-owned enterprises. The Law on Free Economic and Trade Zones contains general and comprehensive provisions covering promotion and facilitation of economic activities in a Free Economic and Trade Zone. This law provides the legal status of the zone, the powers of the zone authorities, and the special system governing investment, and economic and trade activities by foreign investors, including use of land and labor, circulation of products, immigration, customs duties, the financial system, and a variety of incentives. To specify the system governing economic and trade activities of investors, the DPRK Government has drafted and promulgated other relevant laws and regulations such as the Law on Land Leasing, the Law on Foreign Exchange, the Law on Foreign-invested Banks, the Law on Customs, the Regulations on Foreigners' Immigration and the Regulations on Labor for Foreign-Invested Businesses.

Favorable conditions for business and trade activities have been provided by law, including a preferential tariff system. Goods and commodities may be brought into the zone for the purposes of storage, processing, assembly, break down, sorting, packing or repairing. No customs duty is imposed on goods which are brought into the zone for the purpose of re-export, transit trade, or operation of a business. Joint ventures and wholly foreign-owned enterprises may be established to invest in industry, agriculture, construction, transport, telecommunications,

science and technology, tourism, finance, and services. In particular, special incentives and preferential treatment are granted to enterprises which operate on the basis of high technologies or which produce highly competitive export goods.

Investors are protected by law from administrative interference or restrictions by the state. They may obtain the right to use land for a maximum of 50 years and to transfer or pass on this right by inheritance at any time before the expiry of the lease. They may determine prices of commodities through free negotiation with the buyer, employ and discharge labor under a contract with the labor service agency, and remit money abroad free from tax, or reinvest their business profit and other legal incomes. They also enjoy a free visa system.

In particular, the tax schedule for foreign-invested businesses has been simplified and various fees and rates have been set at a relatively low level. For instance, the rate of enterprise income tax in the zone is 14% and can be lowered to 10% for enterprises engaged in a priority sector. In addition, enterprises will be exempted from payment of the tax for three years from the first profitable year and have to pay only half the tax for the following two years. Enterprises engaged in a priority sector will be granted additional benefits in determining the duration of tax holiday and the proportion of exemption or reduction. As for other taxes, in general the number of items to which they apply is smaller and the rates of the taxes lower than in other countries. The land lease rental, land development fee and labor remuneration rate are also lower than other countries.

To create an international investment climate favorable for the development of the zone, the DPRK Government has actively pursued its development in close cooperation and in good harmony with China and Russia, which are the major parties to the development of the Tumen River area. Recently, under the auspices of UNDP, governmental agreements were signed at the TRADP PMC 6 including the Agreement on the Establishment of the Tumen River Area Development Coordination Committee and the Agreement on the Establishment of the Consultative Commission for the Tumen River Economic Development Area and Northeast Asia, which are great contributions to the acceleration of zone development.

The development of the Rajin-Sonbong FETZ is arousing the interest of businesspersons and investors throughout the world. Now that the DPRK Government has taken a variety of legal and institutional measures aimed at creating a favorable investment climate in the zone, and agreements in principle have been reached between the member states on TRADP, thanks to the efforts of UNDP and UNIDO, an increasing number of investors are visiting the Rajin-Sonbong area with the intention of investing there. This

includes companies from Asia such as Hong Kong, China, Japan and Thailand, and also from the United States and Europe, such as the United Kingdom, the Netherlands, Germany and Finland. Since the declaration of the zone, over 200 delegations from different foreign companies and firms comprising about 1,000 people from 23 countries have visited the zone including General Motors of the United States, British-Dutch Shell, Peregrine of Hong Kong, Invesco of Great Britain, and the ING Bank of the Netherlands. About 100 memoranda of understanding and other documents of a similar nature have been signed. Some contracts have been concluded and actual investment has been made in the transport of transit cargoes through the port of Rajin, construction of the Rajin-Wonjong Highway, airport construction and operation, operation of liner services, and construction of hotels.

Although the development of the zone is just beginning, the DPRK Government is convinced that the Rajin-Sonbong FETZ will be successful like everything else directed and guided by the Great Leader General Kim Jong Il. The DPRK will thus make a great contribution to the overall development of Northeast Asia by speeding up the development of the zone in close cooperation with businesspersons and investors throughout the world, the member states of the Tumen River Area Development Programme and various economic organizations.