

INTRODUCTORY INVESTMENT PROFILE INVESTMENT POTENTIAL TREDA: AN INVESTMENT FRONTIER 1994

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 **Tumen River Area Development Issues**

REPORT b

INTRODUCTORY INVESTMENT PROFILE INVESTMENT POTENTIAL TREDA: AN INVESTMENT FRONTIER

Prepared by: The Tumen River Area Development Programme of the United Nations Development Programme New York

During the three years from 1991 to 1994, and with an expenditure of well over \$5 million, professional private and public sector consultants have compiled a compendium of descriptive analyses on this Northeast Asian investment frontier.

A primary goal of this effort has been the attraction of sustainable development investment to

permit this key international entrepot area to tie in to the global economy.

MAJOR ATTRACTIVE CHARACTERISTICS

Market

Its potential market service population, bordering on the East Sea (Sea of

Japan) and extending far West, rivals that of the EEC. Within TREDAs immediate service area lie the consumer markets of Japan, Northern China, the Koreas and the Russian Far East. Indeed, its geographic location makes it available to link the region's productive capacity to all the growing economies of the Pacific Rim.

Resources

Its potential service area contains vast mineral, hydrocarbon, and forestry resources.

Tourism

That service area is also the seat of fabled ancient cities, beautiful mountain ranges, the Gobi Desert, vast and magnificent plains, aviary wetlands and rugged seacoast.

Trade

TREDA includes local economies booming from cross-border trade already under way and growing with both local and foreign capital.

Work Force

Within TREDAs there exists not only the diligent, well-educated workers of China and Korea available for labor-intensive light industry, but also the highly technologically-skilled staffs in the privatizing former military factories of Russia.

Infrastructure

Ports exist and are ready for expansion; new ports are being planned and developed.

Railroads exist, are being upgraded, and new lines have been recommended.

Telecommunications exist, are being upgraded, and are ripe for foreign investment.

ENHANCING THE INVESTMENT CLIMATE

A review of the TREDAs Regional Development Strategy in this document will give an appreciation of the concerted efforts of the three riparian countries, China, Russia and DPRK, and the constituent members, South Korea and Mongolia, to progressively harmonize their trade facilitation efforts and business practices.

The five member countries of the Tumen River Area Development Programme are in the

process of forming institutions which will be designed to:

- Improve regional services;
- Provide attractive investment incentives;
- Assure protection of the environment;
- Promote joint market access infrastructure development schemes;
- Remove cross border trade and people passage impediments.

TREDA consists of two provinces of two very large countries, Russia and China, plus an important province of a small one, DPRK. It, and the surrounding area, are well endowed with energy, minerals, arable land and forest resources. The ocean is a major source of seafood. Northeast China, bordering on the Yanbian district, is one of the country's most important centres of coal, oil and gas production. It also exports corn and soybeans to the rest of the country. Russia's Primorsky Krai and its adjoining territories contain the largest unexploited temperate zone forest area in the world. DPRK has significant coal, iron and non-ferrous metal resources. There are seven deep water, ice free ports in the two hundred miles between Vladivostok and Chongjin. The Trans-Siberian railroad, which extends just across the Korean border, is double tracked and electrified. DPRK has established a development zone, has announced that it intends to open the major port to all countries and is improving its roads and railroads. In the Russian sector, there are new investments in the ports and railroads in the area adjoining the Chinese and Korean borders. The infrastructure base for new growth is being laid.

POPULATION AND LABOUR FORCE

The combined population of the three territories of TREDA, the Chinese (Korean-Chinese) territory of Yanbian, DPRK's Hamyong Province and the Russian Federation's Primorsky Krai, is about six million. The four major cities are Vladivostok, Chongjin, Yanji and Tumen, all with populations of more than three hundred thousand. The other urban areas are one hundred thousand or less. The agricultural/small town population is roughly half the total in the Chinese and Korean sectors. The Russians are much more urbanized. Less than 10% of the labour force is engaged in agriculture there compared to about 40% in the other two sectors. Population increase is moderate in the Chinese and Korean areas and slow on the Russian side of the border.

Literacy in TREDA is almost universal.

The following characterizes the labour force:

It is well suited to light industry and construction.

In both the Chinese and Korean territories labour is abundant and more is available in adjoining areas.

In the Russian sector, despite the fact that semi-skilled labour is scarce, there are groups of scientists, engineers and technicians.

ENERGY, MINERAL AND FORESTRY RESOURCES

Northeast China is an important producer of oil. Reserves in Siberia are even greater. Oil is widely available in the Tumen region from China and Russia. Japanese-American exploitation of the Kamchatka area is expected to produce ample supplies of natural gas. Deposits of non-ferrous mineral resources exist in economically viable volumes throughout the immediate region. There are vast quantities in the potential TREDAservice area.

In terms of the national supply and demand for wood products Russia, the world's largest producer, has a surplus of production over demand and the greatest potential of any producing area in the world to increase output in the next few decades.

AGRICULTURE AND FISHERIES

Both the Chinese and Russian sectors of TREDAservice are well suited for grazing herds that already support a considerable tanning industry. There is also potential for a dairy industry. The rest of northeast China has a surplus of maize and soybeans which could become important transit commodities.

The sea off the Russian coast is a major fishing ground. Fish processing is the most important component of the food industry.

INDUSTRIAL PRODUCTION

The three national sub-sectors of TREDAservice have quite distinct configurations. Yanbian, a late comer to Chinese industrial development missed the phase of heavy industry concentration which dominates the rest of Jilin province. Accelerated growth began in the 'eighties. The major industries are based on local raw materials: logs and bamboo which are processed into timber paper and fibres, tobacco, medicinal herbs, the basis of the pharmaceutical industry, building materials and food. Textiles and garments are currently less important as activities but are among the more important export products.

Yanji and Tumen are the cities where most development is in place. Hunchun used to be exclusively a mining town; it has now become a trading centre and is rapidly launching its career as an industrial district.

Hamyong Province is the most important heavy industrial site in DPRK. The major plants

produce steel, machines and petro-chemicals. Light industry is small and oriented to producing consumer goods for the local market except for garments which are also exported. The province's most important exports are steel semi-manufactures, iron ore concentrates and porcelain.

The most important industrial plants are located in the Chongjin area. In Rajin/Songbong, the major plants are the oil refinery and the ship building and repair yard. The other enterprises currently produce mostly consumer goods or do maintenance work. In the economy of Russian Primorsky Krai, industrial production is dominated by food processing, the largest component of which is fish processing. The next largest sector is machine building and metal working which primarily serves the military bases in the Vladivostok area. There are also plants to process non-ferrous metals and forestry products. It has servicing for advanced electronics and aircraft maintenance as well as facilities for scientific research.

INFRASTRUCTURE

The present situation can be summarized as follows:

PORTS

There is enough capacity to allow for some growth but equipment and storage require new investment.

ROADS

TREDA roads are mostly all weather but narrow, unpaved and overburdened; further investment is necessary.

RAILROAD

Railroad infrastructure benefits from its historically higher priority for investment. The Russian sector has a good system. The Trans-Siberian up to its Pacific terminals at Vostochny and

Nakhodka is electrified and, except for one section, double tracked with automatic signalling.

The Chinese have been actively expanding their system in recent years and their standard of

construction is high. Traffic demand is far in excess of capacity. The Harbin-Dalian trunk line is

double tracked and uses diesels, the other lines are single tracked and use steam propulsion.

The DPRK system was built by the Japanese in the nineteen-thirties and is a light road.

Key railroad connections within TREDA include the following:

A line has been built from the city of Tumen in Yanbian to Hunchun and to the Russian border at Kraskino. The Russians will build from the port of Zarubino to meet it.

The carrying capacity of the Chongjin-Yanji line will, by rebuilding and electrification, be tripled when completed in 1995.

A contract has been signed to build a railroad from Hunchun to the DPRK border, including a bridge to cross the Tumen River to connect to Rajin.

There is an existing coastal railroad from Vladivostok to Chongjin.

A central TRED A marshalling yard is rapidly growing near Hunchun.

The completion of the Yanji-Tumen-Hunchun-Kraskino and the Yanji-Chongjin lines will add significantly to the freight carrying capacity available for cross-border trade and make it more profitable to locate manufacturing facilities.

AIRPORTS

In order to make air travel an efficient method of promoting growth the following goals are being pursued:

- Good roads and/or trains connecting the airports to production areas;

- New terminal facilities for both passengers and freight;

- Modern navigational aids;

- International air agreements allowing for direct international access from a variety of points.

With the improved ground transport, airport facilities and international access, air transport should begin to play a more important role in the near future.

POWER

Electricity is generated mostly by coal in all three territories. Unusually in China, where growth has strained supply, Yanbian has had sufficient power to keep up with growth and additional units are planned. In Korea and Russia there is an unused margin of capacity that can meet rising production. Primorsky Krai is planning two new nuclear installations. There is currently projected no lack of power capacity, especially if a recommended regional distribution system is implemented.

TELECOMMUNICATIONS

The present telecommunications situation in the border area can be summarized as follows:

- The border areas currently have no direct communications with each other.

- Their current links are through their respective international gateways where satellite earth stations are located.

- The domestic connections between the border areas and their own

national gateways
are weak.

In addition, the local subscriber networks within the border areas are inadequate. The area consists of two telecom triangles, one inside the other. The three points of the larger one are Beijing, Pyongyang and Vladivostok. At each of these points there is, or will be in the near future, an Intelsat earth station connected to the global network. The smaller triangle consists of the lines linking Hunchun in Jilin province of the PRC to Zarubino in Primorsky Krai of the Russian Federation to Rajin, Hamyong Province in the DPRK. The telecommunications master plan proposes to improve local subscriber networks in DPRK and Russia and attach them to the Pyongyang-Vladivostok trunkline. The border areas would then be linked with switching centres at Hunchun, Rajin and Slavianka. With respect to international connections, the major intended improvement will be the completion of the Changchun-Beijing fibre optic cable which will give the Chinese border areas good access to its international gateway.

WATER

Water supply is not now an obstacle to development. There are a number of investments being undertaken in both Russia and China which will substantially increase the supply of treated water in the next decade. On the other hand, sewage treatment facilities are limited now.

INVESTMENT CLIMATE

THE PUBLIC ENVIRONMENT FOR INVESTMENT

All three countries promote foreign private direct investment as an essential part of modern development policy.

Through their participation in TRADP they have demonstrated their belief that the complementarities of their individual zones will benefit through providing a regional, cross-border investment environment attractive to scarce international capital. They individually currently provide incentives attractive to foreign investors in existing Special Economic Zones within TREDAs.

China

Enterprises owned by provincial and local governments have proliferated. Although the urban private sector is still small in Yanbian, local publicly owned enterprises are operating in the

private sector and some are increasingly making substantial profits.

DPRK

The public sector is divided between large state companies controlling heavy industries and

local government owned smaller consumer goods companies. Foreign investment is being

actively sought by the Government.

Russia

Private enterprise is entering almost every kind of urban activity. State companies are being

privatized in large numbers.

THE INVESTMENT APPROVAL PROCESS

China requires investments in excess of ten million dollars to be approved in Beijing. Smaller

investments can be authorized at the provincial level. Jilin province has delegated this power

to the principal cities of Yanbian: Yanji, Tumen and Hunchun.

In the case of DPRK, the Rajin/Songbong special economic zone will approve projects located

therein.

In Russia, there is a registration process for small investments at the territorial level and for

larger ones in Moscow. Registration occurs when the parties establishing the venture have

agreed among themselves on terms and conditions. Investments in the Nakhodka Free

Economic Zone must be approved by an Administrative Council formed from the Nakhodka

City and the Partizansk Regional councils.

FORMS OF INVESTMENT

China

The basic vehicle is a joint venture which takes the legal form of a limited liability company in

which foreigners must own at least 25%. There is no upper limit. The foreign share can be

transferred in almost any useable resource: foreign exchange, machinery, technology,

materials etc. Another more flexible instrument is the contractual joint venture in which the

rights and obligations, including the division of profits, is set out in a contract. In this situation

the foreign investor provides capital, equipment, technology while the Chinese partner supplies

premises and labour. Most joint ventures are in the company, not the contractual form.

DPRK

The DPRK promotion of Rajin/Songbong includes a detailed list of projects for which they

invite foreign investment. The three forms are joint stock companies, contractual joint ventures

and wholly-owned foreign enterprises. The latter, while not permitted in the

rest of DPRK, is specified as a possibility for three quarters of the proposals.

Russia

In Primorsky Krai, joint venture companies are a popular vehicle.

INVESTMENT INCENTIVES

China

China has developed numerous incentives. There is national legislation which can be

supplemented by provincial and local schemes. The structure of incentives is biased in favour

of locating in one of the economic development zones. In Yanbian, the four urban centres -

Yanji, Tumen, Longjin and Hunchun- all have one or more zones specialized in certain kinds of activity.

In general, the main incentive is a reduction of the standard company income tax rate from

30% to 15% when an investment takes place in one of these locations. There are also tax

holidays for up to five years or reduced rates thereafter for investments lasting more than 10

years and companies that are substantial exporters. Exemptions from the local income tax and

VAT are available in certain circumstances.

Land leases can be negotiated for periods of 40-70 years.

In Yanbian, exporters that are foreign owned or joint ventures receive two kinds of privileges

as exceptions to the general regime:

1. While required to repatriate all foreign exchange earnings you retain rights to sell in the foreign exchange certificate market (FEC) at a negotiated price or use for your own

imports varying percentages; and

2. imports of machinery, raw materials and other commodities that are inputs to your exports are usually exempted from tariffs.

In January, 1994, China unified its dual exchange rate system consisting of a fixed commercial

rate and the floating foreign exchange certificate (FEC) rate. The consequences for access to

foreign exchange and prices to be applied on sales of domestic products of interest to foreign

investors are still being worked out. The yuan is not convertible in general although this is the

government's declared goal for the year 2000.

DPRK

The standard income tax rate of 25% can be reduced for investment in the Rajin/Sonbong

Free Economic Zone to as low as 4% for specially-favoured projects. There are tax holidays

up to the first five profit making years.

Investors in the Rajin/Sonbong district will have neither tariffs nor licences to contend with. However, the won is inconvertible and in this situation its chief importance will be to determine the cost in foreign currency of the charges for facilities in Rajin and for local labour. All other operations will be conducted in foreign currencies.

Russia

Russia has converted its multiple exchange rate system into a unitary floating rate and established a uniform tariff on most imports of 15%. Certain categories are subject to rates as high as 150% while imports from developing countries, foodstuffs and medicine are exempt altogether. Licensing of imports has been practically eliminated and foreign exchange is freely available in the banks, making the ruble, de facto, convertible. One very important element of control which remains is the licensing of exports and the practice of levying large export duties. Both policies arise from the fact that Russian controlled prices for many commodities are well below those on the world market. Export duties, which, in principle, are supposed to offset the differential, range from 30 to 50%. The export duty on barter transactions is 50%. Export licenses can be issued only to producers, not traders.

Foreign-owned exporting companies and joint ventures with at least a 30% foreign share are exempt from the licensing requirement.

CURRENT TRENDS IN FOREIGN INVESTMENT

The change in political atmosphere and the specific incentives for investors that have been adopted in the Tumen River Economic Development Area, have already attracted hundreds of foreign companies seeking to exploit the investment potential. Current investors are mostly from within the region and are familiar with language, customs, practices and local conditions. They are mostly medium size companies seeking a promising new area to either market in or produce for export. Companies are still putting together relatively small projects, but there is one large deal in the planning stage: a \$110,000,000 investment in beef production in Yanbian for the South Korean market. Investment in the Russian maritime provinces is following the general interest in the Russian economy that began about five years ago. DPRK has had a small flow of foreign investment over many years, mainly sponsored by Korean residents of Japan. Japanese investors are most important in Primorsky Krai, while South Koreans

dominate in Yanbian. The second most important group in Yanbian are those from Hong Kong and other overseas Chinese, while in Primorsky Krai the United States is second. There is only a marginal European presence in either area. There is a flow of regional investments.

To provide some concrete examples of investment in Yanbian, there are, among the ten largest, one for eight million dollars (of which \$4.75 m. is foreign) for wallpaper and PPC pipes; \$5.5 million for bricks, with two South Korean investments; a wholly owned Japanese plant, which cost \$4 million, producing flax products; and a Korean \$2.5 million plant producing laser disks.

In Primorsky Krai commerce, transport and tourism account for 45% of the 270 investments

and 10% are in the area of professional services like marketing and advertising, engineering, software, etc. The average investment is small, \$1-2 million.

DPRK has had over one hundred investments from the Korean- Japanese community. There

is, for example, a flourishing trade in garments and pianos where parts are imported from

Japan and finished and re-exported. The most important hotel in Pyongyang was built by this kind of investment.

NEW ECONOMIC ACTIVITY

In TREDAs the forces that are now driving activity in the three territories are:

- Chinese/Russian trade;

- Russian exporters' search for new ports;

- China's desire to have a TREDAs access to the sea; and

- the objective of all three governments of promoting industrialization and supporting infrastructure through welcoming foreign investors and credits.

The result of these forces is expressed in construction activity in Hunchun, the roads and

railroads that are completed or under construction from Tumen to Hunchun to Kraskino, port

improvements planned or underway at Zarubino, Rajin and Chongjin, and improvement in the

road and rail connections from Chongjin to Yanji.

MOST PROMISING INVESTMENT SECTORS

By 1995 local government and enterprise will have carried out their currently planned

infrastructure projects and we expect that South Korea and China will have concluded an air

transport agreement which permits direct international access to Yanji airport. Because of

these demand-driven developments there will be greatly expanded opportunities for investment in infrastructure, manufacturing and services of all kinds.

Infrastructure

In the area of infrastructure the following types of projects appear the most interesting:

- Light industry;
- Shipbuilding and repair;
- Military factory retrofit for private sector activity;
- Installing and managing port facilities, container and bulk cargo terminals;
- Improving freight and passenger handling in airports;
- Modernization of the railroads;
- Telecommunications.

Manufacturing

In the manufacturing sector, the attraction will be inexpensive productive labour in the Chinese and Korean areas and the availability of forest products. Clothing is already a growing sector both in Yanbian and in DPRK. Based on the evolution of other sites in East Asia, the next steps will be electronics, toys, small hardware items, etc.. The pattern already established in Yanbian of foreign investors providing machinery, know-how and some inputs will be expanded and directed mainly to export markets, including the Russian market.

Forestry Industry

The characteristic of the area which differentiates it from other Asian manufacturing zones is the potential supply of temperate zone hardwoods that can be made into sawn timber, furniture and other wooden objects. There is existing Japanese and South Korean investment in eastern Siberian logging. With a system of sustainable development based on Scandinavian techniques, production can be increased and maintained at a high level for a long period which will serve as a basis for manufacturing in the port areas and/or closer to the forests.

Business Services

In the area of services, investors in Primorsky Krai, including Nakhodka, have already led the way. Engineering, computer services, marketing and tourism companies have already been established. The rationale for the first three categories is obvious.

Tourism

Tourism will be of two types:
appealing to South Koreans, Chinese and Japanese for whom the area has links to the history of their nations; and
other nationalities interested in the ancient sites, nature

preserves, pristine coastal
beaches and undeveloped forest areas.

Financial Services

Finally, there is the banking and financial services sector which is underdeveloped. Making payments abroad, trade financing, the conversion of foreign money and financial instruments are all currently difficult. Foreign banks are permitted in both China and Russia. The latter has the fewest restrictions. DPRK has no foreign banks. TRED A is at the point where expanded foreign investment in services is needed, carries less risk than in the past and is likely to reap rewards fairly quickly.

INVESTMENT REFERENCES

This publication contains the complete documents or major findings of the various TRADP Subcommittees.

A list of the source documents follows, with the names of the Subcommittees' principal professional consultants, from whom the originals may be obtained. They should be reviewed by potential investors. Two other investment-oriented documents that are not included are described at the end of the list.

"Conceptual Infrastructure Master Plan Tumen River Economic Development Area",
CPCS Ltd. Montreal, 84 pages

It covers railroads, highways, ports, airports, power, water.
Telecommunications Master and Implementation Plans, BETELCOM, Brussels, 122 pages

"A Recommended Strategy for Development of the Tumen River Area and North East Asia", PDP, Victoria, Australia

General development and business conditions and projections are presented.

"Promotion of Industry in the Tumen River Economic Development Area (TRED A): Industry Sector Profile, Development Opportunities and Constraints", UNIDO, Geneva, 87 pages

As the title of this document suggests, it is primarily an industrial sector profile. As well, however, the data collection team identified as priority investment possibilities the following sub-sectors:

- Light industry
- Leather industry
- Shipbuilding and repair
- Military conversions

Pharmaceuticals
Construction materials
Automotive components
Fish processing
Livestock/meat processing

"TRADP Tourism Study", Esuko Oy, Helsinki, Finland, 69 pages

It describes the region and its potential.

"Project Development and Environmental Strategy for the Forest Sector", 85 pages;

"Project Presentation Report, Vol. 1, Primary Projects", (intro. and 5 project studies); "Vol.

2 Other Projects" (14 project studies), Jaako Poyry Oy, Helsinki, Finland

It is an in-depth analysis of forestry industry potential in TRED A and its service area.

"Preliminary Environmental Study", The Chinese Research Academy for Environmental

Sciences, Beijing, approximately 170 pages.

Contents are:

Air Quality
Water Resources
Wetlands
Land, Forestry, Reserve Systems
Marine
Biodiversity

"Water Resources Definitional Tasks", Reiter Oy, Helsinki, 30 pages plus annexes

Starting with the premise that "water is a natural resource which is the base of life", it goes on to describe the management, conservation, and dangers associated with its use.

"Studies in Support of Tumen River Area Development Programme", Korea Institute for

International Economic Policy, Seoul, 648 pages.

Areas covered are:

Macroeconomic Projections
Consistency Analysis of Development Plans
Intra-Regional Trade
Division of Labour in Light Industries
Power Generation & Distribution
Land Use Plans

"An Investment Plan for Northeast Asia Railway and Harbour Construction in the Near

Future" (not included), prepared by the China Northeast Railway and Port Group, Limited of

Jilin Province, China with the assistance of a professional accounting/consulting firm from

Hong Kong

Railway interconnects and port developments Jilin Province to Zarubino and Rajin ports; Related transportation and commercial buildings and facilities

"Projects for Investment: The Rajin-Sonbong Economic and Trade Zone, DPR of Korea"

(not included), prepared by the Committee for the Promotion of External Economic

Cooperation of DPRK, 21 pages

Contents are:

Investment by Stages (1993-1995, 1996-2000,
2001-2010)

Seaport Projects

Railway

Highway

Aviation Sector

Telecommunications

Power Sector

Tourism and Service Sectors

Industrial Projects

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Nautilus Institute

2342 Shattuck Ave. #300, Berkeley, CA 94704 | Phone: (510) 423-0372 | Email:

nautilus@nautilus.org