



*Silent Partners: Chinese Joint Ventures  
in North Korea*

A talk by

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**TRANSCRIPT**

**Jae Ku:** Well, ladies and gentlemen, welcome. My name is Jae Ku; I'm the director of the U.S.-Korea Institute here at SAIS of Johns Hopkins University. Welcome to the USKI report release of "Silent Partners: Chinese Joint Ventures in North Korea" by Drew Thompson, director of the China Studies Program at the Nixon Center.

Before I get started let me take care of some housekeeping, if you have a cellphone please put it on vibration or turn it off, we'd greatly appreciate it and I always forget to do it myself. We'll probably have Drew speak for a half hour; afterwards we'll open it up for a Q & A.

I have to admit, this is one of the most interesting studies on North Korea that I've ever read recently. It's important, we've often heard that China is considered North Korea's lifeline. Chinese aid, trade investments – all very critical to propping up the regime, preventing the regime from collapsing. But really, we have very few, if any at all, the kinds of studies that really provide the concrete data into the who, the what, the where, and the how – how trade and investments are done between China and North Korea. The implications of this study are enormous. The Chinese financial investments in North Korea, we think, they're just politically significant, but how so? The China-North Korean joint ventures contribute in a very interlocking manner of China-North Korea relations, but how so? And what do these investments tell us if you are in the South Korean perspective? What does this say about short-term, mid-term, long-term interests of the South Koreans, especially as it relates to potential and future unification? Recently, the U.S.-Korea Institute hosted the Mayor of Incheon, Song Young-gil, we all think that he's an aspiring presidential candidate from the Opposition Party who lamented very strongly the fifty years of lease of the Rajin port and how this is detrimental to Korean national interests.

This study is more so interesting personally to me because I had a chance to travel with Drew in one of his fact finding, data finding trips this past summer in Dandong where we had to be evacuated out because of the floods. And to sit in an interview with a Chinese businessman who has operations out in North Korea, very fascinating. So, before, I don't want to continue, let me go ahead and just introduce our speaker, Drew Thompson, Director of China Studies and Starr Senior Fellow at the Nixon Center. Before coming to the Nixon Center he was the National Director of the China MSD/HIV/AIDS partnership. He was also Assistant Director to the Freeman Chair in China Studies at the Center for Strategic International Studies and he also has private sector experience, having been a president of a Washington D.C. company that manufactures snack food in China and also founded the American Chamber of Commerce

Transportation and Logistics Committee in Shanghai. He is a graduate of Hobart College, was a graduate student at the Johns Hopkins University Center for Chinese and American Studies in Nanjing and did his Masters in Government here at Johns Hopkins University. And I told him next time I see him I'll get him a Johns Hopkins University tie. So without further ado, please welcome Drew Thompson.

**Drew Thompson:** Thank you Jae. I'm gonna make the remarks from here; I'll scoot out of the way a little bit so that you can see the presentation. There are a lot of people that need to be thanked for helping me with this report and I thank Jae first and foremost amongst them, he's been very helpful in conceptualizing this and this has been a work-in-progress for about 18 months. It started with the very basic research question posed essentially by some anxious South Korean friends: Is this tidal wave of investment that's sweeping into North Korea, how important is it? Or more importantly, why are we missing out and what are we missing out on?

So it started out with the let's dig a bit deeper into this and there were a number of other people that were helpful in conceptualizing this: John Park at the U.S.-Korea Institute, who wrote in 2009 also a fascinating report called "North Korea Inc" which looked at state trading companies in North Korea and how they supported the regime and this is that Chinese piece of the puzzle that links in to the "North Korean Inc" side of the equation because they can't do business without outside partners and so this is really a look at Chinese outbound investment into North Korea and what it might mean in terms of geopolitics, in terms of strategy, and implications for both change on the Peninsula and South Korea's strategic position. Obviously a lot of people at the Nixon Center helped me.

Jae was a lot of fun to travel with. That trip to Dandong was memorable; we were literally evacuated from hotels as the flood waters on the Yalu River rose. Dandong City has flood walls

set back from the river that prevent it from being flooded. But of course real estate development in China has led more and more construction on the inside of the wall, including our hotel. It's prime water front property and unfortunately it became prime under water property and we were forcibly evicted. It was, like many Chinese operations, somewhat ad hoc to the point where we were tossed out without Jae's passport, had to figure out a way to get back through the wall and the Chinese know a thing or two about putting up a wall and not letting the foreigners back in. So, we've learned a lot in this process and I'm not sure we come away tremendously wiser, but there's certainly some more data points to chew on and I think I would like to caveat that there are a lot of statistics in this report.

I'm sure that you can find conflicting statistics somewhere that negate just about every finding in this report. Wherever possible I try to stick with official government statistics as opposed to slightly more speculative ones. Unfortunately, there's not a lot of consistency amongst Chinese government and South Korean government, or even different Chinese government statistics from different bureaus or government departments. And the result is it's a little bit frustrating when you find basically the one fact you're looking for in two different statistics. And the result is that I would arbitrarily pick one that seemed to fit or try to average them out or whatever the methodology is. The point though is that you will find inconsistencies in here, don't be alarmed. I think what are important are the trends and that's what I'm trying to track here.

The opening question though: Who are these North Korean trading partners, who are these Chinese companies, and what are they trying to accomplish? Is there a plan to colonize North Korea through these investments and obviously this is a major South Korean concern. What is their intent? Honestly, despite a lot of these concerns I couldn't find any evidence that Chinese economic influence, in terms of the joint ventures, was somehow changing the equation on the Peninsula. We'll get to that some more. This study was really premised on trying to figure out

who are they, what are they trying to accomplish, and whether or not it was changing the balance of power - the balance of influence on the Peninsula. And I think South Koreans have a reason to be concerned. I think North Koreans are equally concerned though I do not do much peering into North Korea in this study. I don't consider myself an expert on North or South Korea; people like Jae are my window into South Korean political thinking. But in terms of what the North Koreans feel about Chinese investment, I've really left that one off this report. But the question is: Could we find evidence of some evil plot? And I think you'll see by the end, I couldn't find any.

In terms of, I mentioned sources being always a concern; I've tried to stick with Chinese sources or South Korean sources for statistics. It's also important to note that I've taken a somewhat realist, as opposed to idealist, perspective on a lot of these investments. When you're hearing about, in the news, some new project that's going to be billions of dollars worth of investment or an MOU that's been signed that promises to change infrastructure in North Korea as we know it. An MOU is not the same as a contract; a contract is not the same as an actual investment. So, wherever possible, when faced with an inordinately large statistic, I would try to dig a little deeper and find something that matched up with actual investment, or actual accomplishments, as opposed to more aspirational figures. So, that said, I think there's a lot of, it's apparent that in China that there's a great deal of expectation, however the expectation so far hasn't really translated into performance.

It's worth stepping back for a minute and thinking about, first, not only are what North Korean companies trying to achieve, but what are the Chinese strategic perspectives of North Korea. And I've laid them out, these are all fairly well covered, I've written on this in the past. Many others have published a report for the Korea Economic Institute, last fall, that looked at how Chinese strategic thinking on the peninsula and the six party talks and denuclearization coincide,

or don't, so there's a lot of reading on this, but basically we know that China wants to maintain the status quo. That really translates into propping up the regime and ensuring its continued survival. At the same time, China's basically against unification, in practice and principle I think they'd accept it, but it's more of a case of what that future unified peninsula would look like. We've had some small insights into that, we know that they might be satisfied with a peninsula that's not antagonistic and doesn't have an alliance against them, but essentially maintaining the survival of North Korea requires Chinese inputs. It requires aid, it requires trade, it requires energy, food, and it requires investment in technology.

Now I've chosen to focus on joint ventures because I think they're a very tangible manifestation of Chinese commitment to North Korea. I think trade and aid are important but I also find them much harder to track, and much harder to track with accuracy. In a way, joint ventures represent the, essentially, Chinese investment in North Korea's future. These are agreements and commitments of capital between a Chinese entity and a North Korean entity that's under the state. Basically that means that they are committed very much to the continued survival of the regime. The disillusion of the North Korean government on a practical matter would raise a lot of the contracts in place into question. How do you have a joint venture when your partner, which is part of the army, or the party, or the cabinet, they suddenly cease to exist. If their chain of command dissolves then what does that mean for this joint venture and investment. And if somehow the government is reconstituted, again, what does that mean for the state run enterprises? Are they still owned by the state, are they privatized, is it a mad scramble? These are all questions that I don't get into in the report in too much detail but I think it might reflect a bit on Chinese anxieties and really their expressed preference for the status quo.

We know that Chinese strategy towards North Korea is largely predicated on not only maintaining its survival but getting it to moderate its policies and that's where this Chinese

engagement approach really comes in. It's about trying to convince North Korea not to be provocative, to engaging with the other members of the six party talks in particular, but also to become a more normal country and engage in a reform and opening process much like China has. And I think China looks at itself and sees North Korea in an earlier state. In that way it's paternalistic but I think it's a common perception, particularly in the northeast where they see North Korea making policy mistakes – domestic policy, social economic policy, foreign policy mistakes that China no longer makes. And they attribute that largely to a more pragmatic, domestic, and foreign policy which is kinda encapsulated in the reform and opening process.

There have been lots of examples on how China's prodded North Korea to enact this reform and opening. They've always been somewhat polite, but every time Kim Il Sung would go to visit China they'd take him to an economic zone, they would take him to Shanghai, same thing with Kim Jong Il. He's been to the Shanghai stock exchange, he's been to Shenjian. When we were in Dandong one of the interlockiters was explaining to us that we keep trying and we keep showing him the advantages of development. Look at our skyline and then look across the river and look at theirs. You think he doesn't see the difference, you think he's not getting this message. He's like, why don't they do it – they're a little bit behind us, but, we're going to keep showing him the difference, we're going to keep showing him, keep the lights on in Dandong so that they see it through the darkness. And one of them pointed out that when Kim Jong Il visited the Northeast in May of last year they actually, the Chinese side, the way he phrased it, I think he said, they forced Kim to get off his armored train and get into a car and drive from Dalian to Beijing by road so that he would see economic development in the countryside, so that he wouldn't be removed by the bubble he traveled in. And the idea that he would get, the idea that, it's not just urban development it's social development and rural development and a whole host of changes in China that North Korea's yet to make. Hu Jintao even stated that in August in his followup trip where they used the word 'opening'. Which is something the North Koreans find a little bit

insulting I think? I think they find it rather presumptuous of the Chinese to impose this reform and opening model on them and I think the Chinese have been respectful and not used that term frequently. But they did use it in August and I think the quote was, and this comes right out of Xinhua, they said, “Besides Beijing Kim also toured some of China’s reform and opening upfronts including the Economic Development Zone, bonded ports, and high tech companies in the cities of Dalian and Tianjin and Shenyang.” So I mean, they’re starting to use the word opening and reform more often as an example to North Korea. And I think, the question amongst most people in China is, why are they not taking advantage of this?

Before you can really think about Chinese investment into North Korea you kinda also have to look at Chinese outbound investment globally. It’s not unique in many ways to North Korea, there is a sense in South Korea however that there has been this wave of investment that has come into North Korea recently, but in reality it’s been a wave of outbound investment globally. So, if you look at it narrowly it’s a bit more dramatic in the North Korean sense, partly because of not a lot of other investment flowing in so it’s got a much higher impact, but it really has been a fairly new phenomenon. It’s driven by a number of factors. It’s driven by China’s go abroad policy which is really driven by WTO accession. And China went through a period in the late 1990s reforming its state-run enterprises and preparing to open up its economy so it could join the WTO but there was a lot of preparation done, basically awareness raising amongst business people, increasing capacity, and the recognition there would be growing competition domestically and the need to compete internationally. So, *zouchuqu*, this go abroad policy really facilitated Chinese outbound investment globally and some of it was fairly straightforward, such as increasing ability for Chinese investors to access hard currency. I mean the RMB is still not convertible though one of the things that happened in the mid-2000 decade was instead of having to go to the central government in Beijing to get approval for hard currency; they centralized it so that provinces and eventually some local jurisdictions could basically approve outbound



investments in hard currency. That suddenly facilitated a massive increase. At the same time you've also seen more rigid regulatory environment that was a response to some very high profile failed investments abroad. I think there were a lot more smaller failed investments, there was a lot of capital flight, I think there was a great deal of fraud going on in China in the later 1990s, so this was also an attempt to bring some discipline to the market. So you've got this regime in China forming that would qualify outbound investment better and one of the examples is outbound investment was eventually required to have any outbound investor register with the Ministry of Commerce. That's an important distinction, if you think about it in the United States – if you want to invest abroad, as long as you're not violating monopoly statutes, you don't have to ask permission, China you do. And what this has done is it's basically narrowed the band and prevented a lot of irregular outbound investment.

The other issue, of course, is that costs in China have been increasing, some of it we read about often: Labor shortages in the special economic zones and in south China, Guangdong area, so you've got rising labor costs, shortages and you've got increasing costs for electricity, for energy, and in some cases you just have better enforcement of environmental regulations that leaves some of these investors, particularly in heavy polluting industries and more labor intensive industries, to seek other places. And North Korea is attractive for some of them.

Obviously, rising global costs for commodities is an important factor as well. There is high political risk to invest in North Korea and we'll talk about that in a bit. It's not an easy place, but basically the benefits will have to, at some point, outweigh the risks. And if you look at things like coal production, China's been a net exporter of coal for most of the last two decades, but in about 2009 China became a net importer of coal, and essentially what's happened is the cost of Chinese domestic coal and transport bottlenecks and a few other factors have risen the costs to the point where imported coal suddenly becomes much more cost effective, it becomes cheaper.

Copper, zinc, these are other items that have pretty wild price swings. I mean the price of copper I was tracking and the price of copper in 2003, it was \$2,000 a ton, in 2006 it hit \$5,000, 2007 it hit \$7,000 and then it reached \$9,000 in 2010. Now somewhere between 2007 and 2010, as you might imagine, it tanked, so I mean you've had these wide swings in copper prices, the same thing with coal prices. One of the things that Chinese companies have done to adapt is invest in processors and invest in mines. One of the reasons they are doing that is because China does not have well developed commodity markets. There is now trading in copper, zinc, maybe one or two other metals, but by and large most companies have not been able to effectively make use of futures markets, arbitrage schemes to mitigate their trading risks and one of the ways they do it is vertical integration. So, there's been a wave of outbound investment in the extractives industry, and we've read about this, China has a mine in Zambia or a mine in South Korea, but if you look at China's outbound investment, this is one of the areas that it's definitely going and North Korea's no exception.

I think one of the other factors of course is that you have to have a certain amount of pull from foreign countries. In places like Australia there are actual government offices in different states of the different Australian states. They have China experts in the government whose jobs it is to attract Chinese foreign investment. They basically have ambassadors to bring in Chinese companies to help them invest in various projects. There are active efforts to attract capital from China in places like Australia and South Africa; it's not all Chinese companies with wads of cash looking for places to park it, there's a receptive market. And I think North Korea is also been looking for foreign investment and they've been trying but I don't think they've been successful yet in coming up with the right formula. There's a whole section in the report about Rajin and the experience with investors there. Someone once said this about India, "It's always forever the market of the future, never the market of today." You start going back looking historically at the efforts to integrate Rajin with the rest of northeast China – it's a graveyard for failed MOUs, for

companies that have somehow gotten a concession and haven't yet been able to implement it. So it's a very difficult investment environment despite North Korean desire to bring it in, it hasn't yet become a very favorable destination. I think that if you look at Chinese outbound investment, and the question is: Are they trying to achieve some strategic objective or strategic influence? I definitely see an interest in commodities but it's hard to see China using its outbound investment as somehow strategic leverage. I don't think they're practicing some checkbook investing or checkbook diplomacy through investment but that said, it's definitely linked to resource acquisition.

This is a chart from the Ministry of Commerce in China who puts out an annual outbound investment report. The latest statistics cover up to 2009. This gives you a sense of how much it has grown and, actually prior to 2002, Chinese outbound investment was so small they didn't even track it themselves, as I mentioned it was somewhat chaotic but by and large it didn't matter. So most of the statistics are UN statistics that the Ministry of Commerce simply accepts and then after 2002 you're then using Ministry of Commerce statistical methodologies. Now, one of the problems in tracking data is that the Chinese ministries have a habit of changing the denominator from one year to the next when they're assembling statistics like this. So actually there are some bumps in here and anomalies because of the way they calculate outbound investment and whether they include, for instance, financial outbound investments versus non-financial. This is technically all investments including financial but prior to about 2006 I don't think they included financial investments – purchases in banks, bond investments. I don't believe any numbers, any statistics. I find them really hard to get a grip on. I mean 56 billion dollars, I've never seen a billion dollars, I don't have any real sense about how that impacts globally. Its small compared to global investment flows, China's normally less than 5 percent of total outbound investment, but that said, the change and the trend is pretty dramatic and I think that's the take away here.

The go abroad policy starting in about 2002 is really evident; you can see the impact it's having. Whether, I think you can quibble with these statistics if you look at government statistics on inbound rates of investment, how they calculate China – they won't all add up, but I think the trend is clear. It is growing and it's growing fast. But just by comparison, if we look at that number, for say, 56 billion, and again the numbers here because it's a Ministry of Commerce chart it says 565 but the way the Chinese count they put commas in a different place, if you will. So it's 56 billion dollars in outbound investment, but inbound foreign investment to China was 105 billion in 2005 so China's still a net absorber of investment.

Again, why are we focusing on joint ventures for this North Korean equation? Because, as I mentioned, these joint ventures have a real stake in its future. And I think presumably they contribute to stability in North Korea. We can assume that it creates employment. We do know that Chinese investors pay a higher salary than market and we hear different amounts, one of the investors that we met with said we pay them 50 euros, sometimes it's dollar denominated, sometimes it's euro denominated. There are different methodologies, some companies pay the workers directly, others give a lump sum to the North Korean partner who then distributes it, or not, we don't know. So there are different structures, but by and large, the Chinese I've spoken to and the general sense that I get is that North Korean workers and Chinese joint ventures are better off than their counterparts in state owned enterprises. We can assume that that contributes to social stability. There's potential for other implications in terms of how those workers perceive China, and how they perceive the outside world. We also know, of course, that hard currency transactions directly benefit the regime. I mentioned John Park, his excellent report in 2009, "North Korea Inc", where he really outlines how these various offices absorb transactions and things like office 39 and others then channel funds to the regime. One of the quotes in that paper was memorable, it said basically that resources from the state coffers are only provided to

individual cabinet level or military budgets after Kim Jong Il's personal requirements are met. So clearly there's an interest tax, if you will, and these Chinese investments create wealth, that then goes to support the regime, and that we assume is one of the main means that Kim uses to buy loyalty amongst senior officials and possibly fund other special projects.

I think one of the research questions for this project was whether or not Chinese investors can shape Chinese policy towards the peninsula, and I'll get to that at the end, but it's also unclear whether or not they can shape North Korean investment and I decided to really leave that out of the report but I think that may be an area to study going forward. What influence do these have on changing both North Korean workers perceptions, culture perceptions, economic balance, but also what influence do they have on leadership thinking?

One of the questions that I was asked in a review process in running some of the take aways from their report was from a South Korean friend who said, "What percentage of total North Korean investment do Chinese companies make up?" "That's a really good question; we'll have to check with North Korean economic sources." "Good luck." We can guess there's no really good way to look at it, if somebody has access maybe that would be a good follow-up report. But there is a teaser in this report that looks at the Pyongyang trade fair and where Chinese companies compare with others. One of the statistics we dug up was that of the total number of exhibitors of the spring 2010 Pyongyang trade fair 57 percent of them were from China. And then, of those 57 percent, 42 percent of them were from Dandong City. We can talk a little bit more about Jilin Province versus Liaoning Province; it's an interesting interplay between the two. There's local protectionism and there's competition between Dandong and Yianbian in particular the two border regions – one in Liaoning, and one in Jilin province, for access to the market and I think by and large Dandong is winning.

Here are some official Chinese statistics and all of my caveats still apply. This slide gives you a sense of the scale – the top figures are in millions so we’re not talking a lot of money here. 5 million, 5.86 million in U.S. dollars total in 2009 is really quite miniscule. If you look at the total 98 million, again, miniscule especially if you compare it to other states in the region. Now never mind South Korea, where obviously you’re going to have a much more economic integration, but, I mean Mongolia, Myanmar, Vietnam, and even Thailand you have much, much smaller rate of investment to North Korea. Now Thailand is an interesting case. I don’t see Carl Jackson here, the head of the Asia Department, if he were here he’d ask, “Why is Thailand so small?” It’s a good question. It might be because a certain amount of investment into Thailand goes through Hong Kong and therefore isn’t captured in these statistics. It’s also possible that at that top number of 98 million Chinese investments in North Korea is channeled through third countries. Macao for instance, it’s not captured in these statistics. The question there is does that matter? And I think it does in terms of social stability, economic impact in North Korea. But in terms of the question of whether those companies then influence Chinese policy making that’s another question. Does a company in Macao have the same influence over central government policy of North Korea as a company in Dandong, or a company in Beijing for that matter?

One other question that I cannot answer is how much of China-North Korea bilateral trade is conducted by joint ventures. There’s no way to disaggregate those figures. One more statistic that’s not in this slide but worth noticing is that there’s not a lot of Chinese investment in North Korea even when you compare to something such as South Korean investment in China, just in terms of scale. There are approximately 20,000 South Korean companies invested in China over the past 20 years with accumulative FDI of 29.3 billion. So you look at 29 billion from South Korea going into China and then compare that to 98 million going to North Korea over that 2003-2009 period, I think we’re looking at a fairly small scale.

These are the statistics graphically represented; again, I don't like the numbers as much as I like the trends and curves. Black line is North Korea at the bottom, the dotted line that seems to shoot up is Myanmar, I would suspect that a lot of those rapid increases such as 2008 where Myanmar is going like this, that's probably two pipelines. It's still not a lot of money, 41 million. It gives you a sense of where North Korea compares to these other countries on China's periphery.

So this is the heart of the study. We basically collected information on 139 joint ventures from 1997 to August 2010. As far as I can tell this is all of the legitimate joint ventures in North Korea. Now this doesn't count how many have failed and closed up shop, it does not count trading companies, it does not count companies that are maybe invested in an infrastructure project where the Chinese side does not have an equity stake, and it also doesn't capture illegal or informal investments. Now I mentioned that to somebody and they laughed. How can there be an illegal or informal investment, but if you think about the mining sector in China, China is littered with illegal mines and informal mines. You can drive through the country side and find literally guys crawling out of a cliff at the side of the road with a bucket full of coal and you realize that's not a state owned regulated mine that's just a bunch of farmers that have dug a hole and are pulling coal out of the seam. And sometimes those get successful enough that they become little incorporated businesses but they're not necessarily regulated by the government.

So I think there's probability that you have a fair amount of investment from small companies, particularly ethnic Korean ones, ethnic Korean-Chinese ones from places like Yianbian or Dandong or Dalian that have ventures in North Korea that are not captured by official statistics. But that said do they matter? I would posit they matter less than the official ones. Companies that have gone through the trouble to register their investments, that have contracts that are then proved by the Ministry of Commerce on both sides, by the foreign ministries on both sides, then they will enjoy a certain amount of state sanctions and state protection that then has serious

implications for dispute resolution or the future of the peninsula as I mentioned.

Obviously all of these figures are in the report. But the number of joint ventures per year is at the very bottom here, this is a three axis chart, so the number of joint ventures at the bottom here you'll notice is really relatively small. On the far side, you've got the total number of investments, or the total value of the investments, and then here you've got an average value. Now this is not terribly scientific, no one will ever accuse me of being an economist. Basically you take that number and that number and you come up with this number. But it gives you an average size and you notice they track fairly closely but you have an interesting aspect here in that 2008 you had only 10 joint ventures being signed, but at the same time you had a fairly high value and that meant that the average value reached about 4 million. But if you look at all of the other years they're much more modest. The actual values of these investments are all under this level here. They're at a million dollars, for most years it's even under a million dollars. So these Chinese investments in North Korea are all fairly small scale. I'm not sure if it's worth taking the average out overall but it's really less than 500 thousand dollars per investment. So the point is, if you take out maybe one or two fairly large scale investments you're really looking at small scale, small and medium enterprises. Those statistics are borne out when you really look at who are these people – the guy with the cat and the evil intent. Are these a bunch of Beijing state owned enterprises working for the Central Committee taking over North Korea? And the answer is, they're not. Only 4 of the investors I could find were from the 150 that were owned by the central government. You know, keep in mind that when we talk about state owned enterprises in China you've got a central government owned corporation, of which there are about 150, that number changes as they merge and some of them get sold off, but there's now 150. And then the rest of the state owned enterprises in the country are owned by provinces or local level governments. If you look at those Beijing owned companies they're only four: Wuhan Iron and Steel, Sino Steel, Min Metals, and China Nonferrous. Those are the only ones. So to me that does



not scream China plot.

The other thing I cannot tell from the data is how many of them are owned by ethnic Chinese, you know the *chaoxianzu*, and how many are owned by Han Chinese, for example. That data's not captured by Chinese statistics and I imagine if you look at companies from Yianbian or from Hunchun there's a high probability that they'll be ethnic Chinese but if you look at a city like Dalian, where you have a large number of Chinese investors in North Korea, Dalian has an ethnic Korean population but it's not huge. But I would assume that a disproportionate number of them are involved and some of the people that we've interviewed are ethnic Koreans that run their businesses out of Dalian.

What was also interesting to me was how much data was available on these companies. As I mentioned, 85 percent of them have a website and to me that was a fairly large number. Now, not all of them have big corporate websites, a number of them you could just find on Alibaba, and the methodology for coming up with that was just to search two of three major Chinese search engines, Sina, Baidu, and then looking at Alibaba to see who comes up there. Basically if we couldn't find you on Sina, Google, or Baidu we decided that doesn't constitute a web presence. But basically you've got the vast majority, that's 95 percent of the Chinese search market. If they're not listed on those then who cares if you have a website, if it can't be found? But, the idea is: These guys are not hiding. Now, are they thrilled to be talking about their North Korea investments? No, there's definitely a stigma attached to investing in North Korea. But a number of them are willing, and again, for some of the companies that are also trying to facilitate or have their own investment but are seeking outside capital so that they can then increase their investments, they have to advertise. If they don't they won't be able to attract new capital. So there is an element of "Well, we want you to know that we have a successful business there but we don't really want to discuss how successful it is." Part of the survival there is rent seeking

behaviors, that's the nicest way you could say it, there is a lot of predatory behavior in North Korea. If you have money, someone's going to come after it. If you have a successful business, someone's going to come after it.

One of the interviews that were quite illuminating was how one investor basically hedges. How he has a poor business trading zinc but then he has all these other ventures, with the same North Korean partner that he basically uses to protect his zinc business from basically predation. From having his own North Korean partner taking the zinc out from his mine, selling it to other traders but also to support them so that they can withstand, essentially, attacks from the Korea Peoples Army and from other government departments that were going after these essentially strippable assets.

The next question was where are they from? This is a little hard to see but this is Liaoning, this is Jilin. Eight percent from Beijing. Shandong, again, which has a fairly large Korean presence. Again, what this tells me is we've got very few investors from Shanghai, Zhejiang, Jiangsu, and Beijing. We also have very few from Heilongjiang and that tells me that this is not some northeast Asia strategy, this is very much a border based strategy.

I mentioned before the competition between Jilin and Liaoning and it's definitely there, it's not what I would consider to be debilitating but it's definitely there and it's definitely a factor. There's Tumen, and there's a lot in the paper that I won't get into here, about how Jilin Province, in particular, but Liaoning Province as well, has really invested heavily in integrated economic plans and they're pouring concrete like you won't believe, building roads, they're building buildings. I've got pictures in the report, some of them we took. Carla Freeman and I went on up to Yianbian in 2008 to look at all the activities that were going on in Hunchun and Tumen and you've got these massive buildings for customs clearance and nobody coming or going. And the

other day there was a newspaper article in China Daily called “Silent City” looking at essentially the failure of the Tumen investment strategy. You’ve got these bridges. When you go to these border crossings up in the Dalian area, in the Dandong area as well, they’re tourist attractions. People are standing on the middle of the bridges getting their picture taken with North Korea in the background. You don’t have to get out of the way for the trucks, you don’t have to get out of the way for the trains – there’s nothing happening, the roads are empty. Again, Professor Freeman and I took the highway from Yianbian’s capital, Yianji, all the way to the end of the border in Hunchun and that must have been a two, three hour drive. You don’t pass cars, you don’t pass other trucks. Dandong is not much different. Jae and I have a story driving on the highway in Dandong – there’s not a lot of other traffic aside from the police.

Again, there’s a lot in there about how Rajin Port fits into the Jilin strategy and how there’s a lot of aspirations – I won’t get into that here. I do want to end to make sure we have enough time for Q and A. It’s interesting, most of the trade between North Korea and China goes through Dandong, about two-thirds go through Dandong, leaving the border crossings in Tumen empty. But that said, of all of the Chinese investment in North Korea, Jilin factors fairly large. Here it’s 29 percent of the total Chinese investment but by Jilin’s calculations they make up 30 percent, or 38 percent. So, Jilin figures it has accounted for 38 percent of China’s total investment in North Korea. Jilin, in particular, is really dependant on North Korea, I think more so than Liaoning. Partly because Dalian is Liaoning’s access to the outside world and to developed markets in Japan, and Europe, and the United States. But Jilin is landlocked. They keep looking at the Sea of Japan, the Yellow Sea, in the distance and the East Sea and they’re saying, “We’re only a few kilometers, if we could only get over that little piece of marsh and get to Rajin port, we’d have a port of our own.”

Jilin, their fourth largest trading partner is North Korea after Germany, Japan, and of course,

South Korea. And I think the United States is probably fifth. That in some ways make them vulnerable to the geopolitics, it makes them dependant on trade, it also makes them, in some ways, a victim of sanctions and I think that becomes apparent when you travel to the region and you look at these expectations that they have. That you look at the investments that they made in order to tap into North Korean potential, they see themselves as being thwarted in many cases by both the North Koreans and the outside powers.

How do they break up? This gives you the spread. It is heavy on the extractives, its light on services. I think this would not be a big surprise if thinking about North Korea; it's roughly about equivalent to Chinese outbound investment globally, though I think if you look globally it will certainly weigh heavily towards services. There's a large section in the report about mining. Of the 56 mining investments that I counted for, out of that 138, 8 of them targeted molybdenum, which is not a rare earth. Again, never ask policy experts about chemistry, or geophysics, or however you calculate rare earths. You start saying, "Ah, look there's a niobium mine" or "There's a tantalum mine" or "There's a molybdenum mine" and you realize none of those are actually rare earths. The number of rare earths is actually quite small but molybdenum is an interesting case because it's not exclusively made in China, the U.S. and Chile are actually two of the largest reserves and miners of molybdenum. But, it's a very important element for steel production, it's a component in pipe lines, it's a component in high tensile steel, some aircraft metals, and that makes it somewhat important. To me what was interesting was even though it's a lot more common the processes involved, the technologies involved for processing is very similar to rare earths.

There are some rare earths reserves in North Korea but I don't think it's clear how much. Some people might know, but it's not available in the open source literature that I saw, but, if you can refine molybdenum and refine it I don't see any reason why you couldn't refine other materials.

Basically the processing is similar, the risks, the investment, the environmental damage from it is similar, so, if you've got those capabilities in place and by and large there are those capabilities in place. There is actually one rare earths refinery in Hamhung that's got foreign investments but it's not Chinese. The result is, potentially, this is a source of additional rare earth that could come on stream and whether or not this contributes to China's hegemony or whether it contributes to global supply remains to be seen.

I mean I should say a few words here. I don't have a separate slide and I'm coming to the end here, but I don't have a separate slide on how the investment environment is in North Korea but I think it's an understatement to say that it's bad. It's a difficult environment. The Chinese Ministry of Commerce in conjunction with the foreign ministry, they produce an investment guide to North Korea and I mentioned that to someone and they were like, "Really, really, really? That's so exciting." They're just like our commerce bureau, they produce these reports that say here's how you go and invest in England, here's how you go invest in Germany, here's how you invest in wherever. Annual country reports on the foreign investment requirement. The North Korean one is thin, it's factual, but it does describe a lot of the challenges and the wording they used is diplomatic but also quite interesting. They point out that even though a Chinese company may have a majority stake in a joint venture that doesn't give them control over it. This is a phenomenon that many American companies discovered in the 1980s and early 90s when they were investing in China and they thought they had a majority stake but because the Chinese side of the joint venture controlled the work force, the finances, the general manager positions, controlling the board didn't give you actual control over the actual entity. So I think that the Chinese are discovering this as well and they claim that this lack of control is a lack of access to data. North Korea is opaque to the Chinese, not just us. You can't get access to market data, even the census data is unreliable and not terribly useful. So it's hard for them to do marketing surveys. It's hard for them to figure out where to find clients and customers, industrial

customers. So the report says these Chinese companies often operate in what they call a state of blindness. They also point out that they are out of their depth and the other quote that I took that I thought was great was, “A passive position and an unfavorable situation.”

One person that I interviewed said that they had recently been to North Korea and, having a meeting with someone who spoke to the Chinese Foreign Minister, they were told that the Chinese Ambassador in North Korea had been telling perspective Chinese investors in North Korea to go elsewhere, that this was just not a good place to invest. So you’ve got the Ambassador in North Korea trying to discourage Chinese investors, we don’t know why. But I can guess and speculate, and I do in the report quite comfortably, it might be the terrible business environment, it might be the stigma, and it might just be the complicated diplomatic environment. Of course, several investors had said, “You know the legal system in North Korea it doesn’t really work. It’s not a rule of law place.” Basically, if you have a problem you can’t go to the courts, there’s nowhere to go. So where do you go? You run to the embassy is the answer. So I imagine the work load on the embassy staff adjudicating a lot of these financial problems is quite common. And actually that is not unusual; it is a similar case in other states where you have an underdeveloped legal system where basically the government acts as your guarantor.

Trying to deduce what is the intent. This is that number of Chinese mines; again this is all in the report. We were trying to figure out why there was this increase of Chinese investment in the mining sector, in particular 2005-2006, and was it sustained and the answer was, clearly not. But, what was driving it and asking one company, the answer was purely price. Price of commodities was going up. Coal, copper prices have gone through the roof and that makes these Chinese investments more attractive. Now, how do you come up with a grand figure? The blue line is simply an index of metals, gives you a sense of what global supply was doing, it captures iron and steel, scrap metal, and copper and is used by financial traders as a forward looking indicator

for the price of metals. So basically you can see that the Chinese companies were chasing rising prices and this is not uncommon. We've seen it happen in the energy sector, where when the price of oil is high suddenly this extracting energy from difficult places, whether it's deep water well or a low-reducing source, suddenly becomes more cost effective. Now the question is: Are these survivable over time as the price of metals continues to shrink?

Just a couple of conclusions. And I won't go through them all, they're in the report, I want to make sure we have time for questions. My big take away was most of the big Chinese companies that are investing in North Korea, or investing in the border area, are not necessarily seeking to exploit the North Korean market. What many of them are doing is positioning themselves for that future reform and opening that may or may not occur in North Korea. They're anticipating that this Chinese pressure and every time Hu Jintao meets with Kim Jong Il he mentions, "When are you going to reform and open?" They're hoping that the North Koreans will take heed and eventually open up and they want to be ready. Now in some ways this justifies many of the investments that are being put in place, in some cases it reflects the wide availability of deep capital in China. You can do these projects because the banks are giving away money at low interest. And of course that's boosting the economy. This is a virtuous cycle in a lot of ways regardless of North Korea. Where does Chinese economic growth come from and in many cases its investment and infrastructure. Sometimes sustainability or return on that investment is a secondary consideration and I think in many cases it'll have to be in the case of some of these northeast investments.

One thing that is also worth remembering, and I'll jump to the bottom of this slide, is sanctions. When you're talking to people in northeast China, and I discovered this, Professor Freeman showed it to me; you can have long discussions with your Chinese friends about North Korea and not mention the word 'nuclear' once. It's just not an issue for them, "its high politics, we're

involved in business” or “We’re involved in local development” or “We’re involved in border security issues.” The nukes are esoteric issues; they’re not even a threat as far as we can tell. So in some ways they cannot even see a connection between their ways and activities and the broader geopolitical context that we tend to see North Korea in. Their interests are very finite and they’re also very tangible.

This also reflects the way that China interprets the UN sanctions, 1718 and 1874. These are targeting the nuclear and the missile programs, not normal trade. And they’re carefully worded, and when you read them you can see the Chinese hand in the editing process and in the negotiating process at the UN. These sanctions are not targeting regular business; they’re targeting these special areas. So, they don’t see this as constricting their abilities at all. We have to be realistic for us, the implications for us are that the sanctions are not going to be effective at choking all trade and all investment to North Korea. Now what’s happened is the South Koreans have unilaterally restricted all their investment, we also unilaterally restricted our investment, but the Chinese clearly are not going to do that.

I think one other quick observation to make too, going back to that slide that showed how most of these companies are small and local, they’re not big. The fact that you’ve only got two or three of the 100 companies in China invested there says something. This is really a playground for entrepreneurs and specifically entrepreneurs from the northeast. They have a higher tolerance for risk, but at the same time, one of the people I interviewed. I asked him, “Where’s all the steel, you guys are doing all this investing and mining and investing in steel companies and where are the big companies?” The guy kinda laughed and said, “Really, if you thought there was real money to be made here I’d still be here? They’d come in and buy me out, they’d push in and dominate this market, the way they dominate every other market. Because this is still very marginalized we have a role, we have a place.” And I thought that was telling, but it is also very



relavant to the big picture.

What are the opportunities here? I think one of the ones that's intriguing is what can we learn about what's going on in North Korea from these joint ventures. I mean they are a window in some ways to what's going on in North Korea. They might be early indicators of change, positive or negative. They certainly can give us some insights into state capacity. They can give us insights into leadership. One of the issues in the report that I raise is the application process and the process of choosing partners in North Korea, you kinda have to choose a partner in North Korea and stick with it. You can't just arrange a partner, you gotta pick a team. And when you've got different teams competing essentially for investment or for resources potentially you can see, you can get some insights into the higher level elite politics that sponsor and control these different North Korean entities.

They're also potentially important in light of sudden change. If suddenly things start to destabilize these ventures, while they're small, they might become significant. These are tangible interests that China has in North Korea. They're also Chinese citizens present and if you've got law and order situation where Chinese citizens need to be protected that is going to raise a whole series of discussions in Beijing about what to do. And this is not unique to North Korea; we've seen this in 2009 when there was instability on the China-Burma border, when people were uncertain what to do about ethnic Chinese living in Myanmar. This was also the case in the mid-90s when there was unrest in Indonesia targeting ethnic Chinese. What should the Chinese government do to protect overseas ethnic Chinese? Now in this case they are not overseas ethnic Chinese they are Chinese citizens. If you've got instability, these citizens and these investments could become key factors in Beijing's calculations.

Maybe I'll stop here, I mean...

**Jae Ku:** Why don't you just keep it up?

**Drew Thompson:** Okay we'll keep it up and people can read it but it's about time for questions. I think the unanswered question here is: How much influence do these joint ventures represent? Do they have an ear in Beijing? There's some musing in the report, there's a lot of interplay between central government and officials, Jilin and Liaoning provincial officials, there's a lot of experience, the Vice Premier is former party secretary of Yianbian and studied at Kim Il Sung University. You've got a shoots and ladders exchange between the agriculture minister and the Jilin and Liaoning Provinces and they're both big bread baskets so it's not surprising that someone with expertise managing the province would also have the agricultural expertise to run the ministry in Beijing. You've got the system of representative offices between the local governments in Beijing and you've got obviously the ability of some of these smaller companies to have their voices heard. Now I think that the moment they keep their heads down, politics is not their thing. But if their investments get threatened they'll become noisy voices, they might be squeaky ones in the background, but they're certainly gonna be voices and they're gonna be loud if they see themselves as losing out. So I think they are relevant, but until you see real reform and opening happening in North Korea we're still talking fairly small scale and really what might be as opposed to what currently is.

**Jae Ku:** Well thank you Drew. Why don't we go ahead and open up for questions, if you can get my attention, raise your hand and we have a microphone or two in the back. If you can identify yourself and then ask your question with a question mark at the end. Okay, in the front.

**Question:** Hi Drew, it's Susan Lawrence with the Congressional Research Service. Terrific report, thank you. I was very struck, you've got a lot of discussion here about all the investments

going into Jilin, this Chungji Two pilot project, of course the long-term efforts around the Greater Tumen Initiative, and all the investment that China is putting into this area in the hope that North Korea will open up and I felt that that's actually a very significant part of the report, it's not just the joint ventures but also just all the investment China's putting into there is equally... says an awful lot about the way China looks at North Korea. But I had two questions related to that: One is, you chronicle the whole history of efforts to try to leverage North Korea to help to revitalize the Northeast of China and yet you keep saying although there were reports of this deal signed, that deal signed, MOU, yet nothing's happened. Wondered if you heard from any of your interlocutors why nothing's happened from the North Korean side, what kinds of reasons are the North Koreans advancing for why none of these deals ever comes to anything? That's my first question. The second question is, I'm just wondering in terms of long-term viability of all these projects in Jilin, the Chungji Two Project and so on, how much is the viability of this based on the idea that North Korea is going to reform and open up? Is there, does that area have anything intrinsically attractive that will make it successful, the revitalization of that area successful, if North Korea doesn't open up? Those are my two questions, thanks.

**Drew Thompson:** Thank you. Those are great questions. It's hard to answer, but I'll take a stab. Going back and looking at how often and how hard China has tried to get access to Rajin Port and how they have just signed MOU after MOU and yet nothing seems to happen with this Taedong Bank Development Group, the 10 billion dollar investment, I was discussing that with Professor Freeman. A year ago we had some scholars from Jilin and Liaoning here in Washington and I was talking to them, I said, "Come on, how's this different? Taking a real realist look at all these failed investments, how is this 10 billion dollars going to work? What's going to keep the North Koreans from just stealing it all?" And again, it's a predatory environment in North Korea. I think there was a Wikileaks, one of the cables that detailed some of the shenanigans that go on, I think it's probably 10 times worse than what gets leaked in the

cable but basically, you've got a desperate North Korea that's looking to get whatever advantage they have.

One of the takeaways from interviews with not just North Koreans, but I also spoke to a couple of people who are traders with North Korea who are not really captured in this report but they do give you a sense of what it's like to do business with North Korea, and these guys don't think long-term. They'll have something that they've looted, scrap metal or maybe they've got a shipment of ore that they've somehow wrestled from somebody, so they have something of value, hard currency value, that they then shop to their sources in, most often, Dandong. And basically, and this guy says, "And then the cell phones start ringing on our side." And he's like, "This is not a big town, I know all the guys that are doing business with them, these guys, they change their name, they change their company, but by and large, within a few minutes, you can figure who they're representing, never seen this guy before but you know he's KPA or he's Cabinet or he's Party." You pretty much know whatever it is that they're selling, where they got it from, and who their backing is. And he says, "Yeah, we play this game where they try to collect deposits from everybody." So they've now collected, you know, 15 percent of that shipment from 10 different people, which means they're now good, but then they want to get the other 85 percent for actually delivering. So this guy will say, yeah, so, I end up being the winner and I get this trainload of whatever it was he just paid for, I think he was getting gold ore was the story he was telling me, so he just got this trainload of rocks containing some percentage of gold that he's now going to ship off to a refiner. And he says, you know, and it's like, you know, transaction at the border as I'm counting the trains crossing the bridge and then handing over duffle bag after duffle bag until eventually there are no more cars and, you know, they stopped bringing duffle bags. And then he said the next day, I've got phone calls from all these very angry friends of mine who also paid 15 percent down for this trainload. And he says, the next time, I'll be one of those guys. You know, in other words, I can build a relationship with them

and it's not going to change.

The example of the zinc miner was the same: He's like, "Alright, I've invested, I'm now a joint-venture partner, my return on investment is supposed to be the ore but there's nothing to stop them from shipping out, from shopping that ore around." He said, "The only way I can stop it is with these other payments that I make and this rolling credit process where, if there was a functioning banking system, they'd have a letter of credit." But without that you can't have letters of credit; you can't build trust into your transactions so it ends up looking like Miami Vice. You know, you've got the two cars pulling up in the middle of the night and guns tucked away and "show me yours, I'll show you mine" then we'll make a transaction and hope it doesn't end badly. But, that doesn't lead towards long-term, sustainable or large-scale investments either. So you got that. You have the North Koreans, of course, overselling what they've got in order to collect.

So, Rajin Port's a good example. How many times have they sold that, never mind Yeonpyeong, how many times have they sold Rajin Port on these MOUs? But when you think about it, how valuable an asset is it? It's not a deep port; it's only about 30 feet deep, which limits you to a fairly small size of ship. There's like four classes of bulk cargo, and you're only going to be talking bulk cargo here, we're not talking light industrial products, we're talking the products of Northeast China, heavy steel, ores, refined products, heavy industrial products. You've got what they call handy-size, which are these smaller ships, maybe they're about 200 meters long, they can fit into the port. The next size up is called handy-max and you know, it's bigger and deeper, but they can't call at the port. Now the difference between shipping on that handy class and handy-max class, the bigger ship, is about 30 percent cheaper per unit, per ton, or whatever you're shipping. The next level up is Panamax, the biggest ship you can put through the Panama Canal, it's another 30 percent cheaper than the previous class. So, then there's post-Panamax,

cape-sized, things that can't even go through the Panama Canal, they've got to go around the capes. Those are the big mega-ships. So, you're now talking two-thirds cheaper per ton to ship on these very large, very efficient vessels. They can't call at Rajin. So, you want this access to Rajin but you're going to be hobbled by small ships, where it costs more to ship per ton, so now you've got an economic burden. On top of that, the North Koreans are going to extort some tax to get from the border crossing at Trenhe to Rajin Port. Now, it's closer so you can pay less per mile than shipping it all the way to Dandong Port but I'd be less worried about paying the Liaoning border tax than paying the North Korean tax. Plus, whoever's going to build that road, which hasn't been built yet though maybe is being built now, someone is going to charge a toll on that and if it's anything like Chinese tolls it's going to be really expensive. So, I can see why this looks like a good idea on paper, you cut down your transit time to Japan from 2 days to 10 hours, you can save a lot on your transit, you don't have to use the Liaoning Mafia's port, we can have our own, but I just don't see this working.

So in some ways, you've got an unrealistic expectation. Is it sustainable? You'll have to ask an economist about whether or not there's a bubble forming in China. I read Andy Xie and it looks like there's a bubble everyday and it never seems to pop. I think that answers your question, maybe a little long, it's a bubble that never seems to pop. They don't value efficiency in their system terribly much so they can afford to have this huge customs hall that's not used, a brand new bridge that has 10 percent capacity. The highways in China are so interesting, not just in Jilin, you go Yinnan, you go Henan, you're on these major concrete expressways and the tolls are really high, but there's no trucks on them, the trucks are all still taking these older national roads because there's no fee and it beats them up because the potholes are big but the truck drivers aren't worried about time, their time isn't money. So, I think they can afford to, and of course the banking system supports this, these are basically policy loans. So, if you don't worry about the ramifications of not being able to service your loan and hoping it'll get forgiven,

there's all this collusion problem. If it's Jilin Province giving a policy-backed loan as part of the development the Northwest, develop the West project, which also applies to a place like Yanbian, though it's not in the West. So, you take that Dashibufajian money and put it into the Shinbianfubian Project on the border with Jilin, you're not expected to repay it. So, I don't think it'll crash but it'll just never be used efficiently.

**Jae Ku:** I have a feeling you answered probably 5 questions. (**Drew:** I hope so.) Here, gentleman here in the front.

**Question:** Hi, Mark Manyon also from the Congressional Research Service. Drew, thanks a lot, this is a great study, I'll be having it on my bookshelf for awhile to refer to. Question: One of the bullet points at the end of your talk talked about state assistance from Beijing, and I'm wondering if you could go into a little more detail on that. From the little bit of research I've done on trading, which I know is a different topic, but North Korea has a large and growing trade deficit with China and everything that people seem to indicate is that somehow Beijing is financing that and clearly the amount of Foreign Direct Investment, as you document really well, is just a drop in the bucket compared to the hundreds of millions of dollars in the trade deficit. So, have you come across any evidence that firms that are investing are getting some financial assistance, be it local, local government, provincial government or from the center at all, as seems to be the case with some of the trading companies that operate?

**Drew Thompson:** That's a good question. I don't have a straight answer. No, I can give you a long, round-about what I guess but, I think this is a problem not just with who's doing business in North Korea. You can ask any of these guys, "Where'd you get your first million?" and they laugh, good luck finding that out. I think even tracking ownership for a lot of these firms is difficult. It's not transparent enough to really get a sense. What I don't see is an opaque XM

bank working here, like I said, there's no letters of credit. Now, there is banking facilities, but I don't see the government specifically, It's government, I think the bullet was government-facilitated and led, but not directed. So, I don't see a lot of direct support, it's not financed, you don't have a big pool, but that said, there's a lot of capital sloshing around in China that's been a result of this constant pump-priming since 1997. And I think that's given people a lot of access, I mean there's been a lot of wealth generated and there's not a lot of places to put your money in China. I'm not an economist here, so I hesitate to get into this too deeply but where do you put your money in China that's safe? Stock market's volatile, not a lot of access, and again, if you're in Jilin Province, what are your choices? If you're a local level, if you're Hunchun City you're not really thinking about how we're going to get that new deal in Germany, you know. North Korea's right there and you're speaking Korean and you've got this competitive advantage. One of the points in the report is you don't have a lot of competition in North Korea from other pockets of Korean speakers. Jae here speaks beautiful Korean, he can't go open a company in North Korea. If he could, he'd probably have more to offer than that guy from Hunchun. Well, according to some of the research, the North Koreans are very careful to weed out South Koreans posing as ethnic Chinese who are then going in to invest. So, they have a captive market. And I think that was also mentioned in the John Park report and holds true with all of my findings is that the North Koreans don't have a lot of choices either. They're not able to go and access international markets, they're not doing arbitrage on the London Exchange to try to figure out whether, or even have access enough to the internet or, you know, a cell phone to figure out whether or not the offer that this Chinese guy just gave per ton of copper is competitive with market. So, I think what a lot of these traders can do is essentially arbitrage with North Korean commodities. So you can get coal coming out of North Korea, coal, copper, any easily-tradable commodity where there's a high demand. Again, China consumes a quarter of the world's copper, so you get any copper out of one of the big mines and, you know, Haesong, Musan are both two big iron and copper mines and they're right there on the border so you get decent



shipments of semi-refined or just raw ore, you're going to find a buyer and chances are good the North Koreans don't have international options. So I think you can leverage it without needing a lot of finance. I mentioned in that one case study about the zinc investor, 3 million dollars got him started. And, if you think about it in terms of Rio Tinto or major companies, 3 million is nothing, that's executive compensation for one vice president. These are individual actors who manage to scrape money together from we don't know where, but it's enough to get them rolling in that credit process and then have monthly 6 million dollar transactions.

**Question:** Alexandre Mansourov is my name. It's easy to dismiss, you know, anything that's going on there as a failure but could you give us some examples of the success stories in the joint ventures? Because there are those examples and I think they will be instructive to people. Thank you.

**Drew:** Sure. Well, in the three case studies I gave, there's a successful entrepreneur, the zinc miner, who's making a lot of money and who's got a variety of investments, but he makes profit on those. You've got the failed investment, which is the big state-owned enterprise from Beijing that was essentially arm-twisted into being a partner to service one of the major mines and then pulled out because it was, as they said, "Why go there when I can ten times better results in Australia, or Brazil?" And then you've got the guy that I think will ultimately be successful, which is doing assembly work, basically taking complete knock-down kits of trucks and buses and starting to put them together.

**Jae Ku:** Can you give a little more background for people who haven't had a chance to get a pre-copy? The bus company owner- interesting man.

**Drew Thompson:** Yeah, this was in Dandong. Jae and I went to meet with this Chinese non-

ethnic Korean living in Dandong, who's basically spent most of his career doing business around North Korea and he started out in the '90s with small-scale operations. He worked closely with Yanbing, the Chinese guy who was named the head of the Sinuiju Export Processing Zone, so he had a little deal going with them and then Yanbing got arrested and put away and the Sinuiju joint-venture failed, so his venture failed. Then he set up a clothing factory, which I think was using, he didn't say it but indirectly, North Korean workers in this Dandong factory which is used for export. And then that failed. Then he set up a little market right at the foot of the bridge so that North Koreans could come and buy Chinese products and then take them back, 'NorKmart'. And then they redeveloped the whole waterfront and the bridge, and he lost his property, so this guy has been through it several times trying to make a living and he's made a living but he's never really hit it big.

But he got a concession to open up a factory in Pyongyang that assembles trucks and buses, light buses and small dump trucks, to service the Korean market and he's allowed to import spare parts from China, essentially complete kits, duty free, and assemble them in Pyongyang. And he said he wasn't going to make his sales target for last year, largely because of the currency revaluation that occurred in December of 2009, when they basically took the currency and made everybody turn it in and then gave back currency with one less zero on it. He said that stopped all economic activity in the country until May, I think. He said basically, nothing happened between January and May in the factory. Everyone still showed up and everyone still got paid but you couldn't get anything, just the whole country had stopped. So he said, that was hard but he said since then, we've recovered, we started assembling, we sold our first few platforms, we got some customers, we're still figuring out the market and figuring out what sells best. And he said, we fully expect to make a profit. He doesn't have any competition. He doesn't have competition in that one segment, according to him. Now again, I'm not an expert in North Korea, I did not get as much access to as many of the joint ventures as I would like, they were voluntary participants

but I think there are profits to be made, there are successful models. The entrepreneur who's nimble and hedges. The other entrepreneur who seems to be hedging less but having but having a different relationship with a partner that supports him. What's not successful is the big state-owned model, which has a set of expectations for transparency, reliability and I think that's where, that's probably where the future will be until you've got some reform and normalization.

**Dr. Ku:** We had a question from Mr. Kim.

**Question:** Thank you very much for your detailed explanation about the joint-venture investments between North Korea and China. Let me ask you just one thing: Can you tell me about the intention or the attitude of China's government, not provincial attitude, but the government of the Chinese intention about reforming and opening of North Korea and also, can you tell me very briefly about partners of North Korea, governmental and non-governmental people's attitude about reforming or the opening of North Korean society, politically, and also economically? Thank you.

**Drew Thompson:** Perhaps there will be a volume two of this 85-page report that'll look at the North Korean side. I don't have access to North Korean sources, I don't really have a sense of, I don't even really have a good sense of who the North Korean partners are in much detail. I suppose it's knowable but I did not intend to really look into the North Korean side of this equation, I was looking at the motivations and the drivers. In terms of central government perspective on North Korea reforming and opening, again, the insights there are tenuous. The relationship between the Chinese government and the North Korean government is closely-held, it's party-led. They do have an inter-agency process, you do have coordination between the different state council departments, ministry of commerce, science and technology, even the health and other departments that look more at the social services issues. They coordinate policy

towards North Korea but, we're speculating here, Chinese policy still takes place in a black box, so I don't think we know. So that said, I'll guess. I don't think it's made at that level; it's made at a higher level, the big strategic objective. I think that's politburo level at the least, obviously with inputs from the party international liaison office. And I think a lot of other people in here have some maybe better insights than I do. I'm not sure I would characterize them as having a grand vision for North Korea, I think it's a rather simplistic one based on their own experiences. I think they see reform and opening as the way forward for North Korea just as it was for them. The Chinese leadership is not actively considering its own alternative futures. They don't think that way; they're not saying, "Hey, what if we experimented with political reform or what if we experimented with these different directions?" I mean, they're still very much on this Deng Xiaoping track. I don't see them having grand vision for social engineering in North Korea, so I think what they're hoping for is a more stable North Korea that's less threatening to countries that China's trying to have a good relationship with: South Korea, Japan, the United States. I mean, North Korea complicates central government strategy; they're not supportive of North Korean provocations. That said they don't see punishing North Korea or choking them off as being productive either, if that destabilizes the regime. As I said in that very first slide, or second slide, they want to maintain the status quo, which means their intention is to just keep things the way they are and improve them slightly, which I think their only input to that would be a reform and opening process.

**Dr. Ku:** I think the second part of your question is a great research topic for you in the next year as a visiting scholar at the U.S.-Korea Institute, so welcome. I saw a hand up here in the front, here.

**Question:** Hi, thank you. My name is Matthew Robertson, I'm a reporter for the Epoch Times newspaper. I'm curious about what you referred to expropriations perhaps of businessmen by the

KPA; could you explain how that works a bit? That sounds curious.

**Drew Thompson:** In the case study in the report, there was one of the investors who had an aquaculture venture where they were growing kelp and he said basically when they were ready to harvest the kelp, the KPA, the army, came in and said they were going to have an exercise and they closed the beach and the district around the beach and they went and did their exercise and when they left and said, “Ok, the beach zone is reopened to civilians”, the kelp was gone. It’s hard to say no when the army takes over your territory. There’s other anecdotal evidence. I was here at a small USKI event with a South Korean scholar who was basically describing a train ride across North Korea, where every time they came to a new county, the local county government would take the locomotive off the train and use it to haul their own cargo around, leaving the passengers stranded at the station for a few hours. Then when they’re done with the locomotive they bring it back and attach it to the train and let them go to the next place where the next government would take the locomotive and use it to shuttle their stuff around and come back. He said it took them days to get from one part of North Korea to the other by train. So, that’s what I’m saying when we’re talking about a predatory environment or rent-seeking.

**Jae Ku:** Question up here in the front.

**Question:** You mentioned you don’t have good insight into the North Korean partners: Is that because the folks, the Chinese investors you’ve talked to, don’t know who they’re dealing or is it they didn’t want to talk about it? That’s the essence of my question. The other part of it is, do the Chinese businessmen that are in this community refer to it in the terms that you did earlier as far as ‘my partner is Worker’s Party of Korea’, ‘my partner is military’, ‘my partner is cabinet’, cause I’ve heard that distinction before and I’m curious how common in usage that is?

**Drew:** Again, this is a fairly lengthy report. To keep it within a certain set of goal posts, I did not explore who the North Korean partners were. Some of that data's available; I did not go looking for it. So again, in assembling this list of investors, some information I targeted and some I capture but I wasn't looking to fill in the blanks. So the answer is you could compile a matching list of the 138 Chinese investors and 138 North Korean partners. I did not do that. I have the sense that Chinese investors know exactly who their partner is, where they fit into the North Korean work chart, if you will. So again, that one case study about the zinc miner, he said my allegiance, if you will, my partnership is not just with the owners of this mine, but with the Light Industrial Bureau, sometimes it's referred to as the Committee on Light Industry. He said, that's my main partner. They own the mine, they control all mines. This is the committee that's headed by Kim Jong-Il's sister, who's now a 4-star general. And all of that guy's other hedging with the same Light Industry Bureau partners, so he knows where they are. Now, does he know this because he's somehow has the place figured out or because they steer him to the right partners? And I think it's a combination of both. What happens is, he has a good business with the zinc mine, the North Koreans know that he's making money, they are seeking to get other advantages from him, so they're presenting him with these other business opportunities and I list them in the case study of plastics, recycling joint-venture, the kelp business. He also provides them with a lot of, and this gets back to Mark's question about financing, he provides them with a lot of free food aid and a lot of consumer goods and products. He basically just takes a container and fills it with all the consumer goods that Chinese Wal-Mart needs, a North Korean Wal-Mart would need, just put in all the clothes, some of it used, some of it new, shoes, clothes, rice cookers, electronics, whatever. And he just gives it to them or sometimes he'll have them pay something for it. But part of that is the process of building up the relationship with the Light Industrial Bureau's subsidiaries. Part of it also is, as I said, you're giving them food because that then becomes the internal currency. It then gives them in the Light Industry Bureau, the traders or the subsidiaries under it, the ability to take that food and then either sell it or give it to other parts of

the system, whether it's the army or a different part of the government or maybe a local government. I mean, power in China, and I would assume it's the same in North Korea, it's a matrix, it's not all vertical, it's not all horizontal, it's why they call it the TLQuai system in China and I would assume it's similar. Local governments have a fair amount of power; they have less authority than the central level governments do, but on the local level, they got power. So, they have to be taken care of, they have to be accommodated, and I think the relationships that form between, in this case, the entrepreneurs and the partner is based on surviving within that matrix. In the case of the bus company, they had a partner and they were assembling buses and my sense is the partner was strong, the partner was in Pyongyang. Now again, the next study might look at the difference between investments in the provinces bordering North Korea, bordering China, so the northern part of North Korea versus partners in Pyongyang. I mean, if you're dealing with a major company in Pyongyang that has access to the central government that has its own power center, if you will, then maybe they don't have to engage in this hedging to protect themselves from rent-seeking, from predatory other departments. If you're dealing out in the provinces, you've got to deal with not only other bureaus coming to get you and other parts of the government but local-level governments perhaps. These are stovepipes, there'll be a military one, a police one, a government one, a civilian government one and they all have to agree to your existence. But I really don't have good answers about the North Korean side but again, I refer you back to that North Korea, Inc. report in April 2009 at USIP.

**Dr. Ku:** Question over there...we'll take a couple more questions.

**Question:** Thank you for the lectures about the joint-ventures in North Korea and China. My name is Haegu Lee, I'm from the South Korean Navy and I'm currently stationed with the U.S. Navy. Nowadays, the impression that I got is the only countries that have leverage in terms of relations with North Korea is China especially in regarding politically or economically. Even

though the North Korean problem is a problem that we serve that South Korea should do, should play a leadership role also with other partners, but then I feel like South Korea is left behind and then we don't have much leverage in some relations with North Korea, we lost leverage economically and also politically especially in security and economically to China. So, my question is, would you please give recommendations for South Korea to gain leverage in terms of North Korea to cope with this left behind feeling in relations with North Korea?

**Jae Ku:** I think that's a 64,000 dollar question, Drew.

**Drew Thompson:** If I could bottle and sell that, I'd make a real living. How does anybody leverage China at this point? Maybe the answer to your question is this is really more a question of South Korean attitude rather than balance of power in the region. Managing expectations about what they can expect. If you look at the trading relationships in Northeast Asia, and again, I'm going out on a limb here, but with all the economic interdependence between China and Japan, South Korea, Taiwan, the United States, how many of them are effectively leveraging their relationships with China because of trade? China is pursuing its security interests, its own foreign policy based on its perceptions of its own needs, its own threats, or threats that it perceives, and I think foreign trade, it's important, it's a necessary factor for China's domestic development and again, I think many of the challenges that China faces are domestic, not international and that's reflected in their foreign policy as well. No amount of investment in North Korea is necessarily going to change the way North Korea perceives its external threats and its domestic internal instability. So, I'm not sure that this is a shortcoming of South Korean foreign policy. There isn't a great answer. Now, for China, where we have these diverging security and economic interests, the solution is continue to engage. It's harder with North Korea. It's even harder between South Korea and North Korea. I think the trick is striking the right balance and engaging North Korea with a very clearly defined set of objectives. And I think



that's where you've got the problem between U.S. policy, and Chinese policy, and South Korean policy towards North Korea, aside from just being incredibly, badly aligned. And again, this is not unique to North Korea; we can look at Myanmar as well where you've got the same diverging policies. The problem is if you look at ASEAN and China's relationship with Myanmar, you look at China's relationship with North Korea – Are they using that leverage from trade, however much it may be, towards changing behaviors? Or are they simply using it, as we mentioned, for their own benefit for development in their border regions, justification for their investment strategies locally, or do they have a broader set of objectives for shaping North Korean or Burmese, Myanmar government behaviors? And I think that's where the U.S. has struggled in both cases. Where the economic future with China is quite clear but the security interests are quite different. There's no good answer. And again, Burma may be an easier case study because you don't have a South Korea factor. We have to consider our alliance with South Korea, which is really paramount to North Korea policy. You don't have that with Myanmar. And if we look at how the administration has struggled over the last year, to balance sanctions and engagement, and they really tried engagement with Myanmar, and have not been successful yet. I don't know if the solution to North Korea is to try and engage it differently, better, harder, shorter, less, I don't know. But I think it's clear this administration has made clear that the U.S. commitment to South Korea is unconditional.

**Jae Ku:** Now if there's a final question out there we'll take it, if not we'll go ahead and conclude. I want to thank you, Drew, for a great talk. I think you raised a set of questions for really volume two and hopefully you'll be around to address some of the questions that you've raised. I also would like the audience to go and visit our website and see a paper that came out in 2009 that Drew and our Associate Director of China Studies, Carla Freeman, did called "Flood Across the Border: China's Disaster Relief Operations and Potential Response to a North Korean

Refugee Crisis”. That was our first good paper that Drew did for us and this is second and hopefully there will be a third. With that, thank you very much Drew.