PRIORITY ACTIONS TO ATTRACT INVESTMENT INTO THE GREATER TUMEN REGION

1. INTRODUCTION

1. The Strategic Action Plan for the next decade (2006 to 2015) adopted at the Changchun meeting in September 2005 by member governments of the Greater Tumen Region, China, DPRK, ROK, Mongolia and Russia, endorsed support for the private sector to take a lead role in driving businesses and investment and spurring growth and development in the region. It aims principally to make the area around the Tumen River a growth pole for development through attracting investments into the region and the special economic zones in particular.

2. The landmark decision took cognition of the fact that the Greater Tumen Region (GTR) which lies at the heart of continental Northeast Asia[1], and geographically including Japan, offers a new economic frontier for development. Like other regional arrangements in the world, the Greater Tumen Region could draw synergy to exploit untapped opportunities in the region to escalate development in a win-win situation for all its members. Situated at the crossroads of trade and transport routes between Europe, North East Asia and North America, it is provides a perfect location for transit trade.

3. The Changchun meeting also agreed on a strategy which embodies the principles of public-private partnership of which, member governments commit to create an enabling environment for investment, giving private sector a lead role in driving business and investment in the region, and engaging them in constructive dialogue to improve the investment environment**.** In this regard, it was also recommended to set up a Business Advisory Council.

4. Global competition for foreign direct investment is very intense. Investments are risk taking ventures and investors will only invest their money in countries where the rules are clear and transparent， and they are assured a friendly operating environment, as well as adequate provisions on investors' protection. This paper outlines the approach which governments must take to operationalize decisions on attracting investment for development. The paper looks at countries' comparative advantage and opportunities on investment. The GTR's strength is its network of infrastructure links which have been built over the years and will help in paving the way for regional development. This enhances the trade and investment linkages across member countries and subregions. The growth and development of the Tumen River Economic Development Area and its hinterland, must build upon complementarities (in both comparative and competitive advantages) across member countries and subnational regions. However, exploiting these complementarities will require that member countries meet certain preconditions which lay the foundation for economic competitiveness.

5. The GTR is made up of countries with different economic systems and investment conditions. Todate regional economic cooperation efforts have been weak. It is crucial,

[1] At the Changchun meeting of September 2005, the geographic areas of GTR was expanded to cover Jilin, Liaoning and Helongjiang provinces in Northeast China and Inner Mongolia; Rason Economic and Trade Zone of DPRK; Primorsky and Khabarovsky territories and Sakhalin of Russia; Eastern Mongolia and Eastern port cities of ROK.

therefore, that national governments of GTR take individual actions to implement a regulatory and operational framework which is conducive for investment if it is to successfully promote investments to the region. This requires the Governments to make strong commitment towards implementing a sound investment policy regime; and to exercising their political will on facilitating cross border movement of goods and people.

6. Consolidated actions by national governments to bring about harmonized policies, rules and procedures will have a cumulative impact on the region's investment environment. At the national level, it is recommended that governments build on improving the operating and macroeconomic environment in which firms operate and bring them to international good standards. As a quick start measure, countries could focus on bringing best practice standards to existing special Economic Zones to ensure speedy implementation of projects. Projects in these Zones could benefit from fast track investment approvals, applying streamlined procedures and special tax arrangements and free of foreign exchange controls. The GTR will become an attractive area for investment when participating governments meet the challenge on policy convergence on major complementary issues, i.e., removal of physical and non-physical constraints affecting investments. This is predicated against the background that countries in the region will work at constructing the missing links in infrastructure and/or improving existing infrastructure. At the same time, governments should work towards trade liberalization of both tariffs and non-tariffs barriers. These are necessary preconditions in order to bring about real results in regional economic development in the longer term. It goes without saying that translating the Changchun Action Plan into realizable goals will need concerted actions and political commitments at the highest level. Central Government's involvement will have to be part of this process. Not looking too far away, GTR can draw on the success of the ASEAN group represented by countries of varying sizes and development levels, and yet each member country has been able to thrive and benefit from foreign direct investments. Foreign direct investments in trade-related opportunities have contributed in varying degrees to countries' development, especially in meeting capital investment needs, job creation, transfer of managerial and technical skills and technology and increasing and diversifying countries' exports.

2. POTENTIAL TRADE AND INVESTMENT OPPORTUNITIES IN THE GTR

A. Trade flows of North East Asian countries

7. Geographically, the Northeast Asian countries, comprises Northeast, North and Northwest China, the Democratic Republic of Korea, Japan, Mongolia, Republic of Korea and the Primorsky Territory in Far East Russia, and the Greater Tumen Region is at the focal point of this regional trade. Given its central location, the Tumen Transport Corridor could carry a larger share of bilateral trade. Appropriate investments to tap fully the Trans-Siberian Railway links and shipping links connecting the Primorksy Ports will provide further impetus to bilateral trade with Europe, Japan, ROK and the USA.

8. Trade in the Greater Tumen region has seen rapid growth in the last decade. Between 2000 to 2004, average annual rate of growth of intra-trade among the 6 countries in the Northeast Asian region was 19 %. In nominal terms total intra-regional trade increased from $366 billion in 2000 to $702 billion in 2004 (see annexes 1A and 1B). The region's imports and exports growth were fueled largely by China's growing economy. Intra-imports among the trading partners of Northeast Asia increased from

$200 billion in 2000 to $382 billion in 2004. The small economy of DPRK had also benefited significantly from the increase in China's imports. Based on reporting trading partner’s data, China’s imports from DPRK was merely $0.04 million in 2000, and this increased significantly to $586 million in 2004.

9. Total intra-Northeast Asia export trade nearly doubled from 2000 to 2004 reaching $320.7 billion in 2004. Japan and Russia, in particular, reaped huge gains from the region’s exports’ growth (see Table 1). About 60 % of Russia’s exports in the NE Asia region were to China, accounted mainly by crude oil and wood exports. Russia’s imports from the region rose steeply by 54 % in this period, with the bulk coming from China, Japan and Republic of Korea. China alone accounted for nearly three-fifths of the exports of the NE Asian countries. China’s continuing development combined with the other regional members’ development needs will generate higher investment requirements as well as demand for consumption goods.

10. Table 1 shows the share of Northeast Asia’s trade in the total trade of each country in 2000 and 2004. The smaller economies of DPRK and Mongolia are most dependent on their five neighbours. More than three-fifths of their total trade are transacted with the regional partners. In a scenario of expanding intra-regional trade, all countries in the region had benefited from the overall trade growth. Japan and the Republic of Korea had increased their shares of both imports and exports. Russia’s share of exports to the Northeast region increased but their share of imports declined. China’s share of exports to the region decreased from 25 % to 20 %, but in nominal terms, it was more than a two-fold increase.

Table 1. Northeast Asian share of total trade of each Northeast Asian country, 2000 and 2004

IMPORTS IN $ BILLION			Share of total imports from NE Asia	EXPORTS IN $ BILLION		Share of total exports to NE Asia
	Imports from NE Asia*	Imports from world		Exports to NE Asia *	Exports to world	
China						
2000	70.74	225.1	31%	55.74	249.20	25%
2004	169.73	561.23	30%	111.45	593.33	20%
Japan						
2000	80.39	379.66	21%	61.88	479.25	16%
2004	122.27	455.25	27%	121.48	565.76	27%
Mongolia						
2000	0.44	0.61	72%	0.32	0.47	53%
2003	0.57	0.8	71%	0.29	0.62	37%
Republic of Korea						
2000	46.70	160.48	29%	39.76	172.27	25%
2004	79.43	224.46	35%	73.88	253.84	30%
Russia						
2000	1.93	33.92	6%	13.15	103.09	39%
2004	10.67	75.58	14%	19.39	181.63	26%
DPRK **						
1993	-	-	84%	-	-	74 %
1998	-	-	58%	-	-	65%

Source: UN COMTRADE with estimates of UNCTAD Secretariat (data reported by member states), except for DPRK which is not a .reporting country to UN COMTRADE.
Notes:
* Includes trade with DPRK, which are derived from COMTRADE based on trading partners' data.
** Data on shares of DPRK is taken from Paper, " *Trade and Investment Synergies in the Tumen Region*", Prepared by Geoff Wright, Tumen Secretariat, January 2000, Table 3,.and its source if data s derived from IMF: Direction of Trade Statistics

11. The GTR is fortunate to have build up a network of transport links over the years which will enhance the region's cross border trading potential. It could capitalize on this today. Further investments in road and rail links, including upgrading of ports facilities will help to transform the region into a trade hub. Among others, it will pave the way for a new Northeast Asian gateway to the markets in the Pacific Rim. Currently, the Tumen Transport Corridor with cross border points at NE China, Primorsky Administrative Region and DPRK, has spawned cross-border trade, notably between Primorsky/Amur and Heilongjiang in NE China and between China and DPRK. There is no doubt that

Yanbian Prefecture could also develop cross-border trade with Russia. The rail network in the GTR is currently the most efficient way to move cargoes to the regions's ports. There are seven ice-free ports in the GTR stretching 320 km between Nakhoda in Russia Federation to Chongin in DPRK. The ice free ports made it easy to export bulk commodities from landlocked North East China. Cooperation among the GTR members on transport and removing cross border impediments will boost the area as a hub for exports and transit trade. However, to realize the potential, GTR member countries need to continue to work on a framework which addresses, in particular, institutional barriers to trade and passenger flows, and the establishment of a favorable investment climate.

B. Foreign investment flows

12. In the absence of recent data on investment of the Tumen River Region countries, (except for the Primorsky Territory), the trends and profile of foreign investment flows to the Tumen River area in this section are drawn from the paper "Trade and Investment Synergies in the Tumen Region" prepared by Geoff Wright for the TREDA Advocacy Workshop, 2000.

13. According to earlier years data for the period 1985 to 1998, FDI has contributed significantly to the capital stock of each area in the Tumen Region. Between 1985 to 1998 foreign investors have invested nearly $1.2 billion in the region (see Table 2). Yanbian Prefecture and Primorsky each attracted almost equal shares while Rajin-Sonbong's FDI performance has been relatively large given its smaller population. Between 1985 to 1998, Primorsky received $444 million, and updated data showed that it received US$459 million in the subsequent period from 1999 to 2004, bringing the total cumulative FDI stock in 2004 to $903million. However, data of comparable period is not available for the other Tumen countries.

Table 2. Actual foreign direct investment in the Tumen Region ($ million)

	1985-1993	**1994**	**1995**	**1996**	**1997**	**1998**	**Total ($million)**	**Per capita FDI ($)**
Yanbian Prefecture	42	61	78	134	95	47	**457**	**208**
Rajin-Sonbong Zone	1	1	4	31	26	25	**88**	**587**
Primorsky Territory	141	2*	53	97	95	56	**444**	**198**
Mongolia **	10	29	46	53	31	39	**208**	**86**
Total	**194**	**93**	**181**	**311**	**247**	**167**	**1,193**	

Source: Local governments
* Excludes reinvested roubles. ** Registered foreign investment

14. The *sectoral breakdown* of FDI in Table 3, shows that mining exploration attracted a large share of total FDI in Mongolia reflecting the potential of gold and oil discoveries. The country has reformed its mining legislation in 1997. In Primorsky Territory, mining investment is by a Swiss non-ferrous mining joint venture. Yanbian Prefecture began seeking FDI only in 1990, and the bulk of FDI is in light industry and processing sub-sectors (74%). In Primorsky Territory, these two subsectors accounted for

one-fifth of total FDI. As of 2001 to 2004, Primorsky Territory has received a doubling of FDI into wood processing as compared to previous years.

Table 3. Foreign direct investment by sector in the Tumen Region, 1998 (%share of total)

	Primorsky Territory	Yanbian Prefecture	Rajin-Sonbong Zone	Mongolia
Agriculture & Forestry	0.1	5	1	1
Mining	5	0	0	21
Resource Processing	26	) 74	6	11
Light Industry	0.4	)	1	12
Transport	9	0	11	3
Telecommunications	15	0	17	6
Property and Tourism	27	12	36	6
Trade and Marketing	16	)9	3	9
Other	2	)	25	31
TOTAL	100	100	100	100
Total number of firms	1,232	680	113	1,016

Source: Provided by local Governments

15. Early investments in transport and telecommunication infrastructure in Nakhoda and Rason Sonbong Zone (RSZ) attempted to take advantage of potential growth in the region. Japanese and ROK telephone operators have also invested in Mongolia, and a Thai company in RSZ. Share of FDI in property development is relatively high in Primorksy and RSZ. In Primorksy, the investment is mainly in commercial buildings by China, Japan and ROK, and in RSZ the investment was on a hotel and casino development by the Emperor group of Hong Kong. The latter ceased to operate since 2005.

16. ROK is the largest foreign investor in the region (table 4) and a principal investor in Yanbian Prefecture. The investment is mainly in textiles and clothings manufactures. Many of them have relocated from ROK to take advantage of the special tax concessions and lower wage costs in Yanbian. Japan is the second largest foreign investor in each area of the Tumen Region, with investment mainly in wood and food processing. As an investment area, the Tumen Region is particularly attractive to Japan and ROK, which face higher domestic costs of production, their need for natural resources and their georaphical proximity. US investors have been attracted to a range of industries in Primorsky (such as soft drinks bottling, and trading) - reflecting the West Coast US interests in strengthening economic ties with Russia Far East. Mongolia received investments from more diverse sources, including from China and Russia. Most Chinese investment in Mongolia and Primorsky are in retail or wholesale trading and small restaurants. Some Inner Mongolian investors have established cashmere and garment making businesses.

Table 4. Sources of FDI in the Tumen Region, 1998

	Yanbian Prefecture	Rason Sonbong Zone	Primorsky Territory	Mongolia
Origin of investment				
Republic of Korea	53	0	25	7
Japan	11	9	19	7
Hong Kong	14	32	0	6
Malaysia	9	0	0	0.2
China	-	23	2	25
USA		1*	26	6
Russia		2	-	9
DPRK		-	0	0.7
Singapore		1	10	4
Thailand		17	0	0
UK		o.6	2	3
Other Europe		14	9	17
Other		0.4	7	9

* Korean Americans.

17. So far investment links between the Tumen Region partners are modest, and, limited generally to short-term trading and retail overseas opportunities. The China Hyungtong Shipping Group is investing in RSZ to develop the Tumen Transport Corridor as the Port at Rason is the closest outlet for its goods from NE China, in a particular. This investment complements the development of the highway upgrade between Changchun and Hunchun, representing large section of the Corridor. Furthermore, cross-border interests will be strengthened if Chinese investors proceed with the oil refinery in Mongolia.

C. Trade-related investment opportunities

18. Ample assessments made of GTR's investment potential indicate that there are vast opportunities just waiting to be exploited. Table 5 serves as a good guide of the subnation's comparative advantages on the one hand, and on the other, the regional potential building upon the complementarities in both comparative and competitive advantages across member countries and subnational regions. However, the fact that the Tumen River area is not yet on the radar screen of many investors has much to do with the operational investment environment of the member countries, which are characterized by many weaknesses, relating both to cross-border barriers and poor investment climate. These impediments are discussed in section 3 below.

Table 5. Potential industrial development opportunities

China Yanbian Prefecture	DPRK Rajin-Sonbong Free Economic Zone	Russia Primorsky Territory	Mongolia
1. Export-oriented • Timber processing • Food processing • Traditional medicines • Textiles and apparel • Livestock farming 2. Service industry • Tourism	1. "Gateway" Transit transportation 2. Service industry • Tourism • Oil refining 3. Fisheries and seafood processing. 4. Export processing	1. "Gateway" Transportation centre 2. Resource-based industries • Seafood processing • Timber processing • Agriculture 3. Technology-based industries • Ship repair • High-technology industry 4. Service industry • Tourism	1. Mining 2.Textile and apparel: • Cashmere • Cotton 3. Service industry • Eco-tourism

19. The Tumen region has a comparative advantage in resource-based industries, which includes the scope for building cluster industrial activities around these industries. This will be an important source for cross-border interests, especially from Japan and ROK because of their proximity to the Tumen Region. They are expected to be major players, as suppliers of capital, technological know-how, and marketing expertise to the region's development. In addition, Japanese and ROK firms investing abroad could avail themselves of development facilities from their banks, namely, the Japan Bank for International Cooperation and the Korea Export Import Bank. Thus, it is likely that they are the ones to ensure a longer-term relationship building investments in the area. For example, Sumitomo Corporation has been building its relationship with Primorsky for over 15 years in timber, water and gas sectors.

20. At the regional level, major investment opportunities occur in infrastructure, tourism and energy projects. For example, regional tourism offers possibilities to exploit it as a multi-destination area combining the scenic Mount Paekdu Nature Reserve/Mount Changbai and lake at the China-Korea border with coastal areas of Primorsky Territory and Rason-Sonbong and eco-tourism in Mongolia. To tap this, countries should agree to ease visa restrictions and border crossing formalities, develop cross-border tourism products, improve transport links, e.g., by designating more carriers and jointly promote the region.

21. The long term prospects for regional cooperation in energy is very bright and should constitute one focus of regional effort. A concrete proposal is already on the table from the Russian Federal Government to implement the construction of a crude oil

pipeline from Eastern Siberia to the Pacific.[2] The first phase will involve a pipeline of 2,300 km from Taishet in Irkutsk Oblast to Skovorodino in Amur Oblast, known as the Pacific pipeline project due for completion in 2008. When completed, estimated deliveries will be 30 million tons of crude oil from Western Siberia. This is planned to be transported by rail over 1,900 km (while awaiting a second phase of the crude oil pipeline) to Perevoznaya Bay in the Primorsky Krai which is within the Tumen River Basin. Part of the first phase of the Pacific oil pipeline project is the construction of an oil terminal in Perevoznaya Bay. Another possible development announced by President Putin in his March 2006 visit to China, was the construction of a branch route of oil pipeline from Skovorodino to Daqing in China. The distribution of this energy whether through a pipeline or rail/sea network throughout Northeast Asia will require careful cooperation among all countries. The Russia Far East oil and gas fields will be linked eventually to markets in China, Japan and ROK. Two possible routes passes through the Tumen Region - one crosses Mongolia, and the other passes through the RSZ in order to reach Japan and ROK. Stemming from this development, investment opportunities will spring up in several areas, from investments in developing terminal facilities, ports, trucking services, distribution and oil refining activities in the ports in Russia Far East. It will also create opportunities for the existing oil refining facility at Rajin-Sonbong. The need for upgrading and modernizing terminal and oil refining facilities and creation of new ones will be an important source for potential foreign investment. Building on these complementarities will give the Tumen Region a chance to transform the region into an international shipping and trading hub. Mobilizing strong private sector participation will be an integral feature of regional development, and invariably this will mean combining the resources of the broader NE Asia region, particularly, tapping capital resources and technologies of ROK and Japan.

22. As the Tumen Region develops, the Tumen Transport Corridor could carry a larger share of bilateral trade between the three North east Chinese provinces (Jilin, Helonjiang, and Liaoning and the Russian Far East) and Japan and ROK, and the Northeast Chinese provinces and the Russian Far East and USA. The transport corridor could facilitate import and export activity of Yanbian Province and other areas of North east China, give a access to Mongolia’s natural resources and to the Tumen Region, and promote transit trade for Primorsky Territory and Rajin-Sonbong Zone.

3. IMPEDIMENTS TO CROSS-BORDER INVESTMENTS

23. The 3 riparian countries in the Tumen River Basin have each created special Free Economic Zones (FEZ) as part of their investment promotion drive. Special concessions are granted to firms operating in the Zone (see Box 1 on the special provisions for investors, including incentives in the Yanbian FEZ, Hunchun Export Processing Zone (EPZ, Nakhoda FEZ and Rajin-Sonbong FEZ). FDI flows to these Zones could have been higher considering the areas’ potential. It has been assessed that these Zones are functioning quite poorly, and the main administrative barriers are highlighted in paragraph 24 below.[3] Well functioning special economic zones, going by best practice standards in the world, not only provide a friendly environment for investors but they

[2] Economic Research Institute for Northeast Asia, 2005 Japan-Russia Energy Forum in Nigata, 8-9March 2005: Introduction.
[3] Economic Research Institute for Northeast Asia (ERINA) and the FIAS, World Bank Group, “The Tumen Region Growth Area: Current Impediments and Investment Potential” paper submitted to the TREDA Advocacy Workshop 2000 on Stimulating trade, Investment and Growth in and around the Tumen Region.

also administered the zones in a way which facilitates investors, by reducing bureaucratic obstacles to a minimum.

24. Some of the <u>administrative barriers</u> in the FEZs in the three countries are highlighted below:

(i) In *the FEZ in Yanbian Prefecture*, while tax and incentives scheme are well administered, investors' expressed concerns over the frequent change of laws and regulations owing to incomplete legal and institutional systems. Rules and procedures are also often not properly transmitted from upper to lower levels of administration, and it was cited that implementation of reforms in the system of administrative charges often takes a long time. Costs of energy is high and they includes administrative charges. They were higher than that received by electricity producers and the charges also have to be paid in advance.

(ii) In the *Rajin-Sonbong FEZ in DPRK*, land leasing costs are high and includes a land development fee. The higher rates reflect the belief that foreign enterprises should cover basic infrastructure costs such as land leveling, road construction, water supply and drainage, electricity, telecommunications and heating. Although processing applications for joint ventures has a maximum 50day limit, in practice delays often arise from complicated negotiation process with local partners for starting joint ventures. Also, it seemed that the local authority of the FEZ does not have the autonomy to decide and have to consult regularly with central government. Other encumbrances are the Zone lacks labour flexibility and foreign investors are not allowed to recruit employees directly. It has to rely on the labour exchange in the Zone. Furthermore, visiting the Zone is not easy for citizens of ROK, and they are the potentially important investors, and visa procedure can be cumbersome. The costs of telecommunication services are high and international calls are routed through Pyongyang. There are no cellular phone connections in Rajin-Sonjong and although it is technically possible for Chiense to use their phones in RSZ via connections in Yanbian Prefectire, the administrative authorities of the Zone prohibit this.

(iii) The *Nakhoda Free Economic Zone in Souther Primorsky,* does not provide special favourable concession for investors. Income tax for foreign investors are taxed at a high rate, as for nationals at 35 %, VAT at 20% of turnover and there is an employer tax (including pensions and social security contributions). Major concerns of investors are the uncertain regulatory investment, an undeveloped banking system, complicated unfair and unstable tax system. There are various discriminations against the Russian Far East region as compared to Moscow on trade privileges. Apparently only few organizations have trading privileges in Primorsky such that it is often cheaper to import goods through Moscow rather than directly through RFE

25. These assessments on the FEZs made in 2000 considered only the administrative barriers. It did not include a comprehensive evaluation of the countries' regulatory and investment framework. Other apparent weaknesses of concern to investors are the poor macro-economic fundamentals, weak financial intermediation of banks, absence of a liberal foreign exchange system and inadequate protection for foreign investors. North Korea is still a closed economy, and Mongolia and Russia Primorsky do not have a matured market-oriented system and investors tend to be hesitant about the predictability of the operational environment and on returns to investment. The foreign business sector,

however, may derive some comfort if there are Bilateral Investment Treaties (BITs) ratified with their home countries. China has ratified BITs with 89 countries of which three are with member countries, namely Mongolia, ROK and Russian Federation; DPRK has ratified with 11 countries and none are with GTR countries; Mongolia has ratified BITs with 33 countries and China, ROK and Russian Federation count among them; and Russian Federation have ratified with 36 countries, and among them are 3 members of the GTR.

Box 1. Tax, incentives regimes and administrative charges in the Special Economic Zones of the Tumen Region

China- Yanbian FEZ and Hunchun EPZ

- Foreign enterprises are exempted from income tax for first 2 profit making years. Maunfacutring enterprises corporate tax is 12 to15 % (this compares favourably to China's other special economic zones). Tax refunds is given for one, two or three years from the sixth profit-making year according to size of investment ranging from RMB 2 - 5 million; RMB 5-10 million and RMB 10 to 50 million; and above RMB50million.

For ***Hunchun EPZ,*** foreign enterprise with contracts of over 10 years, are exempt from tax for first three profit making years. Foreign enterprises which reinvest profits for 5 years are eligible for complete refund of income tax.

- Exempt from customs duties and VAT for imports of capital equipment, raw materials, parts and packing materials (no claims were made because of complicated VAT system).
- Manufacturing-use land lease in Yanbian is US$ 17 – 20 per sq m. The authorities reduce annual land use of RMB 1/sq. m by 50% for first 3 operating year,

DPRK-Rajin Sonbong FEZ

- Corporate tax is 14 %, and 10 % for high technology, resource development and infrastructure investment.
- Exempt from customs duties, goods on transit or re-exports; capital equipment and raw materials for processing.
- Other customs duties are reduced by half for first 5 operating years , and by 30% fro next 3 operating years,
- Manufacturing-use land leases is US435-45 per sq m.

Russia - Primorsky

- Foreign investors are taxed at the same rate as domestic investors, at 35 % for income tax, 20 % for VAT and an employer tax which includes pension and security contributions, amounting to 39 % of total employee wages.
- Income tax holiday is granted for the first two years (followed by 50% and 25% reductions in the third and fourth years respectively) for manufacturing, agro-processing, pharmaceutical products and housing construction. To qualify, the share of sales should be at least 70% during the first 2 year and 90 % thereafter.
- An additional reduction of income tax (Primorsky's share) for the period of complete recovery of investment costs, but up to 3 years.
- 90% tax reduction for leasing ventures for the first 2 years and 50% reduction for following 3 years.
- No export duties,customs duties and Vat on imports of capital equipment and raw materials.
- Primorsky Authorities can approve investments to US$100,000 and federal approval is needed for amounts larger than this.

Source:Economic Research Insitute for Northeast Asia and Foreign Investment Advisory Services, World Bank Group.

4. MOBILIZING INVESTMENT: PUBLIC-PRIVATE SECTOR PARTNERSHIP

26. Incremental efforts made by GTR countries in the last decade to move towards an integrated regional economic cooperation needs an even greater push today if it is to turn the decisions on investment agreed at the September 2005 meeting in Changchun into a reality. The GTR countries lack capacity and clearly, greater benefits can be obtained through subregional cooperation than would be possible through independent actions. Integrated cooperation will also bring potential contribution to the economically marginalized subnational units.

27. The dynamics to producing an effective transnational growth area will hinge on an <u>effective public-private partnership</u>. This calls for close collaboration between the public and business sectors in planning and implementing projects to promote regional economic development. It is the Governments' responsibility to provide the right policy and operational environment so as to enable the private sector to play its role. The role of the business sector is critical as the GTR countries have limited capacity, and the foreign business sector can bring in the new capital investments, technology, skills and marketing expertise. It has to be underlined that the business sector’s willingness to take advantage of transnational business opportunities are contingent upon the governments providing the appropriate policies, incentives, infrastructure, and other basic goods in the initial stages.

28. Assessments made in several studies revealed that cross-border barriers, both physical and non-physical still stand in the way. Even the so called Free Economic Zones, which were created to facilitate trade and investment faced inherent obstacles. Although borders have gradually been opened, the degree of opening is still insufficient to permit free flows of goods and people. Instances cited are the limited opening hours of border, time consuming border checks; requirements to obtain visas which are costly and time consuming; limits placed on vehicles within territory of partner countries, especially between China and Russia. Russian trucks may enter China as far as Hunchun, while Chinese trucks may enter Russia as far as Slavyanka. The local business community expects further extension of the mutual operating zone, up to at least Yanji (where there is the airport) and Vladivostock (where there is a port) to facilitate cross-border trade, transit and tourism. Concessions for cross border trade must also be more aggressively pursued.

29. Improvements in these areas require little cost but strong political will. However, progress would improve the image of the Greater Tumen Region, and send useful signals to potential investors as a whole.

5. PRIORITY ACTIONS IN THE SHORT, MEDIUM AND LONG TERM ON ATTRACTING INVESTMENT IN THE GTR

30. Under the current conditions, the goal to make the Greater Tumen Region a growth area is a challenge. There are many unresolved issues on cross-border developments and the investment climate is weak in each country. The lack of political commitment has so far stood in the way of successful regional cooperation. Member governments' commitment at the September 2005 Changchun meeting to create a right

business climate in the region which will establish a sustainable competitive position for GTR to capture increased FDI inflows is an important step in building investors' confidence. However, the governments need to demonstrate this with actions on the ground to give the right signal to investors. A set of priority actions is presented in a matrix in Table 6 for the short term, medium and long term. Building on complementarities across the member countries will be a win win situation for the region although the benefits may not always be equal for all countries. The identified actions essentially address the following six key areas:

(a) Creating an enabling environment for private investment and bringing the investment framework to an internationally competitive standard. Paragraphs 31 to 35 outlines the determinants which investors look at in making location decisions; and proposed actions such as governments issuing a national policy statement on their investment objectives which will help sensitize all departments and agencies dealing with investors to facilitate investors; implementing fast track approvals for projects in the already existing special economic zones, and giving proactive support to the work of the Business Advisory Council.

(b) Raise the efficiency of the transport corridor of the 3 riparian countries (NE and NW China, Rason-Sonbong in DPRK and Russia Far East). The realization of an efficient transport corridor is a key to successful development of the region and will stimulate intra-trade and provide support services needed by business (see paragraph 37).

(c) Remove physical barriers to cross border trade and investment and promote the free flow of goods, services and people.

(d) Promote foreign direct investment into regional projects on tourism. There is potential to promote the region as a multi-destination area for tourism and attract private investments (see paragraph 39).

(e) Promote foreign direct investment into regional projects in energy. As stated in paragraph 40, concrete opportunities are provided by oil developments in the region and they will generate businesses in all the member countries.

(f) Promote foreign direct investment into the region's infrastructure development (see paragraph 38).

Table 6. ACTION MATRIX ON IMPROVING TRADE AND INVESTMENT ENVIRONMENT IN THE SHORT, MEDIUM AND LONG TERM

A. Creating an enabling environment for private investment and bring the investment framework to an internationally competitive standard

Short term	Medium term	Long term
1. Each government to issue a policy statement on attracting foreign investment for development. To coordinate with relevant departments/agencies dealing with foreign investors.	4. Develop a regulatory framework on investment in GTR countries which are in line with international best practice.	.
2. Governments to concentrate resources and speed up implementation of projects in existing Special Economic Zones in DPRK, Yanbian, and in Primorsky Territory. Allow for fast track approvals for projects in these Zones -reduce red tape and introduce a one stop in approving project applications. Central governments to allow Zones autonomy in making decisions.	5. Develop the banking sector in DPRK and Primorsky.	
3. GTR governments to participate at a high level and engage in a constructive dialogue with the Business Advisory Council which will provide a vision on business development and recommend policies on improving the business environment.	6. Strengthen the Tumen River Investor Services Network which were set up in the late 1990s. Improve their effective functioning in servicing investors and in promoting countries investment opportunities.	

B. Raise efficiency of the transport corridor of the three riparian countries in the GTR

Short term	Medium term	Long term
1. Complete the 54km road from Wonjong and Sonbong on the Rajin-Sonbong route in DPRK (currently under negotiation with a Chinese investor).	3. Restart the operations on the Hunchun-Kraskino railway link.	
2. Carry out feasibility study on the missing railway link between Eastern Mongolia and Jilin Province	4. Modernize the Namyang/Rajin Railway,including rail and sleeper replacement ,and strengthening of the tunnel.and bridge.	
	5. Modernize Zarubino and Posiet Ports,(feasibility study was carried out in 1996)	

C. Remove physical barriers to cross border trade and investment and promote free flow of goods, services and people

Short term	Medium term	Long term
1. Re-open common border free economic zone between Hunchun and Rason Sonbong.		7.Undertake negotiations on tariff liberalization among members in the region, including setting targets on tariff reductions.
2. Simplify checking procedures at border on Russia side. Introduce a single window control, i.e., joint inspections by the authorities in China and Russia .		
3. Extend opening hours at the Changlingzi/Dalzavodsky border and the Quanhe/Wonjong borders, and uplift the closing of borders on Saturdays,Sundays and public holidays at the Changlinzu/Dalzavoodsky border. …		
4. Reduce the fees of Russian visas in Primorsky.		
5. Allow entry of Russian vehicles to go beyond Hunchun to Yanji, and Chinese vehicles to go beyond Slavyanka up to the port of Vladivostock..		
6. Allow foreign investors of all nationalities entry into DPRK.		

D. Promote foreign direct investment into regional projects on tourism

1.Attract investments into regional tourist development projects.	2. Sign a Protocol on facilitating tourism in the region. Coordinate policies on free entry of people, air and road links.	

E. Promote foreign direct investment into regional projects in energy

1. Governments of GTR to participate in the Energy Council and coordinate polices on energy development.	2. Improve port facilities in in Vladovsitock and Zarubino ports.	
	3. Upgrade oil refining facilities in Rason.	

F. Promote private investments into the regions' infrastructure development

1. Mobilize public-private rtnerships in financing infrastructure projects..		

31. Investors’ decisions on investment location are influenced by different sets of determinants. A country with potential based on its comparative advantage will enable it to go on a potential investor’s long checklist. A shortlisting will follow and the regulatory and operational issues become important. These issues, both at the macro and micro levels are factors which influence economic competitiveness and impact on returns to investment. Broadly, this includes issues relating to entry and establishment of the business, protection of investors’ interests, incentives as well as a stable macro-economic environment. To meet the strategic objective of making the GTR a competitive area to attract investments and promoting intra-regional trade, it is imperative that participating governments liberalized its investment environment and establish a regulatory and operational framework for investment which are friendly to investors. It is recommended that China, DPRK; Mongolia and Russia Primorsky undertake review of their investment policies, and address important policy issues which impact on investment, in particular, as follows:

- Entry and admission of foreign investment – open sectors to foreign direct investment, and do not put a restriction on size of investment
- Simplify rules on approving projects and reduce bureaucracy to a minimum
- Employment of expatriates – allow for flexibility, and quick approvals for non-citizen work and residence permit
- Extend national treatment to foreign investors, i.e., no less favourable than that it accords to its own investors and investments
- Land tenure issues and leasehold land title should not be too rigid
- Clear rules on expropriation and how this will be dealt with
- Allow for repatriation of funds
- Liberalize foreign exchange control
- Provide mechanisms for dispute settlement. Allow also for international arbitration. It is recommended to be a signatory to the International Court for Settlement of Investment Dispute(ICSID)
- Incentives, general incentives and also preferential tax treatment to promote investments in special zones (export processing) and industrial estates
- Requirements on environment impact assessment
- Target sectors in investment promotion at the national level and coordinate a platform on investment promotion at the regional level
- Liberalization of trade among member countries, and removal of tariff and non-tariff trade barriers to promote greater economic efficiency, productivity and competitiveness

32. Countries in the GTR have different economic systems and different investment conditions and currently some are relatively far off the mark based on internationally competitive standards on investment. Furthermore, local private sector development is barely evident, except for China, and the operating environment therefore poses many challenges. **At the national level,** GTR countries must individually bring its investment regime to a competitive international standard and create an enabling environment for investors, ie, liberalize FDI entry, reduce red tape on starting business, ensure that there are adequate provisions on protection of investment. There is a lot of ground work required of governments as the analysis on constraints has borne out. Though Governments may have laws on investment and special concessions for investors, it is not always consistently applied. This militates against investment inflows. While incentives are generally helpful to investors, they are only icing on the cake and regulatory issues must be tackled with rigour.

33. It is recommended that firstly, respective governments at the highest level should issue a national policy statement on their vision on investment and objectives to attract foreign direct investment. This is important as it amounts to sensitization of stakeholders and help to create awareness of the stated national goal. This will generate greater cooperation and willingness to facilitate investors by departments and agencies which handles issues relating to investors, e.g, work permits, customs and tax administration etc.

34. Secondly, each government should focus efforts and concentrate its resources to bring at least the special economic zones to international best practice standards. It is all the more crucial that these countries ensure that the special economic zones which they have created to attract investments play their role effectively**.** Countries could allow for quick start measures for projects in the Zone, for example, provide fast track approvals from project initiation to project implementation. All efforts should be directed to making the FEZ a best practice area. Countries should be ready to institute reforms to streamline procedures and regulations, including bringing high quality customs administration and guarantees on foreign exchange and tax arrangements. Governments should try to mobilize momentum in the FEZ and make it realizable in a short time frame over the next two years. Generating growth momentum and wealth creation in these targeted areas will have spillover effects for the local economy. This will have a demonstration effect, too, and invariably will lead to increased inflows of investments into the countries. For the longer term, entering into Bilateral Investment Treaties and Double Taxation Agreements with major investing countries are equally important.

35. Thirdly, the governments must be actively involved in supporting the Business Advisory Council's work. The Council will play an important role in giving a business perspective on the way forward and in providing the governments with feedback on how to continually improve the investment environment. It is crucial that governments are active partners in this process and hold constructive dialogue with the Business Advisory Council, discuss issues put forward and follow up on implementing recommendations on issues which are obstacles to business.

36**.** **At the regional level**, investment opportunities abound in the region and there is huge scope for utilizing FDI for development. This takes into account the financing requirements of GTR's identified goals on regional development and their limited access to public or international finance. DPRK is severely handicapped because it is not a member of international financial institutions. Domestic financial intermediation is limited in all three member countries. Thus, it is important that GTR countries improve its investment environment and bring its regulatory and operational framework for investment to an internationally competitive standard. Among the important determinants will be the countries' stage of economic liberalization and how well countries treat the investment-related issues highlighted in paragraph 27 above.

37. GTR has three key concrete areas which it should work on to bring about results on the ground and accelerate regional development. As has been pointed out, regional projects on tourism, energy and infrastructure will create benefits for all countries, including Mongolia, ROK and Japan. The most crucial link is to make the transportation corridor operational and raise its efficiency. This will facilitate the achievement of the goals on promoting regional tourism, expanding intra-regional trade and exploiting trade and investment opportunities in energy and manufacturing. Overall, the generation of economic activities will pave the way for growth and wealth creation for the region.

38. GTR's infrastructure needs will require investments in completing rail, and road links, improving port facilities, including oil refining facilities and investing in expanding the airport to allow for international access. Currently, there is also under investments in the provision of utilities and telecommunications services. All three contiguous regions of the Tumen River Area face challenges in meeting their infrastructure needs. Attracting FDI to infrastructure development is a viable alternative, using public-private sector partnerships as is done in many countries. Under this arrangement, infrastructure development is orchestrated by the governments or quasi-government agencies, but it will largely depend on participation and cooperation of the private sector partners as "owners". The more common forms are Build-Operate-Transfer (BOT), Build-Own-Operate (BOO) or Build-Own-Operate-Transfer (BOOT) which is similar to BOO but the service provider retains ownership of the asset in perpetuity. To mobilize private sector participation in infrastructure development GTR countries need to put in place a regulatory framework on investment, prepare feasibility study proposal and negotiate the form of investment. Ultimately, the countries should be able to assure investors of a friendly investment climate.

39. Private sector participation can also be mobilized to help develop regional tourism. Foreign investment can be attracted to property development, including hotels development, tourist services like tour operators. The successful promotion of regional tourism, will help meet the countries' goals on poverty alleviation. Jobs will be created directly and indirectly. It will generate demand for consumer goods used by the hospitality industry, thereby increasing linkage with the local economy (see also paragraph 20).

40. There is a very large scope to mobilize FDI into energy projects and GTR should not lose this opportunity and intensify regional efforts to make this realizable. As stated in paragraph 21, based on GTR countries' comparative advantage, each country will have the opportunity to attract foreign investment into building of port terminals, oil storage and refining facilities and create businesses for transportation services and distribution

services. In addition to this, there will be wide implications for both intra and international trade for which the Russian ports can serve as gateway to Japan and USA.

41. The goal of making GTR a pole for development into a reality requires that governments address all cross-cutting issues in full measure. While on the one hand, GTR governments should work rigorously at creating an enabling environment for investment, addressing regulatory and legal issues, it should also put a very high priority on removing cross-border physical and non-physical barriers. This affects the operational environment for businesses and are costly to businesses in terms of time and money. Most important actions are simplifying crossing procedures, remove impediments to cargo and passenger flows, permit crossing by foreign businessmen and tourists, reduce costs of transit and introduce a progressive harmonization of customs procedures. These issues are not difficult to fix but will require strong political will.

42. In the longer term, GTR countries should also engage in a progressive liberalization of tariffs and non-tariff barriers to promote regional trade. GTR countries should work towards this objective and negotiate a framework of agreement. This is a long and complex process. Among others, countries would initially need to identify products for tariffs reduction and the applicable margin of reduction, and to consider the origin rules to determine the origin of products eligible for preferential concessions. The GTR countries may wish to seek technical assistance from ESCAP which has a programme on trade negotiations under regional arrangements. Six countries (Bangladesh, China, Laos PDR, India, Republic of Korea and Sri Lanka) have been assisted to establish a preferential trading arrangements under the Bangkok Agreement, which is now renamed as the Asia Pacific Agreement. It is noted that China and ROK are already signatories of the Asia Pacific Agreement

43. An important strategy to mobilize external financing must include systematic efforts at investment promotion and investment facilitation. Under the Tumen River Investor Service (TRIS) networks set up by UNIDO beween 2003 and 2005 for the Tumen region, a TRIS Centre has been set up in Rason, DPRK, Yanbian in China, Russia Primorsky and Mongolia. The Centre is charged with a range of functions from providing support services and business-related information to investors, including the identification of strategies on investment promotion. However, these bodies have not been operational, and they remain weak and are lacking in capacity. It is important that Governments take steps to strengthen these bodies and enable them to carry out their investment promotion functions in a systematic manner. In addition, the TRIS Network is expected to facilitate a common approach to investment promotion in the region.

CONCLUSIONS

44. The Greater Tumen Region has the comparative advantage to attract investment for development but competition for investment is very intense. Investors benchmark locations and their major consideration is returns on investment which is based on several determinants. There are still several challenges facing GTR countries which require concrete steps in order to realize its investment potential. Building a good transport infrastructure is vital and this can spearhead growth of new economic activities. On the top of this agenda are parallel actions which governments should individually take to create the enabling environment for investment, and removing institutional barriers to trade and passenger flows. The agenda to make the goal of creating GTR as a pole for

development rests with the governments and this requires their strong political commitments.

Ms Lena Chia
UNCTAD Advisor on Investment
23 March 2006

Annex 1A. Intra-imports of GTR countries

China's imports from DPRK,Japan, Mongolia, ROK and the Russian Federation, 2000 to 2004 (in US$ millions))

	2000	2001	2002	2003	2004
DPRK	0.04	166.7	270.7	395.3	585.7
Japan	41,509.6	42,787.3	53,466.0	74,148.1	94,326.7
Mongolia	212.1	239.5	223.4	283.9	461.1
Republic of Korea	23,207.4	23,376.9	28,568.0	43,128.0	62,234.1
Russian Federation	5,769.9	7,958.8	8,406.7	9,728.0	12,127.4
TOTAL NE ASIA	70,699.0	74,529.2	90,934.8	127,683.3	169,735.0

Japan imports from China, DPRK, Mongolia, ROK and the Russian Federation, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
China	55,100.1	57,866.1	61,783.7	75,469.3	94,340.4
DPRK	256.8	225.6	235.1	174.6	164.1
Mongolia	9.6	10.8	7.4	6.9	8.3
Republic of Korea	20,446.4	17,198.0	15,484.6	17,902.7	22,046.5
Russian Federation	4,579.4	3,857.5	3,276.5	4,237.3	5,710.0
TOTAL NE ASIA	80,392.3	79,158.0	80,787.3	97,790.8	122,269.3

Mongolia imports from China, DPRK,Japan, ROK and the Russian Federation, 2000 to 2003 (in US$ millions)

	2000	2001	2002	2003	2004
China	109.4	119.5	n.a	172.3	n.a
DPRK	0.00	0.04	n.a	0.05	n.a
Japan	73.3	55.8	n.a	63.4	n.a
Republic of Korea	55.5	58.3	n.a	67.6	n.a
Russian Federation	206.2	221.0	n.a	265.3	n.a
TOTAL NE ASIA	444.4	454.6		568.7	

Republic of Korea's imports from China, DPRK,Japan, Mongolia and the Russian Federation, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
China	12,798.6	13,302.6	17,399.7	21,909.1	29,584.7
DPRK	14.7	12.4	21.9	0.0	21.9
Japan	31,827.0	26,633.1	29,855.1	36,313.0	46,144.4
Mongolia	2.1	2.3	5.7	3.9	4.6
Russian Federation	2,058.3	1,929.5	2,217.6	2,521.8	3,671.4
TOTAL NE ASIA	46,700.7	41,879.9	49,500.0	60,747.8	79,427.0

Russian Federation imports from China, DPRK, Japan. Mongolia and the Republic of Korea, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
China	948.6	1,616.8	2,394.7	3,300.8	4,734.4
DPRK	7.6	16.6	10.8	2.9	4.8
Japan	571.7	814.4	978.6	1,879.6	3,887.6
Mongolia	40.4	35.2	48.6	35.6	21.4
Republic of Korea	358.5	788.9	926.4	1,330.3	2,020.1
TOTAL NE ASIA	1,926.8	3,271.9	4,359.1	6,549.2	10,668.3
TOTAL NE ASIA IMPORTS	200,163	199,294	225,581	293,340	382,100

Source: UNCTAD COMTRADE data derived from reporting partner country. DPRK is not a reporting country to UNSD/COMTRADE, and reverse data is obtained from reporting partner country.

Annex 1B. Intra-Exports of GTR countries

China's exports to DPRK,Japan,Mongolia,Republic of Korea and Russian Federation, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
DPRK	450.8	573.1	467.5	627.7	799.5
Japan	41,654.3	44,940.5	48,433.8	59,408.7	73,509.0
Mongolia	110.5	122.8	140.0	155.8	233.3
Republic of Korea	11,292.3	12,518.8	15,534.5	20,094.7	27,811.5
Russian Federation	2,233.3	2,710.4	3,520.7	6,029.9	9,098.1
TOTAL NE ASIA	55,741.2	60,865.6	68,096.5	86,316.8	111,451.4

Japan's exports to China, DPRK,Japan,Mongolia,Republic of Korea and Russian Federation, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
China	30,380	30,996	39,823	57,416	73,939
DPRK	207	1,067	132	92	89
Mongolia	29	37	31	45	74
Republic of Korea	30,699	25,298	28,569	34,806	44,257
Russian Federation	570	717	945	1,765	3,119
TOTAL NE ASIA	61,884	58,115	69,500	94,123	121,478

Mongolia's exports to China, DPRK, Japan, Republic of Korea and Russian Federation, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
China	267.0	231.5	217.2	284.2	n.a
DPRK	n.a.	0.041	0.027	0.104	n.a
Japan	8.1	15.8	6.3	8.5	n.a
Republic of Korea	2.7	3.4	22.3	7.5	n.a
Russian Federation	45.1	43.8	47.7	41.2	n.a
TOTAL NE ASIA	314.8	294.5	293.5	341.5	

Republic of Korea's exports to China, DPRK,Japan, Mongolia and Russian Federation, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
China	18,454.5	18,190.0	23,753.2	35,109.7	49,763.2
DPRK	n.a	n.a	n.a	n.a	n.a
Japan	20,466.0	16,502.4	15,140.3	17,276.1	21,701.0
Mongolia	54.7	76.6	87.2	99.5	75.3
Russian Federation	788.1	938.1	1,065.9	1,659.1	2,339.3
TOTAL NE ASIA	39,763.3	35,707.1	40,046.6	54,144.4	73,878.8

Russian Federation's exports to China, DPRK, Mongolia and Republic of Korea, 2000 to 2004 (in US$ millions)

	2000	2001	2002	2003	2004
China	5,234.7	3,878.2	5,309.9	7,815.1	8,375.6
DPRK	38.4	57.4	68.6	110.7	204.8
Japan	2,763.3	2,020.7	1,743.0	2,250.3	3,171.2
Mongolia	182.4	211.6	231.4	283.8	363.2
Republic of Korea	972.0	733.8	1,153.3	1,227.1	1,767.4
TOTAL NE ASIA	9,190.8	6,901.7	8,506.2	11,687.0	13,882.2
TOTAL NE ASIA EXPORTS	***166,894***	***161,883***	***186,443***	***246,613***	***320,691***

Source: UNCTAD COMTRADE data derived from reporting partner country. DPRK is not a reporting country to UNSD/COMTRADE, and reverse data is obtained from partner reporting country.

Notes: No data is available for Mongolia in 2002 and 2004.