

## **An Uncertain Future for the Russia-DPRK “Rajin-Khasan” Project**

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The world media and experts actively discuss the intensification of Russia-DPRK cooperation seen since 2013. Though many investment plans involving the DPRK are yet to be realized, Moscow and Pyongyang have already started full-scale work on the so-called “Rajin-Khasan” Logistic Project (the RKLP project). At the end of November 2014, in a landmark pilot operation 40,500 tons of Russian coals were transported to the South Korean port Pohang through the RKLP project. In 2015 South Korea shipped coal through Rajin two more times. Recent developments on the Korean Peninsula, including new nuclear and missile tests done by the DPRK in January-February, 2016, additional international and unilateral sanctions by certain states against Pyongyang, have created serious obstacles and problems for the project. Many experts expect the RKLP to fail. However we believe that there are chances for continuation of cooperation and the project is worth to be saved for the future of the Korean peninsula. This article presents a brief description of the RKLP project, points out possible problems facing the cooperation as well as benefits for every party and discusses the immediate prospects for the project.

**Keywords:** DPRK, Russia, Republic of Korea, Rajin, logistics, inter-Korean relations

Since the end of 2013 there has been a sudden upsurge of diplomatic activity related to economic cooperation between Russia and the DPRK. After a long period of stagnating relations, Russia and North Korea have begun to discuss a number of large-scale projects. Both sides were also eager to engage with South Korea, which was seen as a potential investor (Tiezzi 2014).

Despite many statements by high-ranking Russian officials about

possible multibillion projects between Moscow and Pyongyang (The Official Website of the Far East Development Ministry of the Russian Federation 2014), by the beginning of 2016 Russia and North Korea had only one joint Russian-North Korean project to have actually advanced beyond the negotiation and survey stages and commence normal operations. This is the Rajin-Khasan Logistic Project (RKLP), which seeks to reconstruct the North Korean railway link connecting Khasan station in Russia (located right on the short border between Russia and North Korea) with the port of Rajin in North Korea, and also re-develops one of the port's piers to be used as a new logistic terminal. The project became operational in 2014. At the end of November 2014, 40,500 tons of Siberian coal were transported through the Russian and North Korean railway network, delivered to the port of Rajin, and then shipped to the South Korean port of Pohang. The coal was to be used by the POSCO steel mill located there (Kim, Ji-Yoon, Lee, Young-Jong, and Lee, Sang-Jae 2014). From the end of April to the beginning of May 2015 the second expanded shipment of Russian coal (140,000 tons) was delivered to POSCO and two South Korean power generation firms — Korea East-West Power Co. and Korea Midland Power Corporation (Byrne 2015). From November to December of the same year there was the third shipment to South Korea through the RKLP project: 120,000 tons of Russian coal were delivered to POSCO (Pohang, Gwangyang ports) and 10 containers of Chinese mineral water (170 tons) went to Busan (Jung, Suk-Yee 2015).

It was hoped that in the future a South Korean consortium would join the RKLP, thus making for three-way cooperation and contributing to the stability of the region. However, developments in the situation on the Korean peninsula since the beginning of 2016 have made the prospects for the RKLP dim. North Korea conducted new nuclear and missile tests in January and February (*Associated Press* 2016). The international community reacted by adopting a set of unprecedentedly severe sanctions through the UN Security Council's resolution # 2270 (2016) (United Nations 2016). Some other states including the Republic of Korea, the U.S., and Japan introduced additional restrictive measures including those directly related to the Rajin-

Khasan project (ROK Ministry of Unification 2016a; Lee Rachel 2016a; Pollmann Mina 2016). South Korea decided to stop all economic cooperation with North Korea, including the Gaeseong Industrial Complex, and notified Russia about Seoul's withdrawal from negotiations related to the Rajin-Khasan project (ROK Ministry of Unification 2016 b; Yi Whan-Woo 2016). At the same time, Russia managed to make amendments to the draft of the UNSC resolution # 2270 allowing the RKLP to stay alive and saving hopes for the revival of the project in the future (*Sputnik News* 2016).

The present article's goal is look at this potentially important project in greater detail and define its future from a consideration of the present situation. This is the first case study of an international cooperation project with North Korean participation and it focuses mainly on practical matters of the issue. The paucity of such studies is understandable, given the small number of such projects and the tendency of their leaders to keep a low profile. Nonetheless, now there is indeed a pressing need for such research.

The article is based on press reports and also the author's individual observations, as well as his interviews with Russian, North Korean, and South Korean officials. The author visited the Rajin port when shipping operations commenced in November 2014, and talked with a number of project managers and other officials from Russia and North and South Korea. Since then, the author has stayed in contact with many key participants of the project and visited North Korea several times in 2015 and 2016.

The article begins with an introduction where the RKLP background, history, and current circumstances are described. The second part deals with the reasons behind the parties' decision to get involved with the project. Part Three discusses the problems and obstacles the project has encountered and will likely encounter in the near future. Part Four considers the likely economic and political advantages of the project. In the final part of the article the author outlines the project's likely future with consideration to the latest developments around North Korea.

## The RKLP background:

### *North Korea's "Year of Russia"*

After more than two decades of a largely symbolic presence in North Korean affairs, starting since 2013, Russia has returned to DPRK politics. The period from 2013 to 2015 was marked by an upsurge of high-level bilateral contacts whose frequency and intensity have no parallels since the collapse of the Soviet Union in 1991. The exact reasons for the Moscow-Pyongyang rapprochement should be a topic for separate research. It will suffice to say here that there are a number of reasons why Russia and North Korea found it mutually beneficial to move closer to each other (Yang, 43-50).

Facing deteriorating relations with their main ally, China, and at the same time being ill at ease with their high level of trade dependence on Beijing (reaching a level of around 80 percent of all trade) (KOTRA 2014, 43-46),<sup>1</sup> Pyongyang decided to revert to its old tactic of balancing between foreign powers in order to advance its own interest. This might be the reason why North Koreans started playing "the Russian card": they hoped to find in Russia an alternative to China (Yun 2015, 23-24, 30-31).

On the other side, Russia has found these diplomatic advances from North Korea attractive, since Moscow's relations with the West and especially the U.S. have deteriorated rapidly due to the Ukrainian crisis and sanctions imposed by the West against Russia. "The turn to the East" has become the main strategic direction of Russian foreign

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1. Statistics provided by the Republic of Korea's state agencies and institutes about the DPRK foreign trade usually put the interkorean trade as separate kind of trade and do not include it in the total foreign trade of North Korea. That is the reason why the shares of other countries are usually exaggerated. For example, the Korea Trade-Investment Promotion Agency states the share of China People's Republic in the DPRK foreign trade in 2013 as of 89.1 percent (KOTRA 2014, 46). But if we take into consideration the interkorean trade as well (and the ROK was the second biggest trade partner of the DPRK in 2013) the share of China decreases to about 77 percent.

policy following the Crimean crisis, and the DPRK is one of the countries chosen by Russia to become a new "priority partner." The long history of friendly bilateral relations during the Soviet era helped to speed this mutual rapprochement (Hyun 2014).

Since late 2013, one can see a remarkable growth of intergovernmental contact between Russia and the DPRK. Official exchanges have resulted in the signing of various agreements, declarations, and statements in which the two sides have expressed their interest in large-scale bilateral projects. In May and October 2014 the Minister of the Development of the Russian Far East, Alexander Galushka, visited North Korea. In spring of the same year, Pyongyang hosted the Deputy Prime Minister of Russia and Presidential Envoy to the Far Eastern Federal District, Yury Trutnev, who was accompanied by the heads of the Russian Far East provinces and the incumbent President of the Autonomous Republic of Tatarstan. Simultaneously, Moscow also became one of the most frequently visited foreign capitals for North Korean high-ranking officials (Park Byon-In 2015, 28-30). These visitors included the DPRK foreign minister, Ri Su Yong, and also Choi Ryong-Hae, the special envoy of the North Korean leader Kim Jong Un (Yi Yong-in 2014).

Plans and agreements signed by Moscow and Pyongyang as a result of their negotiations looked impressive, at least on paper. Russia and North Korea agreed to boost bilateral trade from the very modest level of \$112.7 million, as recorded in 2013 (Russian Federation Embassy in the DPRK official web-site 2014),<sup>2</sup> to the level of \$400 to 500 million within a few years, and then to \$ 1 billion by 2020. The two countries also agreed to use the Russian ruble in bilateral trade. Besides that, Russia ratified an agreement to write off 90 percent of North Korean debt to Moscow left over from the Soviet period. As Minister Alexander Galushka stated: "... this agreement provided an impetus to further develop cooperation with the DPRK" (Kelly 2014).

The culmination of the Russian-North Korean rapprochement

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2. The South Korea KOTRA agency gives a smaller volume of Russia-DPRK trade in 2013 — \$104.2 mln. (KOTRA 2014, 46).

came in October 2014 when Alexander Galushka declared the launch of a new joint project, proudly named “*Pobeda*” (Victory). The project envisioned the modernization (mostly building from scratch) of the entire North Korean 3,500 km railway network. The project was said to be have a total cost of around \$25 billion, which was to be gradually invested by the DPRK itself. Pyongyang was supposed to earn this money by selling various mineral resources, including rare-earth metals, to Russian companies (Kutakhov 2014). A few months later, several newspapers and agencies reported that Russia and the DPRK agreed to modernize the North Korean electric power transmission network. The scale of this project roughly equals that of *Pobeda*, approximately \$20 to 30 billion (Ahn 2015).

However, all of these ambitious projects remained at best at the planning stage. Many experts have openly expressed doubts about their feasibility, at least on their declared scale (Akkalaeva 2014; Kang 2014; Lankov 2015, 24-27; Smolyakova 2014). UN Security Council Resolution # 2270 (2016), adopted on March 2nd, 2016, prohibited the DPRK from selling mineral resources, including rare-earth metals, making the *Pobeda* project and many others impossible (United Nations 2016). Russian-North Korean trade statistics also demonstrate a pattern remarkably different from that drawn by politicians. Despite all its accompanying rhetoric, negotiations, and declarations, the actual volume of Russian-North Korean trade declined in 2014, dropping 11.9 percent relative to 2013, (Russia’s Federal Customs Service official website 2015) making Russia’s portion comprise only 0.92 percent of the DPRK’s foreign trade.

Nonetheless, there is one project that stands apart from the ambitious but still “to-be-fulfilled” plans of Russian-North Korean cooperation — the so-called “Rajin-Khasan” Logistics Project (RKLP).

### ***The RKLP: A Brief Introduction***

In spite of its rather short history, the roots of the RKLP go back to days of the Soviet Union. Some Russian experts who have worked in Rajin since the Soviet period recall that the USSR began to use Rajin

and adjacent North Korean ports for shipping cargo as early as 1972. As the CEO of the Russian-North Korean joint venture company "RasonConTrans," Oleg Agafonzev, stated: "Ore, cement, fertilizers, pipes and other different types of cargo were loaded in Rajin. The total volume of cargo was about 800,000 to 900,000 tons a year, which was quite an impressive figure for that time. To use Rajin for Soviet purposes, two railway gauges were built — a Russian wide one (1520 mm) and a narrow North Korean one (1435 mm)" (Kiriyanov 2014).

The goal of the RKLP is to create a unified logistics structure connecting the transport terminal on the 3rd pier of Rajin port with the Russian railway network (through a "wide" gauge link running from the Russia-DPRK border to Rajin) and also with a part of the North Korean railway. This permits the shipment of cargo via the port of Rajin to Russia and Europe by railway and to South Korea, China, and other countries by ships. The basic political decisions regarding the project were made at the Russian-North Korean summit in 2001, when Russian President Vladimir Putin met the DPRK leader Kim Jong Il. From the onset, this project was seen as the first part of a bigger project to reconstruct the Trans-Korean railway, connecting it to the Trans-Siberian railway running to Europe.

As a preliminary agreement was reached, inter-Korean relations experienced an unprecedented "thaw." Many expected explosive growth in inter-Korean cooperation and trade, if not unification. In the year 2000, the first ever inter-Korean summit took place in Pyongyang. Many South Korean producers expressed their interest in transporting cargo, not by a long sea route, but by railway. Such a scheme would allow a significant reduction both in time and in the cost of delivery. Thus, many people were attracted by the idea of creating a transport hub in Rajin for handling cargo brought by ships, which could be sent by trains to/through Russia. It looked promising and economically feasible. The transport terminal on the 3rd pier of Rajin port was originally built on the assumption that it would handle the most profitable type of cargo: containers. Hence, the name of the RasonKonTrans, the principal legal entity at the heart of RKLP: "Kon" here stands for the first few letters of the Russian word for

“container.” The volume of terminal capacity was originally set at 400,000 TEU units a year.<sup>3</sup>

However, unfavorable political developments soon adversely influenced the original plans. Relations between the DPRK and U.S. started to deteriorate, and in 2006, North Korea conducted its first nuclear test. The test caused condemnation and sanctions imposed by the international community, including China and Russia. Relations between Seoul and Pyongyang deteriorated further when South Korean conservatives won the 2007 presidential and 2008 legislative elections. However, in spite of much less favorable political circumstances and delays, the RKLK project finally started in 2008.

The RasonKonTrans, the RKLK owner and operator, is a joint venture company (JVC) officially established on June 16, 2008. It is owned by the RZD Trading House (Russia) and the Rajin Port Authority (DPRK), which holds 70 percent and 30 percent stakes in the joint venture, respectively. In turn, the RZD Trading House is owned by the joint stock company (JSC) Russian Railways, a state-owned company (also known by its Russian name — “RZD”) which operates the vast majority of Russia’s extensive railway networks. The DPRK paid its share by providing rights for leasing the 3rd pier of Rajin port as well as a plot of land in the port area. The lease is valid for 49 years, starting in 2008.

Soon afterwards came the global financial crisis in 2008 and 2009, which caused a temporary halt in activity. The initially planned container terminal’s construction had to be postponed, and the joint Russian-North Korean terminal on the 3rd pier had to be modified to deal with bulk cargo, mainly coal.

As a result of these unfavorable external circumstances, actual construction work started only in 2010.

The infrastructure of the project consisted of two principal elements: a 54-km long railway link connecting the Russian railway station of Khasan on the Russian-DPRK border with the Rajin port and a cargo

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3. Information was provided to the author by the International Cooperation Department of the JSC “Russian Railways.”



terminal located on the 3rd pier of the port. The 3rd pier is the only modern facility at the port, capable of handling large ships. According to the chief of the JVC "RasonConTrans" office in Vladivostok Daria Stegnyi, the total pier line is 480 m, and the depth near the pier is 12 m. The terminal allows for loading simultaneously of two ships up to 50,000 GRT.<sup>4</sup>

On September 22, 2013, work on railway modernization was finished and the new railway link with two gauges (1520 and 1435 mm) was officially launched. Work on the 3rd pier was completed a few months later and a new cargo terminal in the Rajin port was officially open on July 18, 2014. The Russian side invested 10.6 billion rubles (about \$270 to 320 million at the then-current rate) covered by a corporate bond issue.<sup>5</sup>

On November 13, 2013 during President Vladimir Putin's visit to Seoul, Russian Railways (RZD) and a consortium of three South Korean companies — the steel giant, POSCO; Korean railway company, Korail; and Hyundai Merchant Marine Co. — in the presence of Russian and South Korean leaders signed a Memorandum Of Understanding (MOU) for looking into the possibility of a South Korean consortium participating in the project. According to preliminary estimates, the South Korean side may invest about \$150 to 200 million into the project by buying 49 percent of the Russian side's share of the JVC "Rason KonTrans" (Park Hyi-Jun 2014).

On November 27, 2014 the Chinese bulk carrier "Xin Hong Bao Shi" left North Korean Rajin, and on December 1st arrived in Pohang, South Korea transporting 40,500 tons of Russian coal (Kim Ji-Yoon, Lee Young-Jong, and Lee Sang-Jae 2014). Russian and South Korean experts and officials monitored the whole process of transporting coal to Rajin and loading it to the ship in the port. This shipment had a highly symbolic meaning since it was the first time in history that a shipment of Russian coal, jointly organized by a Russian and North

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4. The presentation of the JVC "RasonConTrans" in Busan on February 11, 2015.

5. Information was provided to the author by the International Cooperation Department of the JSC "Russian Railways."

Korean railway, was shipped through the DPRK port and then to South Korea.

In 2015 there were two more shipments to South Korea through the RKLP project: 140,000 tons of coal from April to May and 120,000 tons of coal and 10 containers of mineral water towards the beginning of December (Byrne 2015, Jung 2015).

## **The Rationales Behind the RKLP**

### ***Political or Economic Cooperation?***

Many specialists have pointed out that Russo-North Korean cooperation is largely driven by political rather than economic considerations. Furthermore, many people in South Korea and the West oppose any type of cooperation with the DPRK claiming that Pyongyang uses all profits to support its missile and nuclear programs. The argument is that cooperation enables the North Korean government to conduct military provocation in the region (Kim So-hyun 2011; Culliane 2013; Ryall 2013).

Despite being called “economic cooperation,” cooperation with the DPRK always has political implications and hence is seriously influenced by politics. To put it another way, it is impossible to separate politics from economics when doing business with North Korea. There are a variety of different reasons for this.

First of all, the UN introduced several sets of sanctions against Pyongyang for its nuclear and long-range ballistic missile tests. These measures were put in place by UN Security Council resolutions #1718, 1874, 2094, and the recently adopted resolution #2270 with additional sanctions in reaction to the North Korean nuclear and missile tests conducted on January 6 and February 7, 2016.

Second, all economic entities operating in North Korea are fully controlled by North Korean authorities, who do not hesitate to get involved in their operations whenever they see political cause to do so, making the political factor undeniable.

Third, the North Korean nuclear issue and other related factors mean that any country has to keep in mind political considerations even when the issues at stake are of a seemingly commercial nature.

Indeed, the influence of political factors was apparent from the very beginning of the RKLP: the decision was made at the Putin-Kim Jong Il summit in 2001. However, one should not oversimplify; the DPRK is not the only party responsible for politicizing commercial activity. The same is applicable to the South Korean side. According to South Korean law, any ROK citizen who wishes to visit the DPRK is required to receive prior permission from the South Korean government. The punishment for an unapproved visit to the North may include prison. On the other hand, the South Korean government had, until the complete cessation of all inter-Korean cooperation at the beginning of 2016, also subsidized some exchanges with North Korea whenever it regarded such exchanges as conducive to Seoul's political goals.

After the sinking of the *Chonan* in March 2010, which according to Seoul and some Western experts was orchestrated by North Korea (Pyongyang denies responsibility for the incident), the South Korean government introduced its own set of anti-DPRK sanctions, commonly known as "the Measures of May 24, 2010." These measures technically prohibit any cooperation with North Korea with the sole exception of work related to the Gaeseong Industrial Complex (ROK Ministry of Unification 2010). For the RKLP, Seoul had to make a "special exception" from the May 24 Measures to make South Korean participation in the project legally possible. It was also stressed that South Korean participation would take the form of purchasing a part of the Russian stake in the project, thereby avoiding a direct investment in the DPRK. The Russo-South Korean MOU regarding the RKLP was signed during the Putin-Park Geun-Hye summit in November 2013 (Kim Nam-Kwon 2013).

Thus, the impact of politics is undisputable and, to some extent, unavoidable in the case of cooperation with the DPRK, and this is applicable to the RKLP as well. However, its participants often forward the idea that RKLP is, first of all, a business venture predicated

upon profit, reciprocity, and economic feasibility. It is not a project which requires permanent financial assistance from Russia or any other state and it is difficult to imagine that it will last for long if it starts losing money. In other words, unlike many other DPRK-related projects, the RKLP is likely to become viable without continuous political support.

The RKLP allows the use of reliable railway transport which is less dependent on weather and other conditions compared to ships and planes. As the vice-chief of the International Cooperation Department of the JSC "Russian Railways" Igor Mikhayluk put it: "The railway is probably the only means of transportation that does not depend on weather conditions and works 24 hours a day. Air, water, and auto transport are more influenced by weather. Thus, we are heavily reliant on the railways to guarantee shipment of cargo with minimal delay" (Kiriyanov 2014).

The main goal of the project in its initial stages is purely economic, to ensure that there will be enough cargo to cover the cost of infrastructure and yield a profit. This will allow the parties to make it past the potentially challenging early period of the project.

According to estimates made by Russian railway specialists, the RKLP project will become profitable if it handles at least 4 million tons of coal annually. The planned capacity of the terminal in its current form is about 5 million tons a year, and it can be expanded to 6 million.<sup>6</sup> This amount will guarantee bigger profits though for bigger turnover, the terminal's infrastructure will need further expansion. According to the statistics provided to the author by the International Cooperation Department of the JSC "Russian Railways" (RZD), about 1 million tons of coal were shipped through Rajin in 2015, making the total amount shipped since the opening of the terminal about 1,242,000 tons.<sup>7</sup> That is significantly less than the necessary 4 million

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6. From the oral presentation of the JVC "RasonConTrans" made by its CEO Oleg Agafonzev in Busan on February 11, 2015.

7. The statistics provided to the author by the International Cooperation Department of the JSC "Russian Railways" states that by the middle of November 2015 the amount of coal shipped through the RKLP since July

tons a year, but it must be remembered that the project's infrastructure was finished only in July 2014 and became fully operational only towards the end of 2014.

Thus, in general, though the RKLP has been influenced and to some extent driven by political factors, it has necessary economic elements too, chiefly the need to make a profit.

### ***The Chinese Dimension to Rajin***

Geographically, the RKLP operates in the special economic zone (SEZ) established by the DPRK in 1991. A detailed description of the North Korean government's SEZ policy of special zones and regional development lies beyond this research.<sup>8</sup> But it is worth mentioning that the DPRK recently declared its intent to create about 20 such special zones in the near future, though only Rason and Gaeseong have shown some success in attracting foreign investment thus far (*Chosun Ilbo* 2014a).

It is difficult to obtain reliable statistics on the scale of foreign investment in Rajin. According to reports, a number of companies from China (including Hong Kong), Japan, Swiss, Germany, and other countries have shown interest in Rajin, but the majority of investment so far has come from China whose presence is much felt in Rajin (Kim Myon-Song 2013). Probably all Chinese investment projects in Rason, if taken separately, are smaller in scale than the RKLP, but in total, investment from China to Rason exceeds that of any other country including Russia. Chinese businesses have invested in different areas in Rason: roads, construction of offices, hotels and other buildings, shoe manufacturing, light industry, production of tobacco, fishing, and other industries. The most widely accepted currency in Rason is neither the North Korean won nor the American

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2014 was 1,121,630.716 tons. Adding 120,000 tons of coal transported to South Korea at the end of November-December 2015 makes the total amount around 1,240,000 tons.

8. So far, the most detailed description of the SEZ, available in English, is Marton, McGee & Paterson, 1995.

dollar, but the Chinese yuan (as one of the RKLP managers remarked: "For all practical purposes, yuan is the local currency in Rajin").<sup>9</sup>

Some South Korean experts argue that China and Russia are competing to put the port of Rajin under their own respective control. There were numerous reports about an agreement between China and the DPRK to lease the first pier of the port to a Chinese company (Lee Sunny 2010). However, the future of this alleged agreement, if it ever existed, is uncertain. Though China built a high-quality paved road connecting Rajin with the Chinese city of Hunchun, there are no signs of any investment of China in the infrastructure of the first pier. North Korean officials in Rason, in a private conversation with the author, explicitly denied the existence of a Chinese-North Korean agreement concerning the 1st pier.

Some Russian employees of the JVC "RasonKonTrans" company speculated that China might have acquired the land in the port of Rason with plans to modernize it in the future, but in any case no actual construction work was done in the port by the Chinese. As Alexander Novoselov, the "RasonKonTrans" chief engineer, remarked: "The Chinese did not invest a single yuan in the pier; they have not done any work there. They just took over some plots of land, in hope that one day this would work out."<sup>10</sup> Currently, the first and second piers at Rajin stand in stark contrast to the renovated third pier. To date, only the third pier is actively used for the transportation of cargo and it is the only pier in the port of Rajin that can be used by larger ships. Though the South Korean media concentrates primarily on the quantity of coal shipped through the RKLP to the ROK, it should be noted that the main customer of the project is China. According to statistics, by the end of December 2015, 73.4 percent of coal through the RKLP went to China, while the South Korean share is only 23.7 percent and the rest went to North Korea (2.9 percent) (Statistics provided to the author by the International Cooperation Department of the JSC "Russian Railways").<sup>11</sup>

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9. Interview with Russian managers of the RKLP, November 2014, Rajin.

10. Interviews with Russian and North Korean officials, November 2014, Rajin.

## **Problems with the Project**

Russia's decision to start this project with the DPRK produced skeptical criticism from many experts. Indeed, there are some real problems and difficulties to be addressed, which warrant further discussion. And since 2016, the situation started to deteriorate, making the future of the project uncertain.

### ***Organization Problems***

One of the challenges is the multilateral nature of the project.<sup>12</sup> The RKLP needs good coordination and mutual understanding between specialists in different fields: logistics, railway, port service, and marketing. It requires time and continuous effort. Herein lies the reason for the special "test" and "pilot" shipments that permit the identification of and fixing possible problems. Now, two countries are official partners of the project — Russia and the DPRK. Until the crisis of 2016, the possibility of South Korean participation had also existed. Thus, it was expected that specialists from three very different business cultures (Russian, South Korea and North Korean) would have to work together. They have different traditions, rules, and styles of work. This further complicates the project.

### ***Technical and Infrastructural Issues***

A number of problems are purely technical in nature. For example, Russian technicians had to deal with a number of technical issues while modernizing 54 km of the old North Korean railway between

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11. According to the statistics of the International Cooperation Department of the JSC "Russian Railways" provided to the author at the end of 2015, since July 2014 the amount shipped through the RKLP to China equals 911,630.827 tons (73.4 percent of total), to South Korea — 294,741,716 tons (23.7 percent), to North Korea — 35,510,298 tons (2.9 percent).

12. Pros and cons of multilateral versus unilateral projects in the case of foreign aid and development projects are described in Weiss 2012, 7-8.

the Russian-DPRK border and Rajin. Actually they did not have to only modernize, but rather build a new railway link with two gauges — a wide “Russian” one (1520-mm wide) and a narrow “Korean” one (1435-mm). The train from Khasan to Rajin has to pass through three tunnels built during the Japanese colonial period. Modern Russian locomotives are too big for these tunnels, so old locomotives had to be found in other Russian regions and used to run between Khasan station and Rajin. At the same time, tunnels were also widened.

Other problems result from the poor condition of North Korean infrastructure. One of the biggest obstacles of this type is the very poor state of the entire North Korean power grid and North Korea’s limited generation capacity. North Korea is not able to provide enough power for already existing industrial facilities and urban areas, to say nothing of new projects. Power problems are visible at night in Rajin where the third pier of the port makes for the only bright spot in the dark night landscape. Even this is possible only due to a power generator specially brought from Russia exclusively for the needs of the RKLP, while the rest of the city is shrouded in darkness, with only some monuments and slogans being dimly lit. Roads and railways in the country are also in poor condition. Shortages of even the most basic materials force Russians to bring everything necessary from abroad.

### ***Political Issues***

As noted previously it is often impossible to separate politics from economics in dealing with the DPRK. International sanctions constitute one of the biggest obstacles hindering full-scale cooperation with the DPRK, and the RKLP is no exception.

As previously mentioned, the latest set of North Korean nuclear and missile tests conducted in January to February of 2016 led to a set of unprecedentedly harsh sanctions through the UN Security Council Resolution #2270 (2016) (United Nations 2016) in addition to those already existing measures set by resolutions #1718 (2006), #1874



(2009), #2094 (2013).

Besides the sanctions adopted by the UN, which mandated every UN member state to maintain, many countries (including the U.S., Europe, Canada, and Japan) have introduced their own restrictive measures concerning interactions with North Korea. The Republic of Korea, formerly the second biggest trade partner of the DPRK, finally gave up all cooperation with Pyongyang as a result of North Korean nuclear and missile tests in 2016. In February 2016 South Korea closed the biggest inter-Korean project — the Gaeseong Industrial Complex (ROK Ministry of Unification 2016b) — and one month later on March 8th, introduced its own new unilateral sanction measures against Pyongyang. It should be noted that South Korean unilateral sanctions included measures that directly impacted the RKLP and Seoul's chances of participating in the project. They prohibit any foreign vessels from entering a ROK port within 180 days after docking in a North Korean port (ROK Ministry of Unification 2016a). The ROK government also notified Moscow about its decision to halt discussion about South Korean possible participation in the project (*KBS World Radio* 2016; Lee Rachel 2016b; Yi Whan-Woo 2016).

International sanctions also hindered most financial transactions to and from the DPRK. Even when business deals are completely legal and transparent, the banks and financial institutions of most countries refrain from sending money to North Korea, being wary of international sanctions. Bankers are also well aware of the special attention that American financial authorities' pay to the DPRK, and they fear ruining their relations with American financial institutions and regulations, especially given the U.S.'s central position in the international financial system.

Governments of many countries treat any contact with North Korea with serious suspicion. As noted above, the Republic of Korea has a special law forbidding its citizens from visiting the DPRK without special governmental permission. South Korea and many other states also have influential domestic political forces, indeed, even entire political parties, that oppose any kind of cooperation with North Korea at all, believing that pressure and isolation are the only accept-

able ways of dealing with Pyongyang (AFP 2015).

Recently, some Western-backed sanctions came to be applied not only to the DPRK, but to Russia as well. The conflict in Ukraine, and the consequent deterioration of Russo-Western relations resulted in the introduction of sanctions against Russia by the U.S., EU, Japan, and other states. Though South Korea has not formally joined the Western-backed sanctions against Russia, it cannot be completely free from the influence of the U.S., its main military and political ally.

### ***Economic Issues***

The RKLP also faces some obstacles of an economic nature. In this regard, admittedly, it is not very different from any other economic project at the early stages of being realized. The Rajin port has a number of competitors in other regional ports and transport hubs. This means that Rajin has to show it has the ability to compete by shipping cargo cheaper, faster, and more efficiently.

Of late, the project has also faced the unfavorable trend of declining international market prices for coal that constitutes its main cargo (Critchlow 2014, PennEnergy Editorial Staff 2016). China, which is one of the main potential importers of Russian coal, has imposed additional tariffs on coal imports. This has worsened the situation for the RKLP and damaged profits from the shipment of this type of resource (*Reuters* 2014).

The RKLP must also overcome the inertia of logisticians and industrial managers reluctant to abandon established trade routes, and instead switch to the new line offered by the Russian-North Korean project. This new route still has to prove its credibility.

### ***“The North Korean Factor”***

The uncertainties of the world market, fluctuations in international commodity prices, and other economic issues can impact any business project, but the RKLP has a number of peculiar obstacles and potential problems which are described by many watchers as “the North Korean

Factor." Though we have mentioned some of these issues above, it is necessary to point to some others related to North Korea's peculiar positional situation and domestic politics.

First of all, most if not all business people who have considered engaging Pyongyang have to worry about the future of their investment, at least to a certain extent, because of the unpredictable character of cooperation with the DPRK. As demonstrated in the beginning of 2016, any outbreak of tensions on the Korean Peninsula may lead to the complete freeze of all projects there; the imposition of new international sanctions is not impossible. Pyongyang's behavior towards foreigners, including foreign investors, is often volatile and difficult to predict. Mass media and expert reports are full of foreign investor stories that speak of numerous difficulties faced in the DPRK (Abrahamian, 2015, 35-45). Among other problems frequently cited, there is lack of a clearly defined set of legal norms governing commerce, poor infrastructure, and corruption (Shepard 2010, 3-8). There even have been reports that some foreign investors were forced by the DPRK to leave the country after having invested a considerable amount of money and without receiving any compensation (Lankov 2012).

South Koreans also worry (and with good cause) that the DPRK could use joint projects to apply pressure on Seoul in order to gain additional political concessions. The situation with the Gaeseong Industrial Complex's temporary closure in 2013 and its final shut-down in 2016 demonstrated that inter-Korean cooperation is very vulnerable to political tension.

It is possible that some problems in doing business with the DPRK are exaggerated and that the North Korean authorities may also have good reason to blame their foreign partners for their unreliability. Nonetheless, certain worries about the North Korean government's behavior are based on past experience and are understandable.

Many businessmen dealing with the DPRK also complain about seemingly irrational restrictions frequently placed on foreigners residing in North Korea. The recent example of such measures is the set of restrictions imposed because of Ebola outbreak in Africa (Ryall 2014; Abrahamian 2015, 35-37). As a response to this faraway medical crisis,

North Korea introduced strict quarantine measures that lasted until March 2015, and made trips to North Korea almost impossible to arrange. In a similar vein, during the visit of the Russian-South Korean delegation to Rason in November 2014 all participants were allowed to stay only in two places, the hotel where they stayed, and the “RasonKonTrans” headquarters on the third pier of the port of Rason. Nobody was allowed to leave the hotel or the pier area and no contact with North Koreans was allowed, with project personnel being the only exception.

There are also frequent complaints about the great amount of working time spent on numerous “party meetings” and other events related to ideological indoctrination.

Furthermore, some businessmen point out that North Koreans often fail to fulfill signed agreements or interpret them in different and unexpected ways. There were reports about attempts by North Korean officials or business partners extorting additional money from foreigners under the guise of “new tariffs” or “state taxes.” Sometimes these “taxes” may be camouflaged as demands to build new infrastructure unrelated to the main project. Many foreign businessmen (especially Chinese) complain about deeply rooted and widespread corruption among North Korean officials (Haggard and Noland 2009).<sup>13</sup>

While these stories contain exaggerations, it must be admitted that North Korea does have some peculiar features, rules, and practices which are hard for foreigners to understand and accept.

## **Potential Benefits of the Project**

As we have seen, there are a number of problems that seriously impede the realization of the RKLP. However, despite all difficulties,

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13. According to surveys, 53 percent of Chinese businessmen, working with the DPRK, admitted they had to spend as much as 10 percent or more of their total profits for bribes (Haggard and Noland 2009).

the project also has a number of potential distinct benefits for all participants.

### ***Benefits for Russia***

Economically, the RKLP success will allow Russian participants to make profits, while also granting access to a North Korean port and creating a new logistical hub there.

First of all, this project allows Russia to secure the use of another port near its borders. Russian Far East ports are at capacity in dealing with trade of Russia's natural resources. (Kim Ji-Yoon, Lee Young-Jong, and Lee Sang-Jae 2014). South Korean experts also see this port as promising for logistical purposes because of its close proximity to China and Russia. A few years ago, there were talks of South Korea also planning to build its own container terminal in Rajin (*Yonhap News Agency* 2003, p. 353). Besides that, POSCO and Hyundai Merchant Marine company are currently building a large logistic hub in the Chinese city of Hunchun, located just 70 km away from the Chinese-DPRK border. The connection of this emerging hub in Hunchun with Rajin presents a lot of opportunities (POSCO 2013; Foster-Carter 2014), at least in the future.

Second, as said above, the Russian and North Korean sides have worked together in the port of Rajin since the Soviet period.

Third, the port of Rajin has some advantages over many ports in the Russian Far East. It is ice-free throughout the whole year allowing full use in all seasons. Other Russian Far East ports cannot boast such an advantage. When not ice-free, they require the use of icebreakers, which raises transport costs.

As for the main investor — the JSC Russian Railways (RZD) — the project gives the company's direct control of a logistics terminal in Rajin port. It will allow them to ship cargo in accordance with their own needs and preferences. As the business development director of the JSC "RZD-Logistics" Denis Mazurin put it: "In our part of the Rajin port we are in charge, we do not depend on anybody. So we can control and manage cargo transport as we need" (Kiriyanov 2014).

The strategic dimension of the project for Russia is hard to deny. In the future, the volume of cargo between South Korea and Europe is expected to grow, making this line more important. If the two Koreas ever unify, all political obstacles hindering the growth of cargo flows will cease to exist, and this logistics hub will have yet more growth potential.

There are also some political benefits for Russia. This project was initiated by Moscow, and contributes to the growth of the Russia's international prestige and influence. Though it now seems as a remote goal, the RKLP also encourages more cooperation between South and North Korea, and thus will contribute towards making the region into a safer place (Park Byon-In 2015, 31-33). To a certain extent, the project can be seen as Russia's contribution to inter-Korean reconciliation and, possibly, to eventual Korean unification (Toloraya 2014). While politicians in the two Koreas often find it hard to agree, representatives of South and North cooperated, with Russia's help, in the RKLP project, at least until 2016.

### ***Benefits for the DPRK***

For the North Korean side this cooperation also seems to be beneficial in multiple ways. First of all, there are financial and economic benefits. The DPRK holds a 30 percent stake in the joint venture "RasonKonTrans," and thus is entitled to that portion of the project's revenues. It should also be noted that the DPRK entered the project not by paying cash, but by providing the right to rent the third pier and a plot of land nearby. If the project works well, the port of Rajin will be able to earn additional money by providing assorted services for visiting ships and trains, including repair, etc. This will generate more income for the North Korean state and business. Besides that, as the vice-chief of the International Cooperation Department of the JSC Russian Railways Alexey Astafyev noted to the author, according to the agreement, North Korea receives 600,000 euros annually as rent for providing land for the modernized railway line connecting the Russian-Korean border with Rajin.

Second, North Korea has come to possess a functioning logistical project, complete with a new modern transport terminal capable of handling large-capacity ships as well as a 54-km long new modern railway line. Even if for some reason the project is to be terminated, all of this will remain in North Korea and can continue to be used.

Third, according to Russian officials at JVC "RasonKonTrans" there are about 90 North Korean workers and specialists among some 130 employees at the company. According to the Russian managers, North Korean workers and technicians are paid between 75 and 200 euro a month. This means that their wage level at least equals or perhaps exceeds that of North Korean employees in the Gaeseong industrial complex (Park Byon-Yong 2014). All of them live in Rajin and spend at least part of their money in North Korea. If the project proves to be successful it will continue developing, expanding its capacity and leading to further job creation in the area.

Successful operations at the project will help to change the generally negative attitude of foreign investors towards North Korea. Potential investors are likely to see the RKLP's possible success as proof that it is possible to do business profitably in the DPRK. That would help to create a more positive image of the DPRK as a target for foreign investments. Last but not least, through cooperation, North Koreans can also receive valuable experience and knowledge of working on international projects.

The project likely will lead to a reduction in their unilateral dependency on China, now seen as a political problem for Pyongyang. While China currently controls about 77 percent of the DPRK's foreign trade, political relations between Beijing and Pyongyang have worsened recently (Snyder, Byun See-won 2015). North Korea has actively sought out new partners abroad. The "Rajin-Khasan" project alone is not able to reverse the entire situation but it is a step in the right direction.

### **Benefits for South Korea**

As mentioned before, since 2016 South Korea introduced new sanctions against North Korea and decided to withdraw from the project for at least the foreseeable future. However as South Korean president Park Geun-Hye said, Seoul will not shut the door to dialogue with North Korea (Kim Jack 2016). Considering the previous interest of Seoul in the RKLP it is worth mentioning some possible benefits for South Korea if they decide eventually to return to economic cooperation with Pyongyang.

As was discussed above, the ROK would likely not participate in the KRP unless it is economically viable. While a political rationale, described below, certainly exists, economic considerations alone make the project beneficial for Seoul. According to experts' estimates, the use of the logistics route provided by the RKLP allows them to reduce transportation costs and shipment period by 10-15 percent (*YTN News* 2014b). A member of the South Korean delegation, who visited Rajin in November 2014, also said that there are even more optimistic estimates of possible cost reductions for transporting coal from Russia to South Korea. Reportedly, optimistic estimates of reductions are as high as 50 percent to 70 percent (Kiriyanov 2014).

In the future, the shipment of containers via Rajin to Europe will also be possible, thus making the project even more profitable. The creation of a direct railway line connecting South Korea with Europe through the DPRK railway network and Russia's Trans-Siberian railway still remains a matter for the rather distant future, but such prospects should not be forgotten either. The RKLP can be seen as the first step towards this ambitious and much discussed project (Kim Tae-Shik 2015, 8-9).

Potential political gains are another reason for Seoul to consider participation in the project. Cooperation would contribute to improving relations with Pyongyang, thus reducing tensions on the peninsula. It can also push North Korea to be more open and start deeper and more active economic reforms — another goal Seoul wants to achieve in dealing with Pyongyang.



In the long run, Seoul's investment in the RKLP may also be seen as an investment in creating a unified Korea — a high priority for any Korean government.

The Republic of Korea also sees a reduction of North Korea's excessive dependency on China as an important goal. Many experts in politics and the media in the South openly express concerns about the political and economic consequences of North's reliance on China and the negative impact such reliance is likely to produce on the North-South relations (Choi 2007, 77-83). The RKLP presents the opportunity of beginning to change this trend (though this project alone would not be sufficient) and helping North Korea to find other partners (including South Korea) besides China.

It is also worth mentioning that the leading role of Russia in the project serves Seoul's interests as well. Russian participation significantly reduces the North Korean temptation to use South Korean involvement (should it become real) as a tool to put pressure on Seoul with respect to political issues. This "political blackmail" scenario has always been among the most common worries for South Korean experts who analyze possible problems in North-South cooperation issues. With Russia's involvement in the RKLP North Korea will be strongly discouraged from instigating conflicts with the South — at least as far as this particular project is concerned.

### ***Contribution to Regional Stability and Security***

The RKLP is likely to produce a positive impact not only on bilateral and trilateral relations but on the regional situation as a whole. This serves the interests not only of direct participants of the projects but all neighboring countries.

The smooth functioning of the project in this remote part of the DPRK would encourage further economic development in this area. At the same time multilateral cooperation allows for the accumulation of valuable experience with cooperation and provides the impulse for future multilateral and inter-Korean projects.

Another positive consequence of the project should be mentioned

as well. Many foreign business people complain about the “free-rider attitude” the DPRK frequently demonstrates. North Korea has grown accustomed to asking for free assistance from foreign states and international organizations, and sometimes is irresponsible in keeping its promises (Jaurequi 2013). That is why the RKLP is valuable because it is not direct assistance or a cash gift to the North Korean government, but rather a real, reciprocity-based business project. It will show Pyongyang how to earn money by obeying international rules and laws and by following internationally accepted business practices. The “Rajin-Khasan” may become an experience which allows the DPRK learn how “to feed itself.”

### **In Lieu of a Conclusion: The Future of the RKLP**

Until the beginning of 2016, prospects for the RKLP were at least not bad. Judging by the initial reaction of South Korean officials, experts and journalists, Seoul was satisfied with the results of all three coal shipments from Rajin. Some media outlets, citing officials, predicted that the South Korean consortium consisting of three companies — POSCO, Hyundai Merchant & Marine and Korail — would join the project in the near future (Kim Younkyoo and Blank Stephen 2014, 616; *YTN News* 2014a; Kiriyanov 2014). Rumors appeared about other possible participants as well. Among the candidates there were references to Korea Electric Power Corporation (KEPCO) which imports large quantities of Russian coal for its power plants (Kim Tae-Shik 2015, 16-17). The municipal administration of Busan, the second largest city of South Korea, has expressed interest in the RKLP and signed a MOU with “RasonKonTrans” for cooperation (Park Chan-Su 2015; Jo 2015, 1). When South Korean officials raised the topic of possible cooperation with Pyongyang, they almost always mentioned the RKLP as one of the most promising fields of such cooperation (Yoon 2015, 45; Kiriyanov 2015; Park Dae-Ro 2015).

In any case, it seemed that the project’s start had been auspicious. The whole port infrastructure is ready, and has been tested

many times with coal shipments to China, South and North Korea. According to officials at Russian Railways and the JVC "RasonKon Trans," in 2014 the project shipped more than 120,000 tons of coal in four shipments. By the end of 2015 the total amount of transported coal rose to 1,242,000 tons (JSC Russian Railways 2015). In 2015 the volume of cargo transported through the Khasan-Tumangan Russian-North Korean border point increased 4 times comparatively to a year before while 94.2 percent of those commodities were delivered to the Rajin port for the RKLP (Usov 2016, 1).

Despite problems in the Russian economy, the "Russian Railways" (RZD) declared plans to modernize a part of the Trans-Siberian railway (Boronovskiy — Khasanstn. part, 238 km long) connected to the Khasan-Rajin part to double the transportation capacity of the railway (Usov 2016, 1) to bring more cargo to Rajin. Russia's Far East Development Minister Alexander Galushka told local media that his country intends to expand trade volume between Russia and the North to \$1 billion — a more than ten fold increase from the previous 2014 record (Song 2016).

North Korean officials also have demonstrated their interest in cooperation on the issues which are defined by economic assumptions of mutual profit rather than politics. "We have not introduced sanctions against anybody or any country. We just want to do business profitably for everybody — for us, Russia, and the South. We hope the project receives necessary support for its further development," said one of North Korean officials during the visit of the Russian-South Korean delegation in Rajin in November, 2014.<sup>14</sup> Kim Chol Ho, the deputy head of department of North Korean railways ministry also expressed hopes for the project and plans to create an important logistics hub for Northeast Asia in Rajin (Kim Tae-Shik 2015, 17).

At the same time, right now, the project faces a lot of new big obstacles and troubles. The present crisis in the world economy, as well as difficulties and problems faced by RKLP participants, make it difficult to secure orders for the necessary amount of coal shipments.

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14. Interview with a North Korean official, November 2014, Rajin.

Many observers continue to emphasize the problem of “the North Korean factor” and difficulties that lie in the way of a successful outcome of any project in the DPRK (*Chosun Ilbo* 2014a).

A bigger problem was created by North Korea itself through its latest round of nuclear missile “blackmail” in January and February 2016. As we described over the course of this paper, this led to a new set of very harsh international sanctions, as well as unilateral measures by some states including the Republic of Korea. Seoul, which had been seen before as potentially being one of the main participants of the project, decided to stop all cooperation with Pyongyang, including the RKLP (ROK Ministry of Unification 2016a; Yi Whan-Woo 2016). The situation for the project is now very dim, and its future is uncertain. It is difficult to completely rule out the possibility of ultimate failure for the RKLP.

However, there are also some reasons to believe that despite some South Korean media claims (Kim Jin-Cheol, Kim Ji-Eun 2016) the project is not dead and worth continuing.

First of all, the necessary infrastructure for the project is now in place, has been tested, and keeps working.

Second, Russia has made efforts and secured provisions in the UN Security Council Resolution # 2270 (2016) allowing the RKLP to be legal despite new sanctions. As it is stated in paragraph 29(a) of the resolution, the restrictive measures shall not apply to “... coal that the procuring State confirms on the basis of credible information has originated outside the DPRK and was transported through the DPRK solely for export from the Port of Rajin (Rason) ...” (United Nations 2016). That means the RKLP technically may keep working as before in exporting Russian coal to other states. Those shipments do not need separate permission but only require notification of a special committee of the United Nations.

The JSC “Russian Railways” made it also clear that despite new problems they would continue the project (*RZD-Partner* 2016).

Third, certainly Russia was and is interested to see South Korean companies among the ranks of the investors in the project as well as among those who used the project to transport cargo (*ChosunIlbo*

2014b). But for the aforementioned reasons they will need to be postponed, if not outright forgotten. However, South Korea is not the "last and only hope" for the project. The representative of Russian Railways in Pyongyang Andrey Timchenko stated: "Of course we are interested in attracting South Koreans into the project, but South Korean participation is only one of a few possible variants. We are looking for partners in other countries as well. The first shipments of coal was to China, not the Republic of Korea" (Kiriyanov 2014). Again, it was China and not South or North Korea that is the main customer of the project, accounting for 73.4 percent of coal transported through the RKLK (JSC "Russian Railways" 2015) so this project will continue.

Lastly, the frustration of the international community with North Korean behavior is justified and understandable as well as the decision to punish Pyongyang for its nuclear missile blackmail. However, the strategy of completely cornering the North Korean regime without giving it a chance to buy its way out of isolation may provoke unpredictable and very dangerous steps by the DPRK. Though it does not seem very probable in the foreseeable future, the situation around North Korea has always been subject to change and it is possible that sooner or later the mood will be different and the international community (including the Republic of Korea) and the DPRK will find acceptable terms for mutual reconciliation and cooperation. The Rajin-Khasan Logistics Project can provide a springboard for many countries, including South Korea, to resume their cooperation with Pyongyang without the need to start from scratch.

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