

Analysis and Proposals to the Laws in the Kaesong Industrial Complex: *For Better Regulations under New Environments on the Korean Peninsula**

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Abstract

The Kaesong Industrial Complex (KIC) is a symbol of inter-Korean economic cooperation. Although there have been many political challenges, the complex is still expected to reduce security concerns in the Korean peninsula by providing opportunities for North Korea to open doors to international society. In the field of law, the two Korean governments recognize the uniqueness of the KIC and have tried to establish legal tools for the complex. The complex is subject to certain inter-Korean agreements as well as laws and regulations established by the South and the North. The Korean governments also provide many types of support under inter-Korean agreements and national laws. Almost every South Korean FTA has preferential provisions to recognize KIC products as originating from South Korea, considering the special and unique relationship between the two Koreas. The laws for the KIC are open to change based on internal or external influences. To keep the special project running, however, laws need to be in line with principles to avoid political interferences. Better legal solutions can be found to improve the provisions of inter-Korean, domestic, and FTA laws with new industrial policies.

Keywords: Kaesong Industrial Complex (KIC), Korean Free Trade Agreement (FTA), North Korean economy, inter-Korean cooperation, Korean peninsula, Official Development Assistance (ODA)

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Introduction

The South Korean economy depends on international trade. Accordingly, it has joined many multilateral international agreements, such as the WTO, and has also established many Regional Trade Agreements (RTAs) or Free Trade Agreements (FTAs) with its economic partners.

However, the country has several weak points in its trade environment. Some of them may come from North Korean political issues. Several economic cooperation projects between North Korea and South Korea are in the work to overcome these obstacles. The Kaesong Industrial Complex (KIC) was built as a collaborative economic development project between the two Koreas and became a symbol of the inter-Korean relationship since the late 1990s. Although there have been many political problems between the two Koreas involving the complex, the parties have tried to preserve this special area.

In accordance with its national policies on the KIC, the South Korean government has drafted several strategies or plans to make the complex more international. For this goal, the government put priority on product made in the KIC when negotiating the FTAs with its partners including the United States, the European Union and ASEAN members. As a result, many Korean FTAs have special provisions regarding the KIC.

Many types of rules can be discussed regarding the regulations on the KIC. Most existing legal studies on the KIC introduce relevant laws and analyze the difference between the South Korean and North Korean acts to minimize conflict and produce joint regulation (G. Kim and G. Kim 2006; Lee Kyu-Chang 2007). This paper discusses the background and current state of the KIC, as well as key issues from economic to political stances affecting the future prospects of the complex for inter-Korean and international relations. Then, it analyzes national and international laws on the complex. The analysis leads to the conclusion that the current rules need to change.

The Kaesong Industrial Complex

The Background and Main Concept of the KIC

The idea of the KIC¹ is based on the promotion of inter-Korean economic cooperation to the relative advantages of each party. The capital and technology of South Korea were to be combined with the North Korea's land and labor to produce internationally competitive, jointly-produced goods. The two Korean governments were actively involved in negotiating agreements regarding the rights of the companies operating in the KIC.

Based on the "Sunshine Policy" of the South Korean government, the two Koreas decided to build the special area for economic reasons (Yoon 2007, 939). Although the project was started for creating economic benefits shared between North and South Korea, it is also a peace-building project between the two countries (M. Cho et al. 2005, 16–27). Developing the North Korean economy through the KIC would be helpful for lessening the political tension between North and South Korea and would be beneficial for reunification in the long term.

The complex is located near Kaesong City, where an efficient distribution system can be installed quickly in order to ensure the smooth setup of social infrastructure and transportation of products to the South. The companies in the KIC enjoy the benefits of various types of financial and taxation support from the South Korean government. The support and incentives are generally similar to the state subsidies for small and medium-sized enterprises (SMEs) with additional benefits. During the pilot and first phases, the companies could operate their businesses with low-interest loans at the rate set for public works projects through the special Inter-Korean Cooperation Fund.

There are several reasons for the South Korean government's special treatment of the KIC. First, South Korea puts forth substantial inputs of generally over 80 percent of the price of final goods made from the KIC

1. The "Kaesong Industrial Complex" is called by different names including Kaesong, Kaesung, Gaesong or Gaesung and Industrial District, Area, Zone or Complex.

(H. Kim 2008, 83–85). Second, a precedent for this kind of special treatment exists, such as the Qualifying Industrial Zone established by the U.S.-Israel FTA to promote peace between Israel and Arab nations. Third, the political significance of the KIC also contributes to the special treatment of the KIC since it is anticipated that many military facilities near the KIC would withdraw as a result of the establishment of the KIC.

South Korea recognizes the inter-Korean relationship as a special one and gives preferential treatment to it according to the “inter-Korean” transaction principle. South Korea also expects international society to recognize the consideration for the “inter-Korean” relationship as a basis for the preferential treatment of the KIC. However, sometimes it is difficult for this principle of “inter-Korean” transaction to appeal to international society because North Korea is seen as an independent country. This unique treatment of the KIC may conflict with the Most Favored Nation (MFN) principle of the WTO (Choi 2008, 30–31).

The Main Frame of the KIC Project

Following the Hyundai Group’s initial proposal in 1998, the first North-South Korean Summit meeting in 2000 officially turned the idea of a joint venture between the two Koreas into reality (Knudsen and Moon 2010, 251–252). By the end of 2000, nearly 140 companies were already involved in the project and 18 cooperations were in progress (Nam 2001, 67–88).

After the groundbreaking ceremony in 2003, the production of goods in the complex started in 2004. The inter-Korean agreement provided a legal basis for the two governments to start the KIC project. They also established the domestic legal frames to support the project in the territories of the two parties. For example, the Kaesong Industrial District Management Committee (KIDMC), established in North Korea by the Kaesong Industrial Zone Law and authorized by the Act on the Support for the Kaesong Industrial District, serves, administers, controls, and manages the KIC with a fifty-year lease contract.² With the legal basis, companies

2. See Kaesong Industrial District Management Committee (<http://www.kidmac.com>).

can take advantage of various incentives from governmental support. Out of the 26 firms that began operation in the KIC, 25 applied for the loans from the Inter-Korean Cooperation Fund in South Korea (Lim 2006, 172).

The output growth has been attributed to an increase in labor force from the North. Furthermore, monthly production has reached around \$30 million for almost every month in 2011, and the number of employees has gone up from 46,284 to 48,709 by November 2011. The North said it would recruit more than 400 new employees in early 2012, a plan that had been postponed due to the sudden death of the former North Korean leader in December 2011.³ As of April 2012, 51,518 North Korean workers and 123 South Korean companies were in the complex. The annual output reached \$400 million in 2011, which was an increase from a mere \$14.91 million in 2005.

Changes in the Political Environment of the KIC

In spite of the constant increase in inter-Korean trade for the last 20 years, growth has been slowing since the launching of the new policy of the South Korean government in 2008. The South Korean government's inter-Korean policy was "Denuclearization and Opening 3000," and a depression in inter-Korean cooperation was anticipated. Breaking the trust between the North and South, North Korea rejected talks continuously from March 2008.

Trade volume between the two Koreas recorded \$1.68 billion in 2009, which was a 7.7 percent decrease from the previous year. It was the only decline since 2004. The halt of inter-Korean tourism to Keumgangsan mountain in 2008 was the cause of the decrease in the trade volume. After the 5.24 Action by the South in 2010, almost all inter-Korean trade stopped except the KIC project. The volume of trade had dropped by 10 percent in 2011 to \$1.71 billion. The amount of inter-Korean trade excluding the KIC recorded just \$10 million in that year.

3. "North Korea Will Provide 400 New Laborers to South Korean Firms in Kaesong . . ." *Korea Times*, January 24, 2012.

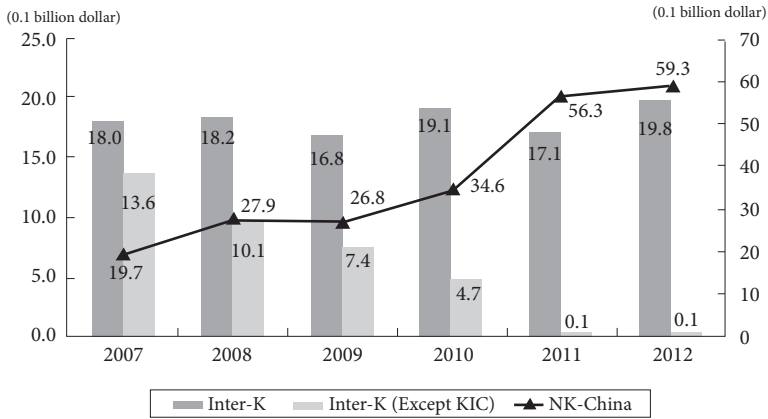


Figure 1. Changing Tendency of Inter-Korean Trade and Trade between North Korea and China (B. Cho 2013, 10)

In contrast, trade between North Korea and China increased rapidly. The inter-Korean trade is influenced by the changes of the two Korea’s core policies while North Korea’s trade dependency on China has risen dramatically, reaching \$5.63 billion in 2011, a 62 percent increase from \$3.46 billion in 2010. It seems as though inter-Korean trade was replaced by trade between North Korea and China.

When evaluating the total volume of inter-Korean trade, it would be inaccurate to say that the volume of trade rose despite the tension between the two Koreas. The KIC business was just 6 percent in inter-Korean trade when it was started in 2004. However, it has increased steeply every year and eventually went beyond 50 percent in 2009. Even during 2010 with the sinking of the South Korean navy ship *Cheonan* and shelling of Yeonpyeongdo island, the KIC was responsible for more than 76 percent of total inter-Korean trade after 2010, which amounted to \$1.4 billion out of the \$1.9 billion after 2010 (B. Cho 2011, 4–6). The KIC business became responsible for more than 99 percent of inter-Korean trade in 2011.

In April 2013, North Korea blocked all access to Kaesong from the South, citing provocations from Seoul against its sovereign dignity, and withdrew all 53,000 North Korean workers. The action resulted in the sus-

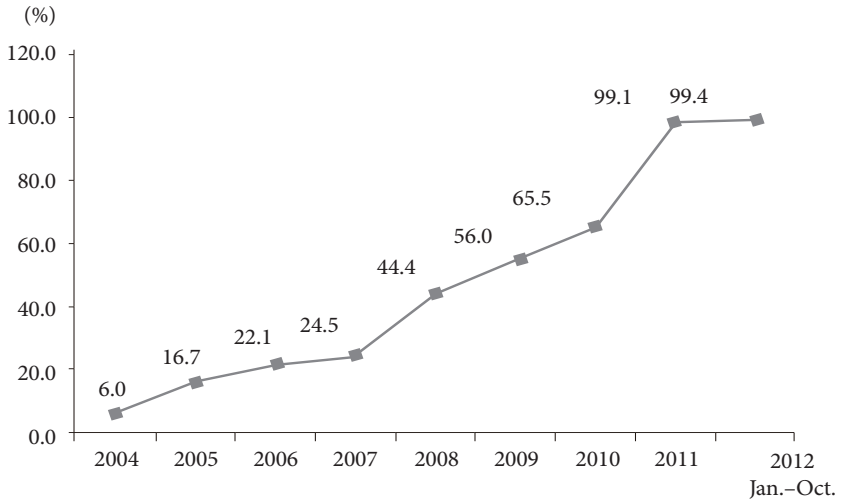


Figure 2. The Importance of KIC in Inter-Korean Trade (B. Cho 2013, 11)

pension of operations at the joint industrial park.⁴ Considering that the KIC had operated normally even during the crises in 2013 caused by the sinking of the *Cheonan* and shelling of Yeonpyeongdo island, the decision was an extraordinary one. The suspension of the KIC was one of several steps North Korea took in protest against the annual joint U.S.-South Korea military exercises and the United Nations' measures to toughen sanctions adopted against it after its third nuclear test conducted in February 2013.⁵

As the suspension of the KIC suggests, North Korea recognizes the KIC as a political tool against the South. The new government of South Korea sticks to the principle of “no trust, no support to North Korea.” At the round of talks on normalizing the KIC, the South Korean government repeatedly demanded the North Korean government to provide a firm guarantee that it would not close the complex in the future as well as set up a system to ensure the safety and protect the property of South Koreans who have invested and/or worked in Kaesong.⁶

4. “North Korea Denies Delegation Entry to Gaeseong,” *Korea Times*, April 17, 2013.

5. “Political Parties Oppose Power Cut off to Gaeseong,” *Korea Times*, May 1, 2013.

6. “Koreas Begin Fifth Round of Talks on Kaesong Park Normalization,” *Korea Times*, July 22, 2013.

Although the reality is different from theory, South Korea knows the KIC should not be influenced by political trends. The South Korean government has a policy to transform the complex into an international manufacturing zone with companies or funds from third countries. If companies from a third country came into the zone, it would be hard for either South or North Korean government to use the zone as a political tool against each other. Thus, South Korea has demanded the North to guarantee the safety of its businessmen in the industrial park and to transform the complex into an international zone by adopting global standards for doing business.⁷ To achieve internationalization of the KIC, a legal infrastructure needs to be prepared.

South Korea and North Korea reached an agreement to normalize operations at the KIC 133 days after the complex was shut down. The agreement guaranteed that the complex would operate normally “without being affected by the political situation under any circumstances.” The South Korean government softened its demands that North Korea take full responsibility for the closure, while North Korea accepted a number of key demands, including internationalization of the complex.

The two Koreas have consented to maintain a business environment in the KIC that meets the international standards and to work together towards improving the competitiveness of the KIC in the global market. The references to developing the area into a “globally competitive” complex appeared to reflect the wishes of the South. The two Koreas will develop a legal system for labor, taxing, wages, and insurance to meet international standards. This system would also lower the trade barrier when KIC products are exported to a third nation to improve the KIC’s international competitiveness.⁸

7. “Kaesong Industrial Park Talks End without Agreement,” *Maeil Business Newspaper*, July 16, 2013.

8. “Two Koreas ‘Will Guarantee Unconditional Reoperation,’ Come to Agreement on Kaesong,” *ZDNet Korea*, August 15, 2013.

Laws on the KIC

Overview

There are various legal bases to be analyzed regarding the KIC. These rules can be a part of international laws, such as the inter-Korean agreements, and domestic laws of the parties. Therefore, the complex is subject to inter-Korean agreements and national laws of South Korea and North Korea. South Korea also has special provisions on the project in its FTAs. These FTAs can be included under the category of international law but are only respected by the South Korean government in relation to its FTA partners. The laws are commonly used as “legal infrastructure” to protect, support, run, and manage the industrial complex. Although the two Koreas commonly adhere to the frameworks of inter-Korean agreements, they have different domestic laws to rule and manage the industrial complex based on different legal systems.

These different domestic considerations may raise some legal issues. Article I of the GATT provides the principle of MFN for the multilateral international economic stage. However, South Korea includes special treat-

Inter-Korean Agreements	Domestic Laws of Korea	Special Provisions in Korean FTAs
<ul style="list-style-type: none"> - International laws between the two Koreas - For the KIC and other inter-Korean economic cooperation projects - Providing fundamental rules and principles 	<ul style="list-style-type: none"> - By the North and the South Korean governments - For the regulation, support or management of the KIC in each society - Providing detailed rules based on principles in the inter-Korean laws 	<ul style="list-style-type: none"> - International laws by the South Korean government with third countries (FTA partners) - For special (favored) treatment of products from the KIC

Figure 3. Three Categories of Legal Bases for the KIC

ment provisions for trade between North and South Korea or regarding the KIC project in its FTAs. This approach can be a kind of detour to obtain a waiver of obligations by members of the WTO (D. Kim, B. Kim and Park 2007, 177–178). The South Korean government is expected to continue with this approach in the future.

Inter-Korean Laws on the KIC

Although inter-Korean economic exchange and cooperation can be based on many types of international and inter-Korean laws about issues on the Korean peninsula,⁹ there are four core inter-Korean agreements for the projects. They are as follows: the Agreement on Investment Protection between the North and the South, the Agreement on Avoidance of Double Taxation on Income between the North and the South, the Agreement on Procedures for Resolution of Commercial Disputes between the North and the South, and the Agreement on Clearing Settlement between the North and the South. These agreements provide the legal framework for all inter-Korean economic cooperation projects including the KIC.

There have been many questions about the legal status of inter-Korean agreements for a long time.¹⁰ For example, after the signing of the Agreement on Reconciliation, Nonaggression, Exchanges and Cooperation between South Korea and North Korea in 1992, the South Korean government did not obtain consent from the National Assembly. The South Korean Constitutional Court also did not recognize its legal validity because the

9. “The Declaration on the Advancement of South-North Korean Relations, Peace and Prosperity” in October 4, 2007, is an example of this.

10. Many international lawyers argued that this agreement should be regarded as a treaty in the proper sense of the term. According to them, the Agreement “concluded and promulgated in accordance with the Constitution,” shall have the same force as domestic law. In contrast, another group of international lawyers contend that the Agreement should not be considered as a treaty, but that it falls under the category of the so-called “non-binding agreements” or “extra-legal agreements.” This category of agreements, which lack legally binding force, are frequently concluded by states for a variety of reasons (Kim Keun-Gwan 1999, 168–186; J. Lee 1998, 227–248).

agreement was a type of a joint declaration or a “gentlemen’s agreement.”¹¹ However, the government officially decided to treat the four agreements as “treaties” for the first time after considering various legal aspects under order of the Korean Constitution (Article 6). The government’s approach to the four agreements was different from the past in that it granted them international and national legal status (Jhe 2004, 19–40).

Based on the four agreements, four other direct inter-Korean agreements on the KIC were adopted to provide the detailed legal tools for work in the special area. For example, the Agreement on Entry into, Exit from, and Stay in the Kaesong Industrial Zone and the Keumgangsang Tourist Zone set forth the procedures and regulations concerning access between the South and the North and their citizens’ safety. The other agreements are the Agreement on Communications for Kaesong Industrial Zone, the Agreement on Customs Clearance for the Kaesong Industrial Zone and the Agreement on Quarantine for the Kaesong Industrial Zone. They commonly have relatively short content with several articles, like the Agreement on Entry into, Exit from, and Stay in the Kaesong Industrial Zone.

The four KIC inter-Korean agreements are inter-Korean laws and international laws, like the four general agreements on inter-Korean economic projects. According to the Korean Constitution, they automatically have the status of national laws if they obtain consent from the National Assembly.¹² However, the KIC agreements have specific provisions on the issue of effect or status. Based on the provisions the rules clarify their (national) legal status. For example, Article 12 of the Agreement on Quarantine for the Kaesong Industrial Zone provides as follows:

Article 12 Effectuation and Termination

1. This Agreement shall take effect on the date when both Parties sign,

11. Decision of Constitutional Court of South Korea, July 7, 2000. Case No. 98HunBa63.

12. The Korean Constitution, Article 6: (1) “Treaties duly concluded and promulgated under the Constitution and the generally recognized rules of international law shall have the same effect as domestic laws in the Republic of Korea. By this provision, international law could act as a national law; thus, in this case, the four KIC inter-Korean Agreements could have an effect in the same way.”

and further exchange this Agreement after the completion of necessary formalities for effectuation of this Agreement.

2. This Agreement shall have the same force and effect as each Party's relevant laws and regulations.

Other inter-Korean agreements can also be related to works on the KIC project. For example, the Agreement on Procedures for Verification of the Place of Origin of Goods Traded between the South and the North, the Agreement on Formation and Operation of Inter-Korean Commercial Arbitration Committee, the Agreement on Motor Vehicle Operation between the South and the North, and the Framework Agreement on Train Operation between the South and the North are codified in relation to the procedures for verification of place of origin, border-crossing of motor vehicles, and train operation.

Domestic Laws of the North and the South on the KIC

North Korea's legal framework for the KIC is composed of the Kaesong Industrial Zone Act (the KIZ Act) serving as the basic or framework law with 16 regulations¹³ that have been enacted to supplement the KIZ Act. The regulations include Development Regulations, Environmental Protection Regulations, Labor Regulations, Customs Regulations, Insurance Regulations, Accounting Regulations, Audit Regulations, Regulations on the Establishment and Operation of Enterprise, Real Estate Regulations, Regulations on Management of Foreign Currency, Regulations on the Establishment and Operation of the Management Organ, Tax Regulations, Regulations on Entry and Exit, Stay and Residence, Advertising Regulations, Automobile Management Regulations, and Regulations on the Financial Management of Enterprises.

Any economic activities within the KIC must be conducted in accordance with the KIZ Act and regulations, and any matters not contained in

13. This law was enacted by the Presidium of the Supreme People's Assembly of North Korea in November 2002.

the act and the regulations must be determined by principles as agreed between the central guidance organ and the management organ. On the other hand, the investors' rights and interests are to be protected, and the investors' assets are not to be nationalized. Any business in the complex is to be operated under the guidance organ.

The Kaesong Industrial Zone Support Act¹⁴ was enacted in South Korea in May 2007. As the fundamental law from the South Korean government, the act permits the KIC to enjoy such infrastructure and financial support as those available to a South Korean local industrial complex and a KIC corporation to enjoy corporate support available under the law. The developmental and operational support as well as the protection of and support for the South Koreans who invest, enter or stay in the complex are provided according to the act.

According to this legislation, the enterprises in the KIC have become eligible to receive benefits from all support systems applicable to SMEs (small and medium-sized enterprises) under South Korean laws, such as the Promotion of SMEs and Encouragement of Purchase Products Act. Consequently, the enterprises are permitted to enjoy financial, facility or technical support from the Small and Medium Enterprises Structural Sophistication Funds, the Environmental Preservation Funds, and the Energy Use Rationalization Funds.

The Inter-Korean Exchanges and Cooperation Act¹⁵ is also applicable to the KIC project. The act regulates general matters related to economic cooperation between the two Koreas and contributes to peace and unification of the Korean peninsula by prescribing matters necessary to promote reciprocal exchange and cooperation. It includes some processes and procedures applicable to the KIC project.¹⁶ With respect to investment on

14. Act No. 7763, Dec. 29, 2005.

15. Enacted in 1990 and amended by Act No. 10228, April 5, 2010.

16. More specifically, the Inter-Korean Exchange and Cooperation Act contains provisions related to the procedures for trade and exchanges, the approval of transportation of goods into or out of the South, and the approval of cooperative projects. The act also serves as a ground for the installation of the Inter-Korean Exchange and Cooperation Promotion Council.

either side, transportation into or out of South Korea, and other cooperative projects and economic trade, the law refers to about 20 acts, including the Foreign Exchange Transactions Act and the Customs Act, for application *mutatis mutandis*.

The purpose of the Inter-Korean Cooperation Fund Act¹⁷ is to establish a special fund to support mutual exchanges and cooperation between the two Koreas. The law also provides several regulations on matters concerning the operation and management of the fund. Under the act, loans are provided to residents of the South, including corporations and other entities that carry out inter-Korea trades.

Apart from the domestic laws, many types of sub-rules are enacted and operated by the KIC management authorities. They govern various fields, mainly the registration and execution of real estate, buildings, the establishment and operation of enterprises, safety management, public health and sanitation, foreign currency management, and automobiles. Thus, 43 sub-rules are applicable to these fields as of the end of 2008.

Special Treatment Provisions of the KIC in Korean FTAs

The initial purpose of South Korea's FTAs is mainly an economic one because its economy is largely dependent on international trade. However, political reasons were added to the FTA policy due to the "Sunshine Policy" toward North Korea and the beginning of the KIC project. The South Korean government thought that the FTAs could contribute to promoting the economic benefits and stability of the Korean peninsula at the same time (B. Kim 2009, 127–128).

The Special Act on the Implementation of the Agreement Establishing the WTO in South Korea has been made to facilitate the application of Korean FTAs. Section 4 of Article 3 in the Act declares the principles of inter-Korean transaction and imposes obligations on the Korean government to make efforts for the KIC to be recognized in international society. Article 5 of the Act also provides the inter-Korean transaction principle. It

17. Amended by Act No. 10303, May 17, 2010.

can be the basis for Korean domestic law for the preferential treatment of the KIC in Korean FTAs.

Article 4.3 and 4.4 of the second South Korean FTA, the Korea-Singapore FTA, originally included special treatments regarding certain goods made at the KIC. Certain KIC-produced goods imported into South Korea and exported to Singapore are treated as (South) Korea-made goods if (1) the total value of non-originating input does not exceed 40 percent of the customs value of the final good for which originating status is claimed; (2) the value of originating materials is not less than 45 percent of the customs value of the final good for which originating status is claimed; and (3) the last process of production or operation takes place in South Korea.

Article 13 and Appendix 4 to Annex I of the Korea-EFTA FTA provides a standard for the treatment of the KIC-produced goods as Korea-origin goods. The KIC-produced goods are considered as Korea-made goods if (1) the total value of non-originating input does not exceed 40 percent of the ex-works price of the final product for which originating status is claimed, and (2) the value of originating materials exported from South Korea is not less than 60 percent of the total value of materials used in manufacturing the re-imported material or product.

Annex 3 of the Korea-ASEAN FTA on trade in goods provides a standard for the treatment of the KIC-produced goods as Korea-origin goods. The standard is similar to that of the Korea-EFTA FTA, i.e., the ratio of non-originating input and originating materials from South Korea is four to six.¹⁸ Article 3.14 of the Korea-India CEPA, Annex 3-B and the notes exchanged by both parties also provide a standard for the KIC-produced goods as Korea-origin goods. The standard is similar to those of the Korea-EFTA FTA and the Korea-ASEAN FTA.

The Korea-U.S. FTA does not directly permit special treatment of the KIC-products. It provides a “possibility” for such treatment only in case the “Committee on Outward Processing Zones (OPZ) on the Korean peninsula” is established. According to Annex 22-B of the FTA, the committee will

18. However, considering the economic stages of the ASEAN countries, preferential treatment of KIC-produced goods shall end from the date of entry into force.

discuss the criteria for OPZs, like the KIC, and the special treatment of the zone under FTA order. This discussion was a concession by both parties because South Korea considered the KIC as an important issue while the United States worried about security problems arising from North Korea. Therefore, the FTA system appears likely to have only a minimal impact on the U.S. restrictions on North Korean imports and controls of North Korean issues (Manyin et al. 2011, 15).

Article 12 of the Protocol Concerning the Definition of Originating Products and Methods of Administrative Cooperation and Annex IV of the protocol in the Korea-EU FTA provide terms of OPZs similar to those of the Korea-U.S. FTA because the Korea-EU FTA was completed after the conclusion of the Korea-U.S. FTA, and the EU requested a similar level of concession compared to the Korea-U.S. FTA.

In sum, the provisions of Korean FTAs on the special treatment of the KIC can be divided into two types as follows:

Rules of Origin Requirement Type	Committee Decision Type
<ul style="list-style-type: none"> - Korea-Singapore FTA, Korea-EFTA FTA, Korea-ASEAN FTA and Korea-India CEPA - Special treatment of the KIC-produced goods as Korea-origin goods - The goods from the KIC will enjoy the treatment if they fulfil the requirements in the FTAs 	<ul style="list-style-type: none"> - Korea-U.S. FTA, Korea-EU FTA - Possibility of the special treatment of KIC-produced goods by establishing a committee on OPZs on the Korean peninsula - The committee shall consider OPZs and the special treatment

Figure 4. Two Types of KIC Provisions in Korean FTAs

Suggestions for New Rules in the KIC

The laws may affect or be affected by political and economic situations in Northeast Asia and the Korean peninsula. This is one of the main limitations of the laws. Furthermore, there have been several questions on the legal status of inter-Korean agreements as researched previously. Different

proposals can be made regarding the laws of the KIC to install a more effective legal basis for the project so that it would be able to overcome such limitations. The following suggestions are mainly concerned with the sustainability or stability of the projects under the volatile political situations in the peninsula or in regards to the new policies for the expansion or internationalization of the complex.

*To Keep or Manage the Project While Avoiding Political or Other Influences
(in Inter-Korean Laws)*

The Korea economic exchange and cooperation projects, including the KIC, are sometimes suspended due to deterioration of inter-Korean relations. Inter-Korean relations are easily influenced by the political positions of the North and the South Korean governments. However, the governments basically agree that the special projects and the area are mutually beneficial to all Koreans. Therefore, the governments need to discuss the management of the projects and their shared benefits. Then, they will be ready to make certain promises with a legal meaning.

It is an option for the two Koreas to establish a “political- or other-influence-free” principle in a provision of the inter-Korean agreements on general economic exchange and cooperation projects. For example, the principle provision could be constructed by adding a paragraph in the Agreement on Investment Protection between the North and the South under Article 2 Permission and Protection as follows (author’s suggestion underlined):

4. Any kind of process on permission and protection in this agreement is free from political or other influence.

Considering the importance of the KIC in inter-Korean trade, the complex at least can be differentiated from other cooperation projects. Therefore, it is necessary for the two governments to make a certain provision in the inter-Korean laws to treat the KIC differently from other projects. Even though other Korean economic exchanges and cooperation programs may suffer from external or political influence, the KIC project can avoid them if

the relevant laws firmly and stably guarantee the “political-influence-free” status of the KIC.

For this purpose, the two Korean governments need to build the “political-influence-free” principle to separate the KIC project from other inter-Korean trade or cooperation programs in the four direct KIC inter-Korean agreements. To do so is a more practical legal method to avoid suspension of the KIC work due to the impact of the political environment on the peninsula. The principle of inter-Korean laws is to block the influence of politics coming from outside the complex. The principle provision can be designed by adding or changing some of the wordings as below (authors’ suggestions underlined):

“The Agreement on Communications for Kaesong Industrial Zone”

Article 2 Basic Principles

2. Both Parties shall guarantee the free exchange of mail and telecommunication in the KIZ and between the territory of the South and the KIZ. This guarantee of the exchange will not be influenced by political or any other issues between the parties.

“The Agreement on Quarantine for the Kaesong Industrial Zone”

Article 5 Quarantine Principles

1. The KIZ Quarantine Office shall simplify the quarantine procedure and expedite the passage of materials without any kind of political or other influence. [. . .]

“The Agreement on Entry into, Exit from, and Stay in the Kaesong Industrial Complex and Keumgangsán Tourist Zone”

Article 2 Basic Principles

1. The South and the North shall actively cooperate with each other to guarantee that personnel, passing vehicles, and others may enter into, exit from, and stay in the Zone in an expeditious and safe manner. Such movement will not be influenced by political or other issues between the parties.

To Make a Better or More Effective Supporting System (in Domestic Laws)

In this way, it seems easier for domestic laws to cover legal problems or improve the system than inter-Korean laws in many ways. Although changing and improving domestic laws must be in line with government policies, it does not mean that domestic laws would be changed or improved by a single domestic policy. In order to do so, each government should consider altogether the whole legal system from international laws to domestic laws and the fundamental policy regarding the KIC. Then, domestic laws would provide a better supporting structure for the special work.

For many reasons, if the KIC's case is included in a policy of internationalization with global companies and international funds from third countries, domestic rules are to be connected with other rules to provide global or international business standards. For example, the labor and environmental conditions of the KIC would have a favorable influence on North Korea's international status and allow North Korea to recover its lost credibility. It would ultimately bring stabilization in the Korean peninsula. Therefore, establishing reasonably high standards of labor, environment, and management is a task the internationalization policy needs to address with legal tools and corporate funds from the KIC companies.

Another example can be made regarding aid to North Korea. Official Development Assistance (ODA) is a form of official assistance that advanced countries provide to developing countries or international organizations.¹⁹ The South Korean ODA is operated under ODA-related acts including the Korea International Cooperation Agency (KOICA) Act and the Economic Development Cooperation Fund (EDCF) Act, based on the Framework Act on International Development Cooperation. We could imagine North Korea becoming a recipient of South Korean ODA in international society. Then, South Korea may utilize its ODA funds for North Korea if it can regard the aid as a part of the ODA projects.

19. For information on Korean ODA, visit ODA KOREA, <http://www.odakorea.go.kr/index.jsp>.

In the case of establishing a supporting system for North Korea with ODA, the position of the South to the North would not be same as other developing countries.²⁰ For example, if inter-Korean economic cooperation can be built at the ODA level, the law on the Inter-Korean Cooperation Fund (IKCF) needs to be harmonized with the laws on the Korean ODA first. We could anticipate that because the Korea Export-Import Bank is the common operation body of the IKCF and the EDCE, unity and harmony can be built through the refinement and application of relative norms.

Recently, there has been an effort to reform the laws to make the Korean ODA policy efficient in the recipient countries. Inter-Korean cooperation and the KIC project can also be considered as a part of this effort to consolidate the ODA policy. Therefore, the policies and laws on the Korean ODA can be improved with KIC policies and related laws.

For Better Treatment of the KIC (in Korean FTAs)

Regarding special provisions of the KIC in Korea FTAs, the Korea-Singapore FTA model is in theory the most favorable to Korea. But in practice, Korea cannot stick to the model in future FTA negotiations. Singapore is already carrying out non-tariff trade liberalization. Most FTAs except the Korea-U.S. FTA and the Korea-EU FTA have adopted the concept of an outward process. The reason for this is to minimize the production cost to the same level set by the FTA Organizing Committee and to clarify the partner's specific requirement in order to give preference of origin for products from the KIC.

The experience of the Korea-ASEAN FTA and the Korea-India CEPA has shown that if the partner is a developing country with a small- or medium-sized market or with less leverage on the negotiating table than Korea, adopting an outward process makes it likely for the country to sign a FTA with Korea.

20. However, when an OECD DAC inspectorate visited Seoul in 2008 and asked if South Korea was willing to include its assistance to North Korea in the ODA, the South Korean authority was unable to provide a definite answer. This ambiguous situation remains unresolved, and it must be determined politically (Chung 2012, 125).

On the other hand, as in the case of the Korea-U.S. FTA, it is not desirable for South Korea to set up an extra committee to discuss the preference of origin of the KIC-products. It is not simple to organize a committee that needs additional requirements to approve the origin of products from the KIC. However, South Korea can also improve the system and develop methods beneficial to the KIC if an FTA follows the Korea-U.S. FTA model. Then, it would be necessary for other rules in other fields to be changed.

Again, ODA matters could also be related to FTA issues. In a legal sense, the ODA is an official policy or action based on domestic and foreign legal systems. The best use of the FTA, a legal infrastructure, may benefit private and public fields. Therefore, it is necessary to harmonize some elements involved in the FTA in the ODA process with reinforcement of the relevance of the ODA-FTA norm. If the FTA and the ODA policy of South Korea are in harmony, direct trade effects and economic profit might be produced.

Ultimately, harmonizing ODA and FTA policies and laws can increase benefits and maintain cooperation flexibly through economic, legal, and other expertise. South Korea can anticipate this synergy by collaboration between their FTA policy and inter-Korean economic cooperation or the KIC project with the support of the ODA. Proper reformation of inter-Korean and domestic laws suitable to ODA-FTA policy and laws should be conducted in other fields as well. For example, the best way to give financial support to the enterprises operating in the KIC, support small and medium-sized businesses, and attract overseas firms and foreign investment should be discussed concretely. A consequential effort is also required to reform laws.

Concluding Remarks

The KIC project is a product of a win-win strategy for both North Korea and South Korea under a changed policy for better Korean relations. The complex is expected to produce a lot of economic benefits for the two

Koreas, and it has already shown positive results. Furthermore, the KIC can be used to reduce tension and improve security by giving North Korea a chance to develop its economy while receiving aid during its devastated economic situation.

All of these policies are related to the idea that developing the North Korean economy will induce North Korea to open its doors to international society, which will be beneficial for reunification in the long term. The KIC is associated with security concerns, including denuclearization of the Korean peninsula. Although it has been impeded by political conflicts several times, the complex has already played a significant role in raising the level of inter-Korean engagement and increasing the priority of economic factors relative to security concerns.

The Korean government recognizes the uniqueness of the KIC and is trying to find a way to obtain special treatment for the complex. The complex is subject to certain inter-Korean agreements, laws, and regulations established by the South and the North, respectively. The two Korean governments provide many types of special treatment and support under inter-Korean rules and national laws. Preferential treatment of the KIC in Korean FTAs was established after the start of the KIC to inform and acquire recognition from international society regarding the special and unique relationship between the two Koreas.

The laws of the KIC are under certain policies, and they are changing according to influence from both countries and from the outside world. However, to keep the management of the KIC project, legal provisions should confirm the principle of avoiding political influence after discussion between governments. Then, they can find better legal solutions for improving the provisions of inter-Korean, domestic, and FTA laws with new policies regarding the special industrial area. The concept of ODA could also be significant for improvement. Other related rules, such as labor, environment, and investment, can also be targets for this goal.

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Appendix A: List of Laws and Organizations and Their Original Titles in Korean

Name in English	Name in Korean
Act on the Support for the Kaesong Industrial District	개성공업지구지원에 관한 법률
Agreement on Avoidance of Double Taxation on Income between the North and the South	남북한이중과세방지합의서
Agreement on Clearing Settlement between the North and the South	남북한청산결제합의서
Agreement on Communications for the Kaesong Industrial Zone	개성공업지구 통신에 관한 합의서
Agreement on Customs Clearance for the Kaesong Industrial Zone	개성공업지구 통관에 관한 합의서
Agreement on Entry into, Exit from, and Stay in the Kaesong Industrial Zone and the Keumgangsan Tourist Zone	개성공업지구와 금강산관광지구의 출입 및 체류에 관한 합의서
Agreement on Formation and Operation of Inter-Korean Commercial Arbitration Committee	남북상사중재위원회 구성·운영에 관한 합의서
Agreement on Investment Protection between the North and the South	남북한투자보호장합의서
Agreement on Motor Vehicle Operation between the South and the North	남북사이 차량의 도로운행에 관한 기본합의서
Agreement on Procedures for Resolution of Commercial Disputes between the North and the South	남북한상사분쟁해결합의서
Agreement on Procedures for Verification of the Place of Origin of Goods Traded between the South and the North	남북사이에 거래되는 물품의 원산지확인 절차에 관한 합의서
Agreement on Quarantine for the Kaesong Industrial Zone	개성공업지구 검역에 관한 합의서
Agreement on Reconciliation, Nonaggression, Exchanges and Cooperation between South Korea and North Korea	남북기본합의서
Committee on Outward Processing Zones (OPZ) on the Korean Peninsula	한반도 역외가공지역 위원회
Declaration on the Advancement of South-North Korean Relations, Peace and Prosperity	남북관계 발전과 평화번영을 위한 선언(남북정상선언)
Economic Development Cooperation Fund (EDCF) Act	대외경제협력기금법
Energy Use Rationalization Funds	에너지활용 합리화 기금
Environmental Preservation Funds	환경보전기금
Foreign Exchange Transactions Act	외국환거래법
Framework Act on International Development Cooperation	국제개발협력기본법
Framework Agreement on Train Operation between the South and the North	남북사이의 열차 운행에 관한 기본합의서

Kaesong Industrial District Management Committee (KIDMC)	개성공업지구관리위원회
Inter-Korea Cooperation Fund Act	남북협력기금법
Inter-Korea Exchange and Cooperation Promotion Council	남북교류협력지원협회
Inter-Korean Exchanges and Cooperation Act	남북교류협력에 관한 법률
Kaesong Industrial Zone Support Act	개성공업지구 지원에 관한 법률
Kaesong Industrial Zone Act (Kaesong Industrial Zone Law)	개성공업지구법
1. Development Regulations	1. 개발규정
2. Environmental Protection Regulations	2. 환경보호규정
3. Labor Regulations	3. 노동규정
4. Customs Regulations	4. 세관규정
5. Insurance Regulations	5. 보험규정
6. Accounting Regulations	6. 회계규정
7. Audit Regulations	7. 회계검증규정
8. Regulations on the Establishment and Operation of Enterprise	8. 기업창설운영규정
9. Real Estate Regulations	9. 부동산규정
10. Regulations on Management of Foreign Currency	10. 외화관리규정
11. Regulations on the Establishment and Operation of the Management Organ	11. 관리기관 설립운영규정
12. Tax Regulations	12. 세금규정
13. Regulations on Entry and Exit, Stay, and Residence	13. 출입체류거주규정
14. Advertising Regulations	14. 광고규정
15. Automobile Management Regulations	15. 자동차관리규정
16. Regulations on the Financial Management of Enterprises	16. 기업재정규정
Korea International Cooperation Agency (KOICA) Act	한국국제협력단법
Presidium of the Supreme People's Assembly of North Korea	북한 최고인민회의 상임위원회
Promotion of Small and Medium Enterprises and the Encouragement to Purchase SME Products Act	중소기업제품 구매촉진 및 판로지원에 관한 법률
Small and Medium Enterprises Structural Sophistication Funds	중소기업구조고도화자금
Special Act on the Execution of the WTO Agreement	세계무역기구협정의 이행에 관한 특별법