

# North Korea's Tariff and Non-tariff System: Implications for Integration into the International Economy<sup>1</sup>

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## I. Introduction

The ROK government's position is to engage North Korea in a principled manner and work with the international community to induce change within North Korea, and to pursue economic development cooperation initiatives with the international community as North Korea makes progress toward denuclearization. Despite the international community's call for North Korea to open up its economy and improve transparency of trade barriers, little is known about North Korea's tariff and non-tariff regimes. Therefore, it is necessary to systematically analyze North Korea's tariff and non-tariff regimes. This study is the first to analyze North Korea's tariff and non-tariff barriers.

The purpose of this study is to analyze North Korea's tariff and non-tariff regimes to reveal the direction of North Korea's trade policy and the structure and characteristics of its legal and institutional framework, and to identify priority reforms in trade-related laws and regulations as North Korea seeks to open up and integrate into the international community.

This article presents only a small selection of the study's findings. Specifically, we analyzed the status of laws in North Korea, the purpose of enacting laws and institutions, and the main contents of North Korea's trade laws, customs laws, and tariff rate manuals. Next, the tariff rates were categorized by industry and product to analyze their relevance to North Korea's in-

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dustrial policy, the degree of industrial protection, and the fiscal contribution rate. Finally, we analyzed the significance of the non-tariff regime under international standards and examined the main issues and characteristics of North Korea's non-tariff barriers.

## II. Analyzing North Korea's Rule of Law and Trade Regime

The rule of law is a driver of economic development because it enables actors to make rational choices based on the clarity of legal provisions. In trade in particular, clearly defined tariff rates and non-tariff barriers are important because they reduce the uncertainty of imports and exports, allowing trade to grow steadily.

North Korea's Customs Act was enacted in 1983, its Trade Act in 1997, and its tariff rate manual in 2005, all later than South Korea's, but North Korea has recently been reorganizing its economic legislation, claiming to be a socialist rule-of-law state. The late enactment of customs and trade laws in North Korea stems from the nature of the socialist system itself, which, according to Marxist-Leninist theory, requires that the state and laws derived from the state should ultimately disappear. As a result, the Party's leadership is the highest authority in North Korea, and the law serves a supporting function. However, as the economy has developed and interaction with the international community has increased, North Korea has enacted and compiled a legal sys-

tem related to trade in accordance with international practices since around 2000, and has recently enacted and revised a legal system covering the entire economy while advocating a socialist rule of law. As the size of the economy has grown and exchanges with the international community have increased, the economy is inevitably governed through laws.

North Korea enacted the Customs Act, which governs the border, first among trade-related laws, with the purpose of establishing order in its customs procedures, ensuring national security, protecting the independent national economy, and developing foreign economic relations, while avoiding imports and exports that undermine national security and break the cycles of the independent national economy.

In 1997, when the socialist economy collapsed and trade transactions of a commercial nature began to increase, the Trade Act was enacted as the second of the various trade laws, with the objectives of developing foreign trade, establishing trade order, achieving a balanced trade balance, expanding trade, and economic development, with the ultimate goal of establishing a self-reliant economy and self-regeneration.

The Tariff Rate Manual, which is the basis for North Korea's tariffs, was established in 2005, a time when the country was trying to formalize its legal system and expand outward to integrate into the capitalist economic order.

### III. The Structure and Role of North Korea's Tariff Rates

According to the Tariff Rate Manual (2005), North Korea imposes tariffs at the 8-digit HS code level, and there are a total of 10,529 imported goods with specified tariff rates, mainly import duties, but also export duties on some export-controlled goods.

There are foreign currency customs duties and domestic customs duties depending on the currency of payment, and foreign currency customs duties are prioritized over domestic customs duties. Foreign customs duties are paid in foreign currency by multiplying the foreign currency import value by the customs duty rate, while domestic customs duties are paid in North Korean won by multiplying the exchange rate.

A key feature of North Korea's tariff rates is the low overall level of tariffs. Based on the basic tariff rate in foreign currency, the average nominal tariff rate was 5.5% and the average real tariff rate was only 4.6%. In 2005, the average nominal tariff rate for all countries in the world, including about 150 WTO members, was 8.1%, which is higher than North Korea's nominal tariff rate of 5.5%, so North Korea's tariff rate is low compared to the global average.

In terms of structure, North Korea has a sloping tariff structure where the tariff rate increases with the level of processing, but the overall tariff level is still low enough to achieve the purpose of industrial protection.

The tariff rate is 3.1% for raw materials, 4.6% for intermediate goods, and 7.8% and 6.2% for consumer goods and capital goods, respectively, which is a typical sloping tariff structure that increases from raw materials to final goods. In addition, high tariffs are imposed on capital goods such as transportation equipment and mechanical and electronic equipment, which may have a negative impact on capital accumulation.

Considering that the most important functions of tariffs for economic development in developing countries are industrial protection and fiscal revenue contribution, North Korea's tariffs fall short on both counts. Contrary to North Korea's claims, the tariff rates were not strictly imposed for the purpose of industrial protection. The industry-specific features of North Korea's tariff structure include (1) low tariff rates on concentrated fisheries products, (2) sloping tariffs on food processing and textile and apparel products, (3) high tariffs on transportation equipment and mechanical and electronic intermediate goods, and (4) low tariffs on metals and chemical products. Although structurally in line with the tariff structure of countries in the early stages of industrialization, the level of tariff rates is very low and not sufficient to protect and promote domestic industries through tariffs. In terms of fiscal contribution, the role of tariffs in contributing to fiscal revenues is also insignificant, with tariff revenues accounting for less than 2% of North Korea's fiscal revenues. If North Korea aims to achieve industrial development and industrial protection through tariffs, as it

claims, it will need to revise the structure and level of its tariff rates. In particular, tariffs should be used to protect the processed food industry, textile and apparel industry, and steel industry, where North Korea has a rudimentary level of industrial development.

#### IV. Non-Tariff Barriers in North Korea's Trade Regime

North Korea's non-tariff barriers were established for the purpose of establishing a centralized governance system for national management of foreign trade, with the goal of building a self-reliant national economy, enhancing the quality of the national defense forces, and strengthening the party-state system. North Korea's foreign trade is subject to state management and control under the principle of state monopoly and is conducted in accordance with state plans, and foreigners are not allowed to trade freely. The emphasis on building a self-reliant national economy has resulted in the DPRK's trade regime limiting imports and exports to a complementary role in developing the country's economy, rather than as a goal in themselves, and includes many elements that discriminate against foreigners and foreign legal entities compared to nationals and national legal entities. The strengthening of the party-state system, which demands the implementation of the party's business system and establishment of party business methods in trade, while emphasizing the strengthening of party leadership, has had a negative impact on foreign economic cooperation.

The non-tariff barriers in North Korea's trade system are centered on the purpose of maintaining the stability of the system, including the centralized trade system, building a self-reliant national economy, and controlling the influx of capitalist culture, as well as the role of managing and controlling state planning. Due to the inconsistency and unclear hierarchy among the systems related to trade, the provisions of the trade-related systems remain unclear and vague, leading to multiple interpretations and potential disputes. All trade procedures, including trade contracts, trade prices, quantities of goods imported and exported, transportation, and payment, are subject to national planning and approval, and the law stipulates those contracts with counterparties in trading partner countries must be reviewed by the central trade guidance agency. The law provides the legal grounds for the state-owned trading enterprise system, the designated trade system, and the trade business license system, stipulating that trade transactions can only be conducted by institutions, enterprises, and organizations that have met the conditions for obtaining trade transactions and have been approved by the central trade guidance agency. Also specified is that approved institutions, enterprises, and organizations must conduct import and export procedures and trade transactions in accordance with their industries and indicators, and may conduct trade transactions on behalf of other institutions, enterprises, and organizations in approved industries and indicators, but must ensure that the contracts are accurately signed and executed.

## V. Policy Implications

The direction of North Korea's trade reform is toward “tariffifications,” which means removing non-tariff barriers and increasing tariff barriers to close the resulting gaps in trade regulations. North Korea should eliminate the non-tariff system and replace it with a tariff system because it is difficult for North Korea to communicate with the international community due to the distinctive characteristics of trade in a socialist country.

North Korea's trade regime should be reformed by phasing out non-tariff barriers, first increasing tariff rates and then gradually reducing tariff rates to close the gaps in trade regulations left by the removal of non-tariff barriers. The reform of the non-tariff system should basically prioritize the decentralization and autonomization of foreign trade.

After North Korea's tariff and non-tariff regimes have been reformed, it will be necessary to systematize free trade agreements. Free trade agreements need to be expanded from a small scope to a wide scope, as in the case of Vietnam. In terms of sequence, the first step in North Korea's opening up to the outside world could be to conclude a CEPA between the two Koreas, followed by a trade agreement with South Korea, China, and Japan, then a regional trade agreement in Northeast Asia, and finally WTO accession.

North Korea does not have the human capacity or experience to reform laws and institutions necessary for opening its economy to the outside world, meaning it will be necessary for the South Korean government to monitor the situation and intervene when necessary. In terms of human capacity, North Korea needs to develop trade experts and actively utilize capacity building and technical assistance provided by international organizations. The South Korean Government's Knowledge Sharing Program could be of great help in reforming North Korea's tariff and non-tariff systems. **KIEP**