

North Korea's Trade System and Implications for Inter-Korean CEPA

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I. Introduction

According to an announcement of the North Korean Workers' Party during its plenary meeting at the end of 2019, North Korea is focusing on institution and legal system reform in order to normalize the economy and improve its economic fundamentals for sustainable growth. North Korea's trade and investment system has been actively reformed, especially in Special Economic Zones and Economic Development Zones to attract foreign capital, and recently is undergoing further change under the influence of the Chinese legal system due to the diminishing of inter-Korean economic cooperation since 2010.

If the denuclearization negotiations produce an agreement, the international community should help North Korea to construct an institutional and legal foundation for sustainable economic growth. For the time being, encouraging economic cooperation between the two Koreas will be necessary to phase out sanctions, carry out initial investments in North Korea to allow economic growth, and improve its legal and institutional system in a more market-friendly direction to accelerate economic transition. In the long run, as the two Koreas ultimately wish for

unification, they will need to narrow the legal and institutional differences between their systems, and the current economic gap.

In order to prepare for the reform and opening up of the North Korean economy and the resumption of inter-Korean trade, it is necessary to consider the characteristics of the North Korean legal system related to trade. However, our understanding of the North Korean trade system still remains unclear, lacking studies on North Korea's economic legal system. Most studies are interested in inter-Korean economic cooperation or the transition of North Korea in relation to China and Vietnam, rather than the North Korean legal system itself, because many scholars believe that North Korea's legal system cannot be used as it is and it would be better to design a new legal system for the economic transition to a market economy. However, if North Korea pursues a gradual reform of its legal institutional basis (as it is, in fact, doing so now), it will be important to study North Korea's legal system in its current form and the options available for improvement.

This study examines changes in trade-related legal systems in North Korea and actual trade transactions, and analyzes them in accordance

with international standards (the WTO regulatory framework). Through this process, we will draw up measures to improve North Korea's trade system to open up the external economy as well as signing of a Comprehensive Economic Partnership Arrangement (CEPA). The results of this study will contribute to understanding the main characteristics of trade-related laws and systems within North Korea and suggest promising directions for their improvement.

II. Expansion of Trade and Changes in Economic Laws

This chapter examines the relationship between North Korea's trade and investment legislation and the expansion of foreign trade by analyzing trade statistics for North Korea. In the early 1990s, as the socialist bloc collapsed, North Korea expanded its trade with Western nations. To accommodate this change, North Korea made efforts to enact trade and investment-related institutions and establish a proper trade system. However, according to trade statistics, despite these legislation efforts, North Korea's foreign trade did not expand significantly in the 1990s. While North Korea proclaimed “trade-first” policies, this did not lead to the actual expansion of foreign trade. This informed experience shows that the legislation of North Korea's trade institutions in itself failed to produce an expansion in trade.

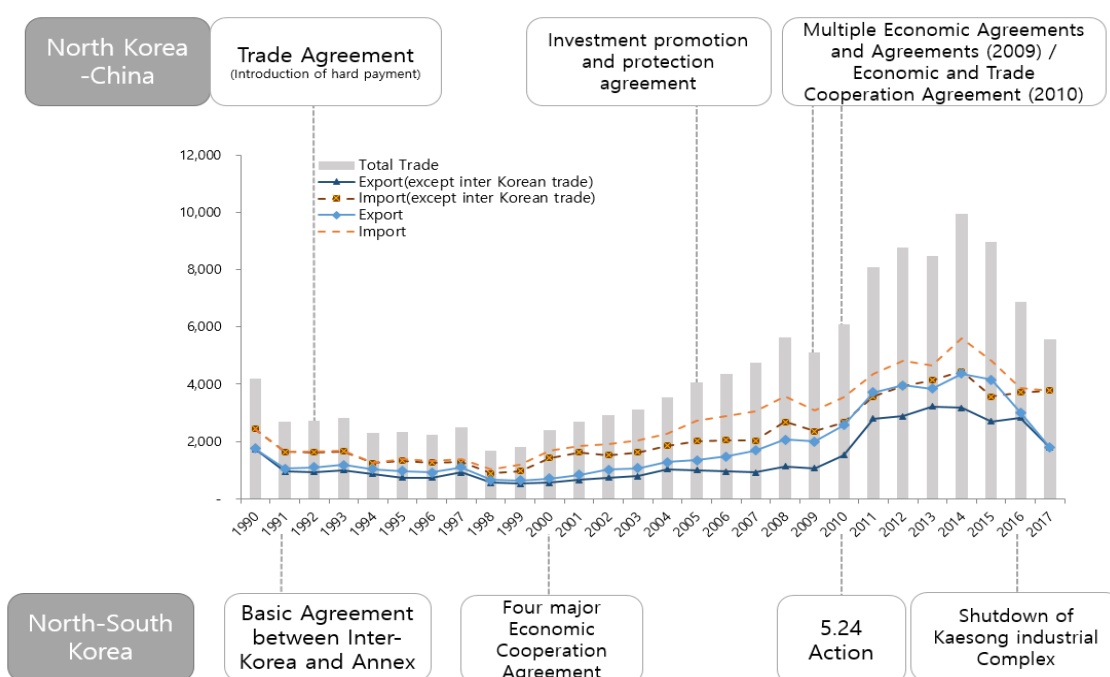
In the 2000s, North Korea's foreign trade legislation was mainly driven by external factors. North Korea's foreign trade began to increase dramatically from 1999, and in order to legally and institutionally support this, one new bill was enacted and 13 bills were amended during the year (Table 1). As inter-Korean relations

reached a positive turning point, the expansion of inter-Korean economic cooperation led to North Korea's enactment of trade and investment legislation. Also, various agreements were signed between the two Koreas, followed by North Korea's enactment and revision of foreign trade and investment legislation.

As inter-Korean relations improved and economic cooperation between the North and China expanded, various agreements between the two Koreas and North Korea-China entered into force, and related foreign trade and investment laws in North Korea also began to be enacted and revised on a continuous basis. The relationship between legislation and North Korea's expansion of foreign trade is clearly visible from this point on. This tendency has deepened since Kim Jong-un took office as the leader of North Korea. In addition, North Korea has been relatively responsive to the demands of its counterparts in economic cooperation. This is evidenced by the enactment of the Mt. Geumgang Tourism District Law in 2002, the full revision of the Rason Economic and Trade Zone Law in 2013, and the revision of the Labor Law of Foreign Investment Enterprises in 2015.

The history of North Korea's economic legislation change suggests two implications. First, in order to improve North Korea's trade and investment legislation, it will be necessary to conduct business in related areas with North Korea first. Second, if North Korea-China economic cooperation deepens without inter-Korean relations improving, there is a possibility that North Korea's economic law system will become more oriented toward China, and the gap between the legal systems of the two Koreas will widen further, which could delay inter-Korean economic integration.

Figure 1. Changes in North Korea's Trade Statistics and Trade Agreements with South Korea and China (1990–2017)



Source: KOTRA

Even though North Korea insists that its trade system is already at international levels, expanding foreign economic cooperation through legislation alone is difficult. North Korea has made its own legislative efforts since the 1990s, and has expanded the scope of its trade through preferential provisions for foreign capital or decentralization of trade authority. However, in order to promote economic growth through trade, North Korea must ensure legal stability based on the actual implementation of the relevant legal system, together with an improvement in the economic conditions that can support the legal system. Even in the case of introducing favorable laws for foreign-invested companies, North Korea has already experienced from the 1990s how difficult it is to expand economic cooperation without trust in such institutions.

III. North Korea's Trade Laws, System and Practice

North Korea's trade system is basically different from other open economies as it is based on the principles of a planned economy. North Korea conducts trade based on a licensing system which requires permission from the government to import and export products regarding the item, quantity, and price of imports and exports. At the same time, however, some autonomy was granted during the “Arduous Marches” in the 1990s, and this led to a gap between practice and institutional regulations.

North Korea's trade proceeds in accordance with a national plan, so the approval process is complicated and time-consuming. In addition,

when compared against international levels, the amount of economic laws and institutions of North Korea is absolutely insufficient. This means that state agencies or other decision makers retain relatively large discretion, with actual trade being carried out in various forms at the discretion of the individual trading entities or the customs manager. Due to marketization and the expansion of the informal economy, recently there seems to be a growing gap between laws, institutions, and customary trading methods, as demand for more efficient methods of real trade increases. Meanwhile, the tariff rate for protecting the domestic economy remains very low. If North Korea removes its current non-tariff barriers and applies the current tariff rate, which is at the level of developed countries, this could be a detrimental factor to domestic economic growth.

According to a survey of the Logistics Performance Index (LPI) of North Korea in trading

industries,¹ North Korea's logistics efficiency is relatively low, but it has a format that conforms to international standards. In order to estimate the logistical performance index of North Korea, this study surveyed defectors from North Korea with experience in the trading industry. The estimated index provides a rough picture of North Korea's logistics level and customs clearance. The level of logistics in North Korea is lower than Afghanistan, which had the overall lowest score in 2018. North Korea was measured below even the lowest scores in most sectors of the LPI, far behind the world average (Figure 1). However, the area of customs clearance and international transport was relatively better than other sectors. North Korea's customs clearance efficiency was also significantly lower than other countries in the LPI survey based on the number of documents submitted to the export approval agency, import and export, and customs clearance time (Figure 2).

Table 1. Logistic Performance Index of North Korea (estimated) and other countries (2018)

Six key dimensions of LPI	Details	Highest score country	Lowest score country	Scores of North Korea (Rank among 161 countries)
Customs	Efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies, including customs	Germany (4.09)	Angola (1.57)	2 (144)
Infrastructure	Quality of trade and transport-related infrastructure (e.g., ports, railroads, roads, information technology)	Germany (4.37)	Guinea (1.56)	1.6 (160)
International shipments	Ease of arranging competitively priced shipments	Belgium (3.99)	Bhutan (1.8)	2.8 (68)
Logistics competence	Competence and quality of logistics services (e.g., transport operators, customs brokers)	Germany (4.31)	Papua New Guinea (1.88)	1.2 (161)

¹ To gain a rough idea of North Korea's logistics level and customs clearance, a survey was conducted using

the Logistics Performance Index, published by the IMF every two to three years.

Tracking & Tracing	Ability to track and trace consignments	Finland (4.32)	Libya (1.64)	1 (161)
Timeliness	Timeliness of shipments in reaching the destination within the scheduled or expected delivery time	Belgium (4.41)	Guinea (2.04)	2 (161)
LPI		Germany (4.20)	Afghanistan (1.95)	1.77 (161)

Source: Estimates for North Korea derived from results of survey conducted by authors (classified), data for other countries taken from LPI Index 2018

Table 2. Customs Clearance Efficiency in LPI of North Korea (estimated) and other countries (2018)

	Average of East Asian Countries	Top 25% Average	Lowest 25% Average	North Korea
Number of government agencies to be approved for Import	3.31	4.79	2.12	6.9
Number of government agencies to be approved for export	3.16	4.76	1.93	6.9
Documents to import	4.56	5.14	2.41	6.6
Documents to export	4.17	5.21	2.02	6.6
Average clearance time taken between the submission of an accepted Customs declaration and notification of clearance without physical inspection (days)	1.2	2.34	0.73	6.1
Average clearance time taken between the submission of an accepted Customs declaration and notification of clearance with physical inspection (days)	2.57	3.86	1.60	10.9
Percentage of import shipments physically inspected on average (%)	22	32	10	80
Percentage of import shipment physically inspected more than once (%)	13	13	5	92

Source: Estimates for North Korea derived from results of survey conducted by authors (classified), data for other countries taken from LPI Index 2018

Although Korea has a legal framework for attracting South Korean and foreign capital, there are few institutional mechanisms to protect investors in practice. Laws that protect investors in conflict situations should be thoroughly implemented. In North Korea, however, decisions are made based on party or political needs rather than rule of law. In order to improve this

situation, it seems that a fundamental change in the legal system is necessary rather than additional and formal legislation. In order to create an investment environment that meets international standards, it is necessary to change the current underlying legal system to provide additional legal information. Additionally, the tariff rate of North Korea has been set too low to protect domestic industries. North Korea needs

to improve its current non-tariff barriers and introduce a new tariff system that fits the economic and industrial realities of North Korea.

IV. North Korean trade system and WTO rules

North Korea recently demonstrated its willingness to introduce an economic system that meets international levels by joining the Convention on Contracts for the International Sale of Goods (CISG), but the actual effects still remain insignificant. North Korea became the 90th member of the CISG, organized by the United Nations Commission on International Commerce and Law (April 2019). The CISG removes legal barriers to trade by establishing international standards for international trade in goods and enacting international uniform laws. Its main purpose is to prevent trade disputes, delays in trade and rise of transaction costs caused by legislative disparities between the two sides. Joining the CISG is a significant development indicating that North Korea has established corresponding law in accordance with international law in contracting the sale of goods to North Korea. However, enforcement of the Convention remains weak because it can be excluded by agreement between the Parties in trade transactions. Therefore, in order to make North Korea's trade-related laws equivalent to international standards, self-improvement of North Korean law is essential.

Currently trade-related North Korean laws violate the basic principles of the WTO in many respects. More specifically, North Korea's ① restrictions on trade rights, and ② measures to restrict trade (items and quantities) according to the plan violate WTO regulations. This is mainly because the WTO is based on non-discrimination, focusing on MFN and National Treatment. Under the WTO rules, trade authority should be granted to all commodities in a

non-discriminatory manner for a specific person or company without distinguishing between domestic and foreign entities, and pricing policies should be transparent and non-discriminatory. In addition, export restrictions such as restrictions on export volume under WTO norms are not allowed except for national security, public order maintenance, human and animal life and health protection, and natural resources preservation. In addition to the trade restrictions mentioned above, the state's control over labor employment and management, poor investment protection regulations, and customs clearance systems are expected to emerge as a major issue in the future when North Korea seeks to join the WTO.

North Korea is expected to need at least 10 years to negotiate with WTO in the future. Usually negotiation takes about 10 years on average for new WTO members, and 10-15 years for the least developed countries. Since North Korea does not have a transparent economic and trade policy as a market economy system, it will have to spend a great amount of time and effort not only in preparing relevant data but also in accommodating the requirements of existing member countries for market opening and institutional improvement. Major transition countries such as China, Russia, and Vietnam were granted Permanent Normal Trade Relations (PTNR) status by the US just before joining the WTO. Therefore, establishing a normal trade relationship with the United States will present a major opportunity for the North to shorten its WTO negotiations.

V. Policy Implications

In order for North Korea to adopt an economic growth model by expanding trade and foreign capital like other transition economies, legal

stability should be guaranteed based on the enhancement and practical implementation of relevant laws and institutions.

Internally, North Korea should ① solve the problem of partial rule of law, ② establish a tariff system that meets international standards, and ③ alleviate and abolish non-tariff barriers. Partial rule of law restricts the growth of trade quantitatively and qualitatively, and weakens legal and institutional binding. In addition, the current tariff rate in North Korea does not correspond to the economic situation in North Korea, so it must be improved to conform to the realities of the nation. North Korea's tariff rate is set high for raw materials and low for final products, which deteriorates the price competitiveness of domestic enterprise products and should be improved by imposing low tariffs on raw materials and high tariff rates on final products. Setting an appropriate tariff rate is a task that North Korea should be prepared for in the future, even during the process of negotiating international trade agreements or joining international organizations. Non-tariff barriers arising from North Korea's incomplete laws and systems; the three issues of transit, communication, customs clearance; and labor management need to be reorganized to comply with international trade rules and practices. In this regard, we should also consider the influence this will have on the Korean Peninsula's economy, both the South and North. These non-tariff barriers have a direct impact on the North Korean economy and the control of its people, making it difficult to restructure them to meet international norms and practices in the short term. Therefore it will be desirable to resolve the problems that arise in inter-Korean economic cooperation step by step through inter-Korean exchange.

Externally, it will be necessary to ① ease and lift sanctions on North Korea, ② restore trust by the international community and resolve past disputes, ③ sign international trade agreements, and ④ foster trade and investment manpower. In order for North Korea to regain economic trust from the international community and expand trade and investment, it will have to faithfully implement contracts, guarantee the return of profits from investments, and settle any unpaid debts. Also, in preparation for North Korea's economic growth in the mid to long term, it is necessary to stably improve the trade environment by signing trade agreements. Sudden reform and opening of the North Korean economy can deepen instability in the North Korean economy. Therefore, it will be necessary to increase the level of economic reform and openness in stages, such as opening up to the Korean Peninsula, then Northeast Asia, and finally to the international community.

In the first stage, it is necessary to enhance the legal stability of inter-Korean economic cooperation through the signing of a Comprehensive Economic Partnership Arrangement (CEPA) between the two Koreas and to establish a soft infrastructure that meets international levels. Trade tariffs between the two Koreas should maintain the “no-tariff” principles of internal trade, but clarify their trade practices and solve problems in the three areas of transit, communication and customs clearance. In this process, it will be necessary to revise the Inter-Korean Exchange and Cooperation Act and the Four Economic Cooperation Agreements (2000).

In the second phase, the two Koreas should sign Northeast Asian regional trade agreements involving China, Russia, Japan, and some Southeast Asian countries. At this stage, North Korea needs to disclose its economic statistics,

liberalize the exchange of capital and labor, protect intellectual property and foreign capital exports, and resolve the issues of debt and property rights problems with neighboring countries. Signing a regional trade agreement for Northeast Asia is an even more difficult prospect than the signing of a CEPA between South and North Korea because it is based on cultural similarity and regional proximity. In the negotiation process, various factors should be considered, such as the timing and speed of Northeast Asian regional trade agreements, problems arising from economic asymmetry with neighboring countries, and the impact of North Korea's Northeast Asian regional trade agreements on the Korean Peninsula's economy.

In the third phase, overall trade laws and systems should be reformed, premising on North Korea's accession to the WTO. In order for the North Korean economy to grow, it must be incorporated into the international market, which ultimately requires entry into the WTO. When South Korea joined the GATT in 1967, it did not go through the MFN mandatory exception procedure for trade with North Korea, so it is necessary to make preparations for inter-Korean cooperation in order to claim an exception to the MFN principle for inter-Korean trade. The problem is that the process of gaining membership to the WTO is time-consuming. For this reason, it is necessary to make arrangements for related issues and prepare policy alternatives from now on. [KIEP](#)

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