

## **Lessons from Gaesung Industrial Complex and Ra-Sun Free Trade Economic Zone**

### **Overview**

Gaesung Industrial Complex (“Gaesung Complex”) is the joint cooperation project between South Korea and North Korea. Gaesung Complex was developed through the contribution of capital by South Korea and the provision of land and labor force by North Korea. Gaesung Complex has been viewed successful in that 3.3 Km<sup>2</sup> area of industrial complex became developed to induce more than 100 South Korean companies, which operated and made profits until the full shut down in 2016 due the worsening of the international relations and sanctions.

Ra-Sun Free Trade Economic Zone (“Ra-Sun Zone”) started by North Korea’s drive to develop the border area fronted with Russia and China during early 90’s. But until the participation by China it has not been implemented in a substantial development phase during early 2010’s. Unfortunately, Ra-Sun Zone also is now in a dormant status mainly due to the international sanctions.

It is true that the development and operation of the industrial zones or other special zones in North Korea heavily depend on the international politics, especially the North Korea’s relationship with the USA or South Korea, which we can see now for the Gaesung Complex and Ra-Sun Zone. However, we also noticed that some experiences at Gaesung Complex gave good lessons to North

Korea, especially in the perspective of rule of law. We also found that North Korea independently developed its legislation through the experience from the operation of Gaesung Complex.

Lift of the international sanctions by thawing the relations with the relevant countries and international bodies should be the very first and most important step necessary for the success of the development and operations of any industrial zones or special zones in North Korea. But I believe opening is not the ultimate solution. In order to operate such special zones invested by foreign investors, a legal system should be established and the experience of the officials and people of North Korea should grow, up to at the level the capitalistic economy may work.

The importance of Gaesung Complex and Ra-Sun Zone should be stressed at the point where a legal system really has worked that operated a market economy within the North Korea regime. I believe such experience will be the basis for the success of foreign investment in North Korean when the time has come.

### **Brief History of Gaesung Industrial Complex and Ra-Sun Region**

Gaesung Complex has the following brief history until its total shut down as now in 2016:

- Oct. 1999, “Agreement for the Development of Industrial Complex on the West Coast Area” was entered into between Hyundai Group and North Korea
- Aug. 2000, “Agreement on the Development and Operation of Gaesung Industrial

Complex” was entered into between Hyundai Asan (Hyundai Group’s affiliate) and North Korea

- Nov. 2002, “Gaesung Industrial Complex Act” was enacted by North Korea
- Dec. 2002, Land use right for 66km<sup>2</sup> area was issued to Hyundai Asan
- Dec. 2004, Factory in Model Section started operation
- May. 2007, “Assistance to Gaesung Complex Act” was enacted by South Korea
- Dec. 2011, Reaching USD 15 billion of accumulated production
- Dec. 2015, 123 companies were being operated

The birth of Ra-Sun Zone is going back to 1991 when United Nations Development Plan proposed the development of the border triangle area fronted by Russia, China and North Korea. Late in 1999, North Korea designated the two cities Rajin and Sungbong as Rajin-Sunbong Free Trade Economic Zone. However, Ra-Sun Zone had not been thriving until early 2010 when Ra-Sun area was designated as a special municipality and “Agreement on the Joint Development and Joint Management of Ra-Sun Economic Zone and Hwang Geum Pyong/Wihwa-do Economic Zone” was entered into with China. North Korea amended Ra-Sun Zone Act in its entirety in Dec. 2011. During the development phase, a railroad to Russia (Hasan) and China (Hunchun), a road to China and three ports were constructed. The sovereign level official development of Ra-Sun Zone has been dormant since 2016, but it is heard that the private economic activities within Ra-Sun Zone has been continuously growing.

## **Legal Framework**

Under the basic principles of socialism, rule of law is unnecessary in socialism country and even contradictory to its core ideology. Since the communism revolution and communist party is deemed to be a final stage of human history, the communist party would stand over the laws. But in the real world, many socialist countries including North Korea have enacted various laws and regulations, and sometimes stress the rule of law in their constitutions or laws due to realistic reasons such as inducing foreign investments.

Starting from Law on Equity Joint Venture in 1984, North Korea has enacted and amended numerous laws regarding foreign investments. Despite of the separate foreign investment law system, special laws were required for Gaesung Complex and Ra-Sun Zone since before some instruments should be tested only within the special zones before adopting them in the whole territory.

North Korea enacted 16 Regulations for the implementation of Gaesung Industrial Complex Act, which covers the areas including companies operation, tax, labor, immigration, insurance, foreign exchange, real estate, accounting audit, vehicles and environment protection. However, with no prior experience such law and regulations were not sufficient to govern the specific legal issues raised in Gaesung Complex. The Gaesung Industrial Complex Management Committee (“Management Committee”), the managing body from South Korea side tried to establish more

detailed rules with the assistance of Korean government and legal advisors in South Korea. Management Committee enacted 17 implementation rules and 51 sub-rules with the consultation of North Korea. Interestingly, there is no legal ground for the Management Committee's enactment of such rules under the laws and regulations. However, in the good mood between two Koreas and in need of coping with the daily matters, North Korea admitted and accepted the effectiveness of such rules.

North Korea enacted Rajin Sunbong Free Trade Economic Zone Act in 1999 and amended in its entirety in 2010. Similarly to Gaesung Complex, there are 14 implementation regulations and further implementation rules and sub-rules enacted by the management committee of Ra-Sun Zone. However, unlikely with Gaesung, North Korea stipulates the legal ground for enacting the implementation rules and sub-rules in Rajin Sunbong Free Trade Economic Zone Act. It seems that North Korea understands the importance of the specific rules from the experience of Gaesung Complex.

### **Legal Issues: Practical Level - Gaesung Complex**

#### 1. Real Estate

All land in North Korea is owned by the state or social cooperative organizations.<sup>1</sup> Land use right may be granted to foreign investors and the building constructed on the eligibly leased land may

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<sup>1</sup> Article 21 and 22 of the Constitution of North Korea

be owned by such foreign investor. Further, under the implementation regulation, the land use right may be transferred or mortgaged. Hyundai Asan was granted with the 50-year of land use right at the beginning of the development of Gaesung Complex.

The practical problem faced with the relevant parties on the day-1 was that there was no basic infrastructure for granting the land use right. Due to the ownership of all land by the state, North Korea has been in no need for measurement of the land. There were no experience of measurement, cadastral map and land registration system. The experts from South Korea measured the whole land for Gaesung Complex and drew the cadastral map, and land registration system was established driven by South Korea. With such systemic infrastructure, the Complex was developed and the portion of land could be leased to the tenant companies.

The next issue was to mortgage the land use right and to execute the mortgaged right. At first to mortgage the land use right was very unfamiliar to North Korea, and the execution of mortgage was that North Korea felt hard to understand. In a case where a tenant company defaulted in payment, the creditor filed for the execution of the mortgaged land use right to the Management Committee and the execution process was dealt with by the court judge in South Korea.

## 2. Tax

North Korea abolished its tax system through the amendment to the Constitution in 1972,<sup>2</sup> therefore officially North Korea is a country where no tax can be imposed. Despite “no tax regime”, North Korea was highly interested in imposing and gathering taxes from the tenant companies operating in Gaesung Complex. However, long history of “no tax regime” led to no experience of accounting which should be equipped with for imposing the taxes.

In late in 2005, the officials of North Korea were provided with accounting and tax training in Shenzhen, China, which was planned and sponsored by Management Committee. It is known that North Korea could train its accounting personnel by itself from late 2000’s.

### 3. Personal Security

Under “Agreement on the Immigration and Stay at Gaesung Complex and Geumgangsan Tour Zone”, the criminal procedure is stated that “North Korean authority first investigates the South Korean suspect and then disports him/her to South Korea. North Korea shall protect the basic human right of the suspect during the investigation. South Korea shall notify North Korea of the punishment imposed on the disported suspect. Notwithstanding the foregoing, in case of any material crimes a separate agreement should be made between the parties.”

There seem many loopholes in the procedures stated in the above agreement. There are no detailed

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<sup>2</sup> Article 25 of the Constitution of North Korea

procedures for the investigation and “material crimes” is too broad concept. However, the two Koreas agreed as above since North Korea gave away the final pursuit of punishment to the South Korean suspect.

#### 4. Dispute

At Gaesung, tenant companies and Management Committee continuously requested North Korea to introduce the administrative proceedings, but failed. It could be understandable since the legal proceedings against the government are hard to find in most communist or authoritarian countries.

#### **Lessons from Gaesung: Legal Improvement in Ra-Sun**

In the perspective of legal system, North Korea had learned much from the experience at Gaesung Complex. At Gaesung, the implementation rules and sub-rules were prepared by South Korea side even without express delegation by the laws of North Korea. And most of the systems at the practical level were provided in such rules and accepted by North Korea.

When North Korea amended the Rajin Sunbong Free Economic Trade Zone Act, it seems that North Korea tried to reflect the experience from Gaesung. In Gaesung Complex, the Management Committee, South Korea side, deals with the daily business of the Complex and prepared the rules. North Korea jointly established a management committee for Ra-Sun Zone together with China.



For Ra-Sun Zone, North Korea introduced the following improved legislations that: (i) the private companies has more autonomous control over the price of the goods or services, hiring labors, wages, profit distribution and business plan; (ii) transfer and mortgage of the land use right is stated in the laws (not rules); (iii) in a default situation the creditor may file for the court to execute the mortgage; (iv) internationally accepted accounting principles should be applied to the companies; and (v) an administrative proceeding is adopted in the laws.

North Korea tightened the protection of labors such as the requirement of severance pay, dismissal procedures and leave. North Korea also introduced new tax item to Ra-Sun Zone and shortened the tax holiday period. We can see in some parts North Korea does not think it fair to grant too much benefit to the foreign investors. At Gaesung, it seems that the benefit was given to South Korean companies partly because it was the inter-Korean project and partly because they did not have sufficient experience.

### **Key Factors for the Future**

In order for the special zones in North Korea to be successfully implemented, first of all, the international relationship should be normalized and the pending sanctions need to be abolished. This material is based on the assumption that such international situation has been changed into where foreign investment into North Korea is legally and politically possible.

From more than 10 years of experience at Gaesung Complex, North Korea had learned the legal and practical systems necessary for the foreign investment. And North Korea also introduced the legal systems and framework from Gaesung to other regions and its own legal system. I hope the lessons from Gaesung and experience from Gaesung and Ra-Sun will lead North Korea to more developed and sophisticated legal system for attracting more foreign investments.

However, we still can see the issues and loopholes in the legal and practical system in North Korea. First, the stability of adopting rule of law should be secured. This may confront with a very fundamental ideas of North Korea as a socialism state, but it would be a great fear to foreign investors that any laws and regulations may be overturned by the decision of government. Second, the real estate issues will be the base of any investment, and still the land area of North Korea (excluding Gaesung Complex) has not been measured. Measurement, mapping and registration need to be first processed to efficiently implement granting the land use right. Thirdly, personal security should be guaranteed. This will only be accomplished by introducing the modern criminal procedures based on due process and human right protection. Lastly, dispute resolution process should be improved by, among others, operating the administrative proceedings by real cases and implementing the arbitration award or court decision from other jurisdictions.

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