

# APPLICATION OF ORIGIN RULES IN KAESONG INDUSTRIAL COMPLEX, NORTH KOREA\*

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## *Abstract*

*Under the expansion of regional economic integration, a product may be assembled in more than one country, creating the problem to determine the origin of the product. This paper aims to analyze the issue to recognize products manufactured in Kaesong Industrial Complex, North Korea, as products originating from South Korea.*

## *Abstrak*

*Sebagai akibat dari berkembangnya kesatuan-kesatuan ekonomi regional, suatu produk dapat diproduksi di lebih dari satu negara. Hal ini menimbulkan masalah dalam menentukan asal negara produk tersebut. Penelitian ini bertujuan untuk mempelajari isu untuk menetapkan produk-produk dari Kompleks Industri Kaesong, Korea Utara, sebagai produk yang berasal dari Korea Selatan.*

**Keywords:** *rules of origin, product, Kaesong Industrial Complex.*

## **A. Introduction**

With the expansion of regional economic integration<sup>1</sup> and globalization in manufacturing, the international trade and commercial policy have changed broadly, which makes it likely that most countries have adopted their new production methods based on comparative advantages. This means that a certain product is not wholly produced in a country, but the product is

manufactured through over two or more countries. The problem rises from which standard is to be applied to determine the origins of products.

Rules of origin determine where a good is made. To import or export goods manufactured, it is necessary to determine their origin so that the proper tariff rate may be applied. Each country has used their own regulation to determine the origin of products

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<sup>1</sup> Regional economic integration is that over two countries or limited members make specific agreements and they are controlled under the common rules. For example, within the integral area, the members enjoy duty-free to import or export their goods with preferential treatment.

imported. Besides, though most countries have concluded free trade agreement (FTA) with trading partners, the rules under FTA are different from each other. World Trade Organization (WTO) even adopted basic principal to determine origins. Namely, harmonized the rules of origins have not been formed as general regulations of to be applied to all countries.<sup>2</sup>

Under these circumstances, it is needed to consider the issue of origins of products manufactured in Kaesong industrial complex. Kaesong Park is the symbol of economic cooperation between South Korea and North Korea<sup>3</sup>. Based on the inter-economic development, both Koreas strive to advance toward the goal of reunification. So, the issue of Kaesong products is important to be solved to promote the relationship and strengthen the economic cooperation at this stage. Because of non-harmonized system codes of items, each country applies its own regulation to determine the origin of goods. Trading partners such as US, EU and Japan have rejected to grant preferential treatment to products from Kaesong. Under FTA negotiation, Korean government has tried to reach the agreement on Kaesong products, but it is not easy to attain our goal.

The purpose of this paper is to review the issue of origins of Kaesong products

with which we are now being faced. Section II discusses the tariff barriers in exporting products originating from Kaesong Industrial Complex. Specifically, it is to review whether the products can enjoy preferential tariff in two aspects: in the Inter-Korean Trade and for exportation. Section II finds alternatives on Kaesong Products' Origin. Through the analyses of FTAs with Singapore, EFTA, ASEAN and US, it considers ways of being accepted Kaesong products as originating from South Korea. Section IV concludes with the brief summary.

## **B. The Problem of Origin of Products from Kaesong Industrial Complex in Exports**

### **1. The Purpose of the Kaesong North-South Korean Industrial Complex**

Kaesong Industrial Complex is located in North Korea, which is an integral part of economic projects between South and North Korea.<sup>4</sup> The project aligns the South's capital and technology with the North's labour and land to develop economic benefits for both. Small and medium companies expect that the project to lower their costs and increase efficiency to enter into overseas markets with their competitive goods.<sup>5</sup> After breaking ground in 2003, the business has made steady progress.<sup>6</sup>

<sup>2</sup> Under WTO members have discussed Harmonization of Rules of Origin, but the negotiation has not yet reached the agreement on origins with sharp conflict.

<sup>3</sup> The Democratic People's Republic of Korea.

<sup>4</sup> North and South Korea agreed on building Kaesong Industrial Complex in June 2002. At that time, the South Korean president Kim Dae-jung, and the North Korea leader, Kim Jong-il, met to push for the project in Pyongyang. See Onishi Norimitsu, "South Brings Capitalism, Well Isolated, to North Korea", *The New York Times*, July 18<sup>th</sup>, 2006.

<sup>5</sup> The goal of the KIC is to allure South Korea companies, particularly small and medium sized enterprises, seeking lower labour and other costs for their manufactured products as an alternative to establishing subsidiaries in China or other low-wage markets. See Dick K. Nanto and Mark E. Manyin R., "The Kaesong North-South Korean Industrial Complex", Report for Congress, Feb 14<sup>th</sup>, 2008, p. 5.

<sup>6</sup> Ministry of Unification, available at <http://www.unikorea.go.kr>.

## 2. Country of Origin Issues of Kaesong Products

### a. Rules of Origin in Inter-Korean Trade

In the case that Kaesong products flow into South Korea after manufacturing in Kaesong Industrial Complex, the origins of inter-Korean trade goods, such as other products of North Korea, are judged by a goods wholly produced test, substantial transformation- change in tariff classification, non-qualifying operation.

The obvious difference is that the tariffs of Kaesong products satisfying appropriate requirement have been imposed in carrying into the South<sup>7</sup>. It is a special regulation to promote the relation between the North and South.

More specifically, when an owner possessing over 60% share of his own company temporarily carries some materials out and manufactures whole products in Kaesong Industrial Complex, the products made in Kaesong are, then, labelled 'Made in Korea'. But, over 60% of direct materials input should be originating from South Korea.<sup>8</sup> Briefly, the rates of material requirement should be over 60% to be accepted as 'Made in Korea.'

Kaesong Industrial Complex established with technology and capital of South Korean companies reflects the specialty between North and South and the further purpose to develop 'free economic zone' between two parties. With the special circumstances, Kae-

song products' origin has been recognized as 'Made in Korea.'

### b. The Tariff Barriers in Exporting Outside

Even though Kaesong products' origin is judged as Made in Korea, the regulation has definite limitations to only apply to products of inter-Korean trade. In cases that goods manufactured in Kaesong area are carried in to South Korea and then exported into the external areas such as U.S. and Japan, the origin of Kaesong products should be determined by the rules of origin of importing countries. The customs policy of the importing countries have been barriers to promote exportation of Kaesong products and cause them to lose price-competitiveness, compared with other products applied to lower tariff rates. In the position both of North and South Korea, it is a very crucial and serious problem because of difficulties in exporting, therefore accomplishing economic development through cooperation between the South and North.

## 3. Strict Rules of Origin of Three Main Countries

North Korean government has not reached any preferential trade agreement on tariff elimination with other countries. Especially, three countries-the United States, European Union and Japan-are main partners of goods trade for North Korea. North Korea's products have been excluded from the Generalized System of Preferences

<sup>7</sup> In inter-Korean trade, the terms of export and import are not used. Instead, the terms of take-in, take-out or carry-in, carry-out are used.

<sup>8</sup> See Yang-sik, Choi, "Origins System and The Future Issue on Trade Goods between the North and South," *The Customs & Trade*, Korea Customs and Trade Development Institute, 2005, p. 19.

(GSP).<sup>9</sup> Countries to take goods from North Korea apply 'non-preferential rules of origin' to define the origin of goods. So, reviewing the rules of origin of main three countries is meaningful in that this process enables us to understand the logic to accept products made in Kaesong as originating from South Korean is material.

#### **a. United States**

United States adopted origin rules of Kyoto Convention as basic regulations. In more detail, agricultural and marine products are adjudged by wholly produced or obtained originally, and the others by substantial changes of HS<sup>10</sup>. For example, according to the precedents to analyze substantial change, the concept is defined that finished products HS items code is modified from input materials' code in the process of manufacturing. Namely, in a country a company uses imported materials- plastic and glass-to make goods, the materials should be transformed into new products such as TV, computer, etc. and then the finished products have new HS item code. The distinct standard of HS item code rests with the uses and the code of finished products, entirely different from (transformed from) the materials imported and used. and it depends on whether in a country, items imported are only packed and assembled or otherwise, materials are transformed into new products through a working process. However, according to diverse rules and policies, US customs

service (agency) adjudges, on a case-by-case basis, origins by where products are imported from. Besides, the United States has made extensive use of country-specific tariff preference programs to encourage economic growth in developing countries. However, the preferential program has not been applied to the products originating from North Korea. It is because North Korea has been recognized as the country that has a communist regime with the nuclear weapons. For instance, a woman's cotton suit (H.S. code 6204.12.00) from North Korea currently is assessed a U.S. tariff of 14.9% while the tariff on a comparable item from North Korea is 90%. If the FTA between South Korea and U.S. takes effect, the tariff of the product originating from South Korea will be eliminated, but the product from North Korea will still remain under 90% of tariff rates.<sup>11</sup>

#### **b. European Union**

The EU's rules of origins categorize into two ways: non-preferential and preferential rules of origin. The former is based on Commission Regulation No. 2454/93 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code. The EU's rules have very complicated standards that include processing tests, value-added tests and change in tariff classification. Moreover, EU applies different rules to products imported according to trading partners.<sup>12</sup> It

<sup>9</sup> The Generalized System of Preferences (GSP) provides preferential tariff treatment to products imported from developing countries.

<sup>10</sup> Harmonized Commodity Description and Coding System.

<sup>11</sup> See Dick K. Nanto and Mark E. Manyin, *supra* note, p. 2.

<sup>12</sup> The EU also applies very detailed rules of origin to several products categories: textiles, clothes, meat, grape, juice, wine, vermouth, leather clothes, shoes, ball bearings, tape-records, magnetic discs, television sets, integrated circuits, copier machines, watch bands, and ceramic articles.

can be recognized that the partners have trade barriers to enter into the EU market. The latter is related with chapter 2 Preferential Origin of Regulation No. 2454/93. The EU applies GSP to separate regional groups. The beneficiary groups include the Association of South-East Asian Nations (ASEAN), the Central American Common Market (CACM), and Andean Group.<sup>13</sup>

### c. Japan

Japan has more comparatively definite rules of origin to apply to imported products. Basically wholly produced tests, and substantial standard are fundamental standards. Substantial standards include change in tariff classification and processing tests. Change in tariff classification means that in terms of 4-digit code product categories, 4-digit code of a finished product is not identified with the 4-digit code of sources imported from other countries that were used in manufacturing the finished product. In addition, special products such as several textiles, chemicals, metals and jewels are determined by applying to processing tests and their origins are conferred as domestic products, in the case of using non-origin materials or non-changeable products of 4-digit code.<sup>14</sup>

### d. The Necessity of Acceptance of Kaesong Products as 'Made in Korea'

As above, Kaesong products of North Korea have not enjoyed preferential

treatment to export them to other significant trading partners. It is because the countries maintain the high tariff rates to Kaesong products, without benefits of preferential tariff so that the price competitiveness of the products exportation deteriorates in world markets.

The United States have not kept the normal trade relations (NTR) with North Korea and imposed high tariffs of Column 2<sup>15</sup> to the products manufactured in North Korea including the Kaesong area because North Korea has the trouble of potentially possessing unclear weapons. The US still maintains the hard-line policy toward North Korea on that matter. The problem makes it difficult for South Korea to negotiate with US to attain the agreement on origins of products made in the Kaesong zone under FTA.

Japan has not yet concluded any agreements on preferential tariff treatment with North Korea. So, the Kaesong products enter into Japan market under inimical conditions rather than equal treatments, compared with products from other nations.

EU's regulations are less strict in determining the origins of imported products. Especially, the EU imposes customs duties on Kaesong products according to the General Agreement in Tariff and Trade (GATT 1994). The tariff rates of EU is advantageous than the US and Japan. But, EU has granted GSP to developing countries such as China,

<sup>13</sup> See Commission Regulation No. 2454/93, article 71.

<sup>14</sup> For more details, see Sang-Sik, Kim, *Methods to Secure Markets for Products of Kaesong Industrial Complex*, May 13<sup>rd</sup>, 2003, p. 5.

<sup>15</sup> See Harmonized Tariff Schedule of the United States 2006, General Notes, 3. Rates of Duty, (b) Rate of Duty Column 2.1. Notwithstanding any of the foregoing provisions of this note, the rates of duty shown in column 2 shall apply to products, whether imported directly or indirectly, of the following countries and areas pursuant to section 401 of the Tariff Classification Act of 1962, to section 231 or 257(e)(2) of the Trade Expansion Act of 1962, to section 404(a) of the Trade Act of 1974 or to any other applicable section of law, or to action taken by the President there under: Cuba North Korea.

Vietnam and etc. Their benefits from EU are of great advantage to export their products with price competitiveness. In particular, the main items of North Korea are textiles and clothes which are the main items of the countries under GSP. So, it is important to take care of the issues with Kaesong products by the negotiation of FTA with EU.

With the start of new era of WTO, 'free trade' beyond the block of national boundary is the symbol of new economic world. However, South and North Korea are still facing difficult problems as the divided countries. This becomes barriers to economic growth. South Korea cannot reconcile with the North at once. So to create the atmosphere of reunification, several ways for cooperation and trade exchange with North Korea should be considered. At the present stage, *North-South economic cooperation is the key way to develop the relationship and the business of win-win to get economic benefit for both Koreas. Namely, it is significant that the Kaesong zone will nudge North Korea toward inducing economic reforms and opening up to the outside world. The north and South have the interactive factors to cooperate. For example, the South has capitals, technology, and several good facilities, while the North has low-income labours, abundant natural resources, and potential consumer market. Through the economic cooperation between the North and South, it is expected North Korea's economic openness and the progress in relation. So, the competitiveness*

*of products manufactured in North Korea is very important; in particular, the Kaesong products' origins. So, it is needed to seek the ways to find new market for products originating from Kaesong areas in North Korea.*

*In this chapter, the significance of Kaesong products to be accepted as South Korean origins was reviewed. Section III discusses the case of FTA between Singapore and Korea, and other ongoing FTA negotiation. Strategic methods to solve the Kaesong issue in the further FTA negotiation will be sought.*

### **C. Alternatives on Origin of Kaesong Products**

#### **1. Acknowledgement of Inter-Korean Trade Based on Special Interim Relationship**

The North and South separately joined the United Nations (UN) and so they are recognized as independent nations in UN.<sup>16</sup> Most countries have also recognized that they are separately independent nations. But, the North and South are in a special relationship with the aim of inter-Korean reconciliation in terms of the respect of mutual existences. It is regulated on preface of Agreement on Reconciliation, Non-aggression and Exchange and Cooperation between the South and the North.<sup>17</sup> and it clarifies that the North and the South lead the joint development and promote the economic exchanges of special inter-Korean

<sup>16</sup> Available at <http://www.un.org/en/members/index.shtml>.

<sup>17</sup> See Agreement on Reconciliation, Non-aggression and Exchange and Cooperation Between the South and the North. Preface: In keeping with the yearning of the entire Korean people for the peaceful unification of the divided land.



trades and welfare of all citizens of the two sides.<sup>18</sup> Especially, the North and the South have concluded supplementary accords on South-North Exchange and Cooperation. According to the accords, it regulates that the two sides do not impose customs duties on inter-Korean goods<sup>19</sup> trades and cooperate to develop the economic relation of South-North into inter-Korean relations. Internally, on the basis of the Accords, Act on Inter-Korean Exchange and Cooperation was accepted and prescribes duty-free of goods taken in<sup>20</sup> from North Korea to admit inter-Korean trade.<sup>21</sup> However, as these regulations are the domestic laws to apply to the internal issues, it is less likely to be accepted in the International areas. So, the issues on the accords between North and South Korea have arisen and so, the tasks are to legally rationalize inter-Korean trade to countries under international law.

For instance, in the case of Germany, WTO accepted the inter-trade between Western and Eastern Germany, joining Western Germany in the General Agreement on Tariffs and Trade (1947 GATT). At that time, though, Eastern Germany was a member of UN and was not recognized as the independent nation. Compared to the

case, it is different with the situation in that North and South Korea are as members of UN simultaneously. North Korea has already been recognized as the independent nation of national identity and the economic benefit of other countries has been bound up with this issue. In this way, the South Korean government has faced with difficulties in persuading the members of WTO into accepting the inter-Korean trade.

In this situation, the expansion of FTA gives the possibility to accept Kaesong products as South Korea's origins, negotiating with trading partners. FTAs are concluded by not multilateral but bilateral negotiations. Considering hardships in WTO, it is likely that FTAs are the affirmative instrument to deal with the problem. But, we need the strategic approach to negotiate with parties concerned.

## 2. Analyses of Special Provisions for Kaesong Products in FTAs

### a. Kaesong Products in Korea-Singapore FTA

#### (1) Originating Status of Kaesong Products Korea-Singapore FTA

In FTA between Korea and Singapore, both parties agreed that products from the

<sup>18</sup> See Id, at article 15: To promote an integrated and balanced development of the national economy and the welfare of the entire people, the two sides shall engage in economic exchanges and cooperation, including the joint development of resources, the trade of goods as domestic commerce and joint ventures.

<sup>19</sup> See Customs Clearance Agreement for the Kaesong Industrial Zone, article 1: Definition: "Goods" refers to those articles necessary for: construction, operation and maintenance of the Industrial Zone; production and management activities of the invested enterprises (hereinafter referred to as "enterprise") in the Industrial Zone; and the daily life of the personnel who reside in the Industrial Zone.

<sup>20</sup> See Act on Inter-Korean Exchange and Cooperation, article 2.3: the term "taking-out and take-in" means movement of goods between South and North Korea (including the movement of goods simply via a third country; hereinafter the same shall apply), by means of sale, exchange, lease, loan of use, donation.

<sup>21</sup> See Act on Inter-Korean Exchange and Cooperation, supra note, at article 2.2: the term "trade" means any taking-out and taking-in of goods between South and North Korea.

KIC<sup>22</sup> and Korean Peninsula are accepted as the origins of South Korea.<sup>23</sup> Kaesong products receive the same preferential treatment with products originating from South Korea. Even though tariff rates of Singapore is almost close to 0% about all products imported from outside and so, there are no the substantial economic benefits for South Korea, it is very emblematic to recognize Kaesong products as the products of South Korea in the FTA. More remarkably,

at that point that trading partners think the issue to be related with the North Korea's nuclear weapons problem, the acceptance of Kaesong products remains the important case for further FTA negotiations.

According to rules of origins under the FTA, the Kaesong products fulfilled by the standard have no limitation to enter into the Singapore market and are allowed to be applied to the preferential tariff.

**Table 1**

**The Applicable Rules of Origins under FTA between South Korea and Singapore**

<b>Regulation</b>	<b>Contents</b>
Basic rules of origins (Article 4.2)	<ul style="list-style-type: none"> <li>- Products produced wholly in the territory of one or both of the Parties exclusively from originating materials acquire origin of the Parties.</li> <li>- Product-specific rules, requiring that the materials used undergo a change in tariff classification or a specific manufacturing or processing operation, shall apply only to non-originating materials.</li> </ul>
Preferential Treatment (Article 4.3)	<ul style="list-style-type: none"> <li>- Products imported into the territory of Singapore from the territory of Korea shall be originating goods.</li> </ul>
Outward Processing (Article 4.4)	<ul style="list-style-type: none"> <li>- Items listed in Annex 4C shall be considered as originating even if has undergone process of production or operation outside the territory of a Party on a material exported from the Party and subsequently re-imported to the Party as following conditions;               <ul style="list-style-type: none"> <li>(a) the total value of non-originating inputs not exceeded forty per cent of the customs value of the final good</li> <li>(b) the value of originating materials of not less than forty-five per cent of the customs value of the final good</li> <li>(c) the materials wholly obtained or produced in the Party or undergone there processes of production or operation going beyond the non-qualifying operation</li> <li>(d) the identity between the producer of the exported material and the producer of the final good</li> <li>(e) the re-imported good obtained through the processes of production or operation of the exported material</li> <li>(f) the last process of production or operation in the territory of the Party</li> </ul> </li> </ul>

<sup>22</sup> Kaesong Industrial Complex.

<sup>23</sup> See FTA between South Korea and Singapore, article 4.3.1: The goods listed in Annex 4B shall be originating goods when the goods are imported into the territory of Singapore from the territory of Korea. The goods shall also be originating material for purposes of satisfying the requirements specified in this Chapter.



## (2) Further Issues

The acceptance of South Korea's origins is a significant precedent for further FTA negotiations, but there is no the substantial and economic benefit from exportation of Kaesong products. Because the tariff rate on importation in Singapore is close to 0%, the friction between South Korea and Singapore had not arisen. On the one side, in the position of Singapore, they did not need to waste their time to negotiate on the issue that does not have any significance on them. On the other side, with the consent on Kaesong products, we gain legal ground for bilateral and multilateral negotiations. Further, South Korea may utilize aggressively the article on Kaesong products to negotiate with other countries. In the point that FTA is a bilateral agreement, though, the effect in persuasion of accepting Kaesong products with low tariff rates is likely to be weak in other FTA negotiation. Besides, the list of items to accept Kaesong products is not made by decisions through consultation of both South Korea and Singapore, but just serialized. This method of approach may not help further negotiation with other trading partners because of distinguishing policies with each other. Namely, South Korea

should consider more prudent proposals to prepare for worse situation and need to set the definite standards of items to apply to Kaesong products.

### b. Outward Processing in Korea-EFTA FTA

In FTA negotiation between South Korea and EFTA<sup>24</sup>, delegates from Korea proposed the list of covered items manufactured in KIC and claimed to provide an article on outward processing. Both the South and EFTA reach the agreement under the proposal. Specifically, originating determination is confirmed; 1) that the value of materials exported from the Party concerned is over 60% of the total used materials in manufacturing the final products of specific items<sup>25</sup>, 2) that the added value of outward processing is lower than 10% in manufacturing the final products.<sup>26</sup> Namely, originating status is obtained not by the products manufactured in the specific areas, but by the country of the high her rates of input materials manufactured of the final products. It may be likely that all products manufactured in the North Korea obtain the originating status in EFTA areas, if the condition is sufficed. Oppositely, the strict conditions become the limitation to export

<sup>24</sup> The European Free Trade Association (EFTA) is an intergovernmental organization set up for the promotion of free trade and economic integration to the benefit of its four Member States: Iceland, Liechtenstein, Norway and Switzerland. Available at the website: <http://www.efta.int/>.

<sup>25</sup> See South Korea-Singapore FTA, *supra* note, at Appendix 4 to Annex 1 (Exemptions from the Principle of Territories) 2. Notwithstanding paragraph 1, for products listed in the Table set out at the end of this Appendix, the acquisition of originating status shall not be affected by working or processing carried out in an area, for instance an industrial zone, outside the territory of a Party, on materials exported from the Party concerned and subsequently re-imported to that Party, provided that: (b) the value of originating materials exported from the Party concerned is not less than 60 per cent of the total value of materials used in manufacturing the re-imported material or product.

<sup>26</sup> See South Korea-Singapore FTA, *supra* note, at Section I article 1. Notwithstanding paragraph 1, non-originating materials which, according to the conditions set out in Appendix 2, should not be used in the manufacture of a product may nevertheless be used, provided that: (b) for products falling within Chapters 50 to 63 of the HS, their total weight of basic textile material used does not exceed 10 per cent of the total weight of all the basic textile materials used.

more items from North Korea in the further, considering that the purpose of establishing industrial complexes between the South and North is to activate the trade on the goods manufactured with low income labours and

abundant resources in North Korea. So, additional negotiations will be required to extend covered items originating from North Korea.

**Table 2**  
**the Applicable Rules of Origins under FTA between South Korea and EFTA**

<b>Regulation</b>	<b>Contents</b>
Basic rules of origins (Annex I, article 2,4,5)	<ul style="list-style-type: none"> <li>- Products obtained in a Party incorporating materials which have not been wholly obtained there, provided that such materials have undergone sufficient working or processing in the Party concerned</li> <li>- Products falling within Chapters 1 to 24 of the HS, wholly obtained in a Party</li> <li>- Products falling within Chapters 50 to 63 of the HS, their weight of basic textile materials used does not exceed 10 per cent of the total weight of all the basic textile materials</li> <li>- Products except for those falling within Chapters 50 to 63 of the HS, their total value does not exceed 10 per cent of ex-works price of the product</li> </ul>
Outward Processing (Appendix 4 to Annex I)	<ul style="list-style-type: none"> <li>- The acquisition of originating status shall not be affected by working or processing carried out outside the territory of a Party on materials exported from the Party concerned and subsequently re-imported to that Party</li> <li>- For 267 items listed in the Table of Appendix, the acquisition of originating status shall not be affected by working or processing carried out in an area, for instance an industrial zone, outside the territory of a Party, on materials exported from the Party concerned and subsequently re-imported to that Party</li> </ul>

### **c. Outward Processing in Korea-ASEAN FTA**

In the negotiation between Korea and ASEAN<sup>27</sup>, there were sharp disputes on the origin of Kaesong products. ASEAN countries on the less developed economic step, compared to South Korea, were alerted to deal with the originating status of Kaesong products in the FTA. Eventually, in the paragraph 3 of Annex 3 'Treatment for

Certain Goods,' it mentions that the products through substantially outward processing shall not affect to the originating status of the final products. and two Parties clarified specific items to apply to the clause with the agreement. Therewith, the predictability of origin rules for Kaesong products could be guaranteed. But, the agreement has differentiation with the clauses under the previous FTA.<sup>28</sup>

<sup>27</sup> The Association of Southeast Asian Nations.

<sup>28</sup> See Ho-Cheol, Kim, *International Trade Review: Article: Does Annex 22-B of the Proposed United States-Korea Free Trade Agreement Contemplate and Allow for Trade with Respect to North Korea?*, Georgetown Journal of International Law, 2008, p. 6-7.

The acceptance of outward processing for Kaesong products is referred concretely to the Exchange Note between economic Ministers of two Parties. However, the number of covered products does not exceed one hundred at HS six digits for each ASEAN country. In addition, ASEAN countries may suspend the application of the Rule 6 and impose the special safeguard measure if the increased products importing from Kaesong cause serious damage to their industry.<sup>29</sup> More importantly, anytime five years after entry into force of the Agreement, any one of ASEAN countries can rescind the application

of Rule of this Note when to determine whether its benefit have been seriously damaged as the result of the application of Rule 6, based on its review and its own discretion. These measures may have the limitations, in applying Kaesong products to Rule 6. In any case, the Korean government attained the aim of originating status of Kaesong products to take a precedent. But, in exporting Kaesong products to ASEAN countries, it should be operated not to violate the Rule and face the difficulty with the measures from ASEAN countries.

**Table 3**  
**The Applicable Rules of Origins under FTA between South Korea and ASEAN**

<b>Regulation</b>	<b>Contents</b>
Basic rules of origins	<ul style="list-style-type: none"> <li>- A good imported into the territory of a Party shall be deemed to be originating and eligible for preferential tariff treatment if it conforms to the origin requirements: <ul style="list-style-type: none"> <li>(a) a good wholly obtained or produced entirely in the territory of the exporting Party</li> <li>(b) the regional value content not less than 40% of the FOB value or a good undergone a change in tariff classification at four digit-level of the Harmonized System</li> <li>(c) the Product Specific Rules considered to be originating in the territory of the Party where working or processing of the goods has taken place</li> <li>(d) certain goods considered to be originating even if the production process or operation has been undertaken in an area outside the territories of Korea and ASEAN Member Countries on materials exported from a Party and subsequently re-imported to that Party</li> </ul> </li> </ul>
Exchange of Notes (Paragraph 2)	<ul style="list-style-type: none"> <li>- Certain goods in the lists referred, which are re-imported as the goods that do not undergo any process beyond operations within the territory of the re-importing Party for exports under the following: <ul style="list-style-type: none"> <li>(a) the total value of non-originating input not exceeded forty per cent of the FOB price of the final good</li> <li>(b) the value of originating materials exported from a Party with not less than sixty per cent of the total value of materials used in manufacturing the final good</li> </ul> </li> </ul>

<sup>29</sup> See Exchange Note of South Korea-ASEAN FTA, paragraph 4. Special Safeguard: (a) When a Party determines that there is an increase of importation of a good covered by Rule 6 into the territory of that Party in such quantities and under such conditions as to cause, or threaten to cause, serious injury to its domestic industry, that Party shall be free to suspend the application of Rule 6 to such a good for such a period of time as it may consider necessary to prevent or remedy such injury or threat to cause injury to the domestic industry of the Party.

#### **d. Applicable Rules on Kaesong Products in KORUS FTA**

In the negotiation of KOURS FTA, South Korea failed to reach the agreement on the origin of goods manufactured in Kaesong Complex, laced with the sharp confrontation. Even though both countries had agreed on the outward processing regulation, there was no specific mention on Kaesong Complex. In other words, South Korea needs to negotiate on the issue separately in the 'the committee on outward processing zones on the Korean Peninsula' after the entry into force of the Agreement.<sup>30</sup> In the Korean side, origin conferring of Kaesong products has become one of the obstacles to negotiate between South Korea and the United States on FTA. Several conditions should be considered on the environmental problem in the area to append the regulation of outward processing in Kaesong Complex. Negotiation on Kaesong products has raised several issues to discuss with U.S. such as human rights, working condition and the violation on environmental standard, etc. More importantly, it is deeply related to whether the U.S. supports the project for the communist regime of North Korea.<sup>31</sup> In addition, the matter on North Korea's nuclear weapons sets limits on providing the foods and other materials with the strong policy of the U.S. The current situation makes difficult to discuss originating status of Kaesong products with Washington. So the direction of resolving the problem will be

the main variable to make the development of Kaesong zone.

#### **e. Preferential Treatment on Kaesong Products in CEPA**

The Korean government attained preferential treatment on the Kaesong products in the rules of origin of CEPA.<sup>32</sup> The method of the preferential treatment is similar to FTA between Korea and ASEAN. According to article 3.14 (see table 3), the acquisition of originating status in accordance with the conditions are not affected by working or processing carried out in the area agreed by two Parties in the Exchange of Notes on materials exported from the Party concerned and subsequently re-imported. But, the clause has restraints just as the clause of FTA between Korea-ASEAN does. First, in the Annex 3, when the amount of imported goods increases or causes serious injury or effects to domestic industry, the Party concerned may suspend the application of the exemption from the principle of territory. Here, the decision on the condition to threaten domestic industry is up to the Party concerned. Second, the application of article 3.14 is restricted to the Kaesong area. In the case that the South and the North try to extend the area of economic complex within inter-Korea, it is needed to re-negotiate for areas covered by the Agreement. These can be limitations in exporting Kaesong products to India and in expanding the list of the covered goods or areas manufactured in Kaesong area.

<sup>30</sup> See KOURS FTA, Annex 22-B Committee on Outward Processing Zones on the Korean Peninsula:

1. Recognizing the Republic of Korea's constitutional mandate and security interests, and the corresponding interests of the United States, the Parties shall establish a Committee on Outward Processing Zones on the Korean Peninsula. The committee shall review whether conditions on the Korean Peninsula are appropriate for further economic development through the establishment and development of outward processing zones.

<sup>31</sup> See Dick K. Nanto and Mark E. Manyin, R., *supra* note, p. 19-20.

<sup>32</sup> See Comprehensive Economic Partnership Agreement between Korea and India signed on August, 2009, available at [http://www.fta.go.kr/user/fta\\_korea/kor\\_india.asp?country\\_idx=18](http://www.fta.go.kr/user/fta_korea/kor_india.asp?country_idx=18).

**Table 4**  
**The Applicable Rules for Kaesong Products under CEPA between South Korea and India**

Regulation	Contents
Exemption from the principle of territory (Annex 3, article 3.14)	- A good with certain conditions re-imported as the goods that do not undergo any process beyond operations within the territory of the re-importing Party for export is originating in the territory of that Party: (a) the total value of non-originating input of not exceeding 40 percent of the FOB price of the final good (b) the value of originating materials exported from the Party of 60 percent of the total value of materials used in manufacturing the re-imported material or good
Exchange of Notes	- The application of Article 3.14 has limitation to goods undergone working or processing in Kaesong Industrial Complex in North Korea.

**f. Specific Articles for Preferential Tariff in Other Nations' FTAs**

**(1) Article on ISI (Integrated Sourcing Initiative) in U.S.-Singapore FTA**

In U.S.-Singapore FTA, outward processing using the ISI is the applicable and allowable method. The purpose of the ISI is that a finished product is accepted as originating from Singapore, even though the product was not made in Singapore, to improve the efficiency and flexibility in manufacturing and exporting. In particular, the ISI simplifies the administrative procedure to reduce importers' paperwork burden and cuts down processing burden for certain information technology (IT) products such as auto machine, electronic apparatus, transmission apparatus, parts accessories and medical devices in the U.S. and Singapore. For a list of limited 266 items of IT products

and medical devices listed in Annex 3B, the ISI eliminates the requirement that these products agreements include such "rules of origin" when shipped between the U.S. and Singapore.<sup>33</sup> For instance, a certain product which is imported to the United States via Singapore from third countries such as Bintan and Batam obtains originating status of Singapore. In this case, the merchandise processing fee (0.21%) is not imposed on the product.<sup>34</sup>

The industrial complex required by Singapore is quite similar to Kaesong Industrial Complex. The South could not draw the agreement on Kaesong products, but agreed to push the Kaesong matter after resolving the issue on North Korea's nuclear weapons. However, Singapore concluded the agreement on originating status of products manufacturing in the industrial complex. The main factor to get the approval from the U.S.

<sup>33</sup> See "Singapore FTA: Integrated Sourcing Initiative", available at <http://www.ustr.gov>, April 22<sup>nd</sup>, 2009.

<sup>34</sup> See Tommy Koh, Chang Li Lin, 2004, *The United States Singapore Free Trade Agreement- Highlight and Insight*, World Scientific, Singapore, p. 68.

is that Singapore constantly persuaded the U.S. on the advantages of the U.S. enterprises utilizing the areas.<sup>35</sup> Like Singapore's case, South Korea would need to make strategies for solving the Kaesong products with the advancement of relationship between the South and North.

**(2) QIZ (Qualified Industrial Zone) under U.S.-Israel FTA**

The United States reached an agreement on Qualified Industrial Zone with Egypt and Israel in December 2004. If added-value not less than 35% of a finished product is created in a manufactory of the area, the product entering into US enjoys duty-free under preferential measures. According to the act on QIZ establishment made in US on 1996<sup>36</sup>, thirteen QIZ located in Jordan had also managed in 1999. Products manufactured in the areas have been applied to get benefit of non-tariff, if the given conditions are satisfied to export to US. The approval of outward processing within specific areas has differentiation with the article of outward processing in other FTAs. The important thing is, though, that the US has basically accepted the outward processing outside the area of FTA. More importantly, the grant of preferential tariff for the products of Israel is considered by the special relation between US and Israel. The case of Central Asia is good material for the negotiation on the origin issues. South Korea needs active

negotiations with the US for the application of low tariff for product manufactured in Kaesong Zone, with the effort to solve the political problem of North Korea.

**3. Review of Ways to accept goods produced in Kaesong as 'Made in Korea'**

After the WTO system, liberalization of the international trade has spread all over the world, based on cooperation and harmonization. But, the inter-Korean relations still remain in divided situation. This situation has been barriers to improve global competitiveness. So, South Korea has sought several policies to create a relaxing atmosphere toward the unification between the South and North. One of the alternatives is 'the economic cooperation between the South and North.' The advantage of the policy is to promote the economic benefits for both Koreas. In this context, the purpose of building the Kaesong Zone is to ease tensions and cooperate for the economic development between the South and North. The development of Kaesong Zone is important for both Koreas in strengthening the economic cooperation. The problem is, though, that we should find new markets to export products manufacturing in the area. The domestic markets are very narrow to take in all products from the area. Because of the problem, it becomes the important and

<sup>35</sup> See Minyul, Kim, Jongbae, Lee, "Production Base of Singapore 'Wind' Seoul Economy", available at <http://www.hankooki.com>, April 4<sup>th</sup>, 2009.

<sup>36</sup> In 1996, the U.S. Congress passed legislation amending the U.S.-Israel FTA Implementation Act of 1985, adding a new section to provide the President with proclamation authority to allow Jordan, Egypt, and even the Palestinian territories to reap substantial benefits under the U.S.-Israel. on November 13, 1996, U.S. President Clinton issued Presidential Proclamation No. 6955 to provide duty free treatment to products from QIZ. See Ho-Cheol, Kim, supra note, p. 5.

serious issue in the FTA negotiation.

In negotiation FTA, we have discussed several agreements about originating status of Kaesong products. Outward processing provisions have been accepted in most FTAs. But, concerned parties have required several conditions to allow the Kaesong products to enter into their domestic market. Even though we take precedents on the origins of Kaesong products through FTA negotiation, we still have limitation to enlarge products manufacturing in Kaesong Zone. In addition, to export a certain product from Kaesong to other countries, the product should be surely exported via South Korea. The red-tape formalities may reduce the efficiency. Henceforth, we need to seek strategies for Kaesong products in negotiation of FTA and propose 'the special annex' related to the economic complex in multilateral negotiation to maximize the economic benefits of Kaesong Zone

#### **D. Conclusion**

Determining where a product comes from is no longer an easy matter when it comes to raw materials and parts flowing through countries to be used as inputs in scattered manufacturing plants. Besides, the rules of origin defined by various countries are very different and obscure to implement, so that those can be used arbitrarily by countries to have the effectiveness of discriminatory

trade regimes. Moreover, countries in FTA make more strict conditions to check 'a free trade' through roundabout trade of the third countries. This circumstance works as trade barriers or causes interfering in the flow of free trade.

In the current situation, discussion on problem of "the acceptance of North Korean products as domestic" will be meaningful. Currently, it is a very sensitive and important matter in negotiation of rules of origin in FTAs because the industries of parties concerned can be affected by the importation of Kaesong products.

In FTAs negotiation, the application of special rules on "Outward Processing" has been suggested as one of alternatives to solve the origins of Kaesong products. The recognition of "Outward Processing" helps to accumulate all contents in the manufacturing processes even though there is a break in the production chain. But, the problem is that a good manufactured outside the territory must return to domestic area prior to the exportation to the other Party. Thus South Korea needs to consider special rules on "the economic complex between the South and the North in FTAs, not to return to the South before its exportation. Therewith, Korean government would need to propose 'the special annex' related to the economic complex in multilateral negotiation with the efforts to persuade Parties concerned.

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