

North Korea is only five years away from building a nuclear missile capable of attacking America. Security experts say that the only thing that stands in their way is cash. On a bipartisan basis, members of the U.S. Congress have urged a tightening of existing U.S. economic sanctions against North Korea. Despite that, **the Obama administration is now pushing a trade agreement with South Korea that perversely could provide a flood of new money for the North Korean dictatorship to bolster their weapons program, as well as maintain their stranglehold over the North Korean people.**

The official U.S. government study of the Korea Free Trade Agreement (FTA) found that it would increase Korean imports here by \$6 billion annually and increase the overall U.S. trade deficit. **If the FTA is implemented as written, that increased trade will include goods *assembled* in South Korea – but comprised of large amounts of North Korean inputs sourced in the Kaesong Industrial Complex. This is a sweatshop zone located 40 miles north of Seoul where 120 South Korean firms employ 44,000 North Koreans, whose meager 25-38 cents per hour wages are paid to the North Korean government, which keeps half.** The FTA also includes several ways for good actually assembled in North Korea to obtain benefits under the trade deal.

The North Korean Kaesong Sweatshop Zone

While North Korea is one of the world’s most economically isolated countries, it has quietly sought to develop deeper ties with investors, especially from South Korea, in order to obtain needed cash. Almost ten years ago, the South Korean multinational conglomerate Hyundai cut a deal with the North Korean government to obtain a 50-year lease to build a massive sweatshop zone – called the Kaesong Industrial Complex. It is located 43 miles north of Seoul, just north of the Military Demarcation Line at the 38th parallel that has

divided the two Koreas since the Korean war. There are currently 120 South Korean firms in Kaesong, employing over 40,000 North Korean workers, who are shipped in daily and supervised by North Korea Korean handlers with a loud speaker system blaring North Korean political messages.

Hyundai has signed a new lease to enlarge the zone from its current 800 acres to an over 6,000 acre complex, where 1,500 South Korean and other foreign firms will employ 350,000 North Korean workers.

Because the North Korean government takes nearly half of the Kaesong workers’ wages, the Korea trade deal could lead to U.S. consumers unknowingly buying goods that directly support the Stalinist Kim Jong Il regime.



The South Korean government has been very supportive of Kaesong, keeping trade open there even as the rest of the bilateral relationship went into a deep freeze after North Korea sank a South Korean submarine and shelled a South Korean island. South Korea offers companies establishing operations in Kaesong the same low-interest loans it offers to public works projects, and offers extensive political risk insurance of up to 90 percent

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“ ***The planned ratification of the South Korea-U.S. free trade agreement will pave the way for the export of products built in Kaesong to the U.S. market.***

- South Korea’s U.S.
Ambassador Han Duk-Soo

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N. Korean Kaesong Sweatshop Zone

-cont'd of Kaesong investments for the South Korean firms making textiles, electronics, car parts and other items there.

It sees Kaesong as a symbol of a unified Korea. And, because Kaesong workers are paid as little as 25 cents an hour and have few labor rights, the zone provides South Korean firms with a means to outcompete low Chinese labor costs. Ironically, these goals conflict with one another:

Kaesong labor costs are less than eight percent of South Korean labor costs precisely because the two Koreas are not unified. **There was \$1.9 billion in total trade between the two Koreas in 2009, about half of which was through production by South Korean firms in Kaesong.** The U.S. government estimates that the North Korean government collects \$3-4 million a month from the Kaesong operations now, prior to a massive planned expansion of the border sweatshop zone. Hyundai predicts that the North Korean regime will receive \$9.55 billion in economic gains from Kaesong over the course of nine years if expansion proceeds. This is equivalent to 36 percent of North Korea's estimated national income.

Korea FTA Would Generate New Income for the N. Korea Regime

There are several ways that goods assembled in North Korea could eventually obtain FTA benefits. **But even if none of these provisions were used, the FTA would allow imports assembled in Korea but comprised of component parts made in North Korea to benefit from the FTA's new duty free U.S. access, thereby generating new revenue for the Kim dictatorship.**

The Bush administration rejected demands from Congress that the FTA explicitly forbid North Korean inputs. Members of Congress then asked the Obama administration to fix the Korea FTA text signed by President Bush in 2007 to make clear that goods with North Korean content could not obtain FTA benefits. Yet, when the Obama administration reopened negotiations with Korea in late 2010, this critical fix was not made. In February 2011, Rep. Brad Sherman (D-Calif.), the ranking member on the U.S. House Foreign Affairs Subcommittee on Terrorism, Nonproliferation, and Trade, reiterated his demand for an amendment that ensured that "any item with North Korean content, including goods assembled in South Korea that include any content from Kaesong, will not only fail to receive FTA treatment, it will not be allowed to enter the United States at all."

Without this clarification, the FTA would allow duty free treatment of goods assembled in South Korea with a large share of North Korean inputs. The FTA has provisions called "Rules of Origin," which determine whether a good obtains the benefits of the agreement such as new duty-free access into the United States. The FTA has different rules of origin for different products, based either on how much of the value of the good is South Korean or American, or on whether it has been "transformed" – meaning that work has been done on it so that the product moves from one tariff classification to another. **Under these rules, 65 percent of the value of a car could come from North Korean inputs, and both the South Korean and U.S. customs services would deem the final product "South Korean" and give it the benefits of the agreement!**

To make matters worse, **South Korean customs officials are permitted to stop tracking many Kaesong-assembled goods once they enter the stream of commerce in South Korea because they are deemed to be of South Korean origin.** Under Korean law, any Kaesong good that includes 60 % South Korean content and comes from a firm with at least 60 percent South Korean ownership is considered to be of South Korean origin. Given that U.S. tariffs on autos and other products will eventually go to zero under the U.S.-South Korea pact, we would expect to see an overall increase in these North-to-South Korea-to-U.S. trade flows.

The FTA Would Undermine Current U.S. Sanctions Against N. Korea

Under current law, the United States has in place a sanctions program which charges high tariffs on North Korean products and requires a license for direct importation here from North Korea. Many have criticized the current regime as too lax, with House Foreign Affairs Chairwoman Ileana Ros-Lehtinen (R-Fla.), Senator John McCain (R-Ariz.) among others calling for tightening of the restrictions. **But the FTA risks unraveling the effect even these sanctions have.** If the FTA were to go into effect, South Korea could claim a violation of the FTA if the United States sought to deny entry to South Korean assembled goods with North Korean content (assuming even that U.S. Customs officials could track this). Under the FTA, such a denial of entry would be subject to a challenge in a foreign tribunal – with the U.S. subject to indefinite trade sanctions until we allowed in such goods.



undermined by the wide range of other trade opportunities for North Korea through Kaesong.

This is not a speculative risk. A recent Congressional Research Service (CRS) report noted:

“Another current issue dealing with enforcement of U.S. policy objectives is the treatment of goods and products manufactured in the Kaesong Industrial Complex (KIC) located in North Korea. While the KIC is physically located in North Korea, many of its manufacturing operations are owned and run by South Korean companies. The South Korean government has asked the United States to treat the products made in the KIC by South Korean companies as South Korean products, even though current U.S. rules of origin laws and regulations would designate them as being products of North Korea. The United States currently has a trade embargo on products from North Korea, and the United States has never granted North Korea “normal trade relations” (NTR) status. ***Whether or not the United States agrees to this proposal, there is nothing to prevent South Korean firms from performing intermediate manufacturing operations in North Korea, and then performing final manufacturing processes (sufficient to confer origin) in South Korea.***”

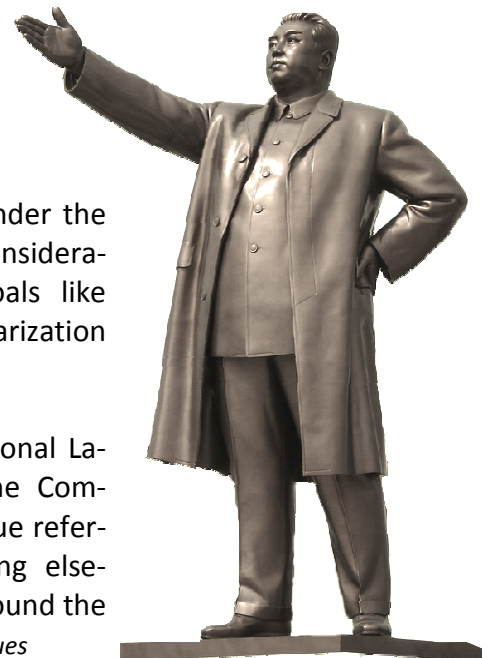
An article in *the Yale Journal of International Law* noted that **“The development of the KIC has allowed goods produced by North Korean labor unprecedented access to international markets, allowing the regime to secure much-needed foreign currency. This could weaken U.S. leverage in negotiations with North Korea, since the United States has relied heavily on trade sanctions”** that are now increasingly

And the FTA Could Allow Benefits for North Korean Assembled Goods Too

The FTA also includes two avenues for goods actually fully assembled in North Korea to get FTA benefits. The FTA’s Annex 22-B requires the U.S. executive branch and its South Korean counterpart to establish a Committee on Outward Processing Zones (OPZ) on the Korean Peninsula within the first year of the agreement. (OPZ is shorthand for Kaesong and other sweatshops outside of South Korea proper.) This committee is instructed to establish criteria for OPZ

goods to qualify for benefits under the trade deal, after taking into consideration certain foreign policy goals like “progress toward the denuclearization of the Korean Peninsula.”

Instead of considering International Labor Organization standards, the Committee is instructed to make “due reference to the situation prevailing elsewhere in the local economy” around the OPZ – i.e. North Korea. *-Continues*



Benefits for North Korean Assembled Goods

-cont'd Finally, the Committee “shall be responsible for seeking legislative approval for any amendments to the Agreement.” Human Rights Watch has blasted the annex, stating, “It would be difficult to find a lower labor rights standard than that prevailing in North Korea” and “Annex 22-B fails to establish clearly, however, that legislatively-approved amendments *are necessary* to extend the accord” [emphasis added]. Ways & Means Committee ranking member Sander Levin (D-Mich.) has also criticized the annex, saying that it could lead to two outcomes: “it is possible that products from the North Korean Kaesong Industrial Complex could be incorporated into goods shipped from South Korea in a manner held not to require approval by Congress.

Second, a recommendation would be forwarded to Congress that would treat goods as South Korean made under conditions contrary to the agreement relating to basic international standards on worker rights.

Since neither is satisfactory, the conclusion is that Annex 22-C [sic] must be removed from the FTA.”

As well, South Korea could take unilateral action in its domestic laws to qualify Kaesong assembled goods for the FTA benefits.

U.S. trade negotiators appeared to partially limit the benefits that North Korea could obtain from the U.S.-South Korea trade pact. For instance, the pact states that “A natural person who is domiciled in the area north of the Military Demarcation Line on the Korean Peninsula shall not be entitled to benefits under this Agreement.” But this language only limits the denial of trade benefits to North Korean people – *not companies, goods or services*.

Negotiators could have made a similar restriction on the definition of “territory” under the agreement. Instead, the pact defines “territory” as “the land, maritime, and air space over which Korea exercises sovereignty.”

This is highly problematic, for several reasons. First, South Korea’s constitution defines the national territory as covering the entire Korean peninsula. Second, Korean officials have declared that “North Korea transferred part of its territorial jurisdiction and sovereignty to South Korean developers” to develop Kaesong.

Third, South Korea could simply enact legislation defining Kaesong as being under its economic sovereignty. Finally, partially as a result of the complicated legal and military arrangements after the Korean war, the United States has never formally recognized the borders between North and South Korea.

But there are no constitutional limitations on the U.S. executive branch’s authority to do so at will were the South Koreans to take action to recognize Kaesong as part of “South Korea” for the purposes of the agreement. Congress would have no role in such a scenario.

What Needs to Be Done to Ensure that the Korea FTA Does Not Benefit North Korea

Unless the U.S.-South Korea trade pact is amended – to explicitly forbid FTA benefits for goods containing North Korean inputs – U.S. actions to prohibit entry of such goods could be challenged as violating the agreement. The deal must be amended to remove Annex 22-B and otherwise prohibit the entry into the U.S. market of goods assembled in North Korea generally and Kaesong specifically. Indeed, without this move, the Obama administration and future presidents would have wide latitude to put congressional desires to see U.S.-Kaesong trade prohibited on the chopping block – claiming that prohibitions would violate the FTA. And, this administration and future ones would also find itself limited from strengthening economic sanctions against North Korea were the FTA to go into effect with its current loopholes.

Americans have but one opportunity to prevent this threat: get Congress to vote against the U.S.-Korea FTA, so that the Obama administration is forced to renegotiate the agreement to foreclose the FTA becoming a means for the North Koreans to use the agreement to obtain increased hard currency revenues.