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## MEMORANDUM

FR: Lori Wallach  
DT: May 2, 2011  
RE: **April 2011 Executive Order on North Korea: Another Missed Opportunity to Address Conflict between Korea FTA and U.S. Sanctions Program**

The April 18, 2011, Executive Order “Prohibiting Certain Transactions with Respect to North Korea” issued by President Obama does nothing to remedy the conflict between the current U.S. North Korea economic sanctions program and the terms of the U.S.-Korea Free Trade Agreement (FTA). Rather, **the executive order was the latest opportunity that the Obama administration did not avail itself of to at least clarify that it intends to exclude from FTA coverage South Korea goods that contain inputs from the North Korea Kaesong Industrial Zone.**

The underlying problem is that the FTA Chapter 6 “rules of origin” that set what goods are “South Korean” and subject to FTA benefits, including duty-free U.S. access, provide FTA benefits for many goods containing only 35% South Korean value as long as final assembly occurs in South Korea BUT do NOT make clear that the non-originating content CANNOT be sourced in North Korea. Indeed, despite efforts by Rep. Brad Sherman (D-Calif.) starting four years ago when he chaired the House Foreign Relations Subcommittee on Terrorism, Nonproliferation, and Trade, the FTA text does not specify that South Korean goods that otherwise meet the FTA’s rules of origin, but that contain inputs from North Korea, must STILL comply with the U.S. sanctions against North Korea and/or Office of Foreign Asset Control (OFAC) licensing rules.

As a national Security Council spokesperson affirmed to the *Asia Wall Street Journal*: “The Executive Order neither strengthens nor weakens our previous restrictions on imports of North Korean products; it rationalizes the process.” Indeed, the order reiterates previous presidential directives made by Obama and former President George W. Bush.

If the administration had wanted to make clear, at least to Congress and South Korea, that the U.S. government intended that trade occurring under the FTA’s terms was expected to meet the policy contained in the executive order and the existing OFAC licensing rules, then the administration needed to have added a savings clause to the Executive Order. The key provision currently reads: "**Section 1. *Except to the extent provided in statutes or in licenses, regulations, orders, or directives that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the date of this order, the importation into the United States, directly or indirectly, of any goods, services, or technology from North Korea is prohibited.***" [Emphasis added]

To make clear that trade under the FTA was expected to conform to the Executive Order’s policy, the order’s text needed to include a savings clause along the lines of the text in bold: “***Notwithstanding obligations established in international commercial agreements to which the United States is a party or statutes implementing them and except to the extent provided in other statutes or in licenses, regulations, orders, or directives ...***”

The way in which the order is written merely reiterates that the Korea FTA's implementing legislation (a statute) takes precedence over the policy in the executive order. And, trade pact implementing bills explicitly adopt the text of the agreement itself as U.S. federal law. Thus, if the FTA is implemented, the conflicting FTA Chapter 6 rules of origin obligations (establishing that the U.S. is required to allow special access for good assembled in South Korea as long as the non-originating content is within the values set in the FTA) will become U.S. statute and takes precedence over this order.

It is worth noting that even if the administration had inserted a savings clause in this executive order, it would not have "fixed" the underlying problem. A change to the FTA text is needed to accomplish that. No mechanism of U.S. law – an executive order, the FTA's implementing bill – can unilaterally fix the problem. Rather, the U.S. and Korean governments would need to agree to insert a footnote to the Korea FTA's Chapter 6 rules of origin or otherwise execute a binding agreement between them that states something along the lines of: "*Notwithstanding the rules of origin set forth in Annex 6-A, qualifying South Korean assembled good containing inputs of any value from North Korea may only obtain entry in compliance with U.S. policy with respect to trade with North Korea including the licensing requirements of OFAC or any successor program.*"

U.S. FTA negotiators also failed to list the OFAC license as an exception to the FTA's ban on import licenses. The Korea FTA reads in General Agreement on Tariffs and Trade (GATT) Article XI, which requires that countries cannot institute "prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures." Korea FTA Article 2.8.3 provided an opportunity to list exceptions to this rule. OFAC licensing is not listed, although U.S. controls relating to raw log exports are, among other licensing programs.<sup>1</sup>

That U.S. trade negotiators acted to preserve other existing U.S. import and export restriction policies by listing them as exceptions to the FTA rules only highlights the clear meaning of the FTA text: "***The Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by regional levels of government.***"<sup>2</sup> Thus, if a U.S. policy (the current OFAC rules, this new order) conflict with FTA obligations, the U.S. is obliged to change its domestic law to conform to the FTA, with indefinite trade sanctions permitted for failure to do so – *unless* an explicit exception has been agreed as part of the FTA text. No such exception exists with respect to North Korean inputs in South Korea goods that otherwise meet the FTA rules of origin.

No one expects that the KORUS implementing legislation will include an amendment to the OFAC rules to exclude FTA trade. However, if the FTA goes into effect and the U.S. government continued to deny entry to South Korea goods with North Korean inputs that otherwise meet the FTA's rules of origin, then the U.S. is subject to challenge for violating the FTA terms.

This is of special concern because many major South Korean firms that export to the U.S. have operations in the North Korean Kaesong Industrial Complex. The wages of the 44,000 North Korean workers there are paid to the Kim regime, which keeps the hard currency and pays the workers 45% of their wages back in coupons for use at stores in Kaesong. There are no labor rights for workers in this facility who are bussed in daily and overseen by North Korean guards.

If the FTA opens a backdoor around the U.S. licensing regime, then the North Korea regime could obtain a significant new flow of revenue for its weapons programs. **The U.S. government estimates that the North Korean government currently collects \$3-4 million a month from the Kaesong operations now, prior to a massive planned expansion.** South Korea cut off most trade with North Korea after attacks last year, but left Kaesong trade open.<sup>3</sup> 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.<sup>4</sup> While \$1.9 billion is not a

lot of money relative to the U.S. or South Korean economy, it constitutes over a third of North Korea's total external trade.<sup>5</sup> Given the Department of Defense estimates that North Korea's nuclear program cost the regime as little as \$200 million to develop, the hard currency generated by North Korean trade flows is sufficient to finance the North's nuclear proliferation regime several times over.<sup>6</sup>

The North Korean government is projected to receive \$9.55 billion in economic gains from Kaesong over nine years under a planned major expansion for which Hyundai and the Korea Land Corporation have already signed a long term lease agreement with the North Korea Kim regime.<sup>7</sup> This is equivalent to 36 percent of North Korea's estimated national income. Hyundai and the Korea Land Corporation, the principal developers of Kaesong, plan to enlarge the complex from its current 800 acres to an over 6,000 acre complex (or nine square miles), where 1,500 South Korean and other foreign firms will employ 350,000 North Korean workers.<sup>8</sup>

The South Korean government has extensively subsidized the Kaesong complex, in the hopes that its firms will utilize the low-wage labor force there as an alternative to establishing Chinese subsidiaries. The government has offered 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 of the value of Kaesong investments.<sup>9</sup> Indeed, contrary to claims now emanating from the Korean embassy in Washington, in the past Korean officials have been clear in their views that the U.S. FTA would provide new opportunities for Kaesong access to the U.S. market. **“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,” said Han Duk-Soo, now-South Korean Ambassador to the U.S. and Korea Prime Minister when the FTA was signed.**<sup>10</sup>

In the U.S., Sherman has not been alone in raising concerns about "leakage" in the current U.S. sanctions program against North Korea. 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.*" [emphasis added]<sup>11</sup>

As this Executive Order again reiterates, the Obama administration has not been inclined to fix this FTA problem.

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ASIA WALL STREET JOURNAL/SOUTH KOREA April 20, 2011, 12:26 PM KST

## Does Obama Order Cover Kaesong Goods?

When U.S. President Barack Obama says or does something about North Korea, it gets attention in South Korea. Wednesday's papers in South Korea contain articles speculating on the meaning of the [executive](#)

[order](#) Mr. Obama signed on Monday night U.S. time (early Tuesday Korea time) that underlines the U.S. ban on imports of goods and services from North Korea.

The order reiterates previous presidential directives made by Mr. Obama and his predecessor George W. Bush. In part, the order says, "The importation into the United States, directly or indirectly, of any goods, services, or technology from North Korea is prohibited."

It gives the U.S. Treasury Department, which has already pursued violators of previous U.S. and U.N. sanctions related to North Korea, the central authority to enforce the ban and contains no time limits for the pursuit of such violations.

The order came out as the U.S. Congress is taking up ratification of the free trade agreement the U.S. struck with South Korea in 2007 and modified last year. One of the ambiguities of that deal is whether the U.S. will accept goods from the factories of South Korean firms at an industrial park just inside the North Korean border at the city of Kaesong. In the FTA, the U.S. and South Korea agreed to settle the matter later.

In the U.S., some congressional and activist opponents of the South Korea deal raised the Kaesong issue in letters and hearings the past two months. One group, Public Citizen, linked the administration's assessment of North Korea's military progress and the money flowing to the authoritarian regime in Pyongyang via the Kaesong project. It said, "Given recent Pentagon defense assessments that suggest North Korea is within five years of strike capacity against the U.S. west coast, Congress and the public are rightly concerned with any policy that could provide further financial resources to the Kim Jong Il regime."

In South Korea, the ratification of the FTA at the moment is being protested by farmers and their supporters who are trying to extract more money from the Seoul government to ease the burden they expect from increased competition with American food products. But the Kaesong issue looms as another stumbling block if manufacturers who operate plants at the facility insist on more assurance of access to the U.S. market.

The wording of Mr. Obama's new order, along with an [accompanying letter to Congress](#) about the order doesn't address the Kaesong matter specifically. But the order itself suggests that U.S. sentiment is strongly against acceptance of goods from North Korea, even if they're made by South Korean firms.

Our Washington colleague Elizabeth Williamson asked the White House for comment. Tommy Vietor, spokesman for the National Security Council, responded:

*"For many years, imports from North Korea into the United States have undergone a review process to ensure that they comply with U.S. and international law, including sanctions regimes, and in the interest of foreign policy and national security concerns. Through this Executive Order, the Obama administration has taken steps to continue this process. The Executive Order neither strengthens nor weakens our previous restrictions on imports of North Korean products; it rationalizes the process."*

**xxx**

THE WHITE HOUSE  
Office of the Press Secretary  
For Immediate Release April 18, 2011  
EXECUTIVE ORDER

PROHIBITING CERTAIN TRANSACTIONS WITH RESPECT TO NORTH KOREA

By the authority vested in me as President by the Constitution and the laws of the United States of America, including the International Emergency Economic Powers Act (50 U.S.C. 1701 *et seq.*) (IEEPA), the National Emergencies Act (50 U.S.C. 1601 *et seq.*), section 5 of the United Nations Participation Act of 1945 (22 U.S.C. 287c) (UNPA), and section 301 of title 3, United States Code, and in view of United

Nations Security Council Resolution (UNSCR) 1718 of October 14, 2006, and UNSCR 1874 of June 12, 2009,

I, BARACK OBAMA, President of the United States of America, in order to take additional steps to address the national emergency declared in Executive Order 13466 of June 26, 2008, and expanded in Executive Order 13551 of August 30, 2010, that will ensure implementation of the import restrictions contained in UNSCRs 1718 and 1874 and complement the import restrictions provided for in the Arms Export Control Act (22 U.S.C. 2751 *et seq.*), hereby order:

Section 1. Except to the extent provided in statutes or in licenses, regulations, orders, or directives that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the date of this order, the importation into the United States, directly or indirectly, of any goods, services, or technology from North Korea is prohibited.

Sec. 2. (a) Any transaction by a United States person or within the United States that evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions set forth in this order is prohibited.

(b) Any conspiracy formed to violate any of the prohibitions set forth in this order is prohibited.

Sec. 3. The provisions of Executive Orders 13466 and 13551 remain in effect, and this order does not affect any action taken pursuant to those orders.

Sec. 4. For the purposes of this order:

(a) the term "person" means an individual or entity;

(b) the term "entity" means a partnership, association, trust, joint venture, corporation, group, subgroup, or other organization;

(c) the term "United States person" means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States;

(d) the term "North Korea" includes the territory of the Democratic People's Republic of Korea and the Government of North Korea; and

(e) the term "Government of North Korea" means the Government of the Democratic People's Republic of Korea, its agencies, instrumentalities, and controlled entities.

Sec. 5. The Secretary of the Treasury, in consultation with the Secretary of State, is hereby authorized to take such actions, including the promulgation of rules and regulations, and to employ all powers granted to the President by IEEPA and the UNPA as may be necessary to carry out the purposes of this order. The Secretary of the Treasury may redelegate any of these functions to other officers and agencies of the United States Government consistent with applicable law. All agencies of the United States Government are hereby directed

to take all appropriate measures within their authority to carry out the provisions of this order.

Sec. 6. This order is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person.

Sec. 7. This order is effective at 12:01 a.m. eastern daylight time on April 19, 2011.

BARACK OBAMA  
THE WHITE HOUSE,  
April 18, 2011.  
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## ENDNOTES

<sup>1</sup> See Annex 2-A, page 2-12 for the U.S. list of exceptions. It is also worth noting that FTA Article 2.8.4 allows a signatory to prohibit the export and import of goods from certain countries, but this applies to finished goods (ie. this allows the U.S. to continue to prohibit sales of North Korean assembled products even if they were to be sold from South Korea, subject paying the non-FTA tariff rates and despite FTA rules banning quantitative restrictions.) But, this provision, which also covers the U.S. ban on re-exporting goods exported with a dual use license, does not cover the situation described in this memo: of imports of a finished good deemed South Korea-originating but that contains inputs from North Korea. This is the relevant provision: "4. In the event that a Party adopts or maintains a prohibition or restriction on the importation from or exportation to a non-Party of a good, no provision of this Agreement shall be construed to prevent the Party from: (a) limiting or prohibiting the importation of the good of the non-Party from the territory of the other Party; or (b) requiring as a condition for exporting the good of the Party to the territory of the other Party, that the good not be re-exported to the non-Party, directly or indirectly, without being consumed in the territory of the other Party."

<sup>2</sup> Korea FTA, Art. 1.3: EXTENT OF OBLIGATIONS.

<sup>3</sup> One Korea policy expert noted that, "Some economists in South Korea have estimated that the actual cost to the North Korean economy in terms of hard currency, would be about \$200 million. Again, in Washington, that's not a big amount of money. But if you're a hard currency-starved isolated country like North Korea, that's a big chunk of money." However, this expert went onto note that Kaesong trade is "not something that's proposed to be on the chopping block right now with this current round of sanctions between North and South." "The Economic Ties Between South, North Korea," NPR, May 24, 2010. Available at: <http://www.npr.org/templates/story/story.php?storyId=127095906>

<sup>4</sup> Dick Nanto and Mark Manyin, "The Kaesong North-South Korean Industrial Complex" Congressional Research Service, Report No. RL34093, June 1, 2010, at 1.

<sup>5</sup> "The Economic Ties Between South, North Korea," NPR, May 24, 2010. Available at: <http://www.npr.org/templates/story/story.php?storyId=127095906>

<sup>6</sup> According to Department of Defense estimates, North Korea's nuclear program cost the regime as little as \$200 million to develop. See Andrew Coe, "North Korea's New Cash Crop," *Washington Quarterly*, Summer 2005, at 79. Available at: <http://www.acq.osd.mil/ncbdp/nm/docs/Featured%20Articles/North%20Korea's%20New%20Cash%20Crop.pdf>

<sup>7</sup> Dick Nanto and Mark Manyin, "The Kaesong North-South Korean Industrial Complex" Congressional Research Service, Report No. RL34093, June 1, 2010, at 12.

<sup>8</sup> Dick Nanto and Mark Manyin, "The Kaesong North-South Korean Industrial Complex" Congressional Research Service, Report No. RL34093, June 1, 2010, at 6.

<sup>9</sup> Dick Nanto and Mark Manyin, "The Kaesong North-South Korean Industrial Complex" Congressional Research Service, Report No. RL34093, June 1, 2010, at 5.

<sup>10</sup> Yoo Cheong-mo, "Prime Minister Han visits N. Korean industrial park," Yonhap News Agency, December 12, 2007, Available at: <http://english.yonhapnews.co.kr/national/2007/12/12/18/0301000000AEN20071212008600315F.HTML>

<sup>11</sup> See Vivian C. Jones and Michael F. Martin, "International Trade: Rules of Origin," Congressional Research Service Report, RL34524, March 6, 2009, at 14-15. Available at: [http://assets.opencrs.com/rpts/RL34524\\_20090306.pdf](http://assets.opencrs.com/rpts/RL34524_20090306.pdf)