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## Four Major Agreements on Inter-Korean Economic Cooperation and Legal Measures for their Implementation

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### Abstract

*This paper argues that the adoption of the four major inter-Korean agreements on economic cooperation shows that barriers to inter-Korean cooperation and building an inter-Korean economic union can be overcome through dialog and cooperation. Faithful implementation and observance of these agreements is expected to stimulate inter-Korean economic cooperation and push forward the implementation of other agreements made between the two Koreas. However, many areas in the Four Major Agreements are incomplete. Thus, there must be clarification through measures or even deletions of ambiguous clauses that could block implementation. At the same time, specific and actionable follow-up measures need to be introduced to ensure implementation.*

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### I. Introduction

In line with the historic June 15 Inter-Korean Joint Declaration, South and North Korea signed four major agreements on inter-Korean economic cooperation in December 2000. Their adoption was a critical milestone in economic cooperation as it formalized and institutionalized economic cooperation. Inter-Korean cooperation has evolved from off again, on again trial efforts at actual trade projects that are expanding both quantitatively and qualitatively. With the agreements in place, businesses involved in inter-Korean economic cooperation can now enjoy real benefits.

Despite their adoption, however, economic cooperation has not grown to the degree expected. A major reason for the lackluster performance is the nature of the agreements: they consist mainly of generalized, abstract legal regulations, and lack necessary measures for implementation. So, while the agreements were a positive rite of passage for inter-Korean economic cooperation, they will not smooth the way toward economic cooperation.

Nonetheless, the agreements have certainly provided some stability to economic cooperation between South and North Korea. In this respect, it is high time that we identify inherent issues in the four agreements on inter-Korean economic cooperation and introduce appropriate follow-up measures. Some agreements may be impossible to implement on their own, and for these, supplementary measures must be adopted immediately.

The purpose of this paper is to identify and propose follow-up measures that the South Korean government should introduce to support the four major agreements on inter-Korean economic cooperation. To this end, the legal and institutional significance and the key points of the agreements will be reviewed, and follow-up measures will be proposed necessary for further economic cooperation between the two Koreas.

## II. The Adoption of The Four Economic Cooperation Agreements: Legal and Institutional Significance

### A. Inter-Korean Agreements after the 2000 Summit

The Inter-Korean Summit of June 2000, the first since the division of the two Koreas a half-century ago, was a critical turning point in upgrading relations between the two Koreas. The South-North Joint Declaration announced at the end of the summit established the framework for reconciliation and cooperation between the two Koreas.

Article 4 of the Joint Declaration was aimed at stimulating cooperation and exchanges in civic, cultural, sports, public health, environment and other fields. Based on this agreement, there have been various efforts to implement the framework, and to realize the spirit of the Joint Declaration. Examples include reconnection of the Seoul-Shinuiju Railway, construction of the Gaesong Industrial Complex, and the Mt. Kumgang Tourism Project, all aimed at expanding and stimulating economic cooperation between the South and the North. So far, various agreements regarding inter-Korean economic cooperation have been adopted to provide legal and institutional support for economic cooperation between the two Koreas. In particular, the four agreements serve as the framework for formalizing and institutionalizing the formation of a national economic union.

Since the Inter-Korean Summit, and up to the end of August 2004, a total of 47 agreements have been reached in relation to economic cooperation.<sup>1)</sup> Agreement documents are labeled under various terms: “agreement,” “tentative agreement,” “accord” or “joint press release,” but regardless of the names, they are all aimed at implementing the Joint Declaration, and in particular, stimulating inter-Korean economic cooperation. Specifically, the term “agreement” (including basic agreement and annex agreement) was used in twenty-eight documents, “accord” in seven, and “joint press release” in twelve.

1) Joint press releases at the Inter-Korean Ministerial Talks and the Inter-Korean Defense Ministerial Talks may also be directly or indirectly related, but were excluded when counting the number of agreements. Also, appendices of agreements were excluded.

### B. Adoption of the Four Agreements

Article 4 of the South-North Joint Declaration stipulates “promoting balanced development of the national economy through economic cooperation.” Two rounds of working-level talks were held to establish an institutional mechanism for economic exchange and cooperation (Seoul in September 2000; and Pyongyang in November 2000). On November 11, 2000, the two Koreas adopted and tentatively signed four major agreements on inter-Korean economic cooperation (hereafter the Four Major Agreements): the Agreement on Investment Protection between the South and the North; the Agreement on Clearing Settlement between the South and the North; the Agreement on Prevention of Double Taxation of Income between the South and the North; and the Agreement on Procedures for Resolution of Commercial Disputes between the South and the North.

At the 4th Inter-Korean Ministerial Talks held in Pyongyang on December 16, 2000, chief delegates from the two Koreas formally signed the four agreements. However, introducing follow-up measures to provide a legal basis for the four agreements was a challenge. Progress was slowed by differences between various South Korean government agencies, not to mention between the two Koreas. After little progress, the South Korean government finally decided to treat the agreements as treaties. After heated discussion at the South Korean National Assembly, they were finally ratified on June 30, 2003. Meanwhile, the four agreements appear to have been approved by the Presidium of North Korea’s Supreme People’s Assembly on July 24, 2003.<sup>2)</sup> After written copies of the agreements were exchanged at Panmunjom on August 20, they officially took effect.

### C. Legal and Economic Significance of the Four Major Agreements

What is noteworthy about the Four Major Agreements is that the South Korean government, for the first time, considered them as “treaties” in order to give them legal status. This new approach becomes clear when the agreements are compared with another agreement: the Agreement on Reconciliation, Nonaggression, and Exchanges and Cooperation between South and North Korea (Basic Agreement)

2) Ministry of Unification, “Status Report” (the report submitted for the 2003 National Assembly’s inspection of government offices), p. 49.

signed in 1992. After signing the Basic Agreement, the South Korean government did not obtain consent from the National Assembly. Also, considering the Basic Agreement as a type of a joint declaration or a gentlemen's agreement, the Constitutional Court did not recognize its legal validity. Therefore, the government's approach to the four agreements differs from that in the past.

The different approach led to questions as to whether the Four Major Agreements can be regarded as treaties, as defined in Paragraph 1, Article 6 of the Constitution of the Republic of Korea, and if they can be treated as treaties, whether (1) parliamentary approval, as stipulated in the Constitution, is required, and (2) whether a treaty between South and North Korea violates Article 3 (on territory) of the Constitution. After considering various aspects of the matter the government finally decided to treat the Four Major Agreements as treaties ("special treaty," type 1 of the treaties stipulated in Paragraph 1, Article 6 of the Constitution).<sup>3)</sup> Such a decision was epochal, especially from a legal point of view, as it meant that at least on economic cooperation, inter-Korean relations would now be recognized within a legal and institutional framework.<sup>4)</sup>

Meanwhile, the adoption of the Four Major Agreements is meaningful as the first example of an institutional framework on inter-Korean economic cooperation that had been agreed to between the two Koreas through consultations. Even prior to the agreements, South and North Korea had concurred on the principles of economic cooperation but had not introduced an institutional mechanism jointly governed by the two Koreas. Therefore, the Four Major Agreements are the first concrete attempt to overcome fixed ideas and approaches to inter-Korean economic cooperation.

In addition, the four agreements provide an institutional mechanism to support inter-Korean economic cooperation in the private sector, which is already underway, bolstering those efforts.

Furthermore, they provide a stable framework that takes into account the

3) The premise for this is to identify the legal nature of inter-Korean relations and determine whether North Korea can be recognized as having the ability to sign a treaty. The South Korean government, according to international law, does not recognize North Korea as a nation, but as a political entity constituting one part of a divided nation. In relation to an inter-Korean treaty, the South Korean government appears to have taken the position that it recognizes North Korea as being eligible to sign a treaty.

4) Jhe Seong Ho, "Legal validity of inter-Korean agreement in South Korea: In view of a treaty recognized by international law and considering its relations to the Constitution of Korea", *Beopjo*, Vol. 53-4 (No. 571) April 2004, pp. 79-85

extraordinary situation of South and North Korea and their significantly different systems vis-à-vis international practices, setting the stage for future agreements between the two Koreas.

### III. Legal and Institutional Follow-Up Measures

#### A. Additional Legal Implementation after the Four Major Agreements

Consent by the National Assembly is required to give legal validity to inter-Korean agreements related to the people's rights and duties (Article 6 and Article 60 of the Constitution).<sup>5)</sup> The announcement of the 1992 Basic Agreement was followed by various agreements on military and economic affairs, but the agreements themselves were not ratified according to domestic law. The South Korean government, as well as the Supreme Court and the Constitutional Court, simply considered them as gentlemen's agreements.

However, the four agreements on inter-Korean economic cooperation signed in December 2000 were treated differently. If they were not treated as "treaties" (i.e., legally guaranteed as South Korean domestic laws), it would be impossible to provide legal rights or benefits to South Korean businesses operating in the North.

Through consultations with the North, the South Korean government decided to recognize them as treaties and in June 2003, moved to seek parliamentary consent.<sup>6)</sup> It should be noted that although the Four Major Agreements were recognized as

5) The Constitution of Korea, Article 6-(1): "Treaties duly concluded and promulgated under the Constitution and generally recognized rules of international law have the same effect as domestic laws of the Republic of Korea." Article 60-(1) "The National Assembly has the right to consent to the conclusion and ratification of treaties pertaining to mutual assistance or mutual security; treaties concerning important international organizations; treaties of friendship, trade and navigation; treaties pertaining to any restriction in sovereignty; peace treaties; treaties which will burden the State or people with an important financial obligation; and treaties related to legislative matters."

6) The four agreements on inter-Korean economic cooperation were jointly submitted by the Ministry of Unification and the Ministry of Foreign Affairs and Trade, and approved by the National Assembly, as in June 2003 when the agreement was established a government agency was not appointed to oversee the agreements with the North. Therefore the agreements were jointly submitted by the Ministry of Unification, involved in forming agreements with North Korea and the Ministry of Foreign Affairs and Trade, governing the signing of international treaties.

treaties, they are different from other general treaties established with sovereign nations and should be regarded as special treaties “recognizing that their relationship, not being like a relationship between states, is a special one instituted as a temporary measure in the process of unification.”(Preamble of the 1992 Basic Agreement)

Following the adoption of the Four Major Agreements, others requiring legal validation under South Korean domestic law were established. Examples include, the Agreement on Motor Vehicle Operations (adopted on December 6, 2002), the Agreement on Customs Clearance at the Kaesong Industrial Complex (adopted on December 8, 2002), the Agreement on Quarantine (adopted on December 8, 2002), the Agreement on the Formation and Operation of a Commercial Arbitration Commission (adopted on October 12, 2003), and the Agreement on Entry/ Departure Procedures and Duration of Stay in Kaesong Industrial Complex and Mt. Kumgang (adopted on January 29, 2004). Recognizing the need to validate the above five agreements, the South Korean government completed the examination by the Ministry of Legislation (July 15, 2004), held a deputy ministerial meeting (July 22), obtained a Cabinet Council resolution (July 27), obtained presidential approval (August 3), forwarded the proposal to the National Assembly (August 5), and within a short period, these inter-Korean agreements would become effective under domestic law.<sup>7)</sup>

### *B. Follow-up Measures to the Agreement on Investment Protection*

The contents of the Agreement on Investment Protection between South and North Korea are similar to investment protection agreements normally signed between states.<sup>8)</sup> By adopting the agreement the two Koreas were able to remove

7) The Agreement on Telecommunications at Gaeseong Industrial Complex, the Inter-Korean Marine Transportation Agreement, and the Annex Agreement Inter-Korean Marine Transportation, which were examined by the Ministry of Government Legislation and the Agreement on Train Operation reached on July 30, 2004, and was forwarded to the National Assembly in early September.

8) Normally, the purpose of establishing an investment protection agreement is to establish a legal mechanism that protects investors from non-commercial risks by protecting investment between the two nations entering the agreement. Non-commercial risks include nationalization and expropriation by the government attracting investment, investment loss resulting from armed conflict, restrictions on overseas remittance, and sterilization. Investment protection agreements only stipulate the obligations of the country attracting investment and not those of

the uncertainties associated with investing in North Korea, and lay the foundation for stable investment. Currently North Korea is not a member of the World Trade Organization (WTO), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), the International Centre for Settlement of Investment Disputes (ICSID) or any other international organization or agreement related to promoting or protecting investment or settling disputes. To mitigate this risk, the Agreement protects South Korean investments (principals and profits), guarantees lost remittances, enables compensation for nationalization and expropriation and offers a mechanism for settlement of disputes, thus making it possible for South Korea to work outside the domestic laws of North Korea.<sup>9)</sup> The Agreement on Investment Protection went into effect immediately, without implementation of any other measures, once written copies of the agreement were exchanged between the governments of South and North Korea.

Despite the Agreement, investing in North Korea entails significant political risks. It is still possible for North Korea to carry out disguised or creeping nationalization.<sup>10)</sup> Therefore, the Agreement should be revised and amended to include various measures against excessively heavy taxation equivalent to confiscation, and forced sell-offs of shares or other measures that could have the same impact as an expropriation or nationalization. Such revisions would prevent North Korea from taking arbitrary actions.<sup>11)</sup> Measures should also protect investment by restricting expropriation or nationalization for a set period after investments are made.

Furthermore, it is desirable to include in the Agreement on Investment Protection, provisions on employment protection of foreign workers, guarantee of various commercial activities, protection of advanced investment and continuance

the investing country or investors. Lee Sang-Hoon, “Legal Aspects of the Agreement on Inter-Korean Economic Cooperation”, *Beopje*, No. 552 (December 2003), p. 68.

9) Full text of the agreement in English is posted at [[http://www.unikorea.go.kr/en/library/library.php?page\\_code=ue0501&ucd=eng0204&ewn\\_num=64&mode=view&ispr=1](http://www.unikorea.go.kr/en/library/library.php?page_code=ue0501&ucd=eng0204&ewn_num=64&mode=view&ispr=1)].

10) ‘Creeping nationalization’ refers to a situation in which discriminatory regulations are applied to a foreign investor to weaken business performance and ultimately make the investor give up the business. Earl Snyder, “Protection of Private Foreign Investment: Examination and Appraisal”, *International and Comparative Law Quarterly*, Vol. 10 (1961), p. 472.

11) Martin Domke, “Foreign Nationalization: Some Aspects of Contemporary International Law”, *Selected Readings on Protection by Law of Private Foreign Investments* (New York: Matthew Bender & Co., 1973), p. 310.

of the effect of the agreement.<sup>12)</sup> In regard to settling investment disputes, third-party intervention and review by the ICSID Convention should be options.

Since North Korea's legal regulations on attracting foreign investment are neither specific, nor transparent, the South Korean government should consult closely with businesses who want to establish investment contracts with the North. In particular, it should develop a model for inter-Korean joint investment contracts that can be used by businesses to ensure profitability. In this respect, it is important to include in the Agreement provisions on settlement of disputes and force majeure. Furthermore, it may also be worthwhile to consider introducing guidelines on investment-dispute settlement, which can be applied to any dispute arising between the two Koreas.

With the Agreement on Investment Protection in force, now is the time to introduce a loss coverage program against non-commercial risks, as defined in Article 5 of the Provision on the Employment and Management of the Inter-Korean Cooperation Fund (In May 2004, the South Korean government introduced a loss coverage program by amending the Enforcement Rule of the Act on Inter-Korean Cooperation Fund). Through consultations with the North, a method to identify losses incurred through non-commercial factors should be determined, and detailed regulations and provisions adopted. In addition, regulations should be amended so as to recognize investment assets in North Korea as collateral for loans from the inter-Korean cooperation fund, while seeking to exchange information on laws governing investment and taxation.

### *C. Follow-up Measures to the Agreement on Clearing Settlement*

The Agreement on Clearing Settlement between the South and the North<sup>13)</sup> enables South Korean businesses to save time and money by directly making

12) That is, to keep an agreement in force on investments made prior to the termination of the agreement. Jhe Seong-Ho, "Protection of North Korean Investment and Settlement of Disputes", Research Report 93-09 (Seoul: Korea Institute for National Unification, 1993), p. 97-136; Moon Joon Jo, "Investment Protection between South and North Korea", Ministry of Unification, "1994 Comprehensive Expert Review on Economic Exchange and Cooperation", Preliminary Summit Material, 94-12-60 (Seoul: Secretariate for Inter-Korean Summit, Ministry of Unification, 1994) p.21-44.

13) See URL: [http://www.unikorea.go.kr/en/library/library.php?page\\_code=ue0501&ucd=eng0204&ewn\\_num=63&mode=view&ispr=1](http://www.unikorea.go.kr/en/library/library.php?page_code=ue0501&ucd=eng0204&ewn_num=63&mode=view&ispr=1).

settlements through clearing settlement banks designated by the South and the North, without having to go through a third-party bank. Also, as businesses supplying goods to the North can now collect payments immediately through the Clearing Settlement Banks, collection risks have been significantly reduced and inter-Korean trade is expected to grow at a faster pace.

The original Clearing Settlement Agreement merely defined the basic principles, which made it necessary to later agree on the details. In order to complement the agreement, the two Koreas produced the 2004 Agreement on Clearing Settlement between the South and the North, and tentatively signed it at the Third Meeting of the Working-Level Talks for Inter-Korean Clearing Settlement, held on April 20-22, 2004 (As of August 31, 2004 this agreement has not been formally signed). A more specific institutional mechanism for clearing settlement between the South and the North has been established with the adoption of the above Agreement, but many issues still need to be resolved between the two Koreas, with matters examined more thoroughly and additional follow-up agreements reached.

Most importantly, the two Koreas have agreed to apply clearing settlement to goods that originate from the South or the North (commissioned processing excluded) and will agree on the scope of application later, through exchange of documents. In defining the scope of the clearing settlement, it is likely that the positive-list approach will be used first, moving to the negative list afterwards.

Setting a credit line could be based on quantity, value or a combination of both. At present, the two Koreas have agreed to set a credit line based on value, but once clearing settlement becomes widespread, a combination of methods would be preferable. In any case, the transaction price must be decided between the contracting parties based on international market prices.<sup>14)</sup>

Three preliminary steps are necessary to enable clearing settlement: a system between clearing settlement banks to enable mutual recognition and settlement must be established, a settlement network such as SWIFT must be connected and a cooperation system for currency transaction agreements must be implemented.<sup>15)</sup> Article 7 of the Clearing Settlement Agreement stipulates that the clearing

14) Ryu Seung Ho, "The Effect of Introducing a Clearing Settlement Mechanism between the South and the North", p. 48.

15) *Ibid*, p. 52

settlement banks designated by the South and the North, respectively, shall by mutual agreement determine the settlement procedures and methods for implementing the Agreement, but such an agreement is yet to be reached, which means that clearing settlement between banks is currently on hold. The clearing settlement banks designated by the South and the North should expedite a final agreement on settlement procedures and methods, including the scope of the clearing settlement, the clearing settlement period, cost coverage, refusal of payment, and calculation of interest, so that the Agreement can be formally signed.<sup>16)</sup>

Meanwhile, special efforts to balance clearing settlement with existing inter-Korean trade practices should be made to ensure successful implementation of inter-Korean clearing settlement. In the early 1990s, when the idea of introducing clearing settlement was first discussed, adopting such a mechanism did not seem to be a problem since trade between the two Koreas was insignificant. Now, however, with increased trade, at a much larger scale, trade practices are already firmly in place. Therefore, it is critical to identify ways to balance the newly introduced clearing settlement with existing trade practices, and this necessitates collecting the views of relevant industries while setting up a mechanism for arbitration.

In addition, clearing settlement should be focused on creating trade. Instead of trying to replace existing transactions, clearing settlement should be aimed at creating new demand to increase trade volume while minimizing impact on existing transactions. New demands should be generated in areas such as resource development which have the potential for increased trade.

In practice, clearing settlement, which is a special form of controlled trade, is in some ways inappropriate for recent trends in global economic development mainly

16) At the third meeting of the working-level council for inter-Korean clearing settlement, held from April 20 to 22, 2004, the Clearing Settlement Banks came close to reaching an agreement on the scope, period and cost coverage but decided to continue discussions on refusal of payment and calculation of interest. Ministry of Unification, "Press Release at the Third Meeting of the Working-level Council for Inter-Korean Clearing Settlement", April 22, 2004. A consensus on overall procedures and methods for clearing settlement, including interest rates, work flow, processes and entry into force, is said to have been reached later between the Clearing Settlement Banks at a working-level contact meeting, but specific details have not been disclosed. "The Export-Import Bank of Korea and Chosun Trade Bank reach an agreement on inter-Korean clearing settlement: the agreement to enter into force once formally signed by the South and the North", *Yonhap News*, June 27, 2004.

based on free trade. Since Article VIII of the Articles of Agreement of the International Monetary Fund prohibits government intervention in currency payments for goods or services, clearing settlement can be in conflict with the IMF Articles of Agreement. At present, South and North Korea are treating inter-Korean trade as internal transactions within a nation, which is not subject to international regulations, but in the long term it will be necessary to secure concordance between the special characteristics of inter-Korean trade within the framework of international regulations. Therefore, once trade between the two Koreas stabilizes, efforts should be made to reduce clearing settlement while gradually introducing common settlement schemes.<sup>17)</sup>

#### *D. Follow-up Measures to the Agreement on Procedures to Resolve Inter-Korean Commercial Disputes*<sup>18)</sup>

In the course of inter-Korean economic cooperation, one of the main concerns of an investor will be resolving disputes, i.e., how, by whom, and under which laws. Recently, disputes arising from international trade or investment have been resolved through commercial arbitration rather than litigation; therefore, with the agreement on procedures to resolve inter-Korean commercial disputes, the two Koreas have established the basic foundation for expanded economic cooperation.

The most urgent follow-up measure needed to support the Agreement is organizing an inter-Korean commercial arbitration commission, and establishing relevant internal regulations. Also, a list of arbitrators must be exchanged and, in the mid-and long-term, efforts should be made to encourage North Korea to join the International Arbitration Agreement. The following are some follow-up measures that should be taken:

##### 1. Formation of an Inter-Korean Commercial Arbitration Commission

According to Paragraph 1, Article 2 of the Agreement on the Formation and

17) Ryu Seung Ho, "The Effect of Introducing a Clearing Settlement Mechanism between the South and the North", p. 54.

18) See URL: [http://www.unikorea.go.kr/en/library/library.php?page\\_code=ue0501&ucd=eng0204&ewn\\_num=65&mode=view&ispr=1](http://www.unikorea.go.kr/en/library/library.php?page_code=ue0501&ucd=eng0204&ewn_num=65&mode=view&ispr=1).

Operation of a Commercial Arbitration Commission, the chairman and members of the commission from the South Korean side are to be selected through consultations with relevant agencies. The agencies likely to be involved in the selection process are the Ministry of Unification, the Ministry of Justice, the National Intelligence Service, and the Secretariat of the National Security Council.

Then, based on Paragraph 4, Article 14, the South Korean government is required to follow up the Agreement by organizing a South Korean arbitration commission immediately. For this, a decision has to be made whether that commission will consist only of government officials or include civilian experts. Such questions are critical legal and policy decisions the South Korean government must make to stimulate inter-Korean economic cooperation. Citing an example, the joint representative scheme stipulated in Clause 3, Article 2 of the Agreement is based on the assumption that the respective committee chairmen from both sides reach a consensus. Consequently, if the chairmen fail to reach a consensus, the arbitration commission could be powerless to act. The Agreement should therefore be amended to include a provision to prevent this from occurring.

## 2. Operational Procedures and Venue for the Arbitration Commission

Article 5 of the Agreement on the Formation and Operation of a Commercial Arbitration Commission outlines the operation of the commission and basically stresses that operation shall be based on mutual consent between the two Koreas. Therefore, as a follow-up measure to the Agreement, the South Korean government should work with the North to agree on matters concerning operation of the commission.

Nonetheless, what happens if South and North Korea fail to reach an agreement? After all, it is unrealistic to expect that the two Koreas will iron out their differences on every issue. Once the commission actually begins operating, it is most important to anticipate such events. In particular, Agreement provisions are sometimes confusing: While a commission meeting requires a consensus, ruling on a case requires a majority (Article 13). Incongruities like this must be amended.

Article 6 of the Agreement on the Formation and Operation of the Commercial Arbitration Commission calls for chairmen of both parties to agree on the venue for the meetings, but it does not anticipate failure to reach an agreement.

Therefore, the Agreement should be amended to include a clause stating that if the chairmen fail to reach a consensus on the venue, the meetings would be held at a certain location, for instance Panmunjom.

## 3. Cancellation of the Arbitration Commission

Article 8 of the Agreement on the Formation and Operation of a Commercial Arbitration Commission states that canceling an arbitration decision requires a consensus, and it stipulates that a request for cancellation will be dismissed if a consensus is not reached. Based on such a regulation it is doubtful whether an existing arbitration decision can be cancelled by consensus as it is unlikely that the opposing parties from the South and the North (in other words, one party in favor of the arbitration decision and the other party against the decision) will easily come to an agreement. Further, if such an agreement can be reached, serious questions can be raised about whether Clause 2 (initiation of a new arbitration process) of Article 8 is necessary. If the intention is truly to enable a decision to be cancelled, the Agreement should instruct a request to be made to an international arbitration court.

## 4. Operation and Secretariat of the Arbitration Commission

Article 9 of the Agreement guarantees (1) the activities of the commission, (2) the security of the chairmen and members of the commission and other relevant people, (3) immunity of the commission and its assets, (4) immunity of the chairmen and members of the commission and other relevant people, (5) attendance of the parties concerned, proxies, witnesses, and appraisers.

Article 10 of the Agreement on the Formation and Operation of a Commercial Arbitration Commission stipulates (1) the designation of a secretariat for arbitration affairs, (2) its role, (3) non-violation of the secretariat's documents. The "secretariat for arbitration affairs" refers to an organization that preserves and holds various documents such as arbitrators list, qualifications of the arbitrator and original copies of arbitration decisions. Following this provision, the South Korean government should take legal steps as soon as possible to designate a secretariat for arbitration affairs. Once an arbitration commission for South Korea is organized, it is likely that the commission will (through close consultations with

relevant agencies) designate a secretariat. Most likely the Korean Commercial Arbitration Board will be designated as the secretariat for the South Korean side as it has expertise and extensive experience in this field.

### 5. Setting Arbitration Rules

Article 3 of the Agreement on the Procedures to Resolve Inter-Korean Commercial Disputes stipulates arbitration rules to be set at the Commercial Arbitration Commission through mutual agreement between the two Koreas. Using the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL), the International Centre for the Settlement of Investment Disputes (ICSID), and the Korean Commercial Arbitration Board, arbitration rules should be proposed, reflecting the unique relationship between the South and the North.<sup>19)</sup> In relation to this, Clause 4, Article 14 of the Agreement on the Formation and Operation of a Commercial Arbitration Commission stipulates that a draft of arbitration rules is to be exchanged within six months of the Agreement taking effect.

#### *E. Follow-up Measures to the Agreement on Prevention of Double Taxation of Income*

As South and North Korea's tax systems are quite different, there is the potential for double taxation of income generated from inter-Korean economic cooperation. Jurisdiction on taxation, which causes double taxation, can be disputed mainly in three situations: First is the conflict of residence jurisdiction, which can arise because the two Koreas use different criteria to distinguish a

19) In preparing the proposal, not only advanced expertise such as years of experience in international commercial arbitration but also the unique situation of inter-Korean relations, common types and characteristics of commercial dispute between the South and the North, potential for resorting to arbitration in the event of a dispute between the two Koreas and the possible contribution of arbitration should be considered. For details on a proposal for inter-Korean commercial arbitration rules, refer to Chang Seung Hwa, "Key Issues and Direction of Setting the Rules for Inter-Korean Commercial Arbitration", and the Ministry of Unification, "The Direction for Resolving Potential Commercial Disputes in Inter-Korean Economic Cooperation", Materials for the 23rd Seminar of the Special Committee for the Study of South and North Korea's Statutes, (June 28, 2004), pp. 7-66.

native corporation from a foreign corporation. Second, is the conflict of source-of-income jurisdiction. Third is the conflict between residence jurisdiction and source-of-income jurisdiction. However, by adopting the Agreement on Prevention of Double Taxation of Income, a framework has been put in place to prevent it and to allay the fears of prospective investors regarding double taxation.<sup>20)</sup>

Overall, the Agreement follows the format of the UN Model Tax Convention and its contents are aimed at promoting investment in North Korea by reducing the tax burden of South Korean companies. However, the Agreement assumes that the process will always go smoothly, which is not the reality. In the event of a dispute, the Agreement directs the parties to reach a consensus on the objection, but it is doubtful whether a consensus can be reached every time. Furthermore, the Agreement does not provide a contingency plan in the event a consensus cannot be reached, raising the need to amend the Agreement to include such a provision.

Although not an essential follow-up measure to the Agreement, it is also worthwhile considering the issue of internal trade within a nation and the value-added tax. The Enforcement Decree of the Act on Inter-Korean Exchange and Cooperation treats goods and services supplied to the North as export goods and services provided overseas (Clause 3, Article 51 of the Enforcement Decree) and applies a zero-percent value-added tax rate on goods and services supplied to the North. Meanwhile, goods and services from North Korea fall under the Value Added Tax Act. In the case of goods, a value-added tax is to be collected by the customs director in reference to the appropriate rate list, and in the case of services Article 34 of the Value Added Tax Act is to be applied (Clause 1, Article 51 of the Enforcement Decree). It is unclear whether this provision on levying a value-added tax regards the entry of goods and services from North Korea as overseas trade or domestic trade. However, considering that Clause 1-2, Article 53 of the Enforcement Decree stipulates that supplying goods and services to North Korea is export or commerce to earn foreign money, while the entry of goods from the North is not considered as import, it is clear that import from and export to the North is treated differently from import and export with other countries.

However, if goods out are exports, goods in should be considered imports, and

20) See URL: [http://www.unikorea.go.kr/en/library/library.php?page\\_code=ue0501&ucd=eng0204&ewn\\_num=66&mode=view&ispr=1](http://www.unikorea.go.kr/en/library/library.php?page_code=ue0501&ucd=eng0204&ewn_num=66&mode=view&ispr=1).



conversely, if goods in are not import then goods out should not be treated as exports. In other words, in the latter situation goods in and out are totally internal trade, and therefore, goods and services provided to the North become subject to a value-added tax. In this event the business operator (not the end user) in North Korea will not be able to receive a deduction on the sales tax, raising the price of the goods or services provided to the North. This appears to be the reason the Enforcement Decree of the Action on Inter-Korean Exchange and Cooperation treats goods out as exports and applies a zero percent tax rate. However, such an approach goes against the recent trend of regarding inter-Korean economic exchange as internal trade within a nation, so it would be preferable to declare in the Act on Inter-Korean Exchange and Cooperation that economic exchanges between the two Koreas be regarded as internal trade within a nation, and then try to resolve issues on taxes including value-added tax through relevant tax laws such as the National Tax Act. Also, the tax laws should have provisions to treat inter-Korean trade as exceptions.

In the case of a value-added tax, levying a significantly lower tax rate on goods and services supplied to North Korea--as the former West Germany did in the past--would be one way to treat inter-Korean trade as internal trade within a nation. Meanwhile, on customs, Clause 2, Article 26 of the Act on Inter-Korean Exchange and Cooperation stipulates that the Customs Act or any other legal regulation on levying a tax on imports does not apply to goods from the North. The Enforcement Decree of the Act also states that the levies, collections, reductions and tax refunds on goods in or out is not applicable (Clause 3-1, Article 50 of the Enforcement Decree). In other words, unlike the regulation on value-added tax, the Enforcement Decree treats the trade of goods originating from the North as domestic trade and does not impose a duty or any other import tax.

#### IV. Conclusion

The adoption of the four major inter-Korean agreements on economic cooperation demonstrates that barriers to inter-Korean cooperation and building an inter-Korean economic union can be wisely overcome through dialog and cooperation. The faithful implementation and observance of the Four Major Agreements is expected to have a positive effect, not only in stimulating inter-

Korean economic cooperation, but also pushing forward the implementation of other agreements made between the two Koreas.

Many areas in the Four Major Agreements are incomplete, however, calling for clarification through measures or even deletions of ambiguous clauses that could cause snags in the course of implementation. At the same time, specific and actionable follow-up measures must be introduced to enable actual implementation of the agreements.

For instance, of the Four Major Agreements, the Agreement on the Procedures to Resolve Inter-Korean Commercial Disputes and the Agreement on the Formation and Operation of a Commercial Arbitration Commission are ultimately aimed at peacefully resolving disputes, so it is necessary to clearly define the methods and procedures for concluding the resolution. The two agreements call for a conclusion to be reached through consent between the involved parties. While such an approach seems reasonable on the surface, it actually raises many problems. In reality, arbitration in commercial disputes inevitably favors the home country's interests, and especially considering the unique dynamic between the two Koreas, it is likely that most disputes will end in conflict or confrontation rather than a consensus. Therefore, a realistic alternative is needed in the event the parties fail to reach an agreement.

Also, while the Agreement on Prevention of Double Taxation of Income between the South and the North stipulates the scope and method for imposing taxes and includes provisions to promote investment into North Korea, it only vaguely states that objection petitions should be resolved through an agreement between the South and North Korean authorities. In other words, there is no other means to resort to if an agreement is not reached.

Overall the four major agreements on inter-Korean economic cooperation do not pose any serious hurdles, but issues such as legalities or missing institutional mechanisms could arise in the course of actual implementation. In particular, the agreements should provide alternative plans in the event consensus cannot be reached on conflicting issues.

Furthermore, to ensure the successful construction of the Kaesong Industrial Complex, international regulations such as the Wassenaar Arrangement should be taken into consideration while trying to resolve issues concerning offering collateral for funding required for the construction of plants in the area. Also a comprehensive agreement on inter-Korean telecommunications and passage is

needed to stimulate inter-Korean economic cooperation following the signing of the Agreement on the Entry/Departure Procedures and Duration of Stay in Kaesong Industrial Complex and Mt. Kumgang. After identifying these issues, South and North Korean authorities must move to establish follow-up measures and agreements.

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## Analysis of the North Korean Invention Act

*Yoon Hee Kim\**

### Abstract

*This article conducts an overview of the new Invention Act of North Korea and offers critical comments. North Korea is realistically establishing the recovery of its economy as a national issue, and is establishing and putting into practice systematic defense strategies for economic development. The “powerful and prosperous country” theory being pursued by the Kim Jong Il regime has prioritized economic development as a means for preserving the system. Among these, economic improvements and development are being emphasized via enhancement of science and technology. Guidelines for the close integration of the economy and science and technology were indicated as one of the means to continuously implement the 5-year (2003-2007) Science and Technology Plan newly presented in the National Science & Technology Congress held in Pyongyang on October 31, 2003. While adhering to the principles of socialism, policies for improvement of economic management that pursue the maximum benefit are being applied to the science and technology field.<sup>1)</sup> The Invention Act was newly promulgated, and this appears to be part of the movement deciding to adopt the Science and Technology Act in the regular meeting of the Supreme People’s Council on December 15, 1988. This is thought to be a necessary stage for economic recovery.*

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1) <http://korea-np.co.jp/news/ViewArticle.aspx?ArticleID=7445> According to the Chosun News, on January 21, 2004, the Internet Chosun News quoted the January 18th Article of the Pyongyang News on the 22nd : “A system