

SOUTH KOREA SPECIAL FOCUS
NORTH KOREA

A global partner in the making?

Sung Taek Lim and Hee Suk Chai, Jipyong LLC

Many believe that the recent reforms and market opening and liberalisation in North Korea (Democratic People's Republic of Korea – DPRK) represent a sudden change. They believe that North Korea, unable to withstand the effects of economic sanctions, has capitulated to the pressures of the international community and instituted these changes as a result. However, in considering the laws enacted and amended by North Korea under Kim Jong Un, especially ones related to the economy, it appears that North Korea's recent reforms and market opening and liberalisation are the result of a long-term plan by the state. At the end of 2011, which marks the start of Kim Jong Un's era, 14 pieces of legislation related to the economy were enacted or extensively amended. This happened against the backdrop of Kim Jong Il's death on December 17 2011. The fact that an extensive overhaul of the economic legal structure was instituted amid the turmoil and confusion surrounding Kim Jong Il's death evidences the new regime's acknowledgement of the pressing need for economic reform and market opening and liberalisation in the North Korean market.

The laws that have been enacted or amended since the start of Kim Jong Un's regime generally fall into one of the following categories: (i) laws that bolster the autonomy of enterprises, (ii) laws that implement changes in the financial system, and (iii) laws aimed to modify the foreign investment framework. It appears that North Korea is looking to boost its economy's efficiency by strengthening the autonomy of enterprises and adopting certain free market elements in its financial system, while also attempting to supplement its lack of funds by modifying the foreign investment framework. In reviewing important North Korean laws that promote economic growth, including those that have been enacted or amended during Kim Jong Un's regime, we are able to assess the direction of the recent reforms and market opening and liberalisation policies.

The reliability of North Korea's legal system

If little importance is placed on the North Korean legal system and North Korean laws and legal processes are not relied on, the North Korean legal

JIPYONG JIPYONG LLC

www.jipyong.com



Sung Taek Lim

Partner, Jipyong LLC
Seoul, South Korea
T: +82 2 6200 1746
E: stlim@jipyong.com
W: www.jipyong.com

About the author

Sung Taek Lim is the partner in charge of the litigation practice group at Jipyong. He is an experienced, skilled litigator renowned for his work on high-profile and complex cases in various areas including real estate, intellectual property, information and communications, finance and securities, fair trade, and employment and labour. He is an expert on North Korean law and currently serves as legal advisor to the Gaeseong Industrial Complex and as Civilian Committee Member to the Ministry of Unification. He has been singled out as the foremost authority on North Korean law and issues by influential domestic and international publications alike.

Sung Taek serves as executive director of the North Korea Investment Consulting Center at Jipyong, a first-of-its-kind consulting body that aims to be the one-stop destination for assisting foreign investors interested in investing in North Korea. He is active in public service matters and devotes substantial efforts and time to assist the disabled and the socially disadvantaged.

system, which has undergone continuous modifications, cannot be relied on to have accurately reflected the actual changes taking place in North Korean society.

Like other socialist countries, North Korea dismissed systems of laws as mere governing methods employed by the bourgeoisie to suppress the working class. However, the importance and necessity of laws in maintaining social order was recognised and in 1992, North Korea amended the Constitution



Hee Suk Chai

Partner, Jipyong LLC
Seoul, South Korea
T: +82 2 6200 1757
E: hschai@jipyong.com
W: www.jipyong.com

About the author

Hee Suk Chai is a partner in the finance practice group and the resources, energy & infrastructure practice group at Jipyong. He advises private equity funds (PEFs), financial institutions and public and private energy companies. As a pioneer in the area of PEFs, Hee Suk took part in the development of the Korean PEF system and has co-authored the much-acclaimed "Introduction to Private Equity Funds", the first legal commentary on PEFs in Korea. He is known for his creative transaction structuring and commercial insight among numerous clients in the dynamic and rapidly-changing field of PEFs.

Hee Suk has extensive experience in the area of energy M&A transactions, renewable energy regulations and resource development. He is also known for his expertise in the capital markets, including the listing of foreign companies in Korea, structuring of novel financial products and investments in overseas funds. In 2013, Hee Suk became the first Korean attorney to be admitted to the Russian Bar and currently serves as Expert Advisor (energy sector) to the Presidential Committee on Northern Economic Cooperation, whose focus is to foster economic opportunities in the Eurasian region. He has keen interest in North Korea, and as an expert on North Korean law, he serves as a management member of the North Korea Investment Consulting Center at Jipyong.

and proclaimed the principle of Socialist Law-Abiding Life, which can be interpreted as North Korea's version of the rule of law principle. At around this time, an extensive reorganisation of the North Korean legal system, including amendments to the Civil Law, occurred. While it is hard to say that the North Korean legal system upholds the rule of law in the same way as legal systems in developed nations, these developments seem to show that North Korea offers a legal system that assures some measure of reliability and stability.

Autonomy for enterprises

North Korea does not recognise private enterprises, so all enterprises are deemed state-owned enterprises (SOEs). Beyond the issue of ownership, enterprises are functionally the state's subordinate agencies which are assigned manufacturing work according to the state's needs under its planned economy. Hence, enterprises must be operated according to the

The amended Enterprise Act develops enterprise autonomy and promotes the socialist enterprise responsibility management system

state's central planning needs and their autonomy is not recognised.

However, as in other socialist states, severe inefficiencies related to SOEs have become apparent. Also, due to the lack of the state funds resulting from longstanding economic sanctions against North Korea, it proved impossible to operate each enterprise by including it in the state's central planning strategy. As a response to this reality, North Korea revised the Enterprise Act in November 2014 and again in May 2015 to extensively expand the autonomy of enterprises.

The amended Enterprise Act develops enterprise autonomy and promotes the socialist enterprise responsibility management system,

by which each enterprise is responsible for its own operations (Enterprise Act, article 29). Also, a planning right that is independent of the state's central planning strategy is given to each enterprise under the amended law. In terms of the statistics that measure financial performance, the enterprise index has been introduced alongside the national index (article 31). Moreover, introducing another important change from the previous law, enterprises have been given independent rights in relation to their operations, including, among others, the right to manage production teams and production processes (article 32) and the right to manage labour (article 33).

Most significantly the trade and joint-venture rights that were exclusively given to state trading companies previously are now

Financial system change

Like other socialist countries, North Korea first adopted a mono-banking system in which the central bank performed the work of commercial banks. This centralised banking system was comprised of (i) the Central Bank of the DPRK, which handles domestic transactions, and (ii) the Foreign Trade Bank of the DPRK, which handles foreign transactions. With the enactment of the Central Bank Law in 2004 and of the Commercial Banking Law in 2006, however, North Korea attempted to introduce a two-tier banking system, like those found in capitalist countries, to separate the central and commercial banks. Unfortunately, due to the financial hardship resulting from economic

Protecting underground resources

North Korea is rich in underground resources, and the interest in such resources is high among foreign investors. However, North Korea recently reorganised its regime relating to underground resources to restrict exploitative development or resource export. The Mineral Resources Act, as amended in February 2013, elevates the status of the regulatory authority in charge of underground resources and introduces stricter procedures for, among others, inspection, approval and construction related to the development of underground resources (Mineral Resources Act, articles 17, 18 and 20).

Also, the Law on Equity Joint Venture, as amended in 2014, prohibits and restricts the export of unprocessed natural resources by equity joint-ventures. This measure is a common strategy found in transition economies such as China and post-economic-sanction nations such as Myanmar, and its purpose lies in preserving underground resources in these countries and in promoting their own technical advancement in resource processing. Therefore, foreign investors interested in developing North Korea's underground resources should keep these restrictions in mind when devising their business plans for North Korea.

A two-tier banking system akin to that found in capitalist markets is now in place

available to all enterprises (article 37). Accordingly, it is possible for a foreign investor who wants to engage in trade or establish a joint-venture in North Korea to directly contact an enterprise to pursue its business, without having to first go through the North Korean regime.

It is also noteworthy that enterprises have been given the right to set prices for products they manufacture. Previously, the prices of all goods were set according to the state's central planning strategy, but now each enterprise can set prices 'according to the price setting principles and methods that it has devised to repay production costs and realize production expansion and in consideration of the purchaser's demand and agreed terms' (article 39). In other words, prices are set according to the principle of demand and supply, and this mirrors the price setting system in capitalist markets.

Another point of particular interest is that enterprises can make use of the unused cash of residents. The Enterprise Act provides that enterprises may 'mobilize or use unused cash of residents' to finance the shortage of operational funds (article 38), and such measure can be interpreted as a first step by the North Korean enterprise system towards the system of private enterprise in capitalist markets.

sanctions and other factors, this plan did not come to fruition right away, and it is believed that no commercial bank was established at the time of the enactment of such laws.

In July 2015, the Central Bank Act and the Commercial Banking Act were amended for the first time since their enactment. These amendments seem to indicate that North Korea has begun, in earnest, to modify its financial system. The focus of the amended Central Bank Act lies in strengthening the authority of the Central Bank by granting rights, such as the right to set the standard exchange rate (Central Bank Act, articles 29 and 30) and the right to manage financial information (article 35). The amended Commercial Banking Act increases the work-scope of commercial banks by permitting bank card services (Commercial Banking Act, article 18) and at the same time attempts to increase the convenience for bank customers by allowing each customer to open multiple accounts with one commercial banking institution (article 30). The Investment Guide to the DPRK, which was issued by North Korea in May 2015 to attract foreign investors, explains that both national and local commercial banks are operating in North Korea, indicating that a two-tier banking system akin to that found in capitalist markets is now in place.

Preparedness is all

There may continue to be ups and downs in terms of the negotiations between the US and North Korea. Nonetheless, it is only a matter of time before North Korea, through further reform and market opening and liberalisation, participates more actively in international trade and becomes a global partner in the process. Believing this to be the case, it is prudent for foreign investors interested in the North Korean market to make necessary preparations to fully take advantage of the investment opportunities that lie ahead. Central to such preparations is the accurate and in-depth understanding of North Korean laws and its legal system. To borrow from Louis Pasteur's timeless axiom: 'Chance favours only the prepared mind.'