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## Canada-Korea FTA Talks Draw Ottawa into the North Korea Debate

While negotiating its Free Trade Agreement (FTA) with South Korea, Canada has inadvertently been drawn into the growing disagreement between Washington and Seoul over ties with North Korea. The issue is whether or not Ottawa will allow tariff-free imports from the Gaeseong Industrial Complex (GIC), an inter-Korean special economic zone in North Korea located 60 km from Seoul and 160 km from Pyongyang. While South Korea has successfully lobbied for GIC products to be included in its FTA with Singapore (effective March 2, 2006), as well as in its pending FTA with the Association of Southeast Asian Nations (ASEAN), the US has already announced that Gaeseong will not be part of any FTA it negotiates with South Korea. This is hardly surprising given Washington's long-standing sanctions on North Korea, its recent crackdown on Pyongyang's alleged counterfeiting of US currency, as well as its mounting frustration over the continued stalemate in the Six-Party Talks. On the other hand, the European Free Trade Area has agreed to allow tariff-free imports of Gaeseong goods, as long as 60% of the materials from which they are made are of South Korean origin. While it appears that proposed Canadian rules of origin in its FTA with South Korea do not cover the GIC, it is doubtful Ottawa will be able to avoid the Gaeseong debate as Seoul presses for its inclusion.

The Gaeseong zone has come to symbolize peninsular hopes for eventual reunification of the Koreas, beginning with economic partnership and cooperation. Identified as a "stepping stone for peace and prosperity of the Korean Peninsula" in South Korean government literature, the GIC took on further legitimacy when the first-ever joint North-South economic office was set up on-site last October. Currently, 15 South Korean companies are operating in the GIC, producing textiles, metal machinery parts and electronic goods under a "Made in Korea" label. Inter-Korean trade has progressed steadily over the years, from US\$425 million in 2000 to US\$1.56 billion in 2005. Some of this growth can be attributed to the development of Gaeseong; the ratio of GIC-related trade to total inter-Korean trade has gone from zero in 2000 up to 16.7% in 2005. Under its "economic blueprint" for future reunification with the North, Seoul has ambitious plans to expand Gaeseong in three phases, to become a "city" covering more than 60 sq. km by 2012.

The main problem at present is finding markets for Gaeseong-made goods. While China, Russia and ASEAN have no particular regulations against North Korean products, the long-term sustainability of the GIC will depend on gaining access to markets that are larger and farther afield, which Seoul is aggressively seeking in its FTA talks with various countries. Most recently, South Korea announced that it would begin discussions with India on a Comprehensive Economic Partnership Agreement, the usual precursor to a full-fledged FTA. Registering growth of 3.4% in 2005, the North Korean economy has tried to gain a boost by launching special economic zones, of which Gaeseong is the

only success so far. Kim Jong-il's tour of China's economically prosperous southern region last month suggests that Pyongyang may be seriously considering further measures to supplement its 2002 economic "adjustments," which saw a very limited introduction of market forces into the economy. From South Korea's perspective, given that the estimated costs of eventual reunification may top US\$650 billion, it has often asked for regional help in economically integrating the North. In October 2005, Seoul made a formal proposal inviting Asia-Pacific Economic Cooperation (APEC) forum economies to participate in developing the abundant mineral deposits in the North. There were no takers. Doing business in North Korea remains too risky, given the political uncertainties, lack of basic infrastructure and unavailability of insurance guarantees. Even in Gaeseong, the South Korean government is currently providing extensive tax exemptions and incentives to attract investment. For example, the GIC's corporate tax rate is lower than that in China's special economic zones.

As for the Canada-Korea FTA, officials from both sides confirm that the Gaeseong issue has already come up and is likely to do so again in further discussions. During the fourth round of talks that concluded in Seoul last weekend, Canada and South Korea began exchanging lists of tariff concessions. Beyond the expected controversial areas -- autos, agriculture and shipbuilding -- it appears that the talks are picking up pace, with the next round of talks to be held in Ottawa in late April. Although International Trade Canada has not set a firm deadline, Seoul has said it expects to conclude the FTA by the end of the year.

Despite Canada's past hesitancy in negotiating bilateral trade deals -- talks with Singapore have been stalled since 2003 -- a successful outcome with South Korea would not be surprising. Canada and South Korea have a long-standing history of economic cooperation, beginning with the launch of a "Special Partnership" at the 1993 APEC Leaders' Meeting. In 1995, Prime Minister Chrétien and President Kim Young-sam pledged to boost two-way trade to C\$10 billion by 2000 although the Asian financial crisis threw a roadblock into that plan. Merchandise trade between Canada and South Korea last year totaled C\$8.1 billion, suggesting there is still room to grow. South Korea's strategic role as a gateway and supply-chain link to Northeast Asia meshes with Canada's own Pacific Gateway Strategy.

Last week, Seoul announced plans to allow international firms into the GIC as soon as possible, subject to "consultation with the North." While there has been no expressed interest among foreign companies yet, all the heads of overseas South Korean missions were recently given a tour of Gaeseong, to help them in their "diplomatic activities in the future." As with the Six-Party Talks, the key remains not only how Pyongyang responds, but also how South Korea's partners, will respond to such overtures. Canada has to decide if it will break ranks with Washington's hard-line stance toward Pyongyang to help Seoul develop an economic bridge to North Korea.

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