

See No Evil: South Korean Labor Practices in North Korea

MARCUS NOLAND

AsiaPacific

I S S U E S

**Analysis from the East-West Center
No. 113
April 2014**

The East-West Center promotes better relations and understanding among the people and nations of the United States, Asia, and the Pacific through cooperative study, research, and dialogue. Established by the US Congress in 1960, the Center serves as a resource for information and analysis on critical issues of common concern, bringing people together to exchange views, build expertise, and develop policy options. The Center is an independent, public, nonprofit organization with funding from the US government, and additional support provided by private agencies, individuals, foundations, corporations, and governments in the region.

Papers in the AsiaPacific Issues series feature topics of broad interest and significant impact relevant to current and emerging policy debates. The views expressed are those of the author and not necessarily those of the Center.

S U M M A R Y Economic engagement between South and North Korea is often justified as a means of encouraging economic and social evolution in North Korea, with the ultimate goal of national unification. The South has invested heavily in the North, and firms have employed more than 50,000 workers. Yet expectations of a transformational impact rest on unexamined assumptions. The North recognizes the Trojan horse nature of the engagement policy: results of an original survey of South Korean employers show that the North Korean government has largely circumscribed the exposure of its citizens to both South Koreans and market-oriented economic practices, in the process violating labor rights defined by covenants to which both countries belong. The problem seems intractable, given that South Korea's diplomatic commitment to engagement with North Korea trumps labor rights concerns and South Korean firms perceive that the North Korean status quo confers benefits. As the experience of labor rights movements elsewhere shows, conditions will likely improve only if an aroused citizenry—here, the South Koreans—demands change.

Economic engagement between South and North Korea often is justified as a means of encouraging sufficient systemic evolution within North Korea to establish a meaningful basis for reconciliation and, ultimately, national unification.¹ The expectation is that economic engagement will promote a lessening of direct state control over the economy, the development of a middle class and concomitant demands for internal opening, and the rise of interest groups with an enhanced stake in peaceable external relations.

In recent years, South Korea has been a major investor in North Korea, and South Korean firms have employed more than 50,000 North Korean workers. Yet the transformational vision rests on unexamined assumptions about the nature of North-South economic integration. The North Korean regime understands the Trojan horse nature of the engagement policy and acts to attenuate its transformational impact.

Results from an original survey of South Korean employers indicate that the North Korean government has largely circumscribed exposure of North Korean citizens both to South Koreans and to new, more market-oriented economic practices. Hiring is largely conducted via the North Korean government, which prescreens workers, possibly on political criteria, sets wage rates administratively, demands payment in foreign currency, and takes a large cut. South Korean investment in North Korea may well be beneficial for both the firms and workers involved, but evidence of the sort of broader spillovers that proponents of engagement sometimes assert is not apparent.

The survey results raise the question of whether the behavior of South Korean investors is consistent with various international agreements and covenants to which the governments of North and South Korea have committed, and whether these existing international covenants or voluntary labor codes could be used to encourage employment practices more likely to generate the desired transformation of the North.

Survey Background

In the case of South Korea, the particular history of North-South relations has resulted in a situation in

which exchange occurs through three quite distinct modes. When cross-border integration began in the 1990s, some trade (mainly the importation of North Korean natural resource products) took the form of so-called “arm’s-length” transactions between unrelated entities. But the majority of trade took the form of processing-on-commission (POC) relations. Under this arrangement, South Korean firms shipped inputs to North Korea for assembly by North Korean partners, with the South Korean investor re-exporting the finished products, typically garments, for sale in South Korea or other third-country markets.

A third mode of exchange subsequently developed at the Kaesong Industrial Complex (KIC). This zone, which opened in December 2004, sits just north of the North-South border and is easily accessible from Seoul. (It was closed in a diplomatic dispute in April 2013, but re-opened in September 2013.) Firms in KIC are also engaged in processing and assembly activities, but without North Korean corporate partners. Inputs are sourced from South Korea, transported to KIC, fabricated into finished products by North Korean workers hired via a North Korean government labor bureau, and then transported back to South Korea for sale locally or re-export to third-country markets.

The results reported here are derived from a survey of 250 firms conducted between November 2009 and March 2010, 200 of which had been engaged in trade or investment in North Korea.² At its peak in the late 2000s, roughly 400 South Korean firms were engaged in economic activities in the North outside of KIC; activity at Kaesong peaked in 2013 with 123 firms and has since declined. At the time it was undertaken, the survey sampled more than half the universe of South Korean firms doing business in North Korea. Forty-six of the firms surveyed reported hiring North Korean labor.

Most of these employers, 33 of 46 firms (72 percent), operated in the KIC, though not necessarily exclusively there. Eight firms (17 percent), engaged in POC trade outside the KIC. A handful of firms were engaged exclusively in arm’s-length importing or exporting, and one firm engaged in both arm’s-length importing and exporting activities.

South Korean investment in North Korea may be mutually beneficial, but evidence of the broader spillovers that proponents of engagement assert is not apparent

Employment Practices

The vast majority of firms, 83 percent overall, reported hiring via a North Korean government labor agency, and this was the almost exclusive means of hiring for operations in the KIC. The only other significant avenue of hiring, and this was a very distant second, at 11 percent, was through North Korean joint venture partners and was highly correlated with firms engaged in arm's-length transactions and those involved in the natural resources sector.

When South Korean employers were asked if they believed that their workers had to pay their North Korean counterparties bribes or kickbacks for the privilege of working, a plurality of firms responded negatively, though most of the group obtaining their labor via North Korean partners believed this to be the case. When asked if they were required to employ members of the Korean Workers Party (KWP), most firms said no, though 27 percent of the firms operating in the KIC indicated that they were forced to employ KWP members. If this was the case, then it was a function of labor agency prescreening, since the firms rarely hired directly.

When asked about wage rates, the overwhelming response (83 percent overall, 94 percent within the KIC, and 54 percent outside the KIC) was that wage rates were set by the North Korean government. Other responses included North Korean partners (9 percent overall, and 60 percent for the firms engaged in arm's-length transactions), the South Korean government (4 percent), and supply and demand (4 percent). The vast majority of firms reported paying wages to the North Korean government and not the workers directly (93 percent overall, 97 percent in the KIC, and 85 percent outside the KIC); 4 percent reported paying directly to the workers; and one firm operating in the KIC said it both paid the government and paid the workers directly.

The pattern of indirect payment is consistent with the observation that wages were overwhelmingly paid in US dollars or other foreign currency (93 percent overall, 100 percent in the KIC, 81 percent outside it, and 100 percent for the arm's-length group), not

North Korean won, although it is technically illegal for domestic residents to hold foreign exchange.

So, for example, at the time of its closure in April 2013, the minimum wage at the KIC was \$67.05 per month, and once all payments and bonuses were accounted for the average wage was \$130.³ Workers, however, were not receiving \$130 per month; the North Korean government was thought to retain roughly 30–40 percent of this payment, ostensibly to cover social security payments, transportation, and other in-kind benefits. More importantly, while South Korean firms pay in US dollars, North Korea pays the workers in North Korean won converted at the overvalued official exchange rate. Evaluated at the black-market rate, North Korean workers may have been netting less than \$2 per month. With market prices for rice on the order of 4,000–5,000 won per kilo, this suggests that monthly after-tax wages might purchase roughly two to three kilos of rice.⁴ There appeared to be no shortage of North Koreans willing to work on these terms.

There was some evidence of incentive pay. While most respondents indicated that they paid on the basis of a set daily or hourly wage rate, 22 percent reported paying overtime, 15 percent reported paying a piecework rate, and 7 percent reported paying bonuses for exceeding production targets. Consistent with relatively greater regulatory oversight, and more direct North Korean government pecuniary interest, overtime was paid more frequently in the KIC (27 percent versus 8 percent outside the KIC), but piecework was more common outside the zone (12 percent inside the KIC versus 23 percent outside of it). Half the POC firms, and nearly half of the KIC operations, used some kind of incentive pay. Yet even the incentive payments went to the North Korean counterparty, and it is unclear how much, if any, actually reached the workers.

Given that wages are usually paid to the North Korean government, the firms hiring via the government were asked if they knew exactly how much money their workers were, in turn, receiving from the government. *A majority of the employers refused to answer the question.* Of those that did, their responses

Monthly after-tax wages might purchase two to three kilos of rice. There appeared to be no shortage of North Koreans willing to work on these terms

Large majorities of employers said they felt their employees considered themselves lucky to be employed by South Korean firms; a low turnover rate seemed to confirm this

split nearly evenly between those that said they knew (21 percent) and those that said they did not (18 percent). *In other words, only one in five firms indicated that they knew how much their workers were actually paid.* Remarkably, none of the firms that reported paying piecework indicated that they knew how much pay the workers received—they simply paid their North Korean counterparty and left it at that. However, when asked the follow-up question whether they believed that the government took a large amount of money that was supposed to go to their employees, a majority responded affirmatively.

In sum, hiring is largely via the North Korean government, which pre-screens the workers, possibly on political criteria, sets wage rates administratively, demands payment in foreign currency, and absorbs the lion's share of wage payments.

Industrial Relations

South Korean managers generally do not directly supervise North Korean workers. Supervision is normally done through a North Korean intermediary manager. Direct supervision occurred more frequently outside of the KIC (15 percent). The lack of direct supervision came at a cost, since it meant that South Korean managers were forced to issue instructions via intermediaries, many of whom were not necessarily selected for their jobs on the basis of their own familiarity with the task. This was a bigger issue at the KIC, where firms tended to rely heavily on North Korean managers.

Most South Korean employers surveyed had generally positive appraisals of their North Korean workers, and when asked the bottom-line question of whether, given the skill level, the employment of the North Koreans was advantageous at the prevailing wage rates, again, large majorities answered affirmatively (91 percent overall).

Relatively few firms reported that workers complained about conditions in their South Korean-operated factories. There was no correlation between direct supervision and responding that workers complained; i.e., the absence of complaints did not appear to reflect lack of familiarity or contact. In fact, large

majorities indicated that they thought that their employees considered themselves lucky to be employed by South Korean firms. This general acceptance of working conditions seems to be borne out by low turnover rates: 76 percent of the respondents indicated that a benefit of hiring North Korean workers was that the percentage who quit was low.

When asked how they handled situations involving unsatisfactory or unnecessary workers, 28 percent responded that they had never confronted this problem, including half of the POC firms. For the POC firms that make piece-rate payments to their North Korean counterparties, this result may reflect the internalization of the pecuniary incentive of the North Korean counterparty management to weed out unproductive workers.

Among the firms that did acknowledge needing to dismiss workers, none said that they were able to do so without obtaining some kind of approval or permission. Most firms that reported making dismissals (77 percent) said that they had to get the permission of the North Korean labor agency to dismiss a worker. Ten percent said that they had to get permission from the KWP, and another 10 percent said that they had to get permission from their North Korean partner. One firm reported paying severance.

Work stoppages occur infrequently; most firms reported that they had not experienced strikes or work stoppages. Among those firms that had experienced labor unrest, there appeared to be no standard method of dispute resolution. Some in the KIC (though none outside of it) appealed to the South Korean government or the North Korean government. The POC firms that experienced strikes or work stoppages most often appealed to their Chinese office or a Korean Chinese intermediary for help. Other employers indicated no method of settling disputes at all. When the South Korean employers were asked if a benefit of hiring North Korean workers was that they were not unionized, 61 percent responded affirmatively (58 percent in the KIC, 69 percent outside the KIC). Eighty percent of the firms engaged in arm's-length transactions agreed with this sentiment.

Labor Standards

The documented labor practices appear both exploitative and unlikely to generate desired transformational effects (Human Rights Watch 2006). Are these practices consistent with international norms, and are there mechanisms that could be used to encourage the adoption of more humane and potentially transformative practices?

South Korea is a member of the International Labor Organization (ILO) and the Organization of Economic Cooperation and Development (OECD), which has promulgated its *Guidelines for Multinational Enterprises* (OECD 2011). The OECD *Guidelines* obligate investors to ensure that North Korean workers are aware of their rights and of how to exercise them. Both South and North Korea are also members of the United Nations, which has released a set of *Guiding Principles for Business and Human Rights* (United Nations 2011). Finally, the South Korean government could extend regulation over its investors extraterritorially; indeed, the Constitution of the Republic of Korea makes claims over the entire peninsula, raising the issue of the extent that South Korean firms investing in North Korea ought to be subject to “domestic” standards and regulations. To what extent, if any, is the behavior of South Korean investors in North Korea constrained in principle, if not in reality, by these covenants?

Both the UN and OECD guidelines are largely oriented toward prescribing behavior for multinational firms in an environment in which the host government is committed to upholding international norms. The problem with their application in the North Korean case is that it is not so much that private firms subvert the government’s attempt to do the right thing, but rather the state opposes or pays only lip-service to the international norms, and the investor stands to benefit.

For example, the OECD *Guidelines* state that investors should respect human rights “within the framework of internationally recognized human rights, international human rights obligations of the countries in which they operate” (OECD 2011 p.31), and

then go on to reference “the International Bill of Human Rights, consisting of the Universal Declaration of Human Rights and the main instruments through which it has been codified: the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights” and the ILO principles (OECD 2011 p.32). North Korea is a state party to the International Covenant on Economic, Social and Cultural Rights. For example, the covenant obligates states to ensure “[e]qual opportunity for everyone to be promoted in his employment to an appropriate higher level, subject to no considerations other than those of seniority and competence” (Article 7)—an obligation eviscerated by North Korea’s *songbun* system of political classifications (Collins 2012) and the rights of citizens to form and join trade unions of their choice and to strike (Article 8). This would seem to establish both the government of North Korea’s obligation under its international commitments to ensure certain rights, and for employers to respect those rights. But the *Guidelines* go on to say that “obeying domestic laws is the first obligation of enterprises... [I]n countries where domestic laws and regulations conflict with the principles and standards of the *Guidelines*, enterprises should seek ways to honor such principles and standards to the fullest extent which does not place them in violation of domestic law” (OECD 2011 p.17). In North Korea, the state’s unwillingness to meet its international legal obligations would seem to emasculate any salutary impact of the OECD *Guidelines*.

However, the *Guidelines* also specify that adhering countries establish National Contact Points (NCPs), which are partly oriented toward supporting the implementation of the guidelines by home country entities in non-adhering countries. The South Korean NCP is the Korea Commercial Arbitration Board. Officials there indicated that the government was working to raise the awareness of the OECD *Guidelines* among South Korean companies operating in non-adhering countries. However, the issue had not come up in the context of the Kaesong Industrial Complex or investment in North Korea more generally, and the government had not formulated a policy.

In North Korea the state opposes or pays only lip-service to international labor norms, and the foreign investor stands to benefit

The UN's *Principles* face similar difficulties, but they do suggest that states may need to consider extra-territorial application of the law. Article 3 of the South Korean Constitution declares that the territory of the Republic of Korea consists of "the Korean Peninsula and its adjacent islands" (Article 103 of the North Korean Constitution makes a mirror claim to the entire peninsula). The South Korean Constitution then goes on to elaborate a number of economic rights, including those in Article 33: "To enhance working conditions, workers shall have the right to independent association, collective bargaining and collective action." Article 6a reads: "Treaties duly concluded and promulgated under the Constitution and the generally recognized rules of international law shall have the same effect as the domestic laws of the Republic of Korea." One could interpret these articles and other similar provisions together with South Korea's international law obligations as forming the constitutional basis for encouraging if not requiring South Korean firms to facilitate labor rights in North Korea.

Realistically, however, the obstacle to the extraterritorial application of South Korean law is not the lack of legal foundations. Rather, it is South Korea's diplomatic commitment to engagement with North Korea trumping labor rights concerns together with the perception of South Korean firms that the North Korean status quo confers benefits.

There is no evidence that the South Korean government has undertaken any steps to date that would encourage or require its firms to abide by any standards whatsoever.

That leaves private activism as a possible remedy. One possibility would be to encourage the development of codes of conduct similar to the Sullivan Principles, which were created by the anti-apartheid activist Rev. Leon Sullivan for foreign companies investing in South Africa.⁵ The Sullivan Principles inspired the development in other controversial situations of a number of similar initiatives, including the MacBride Principles (Northern Ireland), the Slepak Principles (Soviet Union), the Miller Principles (China and Tibet), the Malquiladora Standards of Conduct

(Mexico), and the Ceres née Valdez Principles (environment), making them a natural starting point for thinking about how a similar strategy might be employed with respect to North Korea.

The introduction of the Sullivan Principles did not occur in isolation. Their development occurred symbiotically with a growing anti-apartheid movement, which included shareholder resolutions, divestment campaigns, and at the level of state and local governments in the United States, selective purchasing policies with respect to government procurement.⁶ US investors in South Africa came under considerable pressure either to adopt the Sullivan Principles or divest. In turn, a burgeoning anti-apartheid movement and growing frustration over the apparent lack of progress in South Africa led Rev. Sullivan in 1984 to expand the Principles, adding a provision committing signatory firms to "working to eliminate laws and customs that impede social, economic, and political justice." The following year, US President Ronald Reagan issued an executive order requiring firms to conform to fair employment standards similar to the Sullivan Principles, but this could not stem the tide, and in 1986 the US Congress passed sanctions legislation.

Evaluating the Sullivan Principles' impact, McCrudden (1999 p.177) writes, "there is some indication that the Principles had several positive effects: first, that corporations found them useful by providing a focus for their social and political activities in South Africa; second, that the Principles brought about some changes in conditions for black workers which may not have otherwise occurred; third, that the Principles led to increased funding by companies of social causes in the South African community; and fourth, that they may have increased pressure on government for the recognition of black trade unions, an important factor in the development of organized black politics. It is difficult, however, for the effect of the Principles to be distinguished from the effect of other similar activity, outside the context of the Principles, such as undertaken by other countries, or from larger political and economic forces operating at that time in South Africa."

***Private activism,
along the lines
of the Sullivan
Principles employed
against apartheid
South Africa, is a
possible remedy***

*The Global
Sullivan Principles
focus on firm, not
state, behavior*

The apartheid regime ultimately fell, and in 1999 Rev. Leon Sullivan and UN Secretary General Kofi Annan formulated the Global Sullivan Principles of Corporate Social Responsibility, an antecedent to the UN *Principles* examined above.⁷ In contrast to the UN *Principles*, and consistent with their origins as guidelines for corporate activity, the Global Sullivan Principles focus on firm, not state, behavior. They call for multinational companies to proactively advocate for universal human rights and the rights of their employees, and unlike the OECD *Guidelines*, do not contain the loophole of operating within the constraints of national law.

Conclusion

Most North Koreans are so isolated from the rest of the world that nearly any exposure to foreigners and new ways of doing things has to be regarded as positive. Yet the evidence presented here indicates that the employment practices prevailing in South Korean–invested operations resemble the customs generally observed in the North Korean economy, with little direct exposure to either South Koreans or genuinely market-oriented practices obtaining.

A majority of the South Korean employers report that their North Korean operations are profitable and frankly appear to value the docility of their non-unionized North Korean workers. Given the constellation of interests between the North Korean state

and the South Korean employers, it is doubtful that much impetus to improve the working conditions of North Korean workers will come from these sources.

Change is likely only if the South Korean public agitates for it. The absence of any kind of coherent human rights campaigning among South Korea progressives is notable,⁸ but a campaign organized around worker's rights, anchored in both the South Korean constitution and existing international norms and covenants, would not be a bad place to start. There is a broad political consensus within South Korea as to the desirability of economic engagement with North Korea, but current practices are unlikely to promote transformation. An appropriately calibrated set of principles could be more than a poison pill designed to end engagement. Such principles could center on providing for basic labor rights, recognition of labor organizations, and nondiscrimination on the basis of *songbun*. But to be clear, the history of the Sullivan Principles demonstrates that whatever positive impact the initiative had occurred symbiotically against a backdrop of divestiture, selective purchasing, and sanctions campaigns and policies. Application of voluntary labor standards in North Korea would presumably require a similar political context and in all likelihood would eventually require negotiations between the governments of North and South Korea to reform the labor practices of South Korean firms operating in North Korea.

Notes

¹ See, for example, Kim, 1997, p.121.

² See the appendix of Haggard and Noland (2012) for a complete description of the survey methodology.

³ Park Seong Guk, "Kaesong Wages Rise by 5%," *DailyNK*, August 6, 2012. <http://www.dailynk.com/english/read.php?cataId=nk00100&num=9633> accessed 7 November 2013.

⁴ Figures for December 2013. <http://www.dailynk.com/english/market.php> accessed 29 January 2014.

⁵ The principles were 1. Nonsegregation of the races in all eating, comfort, and work facilities. 2. Equal and fair employment practices for all employees. 3. Equal pay for all employees doing equal or comparable work for the same period of time. 4. Initiation

of and development of training programs that will prepare, in substantial numbers, blacks and other nonwhites for supervisory, administrative, clerical, and technical jobs. 5. Increasing the number of blacks and other nonwhites in management and supervisory positions. 6. Improving the quality of life for blacks and other nonwhites outside the work environment in such areas as housing, transportation, school, recreation, and health facilities. 7. Working to eliminate laws and customs that impede social, economic, and political justice. (Added in 1984.) <http://www.marshall.edu/revleonsullivan/principles.htm> accessed 11 November 2013. When this tactic did not bear fruit, eventually Leon Sullivan called upon companies to exit South Africa.

⁶ So, for example, the State of Maryland adopted a policy that firms bidding for contracts in excess of \$100,000 had to certify that either they did no business in South Africa or adhered to the Sullivan Principles.

⁷ <http://www1.umn.edu/humanrts/links/sullivanprinciples.html> accessed 11 November 2013.

⁸ See Wolman (2013).

References

- Collins, Robert. 2012. *Marked for Life: Songbun, North Korea's Social Classification System*. Washington, DC: Committee for Human Rights in North Korea.
- Haggard, Stephan and Marcus Noland. 2012. "The Micro-economics of North-South Korean Cross-Border Integration," *International Economic Journal* 26 (3): 407–430.
- Human Rights Watch. "North Korea: Workers' Rights at the Kaesong Industrial Complex," <http://www.hrw.org/legacy/backgrounder/asia/korea1006/korea1006web.pdf> accessed 21 March 2014.
- Kim, Dae-jung. 1997. "Three-Stage" Approach to Korean Reunification. Los Angeles, CA: The Center for Multiethnic and Transnational Studies, University of Southern California.
- McCrudden, Christopher. 1999. "Human Rights Codes for Transnational Corporations: What Can the Sullivan and MacBride Principles Tell Us?" *Oxford Journal of Legal Studies* 19:2 167–201.
- OECD, 2011. *OECD Guidelines for Multinational Enterprises*. Paris: OECD.
- United Nations. 2011. *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*. <http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf> accessed 7 November 2013.
- Wolman, Andrew. 2013. *South Korea's Response to Human Rights Abuses in North Korea: An Analysis of Policy Options*, AsiaPacific Issues, no. 110. Honolulu: East-West Center.

About this Publication

The AsiaPacific Issues series reports on topics of regional concern.

Series Editor: Elisa W. Johnston

The contents of this paper may be reproduced for personal use. Single copies may be downloaded from the Center's website. Copies are also available for \$2.50 plus shipping. For information or to order copies, please contact:

Publication Sales Office
East-West Center
1601 East-West Road
Honolulu, Hawai'i 96848-1601

Tel: 808.944.7145

Fax: 808.944.7376

EWBooks@EastWestCenter.org

EastWestCenter.org/AsiaPacificIssues

ISSN: 1522-0966

© 2014 East-West Center

Recent AsiaPacific Issues

No. 112 "Democratic Change and Forest Governance in the Asia Pacific: Implications For Myanmar" by Stephen McCarthy. February 2014.

No. 111 "Creating Korea's Future Economy: Innovation, Growth, and Korea-US Economic Relations" by Sean P. Connell. January 2014.

No. 110 "South Korea's Response to Human Rights Abuses in North Korea: An Analysis of Policy Options" by Andrew Wolman. June 2013

No. 109 "Can a Growing Services Sector Renew Asia's Economic Growth?" by Marcus Noland, Donghyun Park, and Gemma B. Estrada. April 2013.

No. 108 "The Elusive Nature of North Korean Reform" by Marcus Noland. February 2013.

No. 107 "How Emerging Forms of Capitalism Are Changing the Global Economic Order" by Christopher A. McNally. February 2013.

About the Author

Marcus Noland is executive vice president and director of Studies at the Peterson Institute for International Economics and a senior fellow at the East-West Center.

He can be reached at:
mnoland@petersoninstitute.org