

**Development of Free Economic Zones and Labor Standards: A  
Case Study of Free Economic Zones in Korea**

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## 1. Introduction

On November 14th, 2002, the Korea Congress passed the 「Act on the Designation and Operation of Free Economic Zones」 and in August, 2003, the government designated a part of the city of Incheon as the first free economic zone in Korea. Interestingly, when the bill for the Act was announced in 2002, it was not announced as the Act on free economic zones, but was announced as the Act on special economic zones. As such, free economic zones in Korea can be considered as being equivalent of special economic zones.

At the moment, Korea is facing external economic pressures such as the reduction of foreign direct investment (FDI), the possibility of hallowing out in the manufacturing sector and the emergence of China as the major economic power in East Asia. However, Korea also faces a number of economic opportunities such as the rise of the Northeast Asian economic block and the increasing possibility of becoming the hub of Northeast Asian economy. In order to become prepared for the changing external economic circumstances, Korea is pushing ahead with the plan of building special economic zones.

The term special economic zone was coined in 1979 when China opened up four cities along its southeastern coast, as part of its open-door policy. Now this term generally refers to free economic zones or free investment zones which provide manufacturers and traders a specialized environment and incentives in terms of taxation. Such preferential treatment distinguishes the zone from other regions both at home and abroad. The earliest origin of special economic zones can be found in the economic history of Europe, which established free trade zones with the start of international trade. An example of free trade zone is the city of Hamburg in Germany, which was designated by the Hanseatic League in the 13th century as the first special economic zone.

Special economic zones can be categorized into three types according to their primary functions. First, there is the trade-type zone which consists of free ports, free trade zones, duty free zones etc. Hamburg port is a typical trade-type zone. Second, there is the mixed-type zone which conducts both production and trade. In mixed-type zones raw materials are imported duty free and then are processed and exported. Export processing zones, industrial free

zones and others are variations of mixed-type zone. 'Maquiladora' in Mexico and 'Masan Free Export Zone' in Korea are typical examples of mixed-type zones. Lastly, there is the comprehensive-type zone, which is a developed model of the export processing zone. In the comprehensive-type zones, broad preferential treatment such as investment promotion and permission of local sale of products produced in the zones are provided. China, Hong Kong and Singapore are included in this category. Although there are various forms of special economic zones, generally they have developed into one of the three forms: trade-type, mixed-type and comprehensive-type. Special economic zones that are recently being developed in Korea are aiming to be comprehensive-type zones. (Nam, 2003; Kim & Bang, 2003).

The concept of special economic zone is difficult to define, because special economic zones take on various different forms and purposes depending on the needs of the nations establishing them. Generally speaking, the term special economic zone is used to broadly describe a special geographical zone that allows exceptional provisions in terms of economic activities that are not available in other areas. More specifically speaking, special economic zones are areas set up with tax incentives and both physical and administrative infrastructures that are differentiated from other areas within the same country, so as to attract foreign capital and technology. Because of the various different forms of special economic zones, it is difficult to identify the exact number of special economic zones around the world. According to an estimate by the World Bank there are more than 500 special economic zones worldwide (Kim & Bang, 2003).

The civil society and the labor unions opposed the introduction of free economic zones in Korea. Those against the free economic zones argued that it was planned unilaterally by bureaucrats, and that the policies that guarantee preferential treatments for foreign capital, domestic conglomerates and regional developers have a high potential for oppressing labor rights and disrupting public services such as labor, education, medical service and service for the disabled (Song, 2003; Labor & Welfare Committee of Minbyun-lawyers for a democratic society, 2003). Such arguments are based on several questionable provisions in the Act on Free Economic Zones, such as the provision on providing tax deductions for business expenses, the exemption from minority employment requirements, and the provision which allows for the exclusion from application of some provisions in the Labor Standards Act and the

Protection, etc. of Dispatched Workers Act. This shows that oppositions against special economic zones are related to concerns regarding wage decrease, oppression of labor movements and deterioration of employment conditions, which are common trends found in special economic zones of other nations.

However, the government and municipal governments that are promoting free economic zones argue that if free economic zones in Korea do not provide far more favorable conditions than other zones, it will be make difficult for Korea to attract foreign investment, particularly since Korea already lags behind its competitors in this area, and seriously hamper Korea's effort to become the economic hub of Northeast Asia (Yang, 2003). Attracting FDI is expected to become a hot issue in the process of developing various special economic zones, including the free economic zones. The recent increase of special economic zones and the expansion of multinational enterprises are like the two sides of the same coin. In the process of globalization, it will be difficult to avoid the issues raised over trade and investment's influence on social and cultural foundations of the recipient countries.

## 2. Labor Standards in Special Economic Zones

Special economic zones are, above all, a means to attract foreign direct investment. According to UN, the worldwide FDI flow declined once again in 2002 following a decrease in 2001. Among 195 countries, 108 experienced reduction in investment inflows. A noteworthy point is that the growing disparity between nations and regions in their ability to attract FDI. For instance, whereas China has garnered more as the largest recipient of FDI in the world with \$53 billion, Latin America's share of FDI declined by 33% compared to the previous year (UN, 2003). A long-term study of the International Labor Organization indicates that unbalanced FDI flows and competition among nations in attracting FDI will have a negative influence on society (ILO, 2003). In addition, it was pointed out that the core labor standards reached through international consensus are not being promoted through a race to the top but are being neglected in a race to the bottom (Sengenberger, 2002).

In the end, although it is a reality that special economic zones appear to reinforce the world's race to the bottom, for a nation to establish a development strategy of moving towards a knowledge-based and value-added race to the top, it is important to design rational institutions and to create institutions based on social consensus. It is true that attracting FDI for development is essential in the current global economy. However, although it may be somewhat ironical, it is also true that if almost all nations are setting up special economic zones and joining in the race to the bottom, the true winner will be the nation which has established institutions that allow it to participate in the race to the top.

Generally in economic categorization, special economic zones are considered to be the broadest concept which includes export processing zones. However when it comes to labor standards, ILO treats special economic zones as a variation of the traditional export processing zones (EPZ). In other words, with regard to international labor standards, special economic zones can be treated as a form of EPZ, which the ILO has monitored for over 20 years. And according to this standard, zones take many different forms such as free trade zones, special economic zones, bonded warehouses, free ports and *maquiladoras*. The ILO(2002) has defined EPZs as industrial zones with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being (re-)exported again. The key

point here is that these zones are designed to attract foreign investment by providing special incentives. Therefore, the degree to which products are entirely exported or partially consumed in the domestic market after processing is not considered to influence the way EPZ is defined.

Zones have evolved from simply having facilities that perform initial assembly and simple processing activities to including high-tech and science parks, financial districts, logistics centers and even tourist resorts. Their physical form now includes not only enclave-type zones but also single-industry zones (such as the jewelry zone in Thailand or the leather zone in Turkey); single-commodity zones (like coffee in Zimbabwe); and single-factory (such as the export-oriented units in India) or single-company zones (such as in the Dominican Republic). While many public agencies are still initiating establishment of special economic zones, there is an interesting trend towards private initiative for developing special economic zones, often by foreign developers. Public zones usually offer better infrastructure than other geographical areas in the domestic economy, while private zones focus on attracting higher quality investment from abroad. Both the number of EPZs and the number of countries hosting them have expanded rapidly (see table 1).

<Table 1> Development of EPZs<sup>1</sup>

	1975	1986	1995	1997	2002
No. of countries with EPZs	24	47	73	93	116
No. of EPZs	79	176	500	845	3000
Employment (millions)	n.a	n.a	n.a	22.5	37
-of which China	n.a	n.a	n.a	18	30
-other countries for which figures available	0.8	1.9	n.a	4.5	7.0

Source : ILO(2002).

EPZs have been highly effective at employment creation in some countries. By 2002, China alone had 30 million employed in over 2,000 Special economic zones, economic and technological development zones, EPZs and border zones.

<sup>1</sup> source : ILO calculation based on EPZs administrations, national statistics, web sites,

published articles, estimates and responses to ILO surveys.

Total employment in other countries' similar zones was calculated at 4.5 million in 1997, but based on several conservative estimates, the figure quickly rose to at least 7 million by 2002. One social benefit that zones have created was that they became an important avenue for young women to enter the formal economy at better wages than in agriculture and domestic service. Women make up the majority of workers in the vast majority of zones, reaching up to 90% in some of them. Employment in EPZs has increased substantially since the mid-1990s. In the Philippines, employment in EPZs increased from 229,650 to 716,990 between 1994 and 2001, and Costa Rica saw an increase in EPZ jobs from 7,000 in 1990 to 34,000 a decade later (ILO, 2002).

EPZs follow a life cycle and tend to grow rapidly in terms of investment and employment creation, and then plateau as the local labor market tightens. Malaysia and Mauritius are examples of countries that have been able to use their zone strategies to create significant employment opportunities by moving to higher value-added production. In recent years, the skilled job demand increased so sharply that they were even forced to import workers to fill new posts. Thus, EPZ strategy is pursued in both labor-surplus economies and in countries where there are labor-shortages requiring migration of workers.

ILO has continuously monitored EPZs. The conclusion of the 1998 tripartite meeting highlighted the importance of respect for fundamental principles and rights at work including the national and international labor standards as major factors in attracting investment that promotes long-term high-quality growth. Legal restrictions on trade union rights in a few EPZ-operating countries, the lack of enforcement of labor legislation and the absence of workers' organization representation were among the factors noted as undermining the ability of zones to upgrade skills, to improve working conditions and productivity and ultimately to become dynamic and internationally competitive platforms<sup>2</sup>.

Meanwhile, the International Confederation of Free Trade Unions(ICFTU) has continuously criticized EPZs. According to the ICFTU there are 19 terms used to describe export processing zones. In Mexico, they call them *maquiladoras*; in

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<sup>2</sup> Some of the ILO EPZs national case studys are as follows. EPZs case study on Asia,

Maex(1985), Case study on Bangladesh, Bhattacharya(1998), Case study on Bangladesh the Philippines, Remedio(1996), Case study on Malaysia, Sivalingam(1994) etc.

Guatemala "swallow" companies<sup>3</sup>, and in China, "special economic zones". But their characteristics are virtually identical throughout the world. They are based on the same principle - the international segmentation of the production process - and adopt the same practices: creation of an environment that provides low pay and no trade union rights with little regard to international conventions. In addition, wage costs are the most decisive factor for firms to setting up facilities in EPZs, especially for their most labor intensive production facilities. That is why the ICFTU is pressing for the introduction of a social clause in international trade pacts (ICFTU, 2000).

Also ICFTU is focusing on the activities of multinationals. Local entrepreneurs may be active in the EPZs, but without the initial investment and interest of multinationals, there would not be any export processing zones. In 1986, more than two thirds of the 1.5 million jobs in the EPZs were provided by the multinationals. While it is true that big names such as Sony, Sara Lee or Hewlett-Packard are to be found in the zones, more and more medium sized enterprises are taking their chances in EPZs. Even for an inexperienced foreign investor, EPZs are a very attractive platform to enter the market, because the investors do not have to explore unknown territories or adapt to inadequate infrastructure and often very complex legislation. ICFTU notes that to an inexperienced foreign investor, EPZs are like what the holiday package is to a cautious tourist.

The ICFTU's report of the labor situation in EPZs is as follows (ICFTU, 2000). The adequate standard for comparison would be internationally recognized workers' rights such as the core labor standards recognized by ILO. They cover the principles that constitute the basis for all social democracy: the freedom of association, the right to organize and collective bargaining, the prohibition of all forms of forced labor, the establishment of a minimum working age and the respect for acceptable working conditions in terms of wage level, working hours, and health and safety.

According to ICFTU, there are some EPZs where labor-related laws are respected, but there are also other EPZs where no laws are applied. But most are in the middle of these two extremes. In Malaysia, according to the Penang

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<sup>3</sup> The nickname given to enterprises situated in the EPZs because of the ease with which they can "fly" away from the country.



clothing workers' union, workers have the right to form a trade union and to negotiate collective agreements, and to strike if no agreement is reached between management and workers. Yet, there is also a special legislation for the zones that is designed to ensure "industrial peace." When an enterprise is granted "pioneer" status by the ministry of labor, strikes are banned as soon as a dispute is submitted to the minister.

As most of the industries situated EPZs belong to modern sectors of the economy and depend on the international market, it would be reasonable to expect that wages are relatively high. However, in reality, the pay is usually as bad as or even worse than the wages in local enterprises: in the Philippines, the minimum wage in Manila in 1995 was set at 5.27 dollars per day, yet the minimum wage in the EPZs was only 4.9 dollars per day. An ICFTU/APRO study carried out at the beginning of 1995 confirms that approximately 30% workers in the EPZs in six Asian countries earn wages below the legal minimum wage. Meanwhile, the social security in EPZ firms is not guaranteed either. According to an ILO report many EPZ enterprises do not pay their contributions to the social security institutions. However, there are some exceptions to the rule. According to the All Pakistan Federation of Trade Unions, working conditions are generally better in EPZ firms than in other national enterprises outside the zone.

Multinationals invest in EPZs because they can take advantage not only of adequate infrastructure, exemptions from tax and customs duties, and low wages, but also from the anti-union climate. The government is the main actor in oppressing labor union activities in EPZs. Governments even publicize their union-free environment in order to attract foreign investment.

National labor acts are not applicable to EPZ's in Pakistan, Bangladesh and Sri Lanka. In the case of Pakistan, trade unions are not recognized in EPZs and national laws on guaranteeing minimum wages, maternity allowance and the right to bring a case to the labor court is exempted in EPZs. Instead of applying the national labor related laws, special labor code is often enacted in EPZs to handle labor and management relations specific to the EPZs. Although working hours (less than nine hours per day, less than 48 hours per week) and welfare benefits are stipulated in the labor code, it does not do much for the protection of workers in EPZs. (Oberai et al, 2001).

In the past, investors were seeking lower costs by investing in EPZs. Since they were engaged mostly in labor-intensive operations, they sought out

countries with low labor costs. Today, globalization places the emphasis on speed, efficiency and quality as well as the cost, and these factors together influence where a business decides to locate. Policy-makers are increasingly concerned about maximizing their country's comparative advantage for foreign investors and are shifting the focus from cheap labor to productive labor. This shift in focus is changing the way government, employers and even trade unions view human resource issues. Now countries are realizing that to remain competitive, they must get this mix of cost and quality factors right by raising the capacity of their human resources, ensuring stable labor relations and improving the working and living conditions of workers (ILO, 2002).

Even though it is very limited, there are examples of tripartite dialogue on the national level, related to devising an appropriate strategy for attracting foreign direct investment (Mauritius, Kenya, and South Africa). On the international level, framework agreements reached by some multinational companies and world trade unions are playing an important role in improving the labor conditions in EPZs. National Labor Advisory Council in Sri Lanka is a good example of social dialogue on the national level.

In many cases, EPZs lack social dialogue between employers and workers. Discord between the labor and management can not be appropriately solved without adequate arbitration mechanisms and procedures for information sharing, consultation and negotiation for dispute resolution. And the situation is aggravated because many employers of foreign enterprises in the EPZs are ignorant of labor situations in the host country. However, there are evidences for zones where employers or government were pressured by trade unions to engage in social dialogue performed better in labor and management stability and showed low turnover rates. Some EPZ governing authorities included trade unions in their committees such as the ones in the Philippines, Singapore and Trinidad Tobago. And some EPZ authorities encouraged the operation of labor and management committees within the enterprise (ILO, 2002).

At the end of the 1998 tripartite meeting, the ILO was asked to provide advice and technical support to nations which operate EPZs, for the improvement of social and labor circumstances. ILO also expanded its research activities to cover the labor and management relation policies and practices of multinational enterprises (MNE). Since then ILO led many actions related to this issue.

First, various ILO units and local offices are carrying out activities in

cooperation with other indigenous national units or local offices. For example, the South Asia Mutidisciplinary Advisory Team supported a series of regional and national seminars on promoting social dialogue and freedom of association in South Asian EPZs (Oberai et al, 2001). Also in October, 2002, as an initiative of the tripartite committee, seminars were held for the workers in EPZs in El Salvador, Guatemala, Honduras Mexico and Nicaragua to promote the respect for freedom of association in EPZs.

It is too early to identify the concrete impacts of such initiatives, however there were a few positive developments as a result of the initiatives. For example, the Board of Investment in the government of Sri Lanka recently published a manual on labor standards and labor relations in EPZs. This manual urges enterprises in EPZs to respect the freedom of association and collective bargaining, to adopt mechanisms for consultation and cooperation, and to establish procedures for handling discontent (predicament).

On the other hand, there are those who criticize the ILO's basic position of emphasizing social dialogue as a means to secure labor standards. These critics argue that a change in the government and employer's approach toward EPZs and the establishment of minimum standards on employment and the working environment should come before social dialogue. Such an argument is in line with the position that for nations and multinational companies to abide by labor standards in EPZs, there has to be strict regulations in trade and investment on the international level along with various policy efforts of the individual states that need FDI (Aidt & Tzannatos, 2002; 1-3).

### 3. Development of Free Economic Zones and Labor Standards:

#### A Case Study of Korea

##### 1. Labor related provisions in the Free Economic Zone Act and its effectiveness

The Korean government has established a new strategic vision of making Korea the economic hub of Northeast Asia, and in order to realize this vision and attract foreign investment, the government will designate several geographical areas as free economic zones. Against this backdrop, the government announced the introduction of the 「Act on the Designation and Operation of Free Economic Zones」 in August, 2002.

Since then, as the bill went through public hearings, trade unions fiercely opposed to the provisions related to labor standards. And the Federation of Korean Trade Unions and Korean Confederation of Trade Unions resisted the bill by going on general strikes. Despite this, the bill was passed by the national assembly in November that year, and it was enacted on December 30th. Before it was scheduled to take effect on July, 1st, 2003, there was an amendment to the bill on May, 29th, in which some provisions were amended or deleted. And an Enforcement Ordinance was made on June 30<sup>th</sup>, 2003.

The act consists of eight chapters and thirty-five articles. The provisions related to labor market and industrial relations are found in two articles, 17 and 19, which are in Chapter Four titled 'Assistance in Management Activities of Foreign-Invested Enterprises'. Article 17 is on the exclusion of application of other acts, and clause (1), (4) and (5) of Article 17 are related to employment. They can be summarized as follows.

- ① The provision of Article 31 of the Act on the Honorable Treatment and Support of Persons of Distinguished Services to the State (3~8% of the total number of employees are required to be persons of distinguished services to the state) shall not apply to any foreign-invested enterprise located in free economic zones.
- ② The provision of Article 24 of the Employment Promotion and Vocational Rehabilitation of Disabled Persons Act (5% of the total number of employees are required to be disabled persons) shall not apply to any foreign-invested

enterprise located in free economic zones.

- ③ The provision of Article 12 of the Employment Promotion for the Aged Act (the employer shall strive to employ the aged above the standard employment rate) shall not apply to any foreign-invested enterprise located in free economic zones.
- ④ Despite the provisions of Article 54 (an employer shall allow workers at least one paid holiday per month on the average) and 71 (an employer shall grant a woman worker one day's menstruation paid leave per month) of the Labor Standards Act, weekly leaves and menstruation leaves may be unpaid. Also the provision of Article 57 (an employer shall allow workers a one day's paid leave per month) of the Labor Standards Act shall not apply.
- ⑤ The Minister of Labor may expand the work of dispatched workers who are engaged in expert types of business with any foreign-invested enterprise located in the free economic zones after going through deliberation thereon and a resolution thereof of the Free Economic Zone Committee and extend their dispatch period, notwithstanding the provisions of Articles five (Jobs under the Worker Dispatch System: direct production process in manufacturing, activities performed on construction sites, etc. are not allowed for dispatch work) and six (Length of Dispatch Period: the length of service period of dispatched workers shall not exceed one year and if an employer continues to use dispatched workers exceeding two years, such workers shall be deemed as directly employed.) of the Protection, etc. of Dispatched Workers Act.

Exceptions related to employment are stated in clause (1), (4) and (5) of Article 17. They allow enterprises located in free economic zones an exemption from the application of other Acts related to employment, which are considered to be stricter than international standards. These exceptions allow monthly paid leaves and menstruation paid leaves to be unpaid and lift regulations on dispatch jobs and length of the dispatch period.

Aside from this, Article 19 of this law urges employers and workers of enterprises located in free economic zones to maintain industrial peace. It states that the employer of every enterprise located in every free economic zone and the workers shall endeavor to maintain industrial peace by strictly abiding by the procedures resolving for labor disputes stipulated in relevant Acts.

When the Act was amended on May, 29th, 2003, provisions related to

employment and industrial relations were not touched at all. And when the Enforcement Ordinance of the Act was made on June 30th, no provisions were added for Article 17 and 19, which are related to employment and industrial relations.

Throughout the period when the introduction of the Act on the Designation and Operation of Free Economic Zones was announced and passed in the National Assembly, there was much heated dispute between employers who supported the provisions and workers who were against the provisions related to employment and industrial relations. The Federation of Korean Trade Unions and Korean Confederation of Trade Unions resisted the bill by even going on general strikes.

At the time, because some provisions related to employment allowed the exemption from the application of Labor Standards Act and other labor related laws to foreign-invested enterprise located in free economic zones and gave the enterprises special treatment, trade unions were concerned that the Act would lower labor conditions in EPZ, and therefore resisted the Act. On the other hand, employers had already been strongly arguing that general labor related laws that were stricter than international standards should be abolished, and that weekly, monthly and menstruation paid leaves which were a burden on companies should be abolished or shifted to unpaid leaves. Thus employers enthusiastically supported the employment and industrial relations related provisions of the Act, hoping that the provisions would be first realized at least in free economic zones. This shows that during the period of collecting public opinion, both employers and workers believed that the act would have a great impact on labor management in EPZs, and it is true that there was a high possibility that the act would have such an effect.

However on September 15th, not too long after the act was enforced, the amendment of the Labor Standards Act on reducing the legal work hour from 44 hours to 40 hours was passed in the National Assembly. Because of this, the significance of the employment related provisions in the Act on the Designation and Operation of Free Economic Zones was also diminished. On the one hand, the amended Labor Standards Act reduced working hours. On the other hand, the Amendment also abolished monthly paid leaves and shifted menstruation paid leaves to unpaid leaves. As a result, due to the amendment of Article 71 (menstruation leaves) and the deletion of Article 57 (monthly paid leaves) of the Labor Standards Act, clause (4) in Article 17 of the Act on the Designation and

Operation of Free Economic Zones, which allows unpaid menstruation leaves and exclusion of applying monthly paid leaves, became nullified.

Of course, the other labor related provisions of the Act on the Designation and Operation of Free Economic Zones still exist. However, from the very beginning, the effect of these other labor-related provisions was not expected to be large.

First, the exclusion of the application of required employment of persons of distinguished services to the state, the disabled and the aged in clause (1) of Article 17 may be somewhat burdensome to companies, but the required percentage is not that high. And in many cases the jobs carried out by these people are marginal jobs in the business and are not essential jobs. In addition if appropriately hired, it is possible to employ workers with the abilities need in the company from persons of distinguished services to the state, the disabled and the aged, therefore required hiring from these groups of people is not such a burden on companies.

Second, the provision on allowing paid weekly leaves to be unpaid, in clause (4) of Article 17 is expected to have some effect. However, there are more than a few countries that have weekly paid leaves, and the provision only allows the paid weekly leaves to be unpaid. Therefore it is expected that most foreign-invested enterprises located in the free economic zone will not try to shift their weekly paid leaves to unpaid leaves. This is because, unlike the initial phase of development, there are not many foreign-invested enterprises that locate in the free economic zones for the sole purpose of low wages.

Third, the provision on expanding jobs of dispatched workers and extending the length of dispatch period in clause (5) of Article 17 is expected to have a large effect. The Protection, etc. of Dispatched Workers Act, as can be seen in its name, is focused on protecting dispatched workers. Thus jobs under the worker dispatch system are extremely limited and the length of dispatch period can not exceed one year. Compared with international standards, this act is excessively strict and may make companies passive at using worker dispatch system to increase flexibility in the labor market. Since the Act on the Designation and Operation of Free Economic Zones allows the expansion of dispatched jobs and the extension of dispatch period, dispatched worker system is expected to gain momentum in the zones. However the expansion of jobs under the dispatch worker system is not unlimited. It is restricted to expert types of jobs that have gone through deliberation and approval of the Free

Economic Zone Committee.

Fourth, the effectiveness of the provision in Article 19, which is on the maintenance of industrial peace, is still questionable. It states that employers of enterprises located in free economic zones and their workers shall endeavor to maintain the industrial peace by strictly abiding by the procedures resolving for labor disputes stipulated in relevant Acts. However this provision is merely a requirement but a declaration or a recommendation to the employers and workers of enterprises located in free economic zones.



## 4. Policy Direction of the Development of Free Economic Zones and Labor Standards

Since the financial crisis, the Korean economy is undergoing rapid economic liberalization. Above all, institutional barriers are continuously being lowered or removed, so that foreigners can freely participate in economic activities, such as investment and trade. This is an extremely different approach from the so called 'period of push for national development', when FDI was minimized and importance was put on loans and raising domestic capital. In particular, with the launch of a new administration, economic liberalization in Korea is at a new qualitative turning point. Prior economic liberalization was a passive program induced by forces and conditions imposed on by outsiders, but the recent liberalization program is a proactive attempt to adapt to the changing external environments.

The designation of free economic zones (special economic zone) and the expansion of free trade agreements are good examples of such trends. These efforts are now being carried out under the new administration's national vision of making Korea the economic hub of Northeast Asia. The objective of free economic zones is to provide a favorable environment for attracting foreign capital through direct lifting or easing of various regulations and institutions.

In addition, the argument that labor issues need to be considered ahead of time and prevented when operating free economic zones has gained importance. Korea's rigid labor market and unstable industrial relations have been pointed out as significant obstacles in attracting foreign capital investment and FDI (Roh & Kim, 2003). Discussions on setting new and broadly acceptable labor standards on industrial relation and the labor market need to begin. This means that the labor, management and government's yardstick for labor standards need to be modified to some degree to accommodate one another. At a time when we are building free economic zones out of our own need and are striving to attract FDI, we have no choice but to seek clear solutions to labor related issues, which foreign investors have strongly asked to be modified.

However, given that international free economic zones have had a tendency of deteriorating labor standards, Korea needs to think innovatively to develop sustainable free economic zones. In other words, free economic zones need to

be based on social foundations which include labor standards, and we need to develop free economic zones that pursue a race to the top in the world competition. Those who are against free economic zones criticize that the design of free economic zones in itself deteriorates labor standards. However, in global competition, the importance of putting together the efforts to attract FDI can not be ignored.

In the process of further globalization, the most important economic situations that Korea will face are the rise of the Northeast Asian economic block and our strategic positioning and bid to become the economic hub within the new regional economic block. In the future, if the process of reaching a FTA in the Northeast Asia region with China and Japan accelerates, there will be even more extensive discussions on how we must set our labor standards with other trading partners in mind. We need to reach a consensus that, in Northeast Asia, seeking the benefits of economic integration and cooperation is better than a race to the bottom. In particular we need to establish a win-win relationship with China, based on technological competition rather than on wage competition. Also, we need to take full advantage of international actors to lure China into complying with international labor standards, rather than trying to provide more favorable labor standards than China.

There is a high possibility that exceptional labor standards in the free economic zones may become an issue, not only in international relations but also in reaching free trade agreements. Generally, provisions on labor standards in free trade agreements state that universal labor rights should be guaranteed and core labor standards should be abided by. In particular, when economically cooperating with China, the low labor standards in the free economic zones will not be able to give Korea a decisive advantage in attracting capital. And on the international front, Korea will not be able to urge China to improve its low labor standards, if Korea has low labor standards in its own free economic zones.

In the long-term, it is highly plausible that a FTA between Korea, China and Japan will be reached, and will be expanded to a Northeast Asian economic block. Therefore, considering this future prospect, it would be necessary to first set common labor standards with other major countries in the region such as China and Japan, and then work towards meeting these standards. The European Union has steadfastly undertaken efforts not only for economic integration but also for social integration. And labor standards of each country are adjusted toward the social clauses agreed at the EU. This is because for its

sustainable development, EU has made a strategic choice to enhance international competitiveness by engaging in a race to the top within the EU region, rather than engaging in a race to the bottom with the United States or nations in other regions.

Considering that there are thousands of free economic zones around the world and those in neighboring China, encouraging a race to the top with neighboring countries would be better than joining in a race to the bottom with them. This means that Korea should at least avoid a race to the bottom in labor standards with China. And at the same time, Korea's nationwide industrial relations which lag behind should be improved by advanced approaches experimented in the free economic zones. In addition, innovative measures to stabilize industrial relations and increase labor market flexibility must be sought after.

Furthermore, a social consensus must be built on the new growth strategy of the Korean economy, in which free economic zones are in line with. The labor, management and government's sweeping concession reached in February 1998 played an important role in overcoming the financial crisis. Now it is time for the labor, management and government to reach another sweeping concession, which will create a renewed momentum for development once again in Korea. As Ireland used the social agreement and unity as the driving force in establishing itself as the Celtic Tiger, Korea also needs to reach and make use of social agreement to build a sustainable open economy.

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