10. Kim Jong-Il's Financial Bind

NORTH KOREA'S VOLATILE BEHAVIOR has confounded analysts for many years. Of late, the record has included adamant and protracted unwillingness to return to the six-party talks in Beijing followed by an expressed willingness to do so. In the interim, the DPRK's volatility included launching seven missile tests on July 5 (Pyongyang time but, notably, July 4 in the United States) and, on October 9, 2006, its celebratory announcement of a "successful" nuclear explosion.

Pyongyang has explained its behavior as a justifiable response to American hostility, to American unwillingness to engage in direct bilateral talks, and to North Korea's need for a nuclear deterrent against a potential attack from American forces.

Various pundits have conjectured that Kim Jong-Il's behavior is also driven by resentment over the shift of international attention toward Iran and away from North Korea and his desire to reverse this shift.

Although not dismissing these several explanations, a more

Published in the *Wall Street Journal Asia* on November 21, 2006, under the title "Tokyo's Leverage over Pyongyang."

important one probably lies in Kim Jong-Il's need for external sources of flexible funds to run North Korea's dynastic state. One indication of the explanation's importance is suggested by the North's October 30 agreement to return to the stalled six-party talks with the explicit understanding that the agenda will include the subject of financial sanctions, although without any concession thus far that the sanctions would be relaxed.

Whatever North Korea's motives, a central question that has bedeviled the on-again, off-again talks is, "Who has the economic or financial levers to induce Kim Jong-Il to reverse course, return to the six-party talks, halt the North's weapons of mass destruction programs and eventually terminate them in accord with the agreement reached in September 2005?"

The usual answer has been that China has the principal leverage through its continued benefactions (of fuel and food) to the North, whereas South Korea has somewhat less leverage. Yet both China and South Korea are reluctant to exercise this leverage for fear of the consequences: respectively, refugees flooding into China's Jilin and Liaoning provinces or artillery shelling of South Korea.

A key and typically neglected actor in this standard mise-en-scène is Japan, which may well have more financial leverage than is usually acknowledged and probably less compunction about using it than China or South Korea.

Japan's financial leverage derives from the substantial volume of hard-currency (dollar or yen) remittances to North Korea by Korean residents in Japan. Reliable data on the amount of these remittances are elusive, as well as spanning a wide range. The actual amounts, however, may well be even larger than the approximately $200 million represented by the excess of China's annual exports to North Korea (including fuel and food) above its imports from the North.

The principal source of these remittances from Japan is the lucrative revenues accruing to Pachinko gaming parlors in Japan, one-quarter of which are owned by Koreans living in Japan. Although many of them do not favor the Kim regime, even those who don't may still have family members in the North and may believe or hope that the abject living conditions of their relatives will be at least slightly relieved by hard-currency transfers from Japan.

Pachinko, a favored and widespread pastime in Japan, generates gross revenues of more than 30 trillion yen annually, about $256 billion. Most of these revenues are absorbed by business expenses, taxation, and reinvestment, reducing the net income accruing to Korean owners by 75 percent or more. If as much as 2–3 percent of the remaining net income is transmitted to family and friends in the North through various channels—legal and illegal, by mail, by the limited tourism allowed by the North, by ship, by air, by routing through third and fourth countries—the resulting accruals to Kim Jong-Il may well amount to more than China's trade surplus with the DPRK.

Moreover, from Kim Jong-Il's perspective, these revenues have the added advantage of greater flexibility than the subventions provided by China in the form of specific commodities including food and fuel.

The critical importance of these revenues for the Kim dynastic regime can be inferred from the North's economic history and the regime's modus operandi.

In almost every year of North Korea's existence, it has incurred a balance of payments deficit (i.e., an excess of North Korean imports over its exports) of between $500 million and $1.5 billion. The same pattern occurred during the near half-century reign of Kim Il-Sung, the "Great Leader," until his demise in 1994, and during the twelve-year reign of his son, the "Dear Leader," Kim Jong-Il, since then.

During most of Kim Il-Sung's tenure, the principal source of funding for these deficits had been unrequited capital transfers from the Soviet Union. For most of Kim Jong-Il's reign, China and South Korea have been the major sources, along with growing reliance by North Korea on currency counterfeiting (of U.S. dollars) and remittances from the Korean diaspora in Japan.

Most of these revenues have accrued to the occupant of the dynastic Kim chair in Pyongyang. As did his father, so does Kim Jong-Il use this core of externally derived resources to provide the incentives and rewards that secure the loyalty and support of the key elites who manage the system: the generals in the Korean People's Army; the technocrats who direct the economy's industries, including its defense industry; and the top echelons of the Korean Workers Party. Any sign of weakened loyalty or diminished support within these elites results in withdrawal of rewards and their replacement by more severe penalties. Compliant behavior enables the system to survive.

Viewed in this light, several actions by the United States, China, and Japan during the past several months may appear to Kim Jong-Il as constituting a fundamental threat to the regime's survival. Those actions include the U.S. Treasury Department's designation of Macau's Delta Asia Bank as a primary vehicle for money laundering in Asia and specifically as a repository for North Korean accounts derived from counterfeiting of U.S. currency and from other illicit practices. With the cooperation of China, this designation led to the closing of the Delta Asia Bank and the freezing of several other overseas North Korean accounts.

Another worry signaled by Japan, and probably more likely to materialize under the administration of its new prime minister, Shinzo Abe, than his predecessor, Junichiro Koizumi, involves careful monitoring and prospective curtailment of remittances by North Korean residents in Japan of the net earnings from the lucrative Pachinko casinos, referred to above.

China's influence was probably decisive in inducing North

Korea to announce its willingness to return to the six-party talks. It is likely that Japan's influence will be crucial if the talks are to succeed in meeting their salient objectives.

In the long run, reversing and terminating Pyongyang's nuclear program requires addressing as central issues the financial and operational characteristics of the North Korean system, not just the issues of political and security threats by or to North Korea, which thus far have been the principal focus of attention. For the system to survive, it must change. It must be modernized so it can gain access to the financial support that normal integration into the world economy will bring through trade, capital transactions, and tourism and forgo its endeavors to acquire such funding through illicit and hazardous means.

POSTAUDIT

Japan's leverage is both more important than is usually acknowledged and too often neglected in discussions of and with North Korea.