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Sanctioning Ships and Slush Funds: Countering North Korea's Illicit Maritime Trade

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Introduction

Over the past eleven years, the UN Security Council has enacted seven separate rounds of sanctions against the North Korean regime. By not only foreclosing the regime's ability to finance and supply its nuclear program, but also curbing the personal profits North Korean elites enjoy from trade, pressure from economic sanctions—the thinking goes—ought to drive the regime back to the negotiation table on denuclearization.¹ Yet despite the two most recent sanction resolutions targeting coal and rare earth minerals, two of its largest industries, North Korea has still shown no indication that it intends to voluntarily step back its nuclear program.²

What the failure of sanctions on North Korea's *licit* economy points to is the need to target North Korea's *illicit* economy. North Korean sponsored illicit activities, including drug trafficking, arms sales, and the counterfeiting of foreign currency, contributes an estimated \$6.5 billion USD annually to the regime—nearly three times the amount of all Chinese imports from North Korea.³ To effectively pressure Pyongyang to return to the negotiation table on its nuclear program, the United States must focus its efforts towards disrupting North Korea's covert economy. Specifically, the United States must launch a robust campaign to target North Korea's commercial maritime fleet, which serves as an unchecked funnel for North Korean-produced methamphetamine, counterfeit goods, and military equipment to enter black markets around the world.

Background and Data

The North Korean illicit economy dates to 1976, when it was forced to default on its international debts due to an accumulated negative balance of payments.⁴ Shortly thereafter, North Korean embassies began smuggling illicit goods into their host countries via diplomatic pouches to self-finance their operations, leading to a series of high-profile arrests and ejections of North Korean diplomats from Europe. The practice continued, but likely due to the embarrassment these diplomatic incidents caused the regime, North Korea began leaning more on covert operations conducted by "Office 39," often referred to as a "billion-dollar crime syndicate" and "Kim Jong-un's slush fund."⁵ Through the fall and loss of economic support from the Soviet Union, Office 39 has overseen the production and trafficking of opiates and methamphetamine (producing an estimated \$500 million to \$1 billion USD in revenues annually), counterfeit cigarettes (estimated \$80–160 million USD annually), small arms and missiles (estimated \$560 million USD annually), and counterfeit US currency to a diverse range of customers in countries as close as Japan and as far as Syria.⁶ These efforts have allowed the regime to stay afloat, in spite of its crippling trade deficit and the foreclosure of nearly every available trade partner to the country.⁷

These illicit goods are distributed into the Chinese and global markets through two primary routes: land-based and maritime-based trade channels.⁸ The Sino-Korean Friendship Bridge that connects the North Korean city of Sinuiju to the Chinese city of Dandong is one such land route, responsible for approximately 80% of formal trade between China and North Korea.⁹ Illicit North Korean goods that enter China via this route are either hidden alongside regular rail or truck cargo, or are permitted to pass after its traffickers pay a small bribe to customs officials.¹⁰ Another portion of illicit goods enters across the border through the so-called “3-3-3” connection system, where a complex web of North Koreans, Chinese and Chinese-Koreans, and South Koreans ferry the drugs in teams of three across the North Korean border, and then distribute the drugs within China or smuggle larger shipments to Japan and South Korea.¹¹

Though land-based smuggling is more often reported on, North Korean maritime trade is a far more pernicious threat because it offers North Korea the ability to ferry a much larger volume of cargo to a much broader base of customers around the world. For example, various ships among North Korea’s fleet of approximately 240 commercial ships have been repeatedly apprehended for carrying methamphetamine shipments to Japan, or arms shipments to Syria.¹² The most infamous among the fleet is the *Chong Chon Gang*, a general cargo ship that had been detained by Iran and Egypt for carrying “dangerous goods”; detained by Ukraine for carrying drugs, alcohol, cigarettes, and AK-47 ammunition; chased and fired upon by Somali pirates; and in 2013, detained by Panama for hiding two anti-aircraft missile systems, nine missiles, two MiG-21 jets, and fifteen MiG-21 motors under 10,000 tons of brown sugar.¹³

The fact that the *Chong Chon Gang* and other illicit North Korean ships remain operable today can be attributed to two factors: first, despite agreeing to the latest sanctions regime, China has largely refused to enforce mandatory inspections of North Korean ships that dock in Chinese ports; and second, sanctioned North Korean ships regularly take advantage of a quirk in international maritime law known as “flags of convenience,” where unscrupulous merchant ships register under the flag of a foreign nation to evade legal scrutiny. By flying the flag of Tuvalu, for example—as one North Korean ship did in 2003 after being seized by Australian authorities for smuggling heroin—North Korean ships can disguise their identities and more easily ward off international attention.¹⁴ Iranian ships had notably employed this strategy in 2013, registering their ships under the flag of Tanzania to continue operating internationally.¹⁵

Policy Recommendations

On the issue of land-based trade, the brunt of the effort must be made by Chinese authorities, who control railway and bridge access to North Korea and enforce border security along the Yalu River. To support this effort, the United States can offer capacity-building and support for Chinese customs and border agents, who remain direly understaffed. One recent report in the *New York Times* found that

China only had enough customs officials on hand at the border to inspect one of every twenty trucks crossing into North Korea.¹⁶ Exporting advanced scanner machinery to China—like Genia Photonics’ laser-based molecular scanners, procured for the United States by the US government-sponsored venture capital firm, In-Q-Tel—could help alleviate the inspection burden.

On the issue of maritime-based trade, short of imposing a highly provocative, full-scale blockade, the United States can deny North Korean access to international trade by employing softer, diplomatic measures. One model for this exists in UANI (United Against Nuclear Iran), an advocacy platform founded by former US special envoy for Afghanistan and Pakistan, Richard Holbrooke, and led by former US senator Joe Lieberman and former US ambassador to the UN, Mark Wallace.¹⁷ Since 2008, UANI has waged an international campaign calling on shipping companies, flag states, marine insurance companies, and flag classification societies to end their business with Iranian shipping companies. On the research-end, UANI publishes “Minerva reports” on the activities of Iranian shipping vessels that track illicit Iranian maritime activities in real time and name-and-shame companies and countries that continue to trade with Iran. Through its efforts, UANI managed to convince the countries of Barbados, Hong Kong, Moldova, and Mongolia to delist and deny flags of convenience to Iranian ships; and convinced Russian, Korean, Chinese, and Japanese classification societies to refuse registration to Iranian companies.¹⁸ This, in tandem with formal diplomatic efforts from Washington and Brussels, imposed a heavy burden on Iranian trade and undoubtedly contributed to Tehran’s decision to come to the nuclear negotiation table in 2015.

Though the Iranian and North Korean nuclear programs are undoubtedly different cases, a coordinated effort to deny North Korean access to the international maritime system would contribute greatly towards crippling the North Korean illicit economy and starving North Korean officials of vital cash flow. Implementing a similar program against the North Korean regime would involve the following steps:

- 1) *Initiate and provide funding for a spinoff of UANI that addresses the North Korean threat:* UANI was exceptionally successful because it remained a public-facing and nongovernmental organization. While it leveraged its founders’ government connections for credibility and legitimacy, the fact that it remained a nongovernment organization allowed it to take on a far more vocal role in naming-and-shaming foreign countries and corporations. Though the US government can provide funding for a North Korean variant of UANI, it is imperative that it remains nongovernmental for the above reasons, as well as to avoid the general sclerosis of a typical governmental task force. Additionally, the US government can also fund organizations that already produce Minerva-like reports: C4ADS, a data analytics-focused think tank, is one notable organization that has leveraged Palantir and other big-data tools to produce timely reports on North Korean maritime operations.¹⁹

- 2) *Expand the Proliferation Security Initiative (PSI)'s mandate beyond Weapons of Mass Destruction (WMDs):* The PSI is a 105-nation pact formed to combat North Korea's trafficking of WMDs through unflagged maritime vessels. President George W. Bush launched PSI in 2003 in response to the *So San* incident, when the United States failed to intercept fifteen Scud missiles found aboard an unflagged North Korean freighter because at the time, there was no international treaty governing the trade or possession of ballistic missiles.²⁰ While the PSI has long been criticized for being little more than a soapbox for nonproliferation issues, and for its internecine disputes—a product of its leadership being split between the National Security Council and the State and Defense Departments—it offers a natural launching pad for a renewed international effort against North Korean illicit trade.²¹
- 3) *Launch a Treasury-State-Defense interagency working group:* While the PSI offers a platform to coordinate intergovernmental efforts, creating an interagency group between the Treasury, Defense, and State Departments and other relevant government bodies could help synchronize these efforts and minimize overlap. However, it is important to recognize that interagency groups can just as often exacerbate, rather than alleviate, interagency conflict. For example, the Government Accountability Office (GAO) found that the Terrorist Financing Working Group (TFWG), a similar trade-diplomacy-national security interagency effort, was plagued by disputes between the Treasury and State Departments on matters of leadership of the group, as well as a lack of measurable outcomes produced by the group.²² As such, any new interagency body would require a clear line of leadership and optimally would be organized at the deputies-level or below to minimize political infighting.

Evaluation and Summary

Overall, the desired outcome of a campaign against North Korea's illicit maritime shipping is to reinforce the effects of already existing sanctions: to affect a sharp decline in the amount of money entering North Korean coffers. This policy is thus intended as a stopgap, a plug to cover the areas where these conventional sanctions fail.

However, the essential nature of illicit trade means that it would be near impossible to fully credit the effects of interdiction on North Korean finances. Rather, measurements of effectiveness should be gauged by figures like the number of countries that agree to deregister North Korean ships, the number of ships inspected by the United States or partner nations, or the number of Chinese companies that pledge to sever business ties with North Korea.

Finally, it is important to recognize that addressing maritime trade alone is not a "magic-bullet," neither for countering the illicit goods trade nor for the broader goal of denuclearization. On the former point, any effort to constrain the flow of

North Korean illicit goods must also include efforts to address the reverse flow of currency back into North Korea, which is typically facilitated by Chinese and Macau-based banks. On the latter point, constraining ill-gotten profits is intended only as one prong of a much larger strategy to drive the regime to the negotiating table—what must inevitably follow is a comprehensive diplomatic strategy, grounded in a firm analysis of the North Korean regime’s red lines and fundamental interests.

¹ United Nations, “Security Council Strengthens Sanctions on Democratic Republic of Korea, Unanimously Adopting Resolution 2321,” news release, SC/12603, November 30, 2016.

² United Nations Security Council Resolution 2321 (condemning North Korean nuclear test), November 30, 2016, accessed February 13, 2018, https://www.un.org/ga/search/view_doc.asp?symbol=S/RES/2321; Meng Meng and John Ruwitch, “North Korean Ships Head Home After China Orders Coal Returned,” *Reuters*, April 11, 2017, accessed February 13, 2018, www.reuters.com/article/uk-china-northkorea-coal-exclusive-idUKKB-N17D0DA; United Nations Security Council Resolution 2270, 2016, accessed February 13, 2018, <https://www.un.org/sc/suborg/en/s/res/2270%282016%29>.

³ Estimate from Bruce Bechtol, professor of political science, Angelo State University: “The money that North Korea makes from illicit activities is 40 percent of their real economy.” The estimate of \$6.5 billion is based on 40 percent of DPRK’s 2015 GDP of \$16.2 billion GDP. North Korea GDP, accessed February 13, 2018, <https://tradingeconomics.com/north-korea/gdp>; Trade statistics based off of \$2.34 billion figure from MIT Observatory of Economic Complexity, accessed February 13, 2018, <https://atlas.media.mit.edu/en/profile/country/prk>.

⁴ Richard Halloran, “North Korean Lag on Debt Reported,” *New York Times*, February 26, 1976. accessed February 13, 2018, www.nytimes.com/1976/02/26/archives/north-korean-lag-on-debt-reported-payments-problems-said-to-cause.html.

⁵ David Rose, “North Korea’s Dollar Store,” *Vanity Fair*, September 2009, accessed February 13, 2018, <https://www.vanityfair.com/style/2009/09/office-39-200909>; “Kim Jong Un’s Personal ‘Slush Fund’ Known as ‘Office 39’ Hit by Sanctions,” *National Post*, August 10, 2017, accessed February 13, 2018, <http://nationalpost.com/news/world/kim-jong-uns-personal-slush-fund-known-as-office-39-hit-by-sanctions>.

⁶ On methamphetamine figures: Balbina Hwang, “DPRK Briefing Book: Curtailing North Korea’s Illicit Activities,” Nautilus Institute, August 25, 2003. accessed February 13, 2018, <http://nautilus.org/publications/books/dprkbb/terrorism/dprk-briefing-book-curtailing-north-koreas-illicit-activities>; cigarette figures: David Asher, “The North Korean Criminal State, Its Ties to Organized Crime, and the Possibility of WMD Proliferation,” Nautilus Institute, November 1, 2005; Sheena Chestnut Greitens, “Illicit: North Korea’s Evolving Operations to Earn Hard Currency,” Committee for Human Rights in North Korea, 36; missile sales figures: Larry Wortzel, “North Korea’s Connection to International Trade in Drugs, Counterfeiting, and Arms,” testimony before the Senate Governmental Affairs Subcommittee on Financial Management, Budget, and International Security, Heritage Foundation, May 20, 2003, accessed February 13, 2018, <https://www.heritage.org/testimony/north-koreas-connection-international-trade-drugs-counterfeiting-and-arms>.

⁷ Paul Rexton Kan, Bruce E. Bechtol Jr., and Robert M. Collins, “Criminal Sovereignty: Understanding North Korea’s Illicit International Activities,” Army War College, March 2010, accessed February 13, 2018, <https://ssi.armywarcollege.edu/pdf/files/PUB975.pdf>.

⁸ North Korea’s air-based trafficking of arms shipments has been documented in the past (see December 2009 North Korean surface-to-air missile shipment detained in Bangkok), but there is scant evidence that it is nearly as consequential as land and maritime trade. Typically, because of the greater risk of interdiction and the smaller allowable cargo volume, air-based transport is reserved for more sensitive shipments, like missiles and radar technology.

⁹ Jane Perlez, Yufan Huang, and Paul Mozur, “How North Korea Managed to Defy Years of Sanctions,” *New York Times*, May 12, 2017, accessed February 13, 2018, <https://www.nytimes.com/2017/05/12/world/asia/north-korea-sanctions-loopholes-china-UNITED-STATES-garment-industry.html>.

¹⁰ Andrei Lankov, “For N. Koreans in Dandong, It’s Business as Unusual,” *NK News*, February 2, 2016, accessed February 13, 2018, <https://www.nknews.org/2016/02/for-n-koreans-in-dandong-its-business-as-unusual>.

¹¹ Brian Liu, “A ‘Runaway Train’? Human Rights and China’s Response to the North Korean Meth Trade,” North Korea Strategy Center, December 18, 2015, accessed February 13, 2018, http://nksc.us/wp-content/uploads/2016/03/121815_A_Runaway_Train_BL.pdf; “China Angry at NK Drug Trafficking,” *The Korea Times*, July 2011, accessed February 13, 2018, www.koreatimes.co.kr/www/news/nation/2011/07/116_90527.html.

¹² Anshel Pfeffer, “Russian, North Korean Arms Ships to Dock in Syria as Bloody Crackdown Continues,” *Haaretz*, May 26, 2012, accessed February 13, 2018, <https://www.haaretz.com/russian-north-korean-arms-ships-to-dock-in-syria-as-bloody-crackdown-continues-1.5163582>.

¹³ Oren Dorell, “North Korea Ship Held in Panama Has a Colorful Past,” *USA Today*, July 17, 2013, accessed February 13, 2018, accessed February 13, 2018, <https://www.usa-today.com/story/news/world/2013/07/17/n-korea-ship-checkered-history/2524479>.

¹⁴ Keith Bradsher, “North Korean Ploy Masks Ships under Other Flags,” *New York Times*, October 20, 2016, accessed February 13, 2018, www.nytimes.com/2006/10/20/world/asia/20shipping.html.

¹⁵ Claudia Rosett, “Have Tehran’s Tankers Hijacked the Tanzanian Flag?” *Forbes*, July 12, 2013, accessed February 13, 2018, <https://www.forbes.com/sites/claudiarosett/2013/07/12/have-tehrans-tankers-hijacked-the-tanzanian-flag/#388e6ceb3dfa>.

¹⁶ Jane Perlez and Yufan Huang, “A Hole in North Korean Sanctions Big Enough for Coal, Oil and Used Pianos,” *New York Times*, March 31, 2016, accessed February 13, 2018, <https://www.nytimes.com/2016/04/01/world/asia/north-korea-china-sanctions-trade.html>.

¹⁷ “About Us,” United Against Nuclear Iran, accessed February 13, 2018, <https://www.unitedagainstanucleariran.com/about>.

¹⁸ “Shipping Campaign,” United Against Nuclear Iran, accessed February 13, 2018, <https://www.unitedagainstanucleariran.com/shipping-campaign>.

¹⁹ See, for example, C4ADS, “In China’s Shadow,” Asian Institute for Policy Studies, August 2016, accessed February 13, 2018, <https://static1.squarespace.com/static/566ef8b-4d8af107232d5358a/t/57dfe74acd0f68d629357306/1474291539480/In+China%27s+Shadow.pdf>.

²⁰ David Sanger and Thom Shanker, “Threats and Response: War Materiel; Reluctant U.S. Gives Assent for Missiles to Go to Yemen,” *New York Times*, December 12, 2002, accessed February 13, 2018, www.nytimes.com/2002/12/12/world/threats-responses-war-materiel-reluctant-us-gives-assent-for-missiles-go-yemen.html.

²¹ Mark Valencia, “North Korea and the Proliferation Security Initiative,” *38 North*, July 29, 2010, accessed February 13, 2018, www.38north.org/wp-content/uploads/2010/07/38north_SR_PSI.pdf.

²² Government Accountability Office, “Terrorist Financing: Agencies Can Improve Efforts to Deliver Counter-Terrorism-Financing Training and Technical Assistance Abroad,” GAO-06-632T, April 6, 2006, accessed February 13, 2018, <https://www.gao.gov/assets/120/113465.html>.