

Statement before the  
Senate Committee on Banking, Housing, and Urban Affairs

**“Evaluating Sanctions Enforcement and Policy Options on North Korea”**

Testimony by:

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## Introduction

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify before you today. As requested by the Committee, I'll be providing key findings from my research into the North Korean regime's accumulated learning in evading sanctions, and outlining ways to bolster efforts to stop its procurement of banned items for its WMD programs. Such efforts are urgently needed as the regime continues to make rapid advances in its nuclear weapons development program – most recently a 6<sup>th</sup> nuclear test and an intermediate-range ballistic missile flight over Japan.<sup>1</sup>

## How Has the North Korean Regime Evaded Sanctions?

As I highlighted in my testimony in July before a subcommittee of the House Committee on Financial Services, the North Korean regime's sanctions evasion techniques have improved significantly because of North Korea, Incorporated's migration to the Chinese marketplace.<sup>2</sup> As a result, U.S. policymakers need to diversify the set of policy tools beyond sanctions to disrupt North Korean-Chinese business partnerships operating inside of China.

My MIT colleague, Dr. Jim Walsh, and I conducted research on North Korea, Incorporated – a term we use to describe the regime's web of elite state trading companies. We found that the net effect of sanctions was that they, in practice, ended up strengthening the regime's procurement capabilities – what we call the "sanctions conundrum."<sup>3</sup>

In the marketplace, increasing sanctions on North Korea's state trading companies had the effect of elevating the risk of doing business with these entities. However, rather than deterring local Chinese business partners, the elevation of risks and rewards attracted more capable, professional

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<sup>1</sup> The primary U.S.-led response to these provocations has been a robust call for enhanced sanctions in the UN Security Council (UNSC). The pillars of the UNSC sanctions regime on North Korea include resolutions 1718 (2006), 1874 (2009), 2087 (2013), 2094 (2013), 2270 (2016), and 2371 (2017). The context surrounding these resolutions is usually a nuclear test or launch using ballistic missile technology, which then triggers a UNSC response through Chapter VII measures. These tests and launches are repeatedly condemned as a clear threat to international peace and security. North Korea is urged not to conduct any further test or launch, reminded of its international obligations, and called upon to abandon all of its nuclear weapons and existing program in a complete, verifiable, and irreversible manner. With each passing resolution, the scope and substance have both widened and deepened, entailing very specific provisions. "Halting North Korea's Nuclear and Ballistic Missile Development Programs," Asan Institute-Harvard Belfer Center Workshop, Seoul, June 2017.

<sup>2</sup> Park, John. Testimony before the House Committee on Financial Services' Monetary Policy and Trade Subcommittee, "Restricting North Korea's Access to Finance," 19 July 2017. Accessed at: <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402134>

<sup>3</sup> Park, John and Jim Walsh, "Stopping North Korea, Inc.: Sanctions Effectiveness and Unintended Consequences," MIT Security Studies Program, August 2016. Accessed at: [https://drive.google.com/file/d/0B\\_ph0c6i87C\\_eGhCOGRhUVFaU28/view](https://drive.google.com/file/d/0B_ph0c6i87C_eGhCOGRhUVFaU28/view)

middlemen to procure illicit items on behalf of North Korean clients. The process that drove this outcome was the monetization of risk. The higher the sanctions risk, the higher the commission fee that a North Korean entity had to compensate a local middleman.

In sum, targeted sanctions – unintentionally and counterintuitively – helped to create more efficient markets in China for North Korea, Incorporated.

Significantly, one of the biggest setbacks for North Korea, Incorporated in recent years was an accidental one. In the early years of Xi Jinping’s tenure as General-Secretary of the Communist Party of China, his signature Anti-corruption campaign swept up “tigers and flies.”<sup>4</sup> Some of these corrupt party officials were, directly or indirectly, involved in business deals with North Korean procurement agents embedded in the Chinese marketplace.

In applying this potent domestic policy tool, the Chinese authorities had – unintentionally and highly effectively – disrupted specialized North Korea-China business partnerships. While this precedent was an accidental one, there are important lessons that can be applied to the immediate goal of halting the North Korean regime’s procurement of illicit items for its nuclear and ballistic missile development programs.

We can and must disrupt these partnerships upstream – before the procured item becomes a part of globalized trade flows on its way to North Korea. To do so, we need to diversify the set of policy tools beyond sanctions and coordinate with different policy actors – like compliance departments in financial institutions and Chinese law enforcement – to significantly reduce the wide-open space in which North Korea, Incorporated currently operates.

### **What Additional Policy Tools Are There?**

In addition to the policy recommendations offered by my distinguished colleagues on the panel, I’d like to bring to the Committee’s attention what I call the “Three Antis.” These are a set of China’s domestic policy tools – namely, Anti-corruption apparatus, Anti-narcotics campaign, and Anti-counterfeiting activities – that can be used to impede North Korea’s illicit procurement.

#### *1) Anti-Corruption Apparatus*

The September 2016 case of the Dandong Hongxiang Industrial Development Company<sup>5</sup> serves as an important – intentional – precedent for scaling up the application of the Anti-corruption apparatus to target corrupt Party officials involved in these Sino-North Korean business

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<sup>4</sup> The term “tigers and flies” refers to national as well as local-level corrupt Party officials, who have been the targets of Xi’s Anti-corruption apparatus. “Portrait of a purge: Who is being investigated for corruption and why?” *The Economist*, 13 February 2016. Accessed at: <https://www.economist.com/news/china/21692928-who-being-investigated-corruption-and-why-portrait-purge>

<sup>5</sup> “In China’s Shadow: Exposing North Korean Overseas Networks,” Asan Institute for Policy Studies and C4ADS, August 2016. Accessed at: <https://c4ads.org/reports/>

partnerships. Given the link between private Chinese middlemen and local corrupt Party officials, using the Anti-corruption apparatus intentionally to target North Korean-Chinese business partnerships would have an immediate impact on procurement deals. Of all the policy tools, this substantial one is readily available, but dependent on the senior Chinese leadership's decision to go down this path. The U.S. threat of applying secondary sanctions on large Chinese banks and companies could elevate the Chinese leadership's interest in pursuing this path.<sup>6</sup>

## *2) Anti-Narcotics Campaign*

An open secret in China's northeastern provinces is that there's an expanding narcotics problem emanating from North Korea. Called "ice," this cheap and highly addictive form of methamphetamine is produced in large quantities in North Korean pharmaceutical factories. Drawing on the precedent of Sino-U.S. cooperation in the late 2000s when China was confronting an inflow of opiates through its border with Afghanistan, there's an opportunity to adapt the previous program to China's northeastern provinces. Although aimed at the narcotics trade, the positive spillover effect of increased Chinese law enforcement activities would further constrain the areas in which North Korea, Incorporated and its Chinese partners operate.

## *3) Anti-Counterfeiting Activities*

The North Korean regime is well documented as the most prolific creators of "supernotes" – counterfeited US\$100 bills. What's not so well known in the West is that there's strong concern in China that its neighbor has been counterfeiting Chinese currency. From Beijing's perspective, this criminal activity is a direct threat to China's national economic security. U.S. policymakers could leverage this Chinese concern to elevate channels of bilateral cooperation drawing on U.S. experience tracking down the North Korean regime's sophisticated counterfeiting operations. Given the high threat level, the United States should encourage China to further expand the deployment of Chinese law enforcement resources trained on counterfeiting activities, with special authorization to investigate and inspect North Korea-related consignments and facilities.

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<sup>6</sup> If the U.S. government were to solely apply secondary sanctions on large Chinese banks and companies, there would be two likely main consequences that it would have to anticipate and for which it would have to prepare. The first would be an immutable Chinese stance that such measures amount to being forced to apply foreign laws in an area under Chinese jurisdiction, which would be viewed as a violation of China's sovereignty. The second would be unintended setbacks for U.S. business interests following the designation of these large Chinese entities, which operate widely in the global marketplace. These setbacks could range from delays in completing transactions to cancellation of major business projects. Engaging major Asia-based U.S. business firms in a full-scope assessment of the setbacks they anticipate from the application of secondary sanctions on their Chinese counterparts would yield valuable insights. These insights, in turn, could be useful in recalibrating the application of secondary sanctions.

## **Conclusion**

Objectively assessing how criminal North Korean activities affect China's national interests yields a clear view of areas of common ground upon which we can build a common cause with Chinese authorities in stopping North Korea, Incorporated. The work of the Committee, the panel members, as well as sanctions-focused officials in the U.S. government is more critical than ever in this endeavor.

Thank you.