



DATE: July 28, 2017

SUBJECT: Economic Levers of U.S. Policy Toward North Korea

MAIN POINTS

- Despite increased sanctions applied to the North Korea, some pockets of the North Korean economy are on the rise as they embed themselves in the supply chain of foreign trade.
- The reason that coercive sanctions are not successful is due to U.N. influence on which they are based. Instead of engaging the U.N, the U.S. should use its own authorities to push forward reform, such as in the case of Iran.
- The threat of sanctions is more effective than actual sanctions, which will be rendered ineffective the moment they are applied. We should enact secondary sanctions on countries like China but preferably in the form of threat.

Live Stream:

<https://www.cnas.org/publications/video/economic-levers-of-u-s-policy-toward-north-korea>

EVENT OVERVIEW:

Date: July 28, 2017

Time: 9:30 a.m. – 11:30 a.m.

Location: 1152 15th St NW Suite 950, Washington, DC 20005

Attendees

- **Dr. Patrick M. Cronin**, Senior Advisor and Senior Director of the Asia-Pacific Security Program at the Center for a New American Security (CNAS)
- **Edward Fishman**, Research Fellow at the Atlantic Council’s Dinu Patriciu Eurasia Center, where he focuses on Europe, Russia, and the use of economic sanctions as a tool of foreign policy and deterrence strategy.
- **Peter Harrell**, Senior Fellow at the Center for a New American Security
- **Rachel Ziemba**, leader of 4CAST-RGE’s Emerging Markets coverage

- **Sabrina He**, Recorder & Photographer, Research Intern at HRNK

Dr. Patrick M. Cronin's Speech

Today is the 64th anniversary of the armistice that ended the Korean War, yet tension in the Korean peninsula is rising, despite deterrents that have prevailed since the 1953 armistice. There is a balance of terror that deters another war. That being said, both war and a favorable post-war order in the Korean peninsula are at risk.

There are three options for U.S. policymakers:

1. Ignore the problem: This is the idea behind strategic patience, that we could outsource the problem to China. The Trump administration advocates that we can no longer be the police of the world. This is not a real option but a conceptual one.
2. Eliminate the problem: Everyone wants this option but the question is how. A famous Australian author talked about how a pre-emptive war is the least bad option. However, offensive war should not be thought of as a policy option. Fighting under attack is a different matter.
3. Contain and manage down the risk: This is a viable option. We should put pressure on both North Korea and China to make North Korea more pliable and get them to accept our proposed diplomatic framework. Meanwhile, we should continue with deterrence and defense.

The North Korean agenda has not changed. It has been relentlessly trying to build a nuclear arsenal under Kim Jong-un, backed by a lot of other threats including the conventional targeting of Seoul, cyber threats, as well as chemical and biological weapons. Talks about possible regime change are associated with the CIA director, prompting the North Korean press to state that if the U.S. were to initiate regime change, they will strike Washington with nuclear weapons. This is a revealing statement for two reasons: 1) it showcases North Korea's ambitious aspirations; and 2) North Korea's biggest fear is the toppling of the Kim regime.

President Moon is seeking a Sunshine 2.0 policy, the idea of being open to an inter-Korean summit anytime anywhere. He is calling for a peace treaty by 2020 and military reduction talks, but North Korea has not been answering. The Chinese have been receptive to pressure but that pressure has been insufficient given how North Koreans are embedded in the Chinese marketplace. The U.S. is trying to enact secondary sanctions to make China more serious about containing North Korea. The problem is that the U.S. and China have different goals: while the U.S. wants to strengthen deterrence, China opposes deployments like THAAD and does not favor a U.S.-ROK alliance.

Current sanctions fall into four purposes: 1) penalization of bad behavior; 2) pursuit of nuclear mass destruction; 3) unity around North Korea; and 4) coercion of regime change. We are in the third tri-diplomacy to move towards denuclearizing North Korea. Meanwhile, China wants suspension for suspension, or the elimination of a ROK-U.S. alliance.

Rachel Ziemba's Speech

Broadening and combining topics across security and economic relations is a common theme today. I sit here representing the private sector and will speak on behalf of asset managers I communicate with daily.

The North Korean economy is one that is largely built on recycled aid and other key products, and occasionally, the export of cheap labor and goods particularly in the textile industry. Despite targeted sanctions, we have seen progress in some pockets of the North Korean economy, though this is still a country vulnerable to economic shocks. China is clearly a lifeline to the North Korean economy, but it would be wrong to assume all of the trade and finance is coming through China, since Russia has stepped in energy support and other financial areas.

One economic puzzle is that as China reduced coal imports from North Korea very sharply, it has created noticeable changes in the trade deficit (now 2 billion in China's favor) between China and North Korea. Businesses over time are faced with a constant rate of default (the counterpart is high payment, but most have ultimately ended with a loss). Though the impact of North Korean trade on China's broader economy is modest, the regional impact concerning such trade is meaningful. It is important that we consider the North Korean issue in the context of the Chinese government's financial and economic goals on top of security.

Finally, this is a time during which the U.S. and the new South Korean government are at an unfamiliar phase. There is a timeline to renegotiate the U.S.-ROK relationship but also a series of issues relating to both currency policy as well as bilateral trade. We must bear in mind those dynamics when devising policies.

Edward Fishman's speech

Now is an important time to talk about North Korean sanctions, especially when war is not a desirable option. There are a variety of reasons why the U.S. uses sanctions. We use them to stigmatize bad actions, prevent the flow of bad materials, marshal international support, and most importantly coerce foreign governments to do what they do not want to do. They have not worked in the North Korean context but such outcome is expected, as we have not structured our sanctions in a way that will make them work in the North Korean context. We have focused too much on other areas of sanctions at the expense of coercion.

For example, the Iran sanctions are successful because they have applied so much economic pressure as to constrain Iran's nuclear program. They are much stronger than the North Korean sanctions today. However, juxtaposing North Korean and Iranian sanctions, the former are far more expensive, so why was Iran more successful? In Iran, the UNSC resolution was used to marshal international support, but we did not bring coercive secondary sanctions to UNSC members. With North Korea, the paradigm is completely different. We are trying to negotiate a coercive program within the UNSC, thus receiving little success because China and Russia have vetoes. We must therefore shift the paradigm into one like Iran's, where we engaged U.S. authority in the absence of influence from Moscow and Beijing.

The common myth that North Korea is immune to economic sanctions should be reconsidered. North Korea is at the middle of global GDP, but in 2015, a third of North Korea's GDP came from foreign trade, which was higher than Iran's ratio in 2010. From a sanction practitioner's standpoint, foreign trade is the most targeted environment. Secondary sanctions have gotten attention but are not effective because once you apply them, you have already lost. The whole purpose is to use the threat of sanctions. How would we leverage better threat of secondary sanctions to cut into trade with North Korea? We must have a holistic approach in which all branches of the U.S. government work together. Second, we must espouse a broad de-legitimization campaign (against trade with North Korea) around the world. Third, we must outreach to the private sector. It is important for the U.S. government to highlight North Korean tactics against sanctions because doing so will trigger better compliance.

A few ideas in the report (blueprint):

1. Abide secondary sanctions to any entity purchasing North Korean exports, but we must employ significant reduction reception, which we previously employed to Iranian oil exports. Even China at the time halved its oil imports from Iran, so this tactic has a proven record of working even with China.
2. Force North Korean trading partners to keep North Korean revenue in escrow accounts to prevent hard currencies from being repatriated into North Korea to be used for malign purposes.
3. Sanction all eight of North Korea's significant ports.

If these strategies are applied, the economic pressure on North Korea would be dramatically increased and lead to better results. Leveraging secondary sanctions will work because trade is much more important to North Korea than for India, Pakistan, and so forth. If the U.S. pressures those countries, it can significantly reduce trade activities with North Korea.

In terms of China, it does fear instability in North Korea, but whether increased sanctions versus military tension cause more instability to China is to be debated. China will be more likely to accommodate economic pressures if coerced by the U.S. through the above methods. This is a much harder problem than the one in Iran, but given the poor options we have, it would not hurt to try the above economic measures.

Q&A

Q (Mr. Harrell): The Trump administration is much more willing than previous ones to link issues together. Is this a good strategy?

A (Ms. Ziemba): A bigger issue outside of linkage is that other countries are trying to identify key goals to U.S. economy and strategy. There is an environment of differing voices. How do all priorities come together? It is not clear whether linkage leads to better deals, but linking long-term interests such as the threat to the Chinese financial system might. Linkage themselves are not bad, but a whole grand bargain seems challenging.

Q (Mr. Harrell): Will we continue to be on the same page with South Korea on this issue, or do increased economic sanctions tighten the bilateral relationship with ROK?

A (Mr. Cronin): For the U.S. and China, the relationship is greater beyond North Korea, but from the South Korean perspective, the Korean peninsula is the singular issue, the prism from which it would like us to see everything. Therefore, there are some differences in aim. The U.S. and China must concur on China's responsibilities, especially since China cannot contain North Korea singlehandedly. The big problem is North Korea's political will. How should the implementation of an agreement that is in itself problematic due to different constituents, be sustained in the democratically elected U.S. and South Korea?

Q (Mr. Harrell): Eddie, you mentioned how the bill that just passed the House and the Senate is adequate but insufficient. What more should be done? How might China retaliate?

A (Mr. Fishman): The current bill back stocks existing U.S. sanctions and adds discretionary authorities, which the Trump administration could or could not use. The problem with the first element is that it continues to use the ineffective UN paradigm. The problem with the second is that it does not give new authority and acts like an executive order. Congress should but is not engaging the more credible mandatory sanctions. For the bill to be stronger, the U.S. should reject UN contact and make sanctions mandatory. As for Chinese retaliation, it is hard to say. The proper strategy is not to sanction Chinese companies, but to use the threat of sanctions through Congressional legislation.

From the audience:

Q: We requested for the clampdown of 10 different Chinese organizations. Is that not an indication that leverage does not work? Is the situation in Iran completely different?

A (Mr. Cronin): We have seen some indication of China clamping down, but Chinese middlemen are hard to control. Beijing has more say over state-owned enterprises than local and regional businesses. These uncertainties play more on Chinese policies than those of the U.S.

A (Ms. Ziemba): The local and central governments in China complicate the problem even more. In addition, the Chinese case is much more scattered compared to Iran, which provided a very centered commodity easier to manage.

Q: Is peace talk with North Korea an option? What are U.S. policy objectives here? When U.S. stepped back, Russia stepped in. What are Russia's calculations?

A (Mr. Cronin): If the U.S. were to initiate strategic defense talks with ROK and Japan, it would affect secondary sanctions to China and warn North Korea of nuclear risks. As for peace talks, the whole idea of a 2020 conference is coupled with a peace architecture. There is a great intent on behalf of the

Blue House to attempt at peace. The problem is that there is a huge lack of trust amongst all parties involved.

A (Ms. Ziemba): The caveat with Russia is that there may be false pretenses that goods are heading elsewhere than North Korea. There is some degree of individual involvement over state-led strategy. Russia is not a new player and comes in and out.

Q: How much economic leverage does China have on South Korea? Are the THAAD missile deployment suspension caused by Chinese economic sanctions?

A (Mr. Harrell): CNAS is actually about to launch a project looking into the economic coercive might of China. This is a very important issue globally not just in terms of North Korea. We will see more of this tactic (economic sanctions) out of China, in response to which the U.S. should devise new defense strategies with allies. We urge you to look out this year for the launch of this project.

Q: Are there other ways to reduce tension?

A (Mr. Cronin): Offering carrots and not just sticks is key to changing this very circumscribed issue. Measures need to be much more discreet. Open-mindedness in Washington is very important to starting peace talks.

Q: The policy of strategic patience did not work. Of those list of recommendations, which of the ones best hit the sweet spot of strategic pressure on the Chinese, but also was acceptable to the Chinese?

A (Mr. Fishman): The notion of significant reduction reception means that if Congress puts mandatory sanctions on entities involved with North Korean trade, no actual sanctions need to be applied in reward for compliance. Focusing less on the UN does not mean we should be unilateral. We need to be multilateral in engaging like-minded countries in the absence of Beijing and Russia.

Q: Given your focus on sanctions, China and Russia need to be on board to make them successful. Would such leverage give China and Russia the ability to put conditions on the U.S.?

A (Ms. Ziemba): Financial and trade flows mostly are going through Beijing, so keeping Asian allies on board is important, but we cannot keep China out of the picture.

A (Mr. Cronin): A comprehensive affirmative U.S. policy must include sanctions and must involve cooperation of our closest allies. We must then figure out where we could cooperate best with China and Russia. The balance of power amongst major powers still matters.

Report by: Sabrina He, Research Intern