



Sheena Chestnut Greitens

ILLICIT

**North Korea's
Evolving
Operations
to Earn
Hard
Currency**



Illicit: North Korea's Evolving Operations to Earn Hard Currency by Sheena Chestnut Greitens



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Foreword

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In *Illicit: North Korea's Evolving Operations to Earn Hard Currency*, Sheena Chestnut Greitens provides a detailed and thoroughly researched account of the role of illicit activities in the North Korean economy. A central conclusion of Greitens' analysis is that in the context of eroding state control over the licit aspects of the economy, illicit activities are also being "privatized" by North Korea's elite. As HRNK Co-chair and former USAID Administrator Andrew Natsios puts it, Greitens' report provides "evidence that a market economy is developing in North Korea, in this case a criminal one that is feeding off the suffering and deprivation of the population. The report is about the absence of the rule of law on a grand scale in North Korea and in a way that criminal activity is now being privatized. It is very useful in understanding the perverse transformation of the country going on right now."

The ongoing economic transformation has been happening not as the result of top-down reform, but as the consequence of the bottom-up development of informal, "black" markets established as survival mechanisms. While most North Koreans have continued to be impoverished, others have thrived. Success in the gray zone where the centrally-planned, tightly controlled and the semi-private economic activity converge has depended on one's loyalty-based social classification or on receiving the protection of those of the "core class." Association with the Kim regime has provided a path to acquiring wealth and status.

As evidenced in the report by Greitens, in recent years, illicit economic activity has succeeded outside regime controls. In the aftermath of the near collapse of North Korea's Public Distribution System (PDS), most, if not all of those involved in both centrally-directed and semi-private overseas or domestic illicit activities have benefitted substantially. Whether undertaken with central guidance or in a quasi-private setting, illicit activities such as illegal drug production and trafficking, foreign currency counterfeiting and distribution, or cigarette counterfeiting have

continued and serve to enrich those engaged and often the regime through loyalty taxes. North Korea poses a greater challenge than fragile or failing nations, since state assets such as currency printing presses have been used in the execution of such operations. Even foreign currency operations that appear legitimate on the surface are in a gray area, just as, for example, North Korea's extractive industry supply chain is tainted by the use of prison and military labor, and the workers it officially sends overseas face appalling working conditions.

Under the leadership of Kim Jong-un, the fundamental strategic objective of North Korea's regime has stayed the same: its own preservation, at any cost. The methods the regime has employed to stay in power have persisted: conducting relentless surveillance and control of its people; punishing those considered disloyal; brainwashing every North Korean from an early age; and severely restricting the inflow and outflow of information across the borders of North Korea. But there are also forces eroding the Kim regime's grip on power, all having arisen in the aftermath of the famine that killed perhaps one million citizens in the 1990s: small, informal markets developed as a survival mechanism; information that penetrates North Korea's firewall through foreign radio broadcasting and mobile media storage devices sold on North Korea's black markets; remittances and phone calls from many of the 27,000 North Koreans now living in South Korea; and the slow, but steady inroads underground Christianity is making. If, as Greitens indicates, the development of semi-private entrepreneurship has resulted in a gap between regime and society, at least in the economic realm, international efforts to convey information about the outside world to the people of North Korea must be cognizant of that gap.

Greitens points out that the Kim regime has ceased to be a rigid Communist bureaucracy unable to adapt to changing circumstances. Understanding the adaptability of the Kim regime is essential to designing a sanctions regime that would address human rights concerns—a recommendation made by the UN Commission of Inquiry—and to take other steps to induce change and create an environment in which there

can be accountability for crimes against humanity. Furthermore, as Greitens points out, both North Korea's centrally directed and semi-private activities have yielded side effects including the prevalence of illegal drugs, which have spread death and illness in a society already suffering from widespread malnutrition and inadequate medical facilities. Understanding the nature and implications of North Korea's current transformation and modus operandi will be essential to preparations for transitional justice and reconstruction of a unified Korean peninsula.

Greg Scarlatoiu

Executive Director

Committee for Human Rights in North Korea

April 15, 2014

CHAPTER 1

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INTRODUCTION AND FRONT MATTER

This report documents the evolution of North Korea's involvement in illicit economic activities, which have provided a lifeline for a regime long said to be on the brink of collapse. It provides an overview and history of these activities and describes what is known about the current phase of North Korean involvement in them. It also places these activities in the broader context of the North Korean economy and discusses what implications these findings have for the policies toward North Korea pursued by the United States and the international community.

Chapter Two provides an overview of North Korea's involvement in various illicit economic activities from the time of their origins in the 1970s until the mid-2000s. It analyzes patterns of North Korean trade in narcotics and amphetamine-type stimulants, production and distribution of high-quality counterfeit currency, trafficking in endangered species, and the manufacture and shipment of counterfeit cigarettes. This activity can be categorized into two phases. One lasted from the mid-1970s to the mid-1990s, in which North Korean officials trafficked an array of illicit products produced by others; it was geographically tied to the locations in which North Korea had diplomatic and trade relations. During the second phase, from the mid-1990s to the mid-2000s, North Korea's primary role was in the production of illicit products, including methamphetamine and counterfeit currency; distribution was outsourced to criminal organizations, and the geographic reach of the activity was determined by the feasibility of maritime smuggling, by the geographic reach of the organizations that distributed North Korean products, or a combination of the two.

North Korean involvement in illicit activities changed again in the mid-2000s. Chapter Three explores this new "third phase" of North Korean involvement in illicit activities. It focuses particularly on the drug

trade, and its analysis draws on an original dataset of seizures linked to North Korea, combining previously coded data with a new set of incidents (totaling 175 instead of 138) compiled for the first time in this project. The chapter complements its analysis of this new seizure data with qualitative information provided by former residents of North Korea who have firsthand knowledge of and experience in these activities. It also discusses gaps in our current understanding of these activities as they relate to the North Korean regime.

Chapter Three documents a new “third phase” of North Korean involvement in illicit activities that have emerged since 2005. This new phase has the following principal characteristics:

- **Decreased regime monopoly over some illicit activities.**

The role of private production in the drug trade appears to have risen, and the model has shifted from centralized, state-sponsored production to either decentralized private production or production that is state-tolerated (and which may still provide some profit to the regime) but not state-run. Moreover, official enforcement against these activities is increasingly the norm.

- **Reduced regime income from these activities.**

As a result of this apparent shift in the regime’s role in certain illicit activities, the income that accrues to the regime from the presence of these activities is likely to be lower, and less centralized within the regime, than it was before.

- **Absence of evidence of regime involvement in certain illicit activities.**

There is a relative absence of unclassified evidence on the regime's continued involvement in activities such as currency counterfeiting. This is not necessarily evidence that the regime's involvement in these activities has stopped, but may have important policy implications.

- **New geographic distribution.**

The geospatial distribution of illicit activities linked to North Korea has changed. Prior to 1994, geographic distribution was determined by the pattern of North Korean diplomatic and trade relations. From 1994 to 2005, it was determined by maritime smuggling routes and the geographic reach of the organized crime groups with whom North Korea partnered. Since around 2005, the networks involved in these activities have been concentrated inside North Korea and across the land border into China's northeastern provinces. Products are sometimes then repackaged for international sale and shipment, but the percentage of known products reaching beyond the borders of North Korea and China is lower than before.

- **Changes in international impact.**

Unquestionably, the development of this third phase of North Korean involvement in illicit activities has had the greatest and most negative impact on China.

- **Change in size, packaging, and quality of drug shipments.**

The average drug seizure is now much smaller than before—less than 10kg—and packaged in a greater variety of ways. The quality of methamphetamine produced inside North Korea also appears to have become more variable due to an increased variety of production sites and processes.

- **Participation of a broader range of North Korean society in illicit trade.**

No longer limited to elites, the drug trade and other illicit activities now encompass a broader swath of North Korean society than before. This means that a wider array of North Koreans, elite and ordinary, have opportunities for economic activity that is not dependent on the state and benefit economically from illicit trade. The gap between the North Korean state and society appears to be bigger now than it has been previously.

- **New human security challenges.**

Just as the economic benefits of the drug trade are distributed more broadly within North Korean society now, so are the costs of involvement in the drug trade. Rates of drug use and drug addiction inside North Korea have risen. The regime's response so far has been to treat the issue as a law enforcement and/or security problem. Public health, education, and treatment measures are insufficient to deal with this emerging challenge.

Chapter Four explores the importance of these issues for a range of policy debates, including those over sanctions, human security, and overall U.S. strategy toward North Korea.

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ABOUT THE AUTHOR

Dr. Sheena Chestnut Greitens is a Non-Resident Senior Fellow at the Center for East Asia Policy Studies at the Brookings Institution, an Academy Scholar at Harvard University's Academy for International and Area Studies, and an assistant professor of political science at the University of Missouri (currently on leave).

Greitens' research focuses on security studies, authoritarianism, state-society relations, and illicit networks in Asia. Her writing on East Asia has appeared in academic journals and edited volumes in English, Chinese, and Korean. She is the author of the most comprehensive unclassified study of North Korea's involvement in illicit activities, which was published in the leading academic journal *International Security* in 2007, and has been cited in testimony to the U.S. Senate, the U.S. House of Representatives, and the National Assembly of South Korea. Her writing on North Korea has also appeared in *The Huffington Post*, the *CSIS Korea Chair Platform*, and *The New York Times*, and she has provided commentary for radio, TV, and print outlets in the United States and Asia.

Dr. Greitens holds a PhD from Harvard University, an MPhil from Oxford University, where she studied as a Marshall Scholar, and a B.A. from Stanford University. She has previously held positions at the U.S. Department of State's Policy Planning Staff, the International Institute for Strategic Studies, and Oxford University Press, and fellowships at the United States Institute of Peace, the University of Virginia's Miller Center, and the Fairbank Center for Chinese Studies at Harvard University.

DEDICATION

This research would not have been possible without the input of many individuals who formerly lived in North Korea. Their courage in creating a new life, and the many contributions they make to the people

around them as they do so, are both humbling and inspiring. This report is dedicated to them.

CHAPTER 2

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A HISTORY OF NORTH KOREA'S INVOLVEMENT IN ILLICIT ECONOMIC ACTIVITY

I. INTRODUCTION

For almost forty years, North Korea has exhibited extensive involvement in transnational criminal smuggling networks. It has been involved in activities including: the production and trafficking of various drugs, including narcotics and amphetamine-type stimulants; the creation of the world's best counterfeit currency; trafficking of endangered species products; and the reported production of counterfeit goods ranging from cigarettes to pharmaceuticals to brand-name watches and shoes. This chapter reviews what is known about North Korea's involvement in illicit activities from their first known appearance in the mid-1970s to the mid-2000s.

As the author has argued elsewhere,¹ the pattern of these activities across time and space suggests they are primarily driven by economic factors, specifically the Kim family regime's need for hard currency. Domestically, however, some attempt appears to have been made in the earlier period to frame this activity in a way that is generally consistent with elements of North Korea's broader ideology, including self-reliance and national independence from foreign influence, anti-imperialism, and anti-Americanism. The activity also evolved in important ways over time, from a state-run operation using North Korean officials as couriers and traffickers to a more compartmentalized network in which North Korea concentrated on production and outsourced distribution to criminal organizations.

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1 This chapter draws on research done by the author on this topic for the past ten years, parts of which were published in 2007 as Sheena Chestnut, "Illicit Activity and Proliferation: North Korean Smuggling Networks," *International Security*, 32:1 (Summer 2007): 87(80)-111. See also Sheena E. Chestnut, *The "Sopranos State"? North Korean Involvement in Criminal Activity and Implications for International Security* (San Francisco: Nautilus Institute, 19 January 2006).

II. DRUG TRAFFICKING

Among the illicit activities affiliated with the country, North Korea's involvement with the drug trade is the best documented with the longest history. From 1976 to 2005, North Korea's involvement in drug-related activity changed in terms of geography, product type, and role in the networks of drug production and trafficking (from trafficker to production node). State-sponsored production of illicit drugs, particularly methamphetamine, appears to have increased significantly in the mid-1990s, a trend that can be attributed to a combination of the impact of the end of the Cold War on North Korea's economy, agricultural crisis resulting in the well-known "Arduous March," and the leadership transition that followed Kim Il-sung's death in 1994. Prior research conducted by the author identified 77 incidents of North Korea-linked drug trafficking between 1976 and 2004.

The early seizures for which North Korea became known occurred shortly after the country defaulted on its international debts in 1976. After this, North Korean embassies were told to "self-finance" their operations² and a series of drug seizures linked to North Korean embassies occurred around the world in locations where North Korea had diplomatic and trade relations. One of the earliest cases, in 1976, resulted in a dozen members of North Korea's diplomatic corps, including the North Korean Ambassador to Norway, being ejected from four countries in Scandinavia: Sweden, Norway, Denmark, and Finland. They were asked to leave for smuggling illicit goods including "4,000 bottles of booze (mostly Polish vodka) and 140,000 cigarettes" in Sweden, and "400 bottles of liquor, 4.5 million cigarettes, and 147 kilos of hashish" in Denmark. Earlier that same year, two North Korean diplomats in Egypt had been caught with 400

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2 Marcus Noland, *Avoiding the Apocalypse: The Future of the Two Koreas* (Washington: Institute for International Economics, 2000), 119-21.

kilograms of hashish in their luggage, while Malaysian authorities had also asked North Korean officials to leave for similar reasons.³

At this point, U.S. government analysts concluded that the primary role of the North Korean diplomats was that they “purchased drugs for resale” and transported them to market destinations for buyers, relying on diplomatic immunity and protected diplomatic pouches to avoid confiscation, arrest, and prosecution.⁴ The drugs in question at this time were primarily opiates, though there were some seizures of hashish as well.

Official North Korean rhetoric insisted that these were instances of individual misbehavior rather than a matter of state policy, and that it had punished the handful of offenders. Other evidence suggests that North Korea did not punish the diplomats, and in some cases reposted them elsewhere—sometimes with an apparent promotion. A former North Korean diplomat interviewed in 2005 denied that any punishment was meted out to those who were recalled for smuggling.⁵ In another case, one of the North Korean diplomats expelled from Sweden in 1976 for smuggling, resurfaced in Vladivostok in the Russian Far East, where in 1998, after attempting to exchange counterfeit bills, he was arrested and identified as a deputy director of the International Department of the Korean Workers’ Party.⁶

By the late 1980s and early 1990s North Korean involvement in drug trafficking began to diversify. According to North Korean defectors interviewed by the author, the fact that diplomats were getting repeatedly caught in these smuggling operations became an embarrassment

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3 “Scandinavia: Smuggling Diplomats,” *Time Magazine*, 1 November 1976, <http://content.time.com/time/magazine/article/0,9171,914629,00.html>.

4 Joint Interagency Task Force West (JIATF West), “North Korean Drug Trafficking,” United States Department of Defense, May 2000.

5 Author’s interviews, Seoul, April 2005.

6 JIATF West, “North Korean Drug Trafficking”; see also John Pomfret, “North Korea’s Conduit for Crime,” *Washington Post*, 25 April 1999.

and was creating difficulties for North Korea's diplomatic and commercial activities abroad; as a result, intelligence personnel stepped in to help manage the operations.⁷ The record of seizures during this period is a mix of large- and small-scale incidents, raising the questions of whether the central government and party offices had lost control over these operations, whether officials were diverting opium to sell for personal profit while still sending the majority of profits upward, or whether the regime might simply have been experimenting with new methods of transport and camouflage. A series of smaller seizures occurred particularly in the Russian Far East, where North Korean workers repaid state debts to Russia by logging timber, leading to speculation that intelligence personnel—a few of whom were also arrested in the region—had orchestrated a scheme involving timber workers as drug mules.⁸ North Korean trading companies also appeared to be used as smuggling centers, operating in joint ventures with organized crime in China, Japan, and Taiwan.⁹ Diplomatic incidents did not entirely cease—for example, a North Korean diplomat was arrested in Zambia in July 1995 for carrying 2.4 kilograms of cocaine—but these seizures no longer represented the majority of drug incidents to which North Korea was linked.

By the mid-1990s, a new phase of North Korean involvement had emerged. General North Korean involvement in the overall drug trade continued, while drug trafficking activity decreased. There have been no known incidents of drug trafficking by North Korean diplomats or officially accredited personnel since 2001; instead, the North Korean regime was identified by forensic and other evidence as having been the source for drugs distributed by various criminal organizations. Figure 2.1 below shows the divergence between North Korea's role in counterfeit currency operations (represented by the dotted line) and North Korea's role in the overall drug trade (represented by the solid line).

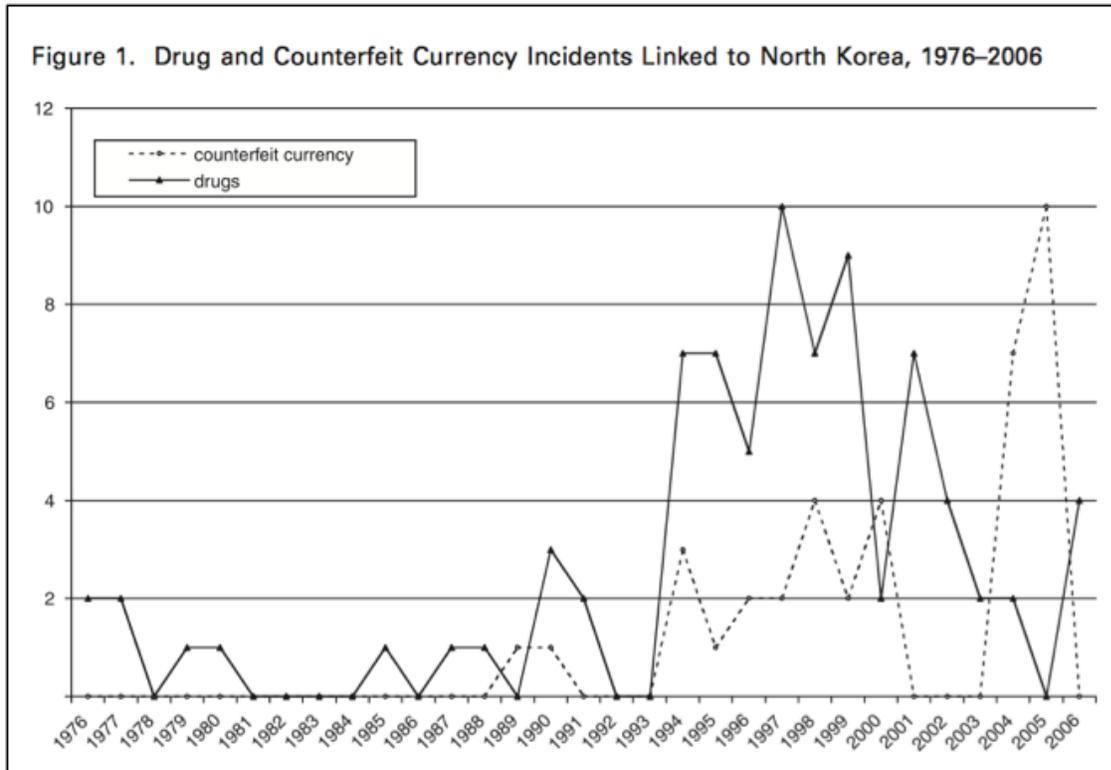
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7 Author's interview, Seoul, April 2005.

8 Sophie Quinn-Judge and Shim Jae Hoon, "Opiate of the Party: North Korea Fuels Opium Boom in Russia," *Far Eastern Economic Review*, 5 December 1996.

9 David E. Kaplan, "The Far East Sopranos," *U.S. News and World Report*, 27 January 2003.

Figure 2.1: North Korean Official Involvement in Drug Trafficking, 1976-2006¹⁰



Under these new arrangements, North Korea produced drugs internally, in factories located on North Korean territory and operated by North Korean officials and official companies. After production and packaging, however, the products were handed off to criminal organizations for transport and distribution. North Korea had reportedly begun to explore this kind of organization in the late 1980s—by partnering with Asian crime rings to help move drugs—but does not appear to have decided to concentrate primarily on production until after 1990.¹¹

A combination of several factors—North Korea’s own leadership transition, agricultural and economic disaster in the mid-2000s, and shifts in both the enforcement environment and the global drug market—likely

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10 Reproduced from Chestnut, “Illicit Activities and Proliferation,” 88.

11 David Kaplan, “The Wiseguy Regime,” *U.S. News and World Report*, 15 February 1999.

combined to prompt this shift. In addition to a change in the government's role, the primary product also changed. Poppy farms had existed in North Korea from the 1970s, but in the mid-to-late 1990s, North Korea also began manufacturing methamphetamine, a synthetic stimulant also sometimes referred to as "hirropon," "bingdu," or "orum."¹²

Defector testimony offers a striking picture of how drug production was internally organized and managed. For one of these statements, see Box 2.1 below:

Box 2.1: Senate Testimony on North Korea's Drug Production

North Korea started its production of drugs secretly in the late 1970s in the mountainous Hamkyung and Yangkang Provinces. North Korea began to produce and sell drugs in earnest beginning in the late 1980s, and that is the time when Kim Il-sung, of North Korea, who is the leader of that country, toured Hamkyung-Bukdo Province and designated the area around Yonsah Town in Hamkyung Province to be developed into an opium farm. It was known that the Japanese colonial government also used this area to grow opium, and Kim Il-sung told the people to earn hard currency by growing and selling opium because he needed cash. The local party province committee developed an experimental opium farm in Yonsah Town in secret, and the farm was tightly guarded by the security police officers. They began to produce opium at the collective farms located in towns like Yonsah, Hweryung, Moosan, and Onsung in Hamkyung-Bukdo Province. All opium produced, thus, produced in these farms were sent to the government to be processed into heroin. They called these opium poppies the broad bellflowers in order to hide the operation from the general public, but this was an open secret because everybody knew what that was all about...

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12 Lankov and Kim find that methamphetamine production increased in the early-to-mid-2000s, but the present author's data suggest that large-scale shipments began much earlier. Private methamphetamine production increased in the mid-2000s (see Chapter Three).

In late 1997, the Central Government ordered that all local collective farms must cultivate, grow, for the area of about 10 chungbo, that is, about 25 acres, of a poppy farm beginning in 1998... All opium thus produced are sent to the pharmaceutical plants in Nanam area of Chungjin City in Hamkyung-Bukdo Province. They are processed and refined into heroin under the supervision of seven to eight drug experts from Thailand, and this is all done under the direct control and strict supervision of the Central Government.

North Korea produces now two types of drugs: heroin and methamphetamine, which is called in Korean, "Hiroppon." They produce these drugs one ton a month each. Heroin is packaged in boxes, each containing 330 grams — that is about 11.6 ounces — of heroin, and those boxes have a Thai label. Methamphetamine is packaged in boxes each containing about 1 kilogram of the substance, but has no label.¹³

In the late 1980s, experimental farms were set up, and police officials ordered farmers to switch from growing grain to poppies. A "foreign currency earning requirement" was levied, and agricultural committees set up collective farms that then turned over their poppy harvests to state-owned trading companies.¹⁴ According to defectors, the residents of these areas who worked on the farms were promised a share of the earnings, but many never received the promised payment.¹⁵ Processing of the drugs then took place at state-run factories, many of them in Hamhung and Chongjin. At these facilities, opiates — and later amphetamine-type stimulants (ATS, or meth) — were produced or processed into final form and plastic-wrapped for shipment. Officials from North Korea's various security agencies were reportedly involved in guarding the plants and factories,

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13 Former North Korean High-Ranking Government Official [Identity Protected], testimony at "Drugs, Counterfeiting, and Weapons Proliferation: the North Korean Connection," hearing before the Financial Management, Budget, and International Security Subcommittee of the Senate Committee on Governmental Affairs (108th Congress, 20 May 2003).

14 Noland, *Avoiding the Apocalypse*, 119-21.

15 Anthony Spaeth, "Kim's Rackets: To Fund His Lifestyle — and his nukes — Kim Jong Il Helms a Vast Criminal Network," *Time Magazine*, 2 June 2003.

and Southeast Asian experts were brought in to advise on production.¹⁶ The drugs were of extremely high quality in terms of their chemical content (which lab tests could differentiate from products coming from China and Southeast Asia), purity, and packaging.¹⁷ Box 2.2 contains further testimonies from North Korean defectors regarding the drug industry, from production to sale.

Box 2.2: The North Korean Drug Trade

“There were some complaints that during the famine we should be growing grain, not poppies, but the instruction from the central government was that if we grow poppies we can sell the product for 10 times as much to buy grain... This country is so desperate to go on that they will do anything to survive. Ninety-nine percent of their factories are not operating, there are no raw materials and no energy. Even fishing boats can't fish because there is no oil for fuel. The only way to earn hard currency is by drugs.”¹⁸

“The boys used to work for 40 minutes, the girls for only 30 minutes. You would get dizzy if you stayed too long... We didn't really know what it was, and we didn't ask. When I think back on it, I realize that North Korea is an ideal place to grow and export drugs because nobody will question the authorities or even question whether it is legal.”¹⁹

“[Poppy resin] would be wrapped in leaves and paper and taken to the factory in boxes to be boiled... I'd pick it up and drive it to the harbor, and it would be taken out to sea to be picked up by ships heading for Singapore, Hong Kong,

16 Quinn-Judge and Shim, “Opiate of the Party”; Jay Solomon and Jason Dean, “Drug Money: Heroin Busts Point to Source of Funds for North Korean Regime” *Wall Street Journal*, 23 April 2003; Kim Young Il, “North Korea and Narcotics Trafficking: A View from the Inside,” *North Korea Review* (Jamestown Foundation, 1 March 2004), <http://articles.latimes.com/2003/may/21/world/fg-heroin21>.

17 Author's interviews, Washington and Seoul, March/April 2005.

18 Defector Yoon Yong Sol, cited in Richard Paddock and Barbara Demick, “North Korea's Growing Drug Trade Seen in Botched Heroin Delivery,” *Los Angeles Times*, 21 May 2003.

19 Anonymous defector, cited in Paddock and Demick, “North Korea's Growing Drug Trade Seen in Botched Heroin Delivery.”

Cambodia and Macau... We never asked questions. We thought we were showing our loyalty to Kim Jong Il. We thought he would use the money to improve our lives.”²⁰

“A processed form of the drug [opium] was then smuggled to Hong Kong, Russia, and China, and sold for cash to buy food and fuel, including rice from Vietnam.”²¹

“The principal export market for North Korean narcotics is Eurasia... North Korean narcotics are sold along the Chinese border for up to \$10,000 per kilogram. Drug smuggling by sea, however, brings a much higher price because of the greater risk involved. These drugs are sold for as much as \$15,000 per kilogram. North Korea sells these drugs through the Chinese border to China, Hong Kong, Macau, and Russia. The regime also deals with international drug dealers on the Yellow Sea and the Eastern Sea, whose primary market is Japan.”²²

“After Kim Il Sung passed away, North Korea grew opium at the national level. In my town, we utilized high school students to harvest the opium and each community farm was ordered to produce 60kg of opium. I think the North Korean government came up with this after Western countries imposed economic sanctions on them. Maintaining the dictatorship required smuggling cars and opium... In 2002, I got a call from my father who is in North Korea. One of his friend’s sons who works at North Korean security command was looking for ways to earn foreign currency, and he asked whether I knew a potential buyer for opium. I did not know anyone so I told him no. In 2005, after I got to South Korea, my father asked me the same question but I told him never to request such a thing again or I will not answer his calls anymore.”²³

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20 Defector Kim Young Chul, cited in Spaeth, “Kim’s Rackets.”

21 Defector Im Young-sun, cited in Chris Dobson, “The Failure of Kim Il-Sung,” *South China Morning Post*, 17 July 1994.

22 Kim Young Il, “North Korean Drug Trafficking.” Note that similarities between the Congressional testimony in Box 2.1 and this article lead me to conclude that these may be two testimonies by the same defector.

23 Jieun Baek, “North Korean Defector Describes Vast Network,” *Policymic.com*, 17 May 2012, <http://www.policymic.com/articles/8497/north-korean-defector-describes-vast-network-of-smuggling-drugs-and-censorship-under-kim-jong-un-s-regime>.

After production, drugs were handed off in large-scale shipments to criminal organizations for the final stages of transportation and distribution. Organizations such as the Japanese yakuza and the Chinese triad gangs would pick up packages of drugs dropped at sea, or would rendezvous with North Korean vessels in order to obtain a shipment.²⁴ Drugs were also transported by train (and other methods) across North Korea's northern border into China. Japan was one of the primary markets for North Korea-made methamphetamine; in 1997 alone, Japanese authorities seized almost 1,500 kilograms of North Korea-sourced meth. It accounted for almost one-third of Japan's methamphetamine supply, worth an estimated \$3 million (at street pricing). Takahiko Yasuda, head of drug control efforts at Japan's National Police Agency, said, "I don't doubt that this is the tip of the iceberg."²⁵ In one famous case in 2001, a North Korean spy ship exchanged fire with the Japanese Coast Guard and was then sunk; authorities confiscated a Toshiba phone from the boat that had calls to gang operatives in Japan.²⁶

III. CURRENCY COUNTERFEITING

North Korea has been said to be the manufacturer of unusually high-quality counterfeit U.S. \$100 dollar bills. These bills are technically referred to by the U.S. Secret Service—the body with responsibility for protecting the United States' currency—by their parent note, C-14342, and informally dubbed "Supernotes" for their quality and the difficulty of detecting them. Although counterfeit dollars today are made with a variety of methods and in a range of sophistication, the Secret Service has been unequivocal that the North Korean Supernotes are the best in the world.²⁷

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24 These kinds of seizures were described in interviews done by the author; see also Spaeth, "Kim's Rackets"; JIATF West, "North Korean Drug Trafficking"; Suetsugu, "Risky Business Leading North Korea to Ruin"; Paddock and Demick, "North Korea's Growing Drug Trade Seen in Botched Heroin Delivery."

25 Spaeth, "Kim's Rackets."

26 David Ibison, "Pyongyang's Spy Ship Reveals a Dark Secret," *Financial Times*, 28 May 2003.

27 Author's interview, Washington, DC, March 2005.

(Colombian counterfeits, by contrast, exist in much higher volume but are lower quality and easier to detect.) In September 2004, Deputy Assistant Director Bruce Townsend publicly linked the Supernotes to North Korea. His statement is reproduced in Box 2.3 below:

Box 2.3: North Korea and Counterfeit Currency

For the past several years, the Secret Service has investigated a family of counterfeit notes which utilizes complex and expensive printing methods such as intaglio and typographic. This family of counterfeit notes is emanating from North Korea. The sophisticated techniques utilized in producing this family of counterfeit U.S. banknotes is evidence of a well-funded, ongoing criminal enterprise, with a significant scientific and technical component.²⁸

This allegation was affirmed subsequently by a series of U.S. government officials, including Danny Glaser, who told *The New York Times* in 2006, “The North Koreans have denied that they are engaged in the distribution and manufacture of counterfeits, but the evidence is overwhelming that they are... There’s no question of North Korea’s involvement.”²⁹ If true, North Korea is one of the only countries in which the government itself is currently the actor engaged in counterfeiting; worldwide, the majority of counterfeiting operations are done by non-state actors.

As with drug trafficking, much of the public debate about North Korea’s involvement has centered on how much money the regime might have counterfeited each year and how much they could have made from these operations. One U.S. government official estimated approximately \$15 million per year, but others have estimated it to be as much as \$100

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28 Bruce Townsend, Remarks to the International Association of Financial Crimes Investigators (Chicago, IL: September 2004).

29 Quoted in Stephen Mihm, “No Ordinary Counterfeit,” *The New York Times Magazine*, 23 July 2006.

million or even \$250 million.³⁰ More credible estimates come from Secret Service official Michael Merritt, who noted in public testimony that the U.S. Secret Service has removed approximately \$50 million in Supernotes from circulation since they were first detected in 1989 (around \$2.8 million a year).³¹ Dr. Stephan Haggard and Dr. Marcus Noland have estimated the total to be around \$1.25 million annually.³²

In interpreting Supernote seizure data, two facts are important to consider. First, the total amount seized is not the amount that North Korea makes from producing the counterfeit. North Korea's profit is some unknown percentage lower, depending on how many times the bills have been resold and the markup each time. Second, seizure data reflect an unknown percentage of the Supernotes that have been printed and distributed. The true amount is some unknown percentage higher, depending on how many of the bills that were printed are being detected and removed from circulation. The quality of the Supernotes, however, makes it difficult to assess what percentage of distribution is actually being captured. One U.S. government researcher said bluntly, "We have no idea how much they're counterfeiting, because it's so good."³³ Media reports have sometimes also suggested that seizures are not publicized because of fears about the impact on confidence in the U.S. currency worldwide. The Secret Service, however, has denied that this plays a major role, and attributes the lack of publicity to two factors: 1) the need to keep ongoing law

30 For the \$15 million estimate, author's interview, Washington, March 2005; for \$100 million, see Larry Wortzel, testimony at "Drugs, Counterfeiting, and Weapons Proliferation: the North Korean Connection," Hearing Before the Financial Management, Budget, and International Security Subcommittee of the Committee on Government Affairs of the U.S. Senate, (Washington, 108th Congress, 20 May 2003); for \$250 million, see statement by Balbina Hwang in Bill Gertz, "Arrest ties Pyongyang to counterfeit \$100 bills," *Washington Times*, 20 September 2005, <http://www.washingtontimes.com/news/2005/sep/20/20050920-121229-5045r/?page=all>.

31 Michael Merritt, Deputy Assistant Director, Office of Investigations, U.S. Secret Service, statement before the U.S. Senate Committee on Homeland Security and Governmental Affairs, 25 April 2006. Testimony on "North Korea: Illicit Activity Funding The Regime," Committee On Homeland Security And Governmental Affairs United States Senate One Hundred Ninth Congress, Second Session, 25 April 2006.

32 Stephan Haggard and Marcus Noland, "North Korea's External Economic Relations," Peterson Institute for International Economics Working Paper WP 07-7 (August 2007), 9-10.

33 Author's interview, Washington, March 2005.

enforcement investigations confidential, and 2) the procedures by which counterfeits are generally detected and reported, which are less amenable to publicity and news coverage than drug busts.³⁴

The first Supernote was detected in a bank in the Philippines in 1989. In the years that followed, the Secret Service detected a series of notes that were all part of the same note “family,” including C-14342 (the original note from the Philippines); C-14403 (an earlier variant, though detected later); C-21555 (the first “big-head” note, found in London); and C-22500 (detected in Macau). There have also been two \$50 notes in the family, C-20000 (detected in June 1995 in Athens), and C-22160 (a big-head note from Bulgaria). As of 2006, a total of nineteen notes in the family had been documented. Counterfeiting expert Stephen Mihm explains:

These links are not a matter of resemblance so much as they are an indication of a common ancestry: the notes in the PN-14342 family have been created by an individual or an organization using the same equipment and the same materials, and most likely operating from a single location.³⁵

There is no authoritative explanation for North Korea’s acquisition of the intaglio presses and materials necessary to make such high-quality counterfeits. Journalistic accounts speculated that North Korea obtained the presses sometime during the Cold War or got them from the KGB after the collapse of the Soviet Union (or from a press stolen by the KGB after the Second World War, a story that the Secret Service says has “no factual basis”).³⁶ When the Supernotes first appeared, many of them were found in the Middle East, including in the Bekaa (Beqaa) valley of Lebanon and

34 Ibid.

35 Mihm, “No Ordinary Counterfeit.”

36 For a review of these stories and their plausibility, see Sheena Chestnut, “The Sopranos State?” 84-86.

in Iran. The Secret Service, however, called the allegations “unsubstantiated” at the time,³⁷ and has insisted in all public statements then and since that they believe the notes are coming from North Korea.

The most plausible explanation is that North Korea purchased the presses and materials commercially from companies in Europe. Former Bureau of Printing and Engraving director Robert Leuver has stated, “for the past two decades Pyongyang has owned the same model of printing press used by the United States, a Swiss-made Intagliocolor 8. Like the United States, North Korea has sent technicians to Lausanne to be trained on the equipment.”³⁸

Supernotes are printed on paper whose composition—a precise blend of three-quarters cotton and one-quarter linen fiber—is identical to that of actual U.S. currency, and made only by a handful of machines worldwide. They are printed using an intaglio press, a more high-end way of manufacturing currency than offset, typographic, or lithographic machines. Since the mid-nineties, supernotes have also used the same color-shifting ink (optically-variable ink, OVI) that has been used in the redesigned American currency. The United States purchased the global rights to green-to-black OVI from the Swiss company SICPA in 1996 as part of a security overhaul of its currency. That same year, North Korea purchased green-to-magenta—magenta being the color closest to black and easiest to engineer to match it—which U.S. officials point out is suspect behavior, given that there are no known cases of individuals wanting to counterfeit the North Korean won.³⁹

Much of the internal detail of North Korea’s alleged counterfeiting operations has come from high-level defectors whose accounts cannot be verified. The stories they tell suggest that the development of counterfeiting

37 Government Accounting Office, “Counterfeit U.S. Currency Abroad: Issues and U.S. Deterrence Efforts,” Report GGD-96-11, 26 February 1996.

38 Ron Moreau and Russell Watson, “Is Your Money Real?” *Newsweek*, 10 June 1996.

39 Mihm, “No Ordinary Counterfeit.”

operations was closely linked not only to the North Korean regime, but to the Kim family itself, and particularly to Kim Jong-il. In the 1970s, Kim Jong-il allegedly issued an order that covert operations should be conducted with counterfeit U.S. currency, which would have the dual benefit of funding North Korea's operations and engaging in economic warfare against the United States.⁴⁰ Defectors also say that they brought back \$1 counterfeit bills – collected because they had the correct and difficult-to-reproduce mix of cotton and linen – after which the regime bleached them for reprinting.⁴¹ Eventually, however, defectors say that North Korea began producing the paper and printing the money itself. Their accounts have contained some disagreement about both the location of the printing operations and the year in which operations began; some place it in Pyongyang, while the majority of accounts seem to suggest that the counterfeits have been printed at the Pyongsong Trademark Printing House (sometimes also called the No. 62 printing house) since sometime in the 1980s.⁴²

The counterfeit bills were reportedly dispersed by diplomats and officials of North Korean trading companies when they travelled abroad. Some accounts of counterfeit production and distribution follow in Box 2.4:

Box 2.4: North Korea's Counterfeiting Operations

"I obtained many \$1 notes and bleached the ink out of them.... The size of the bill was what mattered, not the denomination."⁴³

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40 Counterfeiting has long been a tool of warfare, including in Korea. The National War Museum in Seoul has an exhibit of North Korean-made South Korean currency, manufactured and distributed during the Korean War in an attempt to destabilize South Korea's economy.

41 This account should probably be regarded with some skepticism. It bears a strong similarity to the plot of the original Jack Reacher novel; see Lee Child, *Killing Floor* (New York: G.P. Putnam & Sons, 1997). Alternatively, truth may be just as strange as fiction.

42 "N. Korea's State Mint Counterfeited Dollars, Yonhap Says," *Kyodo News*, 12 January 2000; Tetsuya Suetsugu, "Risky Business Leading North Korea to Ruin," *Yomiuri Shimbun*, 22 August 2003.

43 Kaplan, "The Wiseguy Regime."

"A friend of mine worked for Office 99, which was in charge of weapons sales for the party. He told me that whenever they travelled, part of the money they carried was counterfeit. This was around 1992 when he told me this."⁴⁴

"When government officials or diplomats traveled to south-east Asia they distributed the counterfeit notes mixed in with the real ones, at a ratio of about 50-50."⁴⁵

"There was an agent arrested in Mongolia in 1996, who had also previously been arrested in Russia. Because of this, they realized there was a defect in the bills. The factory worked to improve the bills, and they succeeded. The plant director was made a Major General and a Hero of the Country in 1998."⁴⁶

In the mid-1990s, North Korean trading company officials and diplomats were arrested for counterfeiting in Vladivostok, Hong Kong, Macau, and elsewhere. In one of the highest-profile cases, Yoshimi Tanaka, a former Japanese Red Army terrorist, who with eight compatriots had hijacked a Japan Airlines flight to Pyongyang in 1970, was arrested in 1996 in Phnom Penh, Cambodia, for allegedly laundering more than \$3 million in counterfeit U.S. \$100 bills in Thailand, Cambodia, and elsewhere in Southeast Asia. Tanaka had been living in the North Korean embassy in Cambodia, and he was arrested as he attempted to leave the country on a North Korean diplomatic passport, in a car with North Korean diplomatic plates in the company of two North Korean diplomats.⁴⁷ Two of his co-defendants were convicted, and Tanaka's fingerprints reportedly appeared on some of the counterfeit currency, but Tanaka and three co-defendants were acquitted by a Thai court for

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44 Author's interview, Seoul, April 2005.

45 "What is a Superdollar?" BBC, 19 June 2004, <http://news.bbc.co.uk/2/hi/programmes/panorama/3819345.stm>.

46 Author's interview, Seoul, April 2005.

47 Nicholas D. Kristof, "Is North Korea Turning to Counterfeiting?" *New York Times*, 17 April 1996, <http://www.nytimes.com/1996/04/17/world/is-north-korea-turning-to-counterfeiting.html>.

insufficient evidence, after which he returned to Japan to serve a prison sentence for the hijacking.⁴⁸

Later, however, as it had with the drug trade, North Korea began relying less on its own officials for distribution and more on organized crime. One of the best-known cases is that of Sean Garland, a member of the Official IRA, and five associates. These men were indicted by the U.S. Department of Justice in September 2004—Garland’s alias in the indictment is “The Man with the Hat” —for participating in a Supernote distribution ring that picked up counterfeit bills from North Korean connections in Moscow and subsequently laundered them throughout the UK and Europe.⁴⁹ Garland’s co-conspirators were convicted in British court, but Garland fled to Ireland, which has thus far refused American requests for extradition.

IV. OTHER ILLICIT ACTIVITIES

North Korea has also received attention for smuggling contraband items such as endangered species products, fake pharmaceuticals, and counterfeit cigarettes. These incidents were first recorded in the mid-1980s, and have continued as recently as 2013. Given the variety of products involved in these incidents and the repeated presence of North Korean diplomats in them, these incidents appear to be primarily the result of a continued “self-financing” policy on the part of the North Korean regime by which embassies are expected to finance their own operations, and contribute money back to the regime in Pyongyang.

Since the early 1980s, North Korean diplomats have been caught using diplomatic bags to carry endangered species products. The data collected for this report shows at least nine incidents in which North Korean

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48 Bhanravee Tansubhapol & Nussara Sawatsawang, “Terror Suspect Cleared of Forgery Charge,” *Bangkok Post*, 24 June 1999.

49 USA v. Garland et al., Grand Jury Indictment, 1:05-cr-00185-RMC (D.D.C. 2005), <http://cryptome.org/sean-garland-003.pdf>.

diplomats have been arrested en route from Africa back to Asia with large amounts of rhino horn and ivory – some shipments reportedly in the hundreds of kilograms. In 2000, a U.S. Department of Defense report noted that between 1996 and May 2000, “at least six North Korean diplomats have been forced to leave Africa after attempts to smuggle elephant tusks and rhinoceros horns.”⁵⁰ David Asher, former director of the Illicit Activities Initiative on North Korea at the Department of State, asserted in 2005, “Ivory seizures directly linked to North Korean officials amounted to 689 kg in Kenya in 1999; 537 kg in Moscow in 1999; and 576 kg in France in 1998.”⁵¹ The latest known seizure of this kind occurred in October 2012, when a North Korean citizen named Kim Jong-guk was caught attempting to smuggle around 130 pieces of ivory – with an estimated value of around \$36,000 – out of Mozambique.⁵²

Counterfeit cigarettes have been another lucrative trade item for North Korea, linked to the country by both import and export data. This trade is thought to have begun on a small scale in the 1990s, but increased substantially around 2002, when Chinese authorities closed a number of cigarette factories and cracked down on counterfeit production, thereby providing significant incentives, knowledge, and spare capacity that could be relocated to North Korea.⁵³ In 1995, authorities in Taiwan stopped a ship and confiscated 20 containers of counterfeit cigarette packaging: enough to make 2 million fake cartons of popular brands from Japan and Britain.⁵⁴ This echoed the previous pattern witnessed in the drug trade,

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50 JIATF West, “North Korean Drug Trafficking,” Department of Defense, May 2000.

51 David Asher, “The North Korean Criminal State, Its Ties to Organized Crime, and the Possibility of WMD Proliferation,” Nautilus Institute, *NAPSNet Policy Forum* 05-92A, 15 November 2005.

52 “Mozambique: North Korean Caught Smuggling Ivory,” *AllAfrica.com*, 12 October 2012, <http://allafrica.com/stories/201210121341.html>.

53 Coalition of Tobacco Companies, *Production of Counterfeit Cigarettes in the Democratic People’s Republic of Korea*, 29 June 2005, 2.

54 William Bach, testimony, “Drugs, Counterfeiting, and Weapons Proliferation: the North Korean Connection,” Hearing before the Financial Management, Budget, and International Security Subcommittee, Committee on Government Affairs, U.S. Senate (108th Congress, 20 May 2003).

where North Korea attempted to import large volumes of a precursor material (ephedrine for the drug trade, packaging for the cigarettes) and was then linked to a series of incidents involving the export smuggling of the finished product (methamphetamine for the drug trade, and counterfeit cigarettes).

A series of seizures of counterfeit cigarettes followed, and a significant amount of additional qualitative evidence linked those seizures to production facilities based in North Korea. In February 2004, authorities in Singapore impounded a container of counterfeit Marlboro cigarettes that had come from Najin, North Korea, by way of Busan. The same month, officials in Durban seized additional cigarettes in an incident that appeared to be linked to the first (though the origin of the cigarettes was not specified).⁵⁵ Also in 2004, authorities in Vietnam, Taiwan, and the Philippines impounded three containers—mostly consisting of Mild Seven counterfeits—headed from a factory in the Rajin area to Taiwan.⁵⁶ Additional seizures followed: in September and October 2006, Greek authorities seized a total of 3 million cartons of counterfeit cigarettes from DPRK-flagged vessels; the taxes on just one of these containers were valued at 3.5 million Euro.⁵⁷

Evidence from defectors, as well as an investigation done by the tobacco industry, suggests that as of 2006, counterfeit cigarettes were being produced inside the territory of North Korea. The major factories for cigarette production were reportedly based in Rajin, though defectors also mentioned a factory in Pyongyang.⁵⁸ A report generated by tobacco

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55 "Singapore Customs Seized One Container of Counterfeit Cigarettes," Singapore Customs, 24 February 2004.

56 Coalition of Tobacco Companies, *Production of Counterfeit Cigarettes in the Democratic People's Republic of Korea*, 29 June 2005, 3.

57 "Large cache of contraband cigarettes found on N. Korean flagged ship," Athens News Agency, 30 October 2009, <http://www.hri.org/news/greek/ana/2006/06-10-30.ana.html#15>; "North Korean Ship with Contraband Cigarettes Nabbed," Chosun Ilbo, 26 September 2006, http://english.chosun.com/site/data/html_dir/2006/09/26/2006092661028.html.

58 Author's interview, April 2005.

industry investigators in June 2005 began by stating, “The Democratic People’s Republic of Korea has emerged in the past five years as one of the principal sources of counterfeit international brand cigarettes.”⁵⁹ The report concluded that “between 10 and 12 factories are – or recently have been – active in producing counterfeit cigarettes in the country,” up to six of which were near Pyongyang and as many as six in the Rajin area.

As of the mid-2000s, cigarettes produced using North Korean tobacco were distinguishable from the Chinese product because the Chinese ones had a heavier taste.⁶⁰ According to British American Tobacco, counterfeit cigarettes produced in North Korea often had packaging that was hand-glued rather than machine-adhered, less clear printing, no embossing, and less of a filter.⁶¹ North Korean-produced counterfeit cigarettes were originally sent via containerized shipments through various ports in Asia, consistent with the pattern of seizures documented above. For example, in 2004, authorities in at least three countries seized shipments of ten containers of counterfeit cigarettes that went from Rajin to Busan aboard a ship known as the *MV Chu Xing*, for a total of ten containers of cigarettes seized. Others went via Posyet to Akita, Japan, and shipments produced in Rajin and Pyongyang were also said to be transhipped overland or via the Chinese port of Dalian.⁶²

After some of these shipments were caught in 2004, however, the process appeared to adapt. The tobacco industry’s investigators noted in 2005 that several of the syndicates had shifted to using “small freighters or ‘pelagic’ fishing vessels to ship counterfeit cigarettes to delivery points in international waters near their destination markets. The cargoes [were] offloaded at sea onto smaller, high-speed vessels, which then [made] the

59 Coalition of Tobacco Companies, *Production of Counterfeit Cigarettes in the Democratic People’s Republic of Korea*, 29 June 2005, 1.

60 Author’s interviews, April 2005, July 2008.

61 Author’s interview, April 2005.

62 Coalition of Tobacco Companies, *Production of Counterfeit Cigarettes in the Democratic People’s Republic of Korea*, 29 June 2005, 7, 9.

run in shore"; this method seemed to be especially common for shipments heading to the Taiwan market.⁶³

Counterfeit cigarettes can be shipped as products by themselves, or—as with smuggled cars—can be used to disguise or be combined with even more lucrative commodities. Officials have reported, for example, that counterfeit dollars were inserted inside cigarettes to transport them, and one North Korean defector reported using cigarette cartons to transport drugs across the border between North Korea and China.⁶⁴ Unlike many other North Korea-manufactured illicit products, these shipments had reached as far as the United States on more than one occasion. Officials testified to Congress in 2006 that North Korea-sourced Marlboros cigarettes have been identified in 1,300 incidents across the United States, including in Operations Royal Charm (New Jersey) and Smoking Dragon (California), which also recovered counterfeit currency.⁶⁵

Cigarettes are an especially lucrative item to counterfeit compared to other consumer goods. They are also comparatively less risky from an enforcement standpoint than a product like narcotics. In 2005, Japanese authorities reported that a box of cigarettes sold for 2 to 4.5 yuan in northern China, or approximately 30-45 yuan per carton.⁶⁶ The tobacco industry's report suggested that the sale price by the time North Korea-origin counterfeits reached a nearby Asian port, however—such as Busan, Manila, or Kaohsiung—could be as high as \$130-\$180 per case.⁶⁷ Another

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63 Ibid., 1, 8.

64 Author's interviews, Seoul, March 2005 and July 2013.

65 Mihm, "No Ordinary Counterfeit"; Peter A. Prahar, "North Korea - Illicit Activity Funding the Regime," hearing before the Senate Homeland Security and Governmental Affairs Committee, Subcommittee on Federal Financial Management, Government Information, and International Security (Washington, 109th Congress, 2nd session, 25 April 2006); USA v. Wu et al., (C.D. Cal. 2005), <http://archive.recapthelaw.org/cacd/236658/>.

66 Author's interviews, April 2005.

67 Coalition of Tobacco Companies, *Production of Counterfeit Cigarettes in the Democratic People's Republic of Korea*, 29 June 2005, 1.

expert and former U.S. government official estimated that a standard shipping container of cigarettes might cost as little as \$70,000 to produce, but sell for \$3-4 million—meaning that the regime’s take would presumably be somewhere in the difference between those two points.⁶⁸ (Typically, less than 20% of the street price of a box of cigarettes is production, so counterfeiters are able to undersell legitimate producers and claim not only the 60% that is taxes, but the remaining 20% profit margin.⁶⁹) In a 2005 interview, one tobacco executive estimated that his company was losing \$100 million to North Korea alone.⁷⁰ The report produced by tobacco industry executives calculated the number of cigarettes that could be produced per day at each factory based on the output of the type and number of machines said to be operating at each facility. Extrapolating from input costs and the average protection fee paid in China—between \$20 and \$40 per case—they calculated that the regime’s take could be as high as \$80 to \$160 million per year.

At least two sources of funding and management appeared to exist for these counterfeit cigarette factories. The industry report alleged that three of the production facilities in the Rajin area were run or financed by Taiwan organized crime syndicates, and the cigarettes produced there were intended for—and shipped primarily to—the Taiwan market. At least two of the factories in the Pyongyang area, however—the Linglou Island 888 Cigarette Factory and the Dongyang Cigarette Factory (run by Kosanbong)—were said to be owned and operated by companies of the North Korean military and security services. If true, this would further increase the percentage of revenue that went to the regime itself, above the figures cited in the preceding paragraph.⁷¹ A third factory, the Daesong Cigarette Factory, was run by the Daesong conglomerate, which also

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68 David Asher, “The North Korean Criminal State, Its Ties to Organized Crime, and the Possibility of WMD Proliferation,” (San Francisco, CA: Nautilus Institute, 15 November 2005).

69 Author’s interview, April 2005.

70 Frederick Balfour, “Fakes!” *Business Week*, 7 February 2005.

71 Coalition of Tobacco Companies, *Production of Counterfeit Cigarettes in the Democratic People’s Republic of Korea*, 29 June 2005, 1.

managed the Zokwang/Chogwang Trading Company, which was linked to a number of counterfeit currency seizures in Macau in the late 1990s.⁷²

Finally, in addition to smuggling endangered species products and cigarettes, North Korean diplomats have consistently landed in trouble for commercial or other smuggling activities while posted overseas. The defector who brought one-dollar bills back from Africa for reprinting also claims to have smuggled gems and other currency out of Africa before his departure in 1988; travelling as much as five times a month, he claimed to have cleared an \$80 million profit.⁷³ In March 1998, two diplomats in Bulgaria tried to carry twelve thousand pirated DVDs across the border with Romania, reportedly “the third seizure in recent months.” American officials have accused North Korea of selling pornography in Finland in 2003, and in the early 2000s North Korean diplomats were linked to used car and used mobile phone smuggling schemes in Thailand and Bangladesh.⁷⁴ U.S. government officials also mentioned during interviews that North Korea simply shipped cars under normal conditions, but that if money got tight, had the option of using the cars to smuggle narcotics (particularly in the gas tanks). This would be consistent with a documented North Korean tendency, across a range of activities, to modify relatively low-risk, low-profit activities when necessary to engage in higher-risk operations that earned a higher reward.⁷⁵

A number of these smuggling incidents involved counterfeit or illicit pharmaceuticals. In 2004, two North Korean embassy employees were caught smuggling 150,000 tablets of Clonazepam in Egypt. That same year, embassy employees from Bulgaria were arrested in Turkey in possession of over 500,000 tablets of Captagon (the brand name for the

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72 Ibid., 5-6; see also Chestnut, “Illicit Activity and Proliferation.”

73 Kaplan, “The Wiseguy Regime.”

74 Drug Enforcement Administration, “Major Incidents of Drug Trafficking by North Koreans,” 1998; “Finns Scratch Heads over N. Korean Porn Claim,” *Reuters*, 10 July 2003; Bertil Lintner, “North Korea: Coming In From the Cold,” *Far Eastern Economic Review*, 25 October 2001.

75 Author’s interview, Seoul, April 2005.

synthetic stimulant fenethylamine, or phenethylamine), with an estimated street price of \$7 million.⁷⁶

For at least a brief period in the mid-2000s, there were also indications that North Korea was involved in the domestic manufacture of counterfeit pharmaceuticals. In summer 2004, a South Korean man was arrested in Seoul for selling 4,000 pills of counterfeit Viagra that he claimed to have obtained from North Korea. There were some major discrepancies between the fake and genuine pills—notably that they were white and round rather than blue and oval. They were also being sold for 5,000 Korean won per pill (around \$5) rather than 15,000 won for the legitimate medicine manufactured by Pfizer.⁷⁷ In 2005, Japanese authorities reported that North Korea was counterfeiting Viagra in official factories in Chongjin. In 2005, these counterfeits were reportedly sold to customers in Hong Kong and countries in Southeast Asia and the Middle East. Japanese authorities stated that the pills were sold for a significant markup from their price at the Chinese border. A bottle of 30 tablets sold for 100 yuan (at the time, around \$12.08 USD), but 2000 yen per pill in Japan (\$18.72 per pill, for a price of \$560 per bottle), still below the prescription price of 3000 yen per pill).⁷⁸ A bottle of these pills showed packaging that was close to the original Pfizer bottles but had some small differences in color, orientation, and security features.⁷⁹

V. CONCLUSIONS

This chapter has established the scope and variety of North Korea's involvement in illicit activities prior to 2005. These activities appear to

76 U.S. Department of State, International Narcotics Control Strategy Report (Washington: U.S. Department of State, 2004).

77 Andrew Ward, "Pyongyang may have potent new cash raiser," *Financial Times*, 3 July 2004; Shin Eun-jin, "North Korean Viagra?" *Chosun Ilbo*, 1 July 2004, http://english.chosun.com/site/data/html_dir/2004/07/01/2004070161043.html.

78 At the time, Viagra sold in the United States for \$8-12 per pill, according to Pfizer.

79 Sample obtained by the author, April 2005; for photos, see Chestnut, "The Sopranos State," 150.

be motivated primarily by the financial pressure that North Korea has been under since its economic condition began to deteriorate in the 1970s, though they are also consistent with the emphasis on self-reliance and imperviousness to external pressure that characterizes North Korean ideology more broadly.

There are at least four possible ways of characterizing the relationship between the regime and this set of activities during the period from the mid-1970s to the mid-2000s:⁸⁰

- 1) Lack of state control, where individuals have incentives and opportunities to pursue this activity and do so primarily for personal enrichment, outside the knowledge and enforcement ability of the regime;
- 2) Toleration but not direction, in which the activity is condoned and tolerated by the state, or even encouraged as a perk of holding office, but not centrally supported or coordinated;
- 3) State-sponsored and controlled, but in a decentralized fashion that gives a range of organizations latitude in how they manage their operations; or
- 4) A deliberate, central policy, orchestrated, managed, and supported by the central government.

The material presented in this chapter suggests that a number of diverse organizations that made up the North Korean regime—from military units to trading companies to embassy outposts—each engaged in efforts to earn hard currency, from different sources depending on their earning opportunities and comparative advantages. They did so over an extended period of time in spite of repeated incidents that would have drawn this

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80 Chestnut, "Sopranos State," 8; see also Leonid Petrov, "Criminality Part of North Korea's Survival Strategy," *OhMyNews*, 25 March 2008, http://english.ohmynews.com/articleview/article_view.asp?no=382170&rel_no=1.

activity to the attention of the North Korean regime. The seizure evidence, particularly a number of seizures over a long period involving diplomats and other valuable state assets, suggests that the central government was indeed providing some degree of coordination and support.

Ascertaining the exact degree of centralization depends on identifying the precise role of the North Korean leadership and Kim family, something that has been difficult to assess with any degree of confidence. Based on the evidence that is available, the Korean Workers' Party (KWP) appears to be the main actor linking illicit activities to the regime leadership. Several authors with long experience in the U.S. military and intelligence community have explored the role of "Bureau 39" or "Office 39", which was said to be an office under the Central Committee of the KWP that was closely affiliated with Kim Jong-il.⁸¹ One of these analyses described Bureau 39 as "the state apparatus that directs illicit activities to include the manufacture and distribution of illegal drugs, the counterfeiting of U.S. currency, and the manufacture and distribution of counterfeit cigarettes."⁸² It argued that Office 39 was formed in 1974, and grew in parallel with Kim Jong-il's rise to power. The office has "been under the supervision and guidance of the younger Kim [Jong-il] since its founding."⁸³ Media reports speculated that Kim Jong-il not only supervised the currency-generating activities of this office, but also oversaw the disbursement of funds earned.⁸⁴ Analysts have further suggested that Office 39 may be responsible for managing a large proportion of some \$5 billion that the Kim family has accumulated and stashed in bank accounts in Europe.⁸⁵ Finally, the March 2014 report by the United Nations Commission of Inquiry on human rights

81 See JIATF West, "North Korean Drug Trafficking"; Spaeth, "Kim's Rackets"; Kongdan Oh Hassig, Joseph S. Bermudez, Kenneth E. Gause, Ralph C. Hassig, Alexandre Y. Mansourov, and David J. Smith, *North Korean Policy Elites* (Washington: Institute for Defense Analysis, June 2004).

82 Paul Kan, Bruce Bechtol, and Robert Collins, *Criminal Sovereignty: Understanding North Korea's Illicit International Activities* (Carlisle: U.S. Army, Strategic Studies Institute, March 2010), vii.

83 Ibid., 4.

84 Spaeth, "Kim's Rackets."

85 Jay Solomon and Hae Won Choi, "Money Trail: in North Korea, Secret Cash Hoard Props Up Regime," *Wall Street Journal*, 14 July 2003, A1.

in North Korea includes several statements from North Korean defectors, with varied experience in illicit activities, stating that these activities were “formally authorized [and directed] by central authorities” of the Korean Workers’ Party.⁸⁶ In other words, though other entities in the North Korean government, including the military and diplomatic services, have been implicated in carrying out illicit activities, their actions would have been planned, directed, and coordinated by the party.

A number of voices argued during the pre-2005 phase that these activities represented a critical source of funding for the North Korean government. Defector Kim Dong-hun, a former North Korean businessman who defected in 1997, asserted, “If you cut off Bureau 39, you can kill Kim Jong-il. Kim can’t exist as leader of North Korea without it.”⁸⁷ David Asher, a key architect of many of the financial measures that targeted North Korea’s illicit income, estimated this income at several hundred million dollars a year or one-third or more of North Korea’s total trade and/or cash earnings.⁸⁸ Victor Cha, a former Director on the National Security Council under President George W. Bush, suggests that the regime’s response when these activities were pressured in 2005 and 2006 – arguably the strongest response that any U.S. action has gotten from North Korea in a decade or more – confirms their political importance to the leadership.⁸⁹ The 2014 United Nations Commission of Inquiry report notes that income from the regime’s involvement in criminal activities during the 1990s was “channelled into parallel funds that are outside the regular government budget.... institutionally connected to the Central Committee of the Workers’ Party of Korea [and] at the personal disposal

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86 UN Commission of Inquiry (COI), “Report of the detailed findings of the commission of inquiry on human rights in the Democratic People’s Republic of Korea,” A/HRC/25/CRP.1, 7 February 2014, 201, http://www.ohchr.org/Documents/HRBodies/HRCouncil/CoIDPRK/Report/A.HRC.25.CRP.1_ENG.doc.

87 Quoted in Spaeth, “Kim’s Rackets.”

88 Asher, Congressional testimony.

89 Victor Cha, *The Impossible State: North Korea, Past and Future* (New York: Ecco, 2012).

of the Supreme Leader.”⁹⁰ The Commission notes that these funds have been used for projects that personally glorify the Kim family and to provide luxury goods (valued at \$645.8 million in 2012), instead of benefiting the general public.⁹¹

These claims have not been convincing to all audiences. Some believe the United States government staged allegations of drug trafficking and currency counterfeiting to discredit the North Korean regime. There are others who accept that the activities occur, but doubt the specific claims made about the North Korean regime’s role and the importance of these activities to its leadership.⁹² This report concludes with the position that the most likely explanation for the pattern of events observed is that the regime has provided active support for and direction of these activities. It also acknowledges that the nature of the evidence that is publicly available means that questions about the North Korean leadership’s involvement and dependence on these activities are much harder to answer with a high degree of confidence. As both this chapter and the next chapter show, this report also finds that the regime’s role in these activities has probably changed over time, and that as a result, the likely importance of these activities to the regime has shifted as well.

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90 UN COI, 200-203.

91 Ibid., 203. The Commission notes that this expenditure has risen under Kim Jong-un relative to Kim Jong-il; this is not surprising given that a new authoritarian leader needs to take extra care to ensure elite loyalty.

92 These arguments range from simple skepticism to near-conspiracy theory. On the drug trade, see David C. Kang, “Securitizing Transnational Organized Crime and North Korea’s Non-Traditional Security,” in Kyung-ae Park, ed., *Non-Traditional Security Issues in North Korea* (University of Hawaii Press, 2013); Benjamin Sovacool, “North Korea and Illegal Narcotics: Smoke and No Fire?” *Asia Policy* 7 (January 2009), 89-111. Note that Sovacool’s doubts are primarily about the alleged scale of the activity and its importance relative to the volume of the drug trade in Central and Southeast Asia, rather than relative to other sources of income for the North Korean regime.

On currency counterfeiting, see Klaus Bender online at <http://www.dias-online.org/65.0.html>; John McGlynn, “Financial Sanctions and North Korea: In Search of the Evidence of Currency Counterfeiting and Money Laundering Part II,” *Japan Focus*, 2007, online at <http://www.japanfocus.org/-John-McGlynn/2463>; Kevin Hall, “U.S. Counterfeiting Charges Against North Korea Based on Shaky Evidence,” *McClatchy*, 10 January 2008, <http://www.mcclatchydc.com/2008/01/10/24521/us-counterfeiting-charges-against.html>.

CHAPTER 3

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ILLICIT ACTIVITY IN NORTH KOREA'S ECONOMY SINCE 2005

I. INTRODUCTION

Chapter Three provides an analysis of North Korea's current economic activity. Chapter Two documented a shift that took place in the early 1990s, where North Korea moved from a state-operated network in which its diplomats and officials had primary responsibility for trafficking, to a second phase in which North Korea concentrated on production of illicit goods on a large scale while outsourcing distribution to organized crime. Chapter Three analyzes the development of these activities since the mid-2000s, and discusses their current role as a source of income for the North Korean regime.

This chapter begins its analysis in the mid-2000s because around that time, North Korean regime involvement in illicit activities appears to have undergone another shift, after which a new, "third phase" of the country's relationship with these activities emerged. These conclusions have been corroborated by a number of scholars including Andrei Lankov, Seok-hyang Kim, Minwoo Yun, Eunyong Kim, and Justin Hastings.⁹³

Multiple factors could have contributed to this development. These include broader changes to the North Korean economy (discussed in Section I below). They also include pressure applied to illicit activities by the United States government and the international community. In 2005, a number of operations targeted North Korea's ability to earn income from

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93 Minwoo Yun and Eunyong Kim, "Evolution of North Korean Drug Trafficking: State Control to Private Participation," *North Korean Review*, 6:2 (2010); Andrei Lankov and Seok-hyang Kim, "A New Face of North Korean Drug Use: Upsurge in Methamphetamine Abuse Across the Northern Areas of North Korea," *North Korea Review*, 9:1 (Spring 2013); Justin Hastings, "The Economic Geography of North Korean Drug Trafficking Networks," *Review of International Political Economy*, forthcoming.

illicit activities.⁹⁴ The best known of these is the Section 311 designation of Banco Delta Asia in Macau, which identified the bank as an institution of money laundering concern. That designation took place alongside other actions, including Operations Royal Charm and Smoking Dragon, which arrested organized crime participants involved in trafficking an array of illicit products into the U.S.; the indictment of Official IRA leader Sean Garland for his role in a crime ring that distributed North Korean counterfeit currency in Europe; and public statements from the U.S. Treasury Department about the money laundering risks that banks dealing with North Korea were likely to face. These actions were significant enough to the North Korean leadership that North Korea froze the nuclear talks until the money was returned in a way that guaranteed the restoration of its access to the international financial system. It is therefore unsurprising that we see a shift in North Korea's behavior with respect to these activities at around this time.

This chapter discusses the development of the post-2005 "third phase" of North Korea's relationship with illicit economic activities. In this phase, criminal activity clearly sponsored and controlled by the regime has declined in scale and proportion. Instead, much of the illicit activity in North Korea has become decentralized and partially privatized, operating in a hybrid space between public and private, in relationships where politically powerful people protect and benefit from the activities of those involved in illicit trade and vice versa. This means that the income accruing to the regime from these activities is likely to be lower than it was in previous phases, or at least more decentralized within the regime itself, as lower levels are allowed to take a cut of their operations. It also suggests that both the economic benefits of these activities and their human security costs are distributed across a wider swath of North Korean society. Finally, this third phase of North Korean criminal activity employs different

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94 For the Banco Delta Asia finding, see Notices, *Federal Register*, 70:181 (20 September 2005), 55216. On the North Korea case, see Juan Zarate, *Treasury's War: The Unleashing of a New Era of Financial Warfare* (New York: Public Affairs, 2013); David Asher, Victor Comras, and Patrick Cronin, *Pressure: Coercive Economic Statecraft and U.S. National Security* (Washington: Center for a New American Security, January 2011).

smuggling networks than those used in previous phases: the identities and social statuses of those involved in illicit activity, their geographic concentration, their modes of operation, and the countries they impact are all different than they were in either of the previous two phases. This overall trend is clearest in the drug trade and least applicable to currency counterfeiting, a distinction that will be discussed in more detail below.

These sources of income, alongside other data, reflect broader trends of marketization that have been unfolding inside North Korea for some time. They are notable for two primary reasons. The first reason, as will be discussed below, is that these trends have unfolded alongside an apparent, if slight, improvement in the overall state of the North Korean economy, in terms of both economic growth and possibly a current account surplus.⁹⁵ Second, these trends matter because they suggest a growing gap between state and society in North Korea. This is, in part, because the regime has begun to crack down on ordinary citizens for engaging in economic behaviors that were pioneered by the regime's own elite. Unlike before, when illicit activities were justified to the elite within a North Korean ideological framework, the regime is now explicitly telling society at large that illicit activities and the drug trade are not something that "good North Koreans" engage in. The policy implications of these trends will be explored in Chapter Four.

II. A SURVEY OF NORTH KOREA'S HARD CURRENCY INCOME

Judgments about North Korea's involvement in criminal activity and its importance to the regime should be placed within a broader economic context. It is important to ask two questions: First, what are the major sources of income for the North Korean regime? Second, insofar as

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95 See Chapter Four; see also Myong-hyun Go, "Economic Improvement in North Korea," Issue Brief No. 58, *The Asan Institute for Policy Studies* (June 2013); In-soo Nam, "Did North Korea's Economy Expand Again?", *The Wall Street Journal (Korea Real Time blog)*, 12 July 2013, <http://blogs.wsj.com/korearealtime/2013/07/12/did-north-koreas-economy-expand-again/>; Marcus Noland and Stephan Haggard, "North Korea Running a Current Accounts Surplus?" *Witness to Transformation* (blog), 18 March 2013, <http://www.piie.com/blogs/nk/?p=9647>.

it is possible to understand, how is that income distributed once it enters North Korea? Does it go primarily to the regime, to a broader circle of elites in Pyongyang, or to ordinary North Korean citizens?

This chapter identifies eight major sources of hard currency for the North Korean regime, both licit and illicit. Each of these major sources of hard currency are explained below, with rough estimates on the magnitude of the transfers where possible, and a brief discussion of where in North Korean society the money goes. The second half of the chapter then discusses illicit activities such as drug smuggling and counterfeiting in more depth.

1. **Kaesong Industrial Complex.** The Kaesong Industrial Complex constitutes the only remaining avenue of direct economic cooperation between the two Koreas. It encompassed the entirety of inter-Korean trade in 2012; a total of \$1.971 billion USD.⁹⁶ A total of 123 South Korean companies and 800 South Korean managers employed 53,000 North Korean workers, each of whom earned somewhere between \$60-\$135/month. Estimates of the wages paid to North Korean workers vary widely, perhaps because some estimates deduct the taxes that workers pay to the North Korean government, which are reported to be around 45%.⁹⁷ These studies estimate that, prior to its shuttering in 2013, the complex provided North Korea with approximately \$80-\$100 million/year.⁹⁸

The closure of Kaesong in spring 2013 dropped inter-Korean trade from \$23.4 million in April to \$320,000 in May, most of which was

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96 Statistics taken from the Republic of Korea's Ministry of Unification website, <http://eng.unikorea.go.kr/CmsWeb/viewPage.req?idx=PG0000000541>.

97 For estimates, see Alastair Gale, "Closure would hurt both sides of the border," *The Wall Street Journal*, 3 April 2013; Mark Memmott, "The Best Jobs in North Korea," *National Public Radio*, 3 April 2013; K.J. Kwon, "North and South reopen Kaesong Industrial Complex," *CNN*, 15 September 2013.

98 Patrick Cronin, *Vital Venture: Economic Engagement of North Korea and the Kaesong Industrial Complex* (Washington, D.C.: Center for a New American Security, 2012).

the cost of electricity to maintain the plant facilities in the complex (\$260,000, with a remaining \$60,000 in periodicals imported from North Korea).⁹⁹ The facility was re-opened in September 2013, though some companies and workers have left, and negotiations over its operation are ongoing.¹⁰⁰ While some terms of management have been revised, there is no indication that the structure of worker payments is among the items being discussed.

Because the income from Kaesong is from an official inter-governmental project—with what one analysis referred to as “a significant non-commercial component” — the North Korean government receives and controls the lion’s share of income earned from the KIC.¹⁰¹ North Korea’s only contribution to the KIC is the labor supply; the regime is paid in U.S. dollars, but workers receive wages in North Korean won, calculated based on the official exchange rate rather than the black market exchange rate. This means that the complex’s only ability to impact the broader North Korean economy is through the minimal, post-tax wages paid to the North Korean workers. Any surplus generated by the KIC goes to official coffers rather than into the private economy, where it would be able to stimulate demand.¹⁰² As with North Korea’s other contract labor projects, worker remittances and spending into the private economy appear to be a fraction of the overall amount being confiscated by the regime.

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99 Yonhap/Global Post, “Inter-Korean Trade Comes to Almost Naught in May,” *Yonhap/Global Post*, 23 June 2013, <http://www.globalpost.com/dispatch/news/yonhap-news-agency/130623/inter-korean-trade-comes-almost-naught-may>

100 Kwanjoo Jun, “South Korean Businesses Quit Kaesong,” *Wall Street Journal*, 5 November 2013, <http://blogs.wsj.com/korearealtime/2013/11/05/south-korean-businesses-quit-kaesong/>.

101 Stephan Haggard and Marcus Noland, “North Korea’s External Economic Relations,” Working Paper 07-7 (Peterson Institute for International Economics, August 2007).

102 Myong-hyun Go, “Economic Improvement in North Korea,” Issue Brief No. 58 11, *The Asan Institute for Policy Studies* (June 2013).

2. **Trade with China.** China is by far North Korea's largest trade partner. In the first half of 2013, there was reason to wonder whether this trade would decline. China's trade with North Korea dropped slightly in the first half of 2013, from \$3.14 billion in 2012 to \$2.95 billion in 2013.¹⁰³ The primary reasons appeared to be tighter inspections at the Sino-North Korean border and a decline in Chinese exports to North Korea, including a 15% drop in oil and a 65% drop in food.¹⁰⁴ In early 2013, Bank of China also reportedly closed accounts held by the North Korea Foreign Trade Bank, though the exact status of the accounts and the money in them is unclear, and in September 2013, China's Ministry of Commerce, in cooperation with several other Chinese government agencies, published a list of items banned for export to North Korea.¹⁰⁵

The overall trade decrease, however, was short-lived. According to data released in early 2014, China's trade with North Korea reached an all-time high of \$6.45 billion that year, an increase of 10.4% over the previous year. According to this data, North Korea's main import was crude oil, and its major exports were, again, coal and iron.¹⁰⁶ According to government and banking reports, mining of coal and metal have been one of the major sources of increased North Korean exports during the past several years.¹⁰⁷

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103 "N. Korea's trade with China drops 6 pct in H1: diplomat", *Yonhap*, 12 August 2013, <http://english.yonhapnews.co.kr/northkorea/2013/08/12/19/0401000000AEN20130812006300315F.html>.

104 Ibid.

105 Author's interviews with U.S. government officials, June and July 2013; "China Issues List of Items Banned for Export to North Korea," *Associated Press/Washington Post*, 23 September 2013.

106 "Trade Between North Korea and China Hits Record 6.45 Bln in 2013," *Yonhap/Global Post*, 31 January 2013, <http://www.globalpost.com/dispatch/news/yonhap-news-agency/140131/trade-between-n-korea-china-hits-record-645-bln-2013>.

107 Recent rumors in Beijing suggest that Kim Kye-gwan stopped in Dalian on his way back from Beijing in part to check on the new procedures for border control and customs inspection. William Ide, "China's Exports to North Korea Fall," *Voice of America*, July 2013; Gooheon Kwon, "A United Korea? Reassessing North Korea Risks (Part I)," *Global Economics Paper No. 188* (Goldman Sachs, 2009); Park Yung Hwan, *Gross Domestic Product Estimates for North Korea for 2011* (Seoul, Bank of Korea, 2012); "N. Korea's Coal Exports to China Up 15.1% in 2013," *Yonhap*, 24 January 2013, <http://english.yonhapnews.co.kr/northkorea/2014/01/24/0401000000AEN20140124006300315.html>.

China reportedly pays below market price for its imports from North Korea, particularly on the anthracite and metals such as iron, zinc, and lead, which in recent years have comprised a majority of North Korean exports into China.¹⁰⁸ Interviewees credited this to several factors: possible variations in quality and purity, lack of infrastructure leading to higher transportation costs; China's awareness that this lack of infrastructure makes it the only real buyer available; and a lack of trust in North Korean business practices. On this last point, Chinese managers report that they pay cash on site to avoid losing money on deals, and Chinese businessmen speak in highly uncomplimentary terms about their North Korean counterparts.¹⁰⁹

North Korea's primary exports to China are coal, minerals, timber, and foodstuffs such as crab, seafood, and pine mushrooms. In recent years, the export of light manufactured goods, such as clothing and textiles, has also increased (18% of exports in 2012).¹¹⁰

Much of North Korea's trade with China was previously managed by Kim Jong-un's uncle by marriage, Jang Song-taek, who was removed from power and executed in late 2013. Analyst John Park has called Jang "the CEO of North Korea, Inc." and described him as the lead revenue generator for the regime.¹¹¹ Jang was thought to be the head of a network of state trading companies that generated both operating budgets for the government, military, and party offices, and personal funds for the use of the Kim family.

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108 Kevin Stahler, "Is China Ripping Off North Korea? Part II," *Witness to Transformation* (blog), 23 January 2014, <http://blogs.piie.com/nk/?p=12790>.

109 Author's interviews with two Chinese businessmen involved in trade with North Korea, Dandong, Summer 2009.

110 Many of these goods are imported, reprocessed, and exported back to China. Go, "Economic Improvement in North Korea," 8.

111 John S. Park, "The Fallout from Jang Song-taek's execution," *Power and Policy* (blog), 13 December 2013, <http://www.powerandpolicy.com/2013/12/13/the-fallout-from-jang-song-taeks-execution/#.UynK461dX9s>; John S. Park, "North Korea, Inc.," U.S. Institute of Peace, April 2009, <http://www.usip.org/sites/default/files/resources/North%20Korea,%20Inc.PDF>.

The military's role in these trading operations is significant; each corps reportedly runs several different foreign currency earning operations, including managing mines for export. Because these trading companies are run by the party, state, and military, they likely provide a significant amount of the regime's revenue – by one account, they contribute a third of the profit as a “revolutionary fund” loyalty offering.¹¹²

Among the criticisms leveled at Jang at the time of his execution was that he sold North Korea's resources too cheaply, presumably to China, and that he created factionalism and sowed disloyalty to Kim Jong-un; North Korea watchers have hypothesized that he was executed for not giving enough of his revenues to the Kim family leadership.¹¹³ Analysts expect that Jang's purge will be accompanied by lower-level purges and personnel replacements designed to dismantle his patronage network. In the meantime, Kim Jong-un's younger sister, Kim Yeo-jong, has reportedly taken charge of many of the important organizations previously run by Jang and his wife, Kim Jong-il's sister Kim Kyong-hui, which were related to hard currency earning and revenue management, including banks, trading companies, and party offices.¹¹⁴ It is still possible that North Korea's political instability could lead to difficulties in the economic relationship, though all signs are currently showing no negative long-term impact.

Beyond official trade, which is what is reflected in the official trade statistics, there is also a lively, technically illegal cross-border trade that is operated by ordinary people rather than by the two governments. This trade encompasses both items that most

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112 Author's interview with an analyst of the North Korean military and party, email, March 2014.

113 Author's interview with two North Korea experts, email, December 2013 and January 2013.

114 “Kim Jong-Un's Sister Put in Charge of Regime's Cooffers,” *Chosun Ilbo*, 13 January 2014, http://english.chosun.com/site/data/html_dir/2014/01/13/2014011301572.html.

countries would classify as illicit (such as drugs and pornography) as well as more typical trade in food and consumer goods, which are “illicit” trade simply because they are conducted outside official channels by private citizens in contravention of state restrictions on the private economy.¹¹⁵ Much of the official trade is conducted by *hwagyo*, ethnically Chinese residents of North Korea with right of exit, who tend to live along the western corridor of North Korea. Unofficial or black market trade, on the other hand, is more commonly done by *joseonjok*, the ethnically Korean residents of China, who live primarily in the Yanji/Tumen areas across from the more isolated and poorer provinces of North and South Hamgyong provinces in North Korea.

Cross-border trade with China, therefore, is a mix of legal trade with technically illicit black market activity. It provides income both to the North Korean regime – though much of it on market or close-to-market terms – and to the private economy upon which ordinary North Korean citizens depend.

3. **Tourism.** An estimated 4,000 Western tourists and over 237,400 Chinese tourists visited North Korea in 2012, and tour operators reported in 2013 that numbers that year were on track to be approximately double those of 2012.¹¹⁶ The arrest of Westerners such as U.S. citizen Merrill Newman, one tour director commented, actually produced an increase in tourism volume, saying, “For every one person that cancels we probably pick up five. When things like this happen, we see a surge in interest.”¹¹⁷ Westerners arrive

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115 Author’s interviews with three individuals formerly involved in cross-border trade, Seoul, June 2013.

116 These numbers are subject to some debate. Previous reports put the number of Chinese tourists at 20,000, not 200,000, and a North Korean official reportedly claimed that the number of visitors was closer to 700,000. Official statistics from the Chinese government appear at <http://www.cnta.gov.cn:8000/Forms/Search/SearchResultList.aspx?keyWord=%u6708%u5165%u5883%u65C5%u6E38%u5916%u56FD%u4EBA%u4EBA%u6570&pageSize=20>.

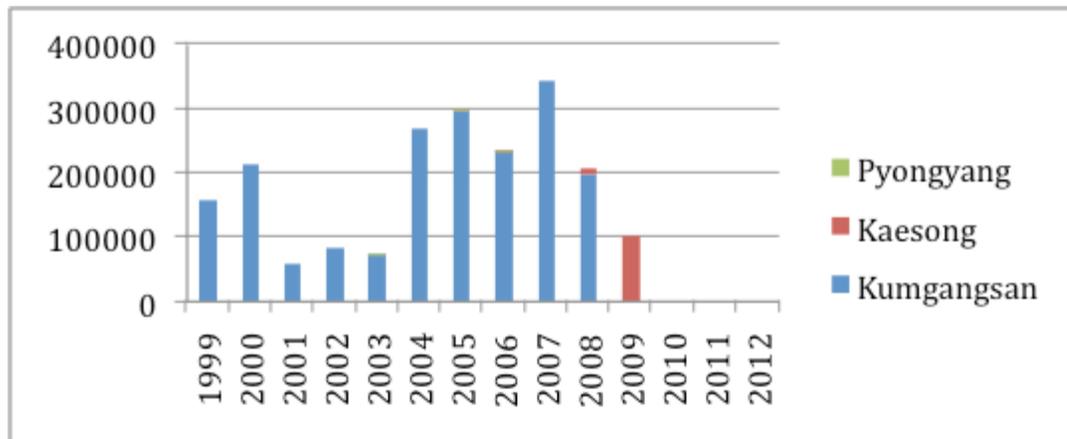
117 Emily Rauhala, “Detention of 85-Year-Old Hasn’t Stopped Tourists From Going to North Korea,” *Time Magazine*, 1 December 2013.

on small group tours such as those run by Young Pioneer Tours or Koryo Tours, typically managed on the North Korean end by the Korea International Travel Company (KITC). In 2013, Koryo Tours took around 2,400 people into North Korea, and Young Pioneers took approximately 1,000.¹¹⁸

Chinese tourism has also increased. Small numbers of Chinese tourists visited prior to the signing of an official memorandum of understanding in 2008-2009. Since 2010, however, tourism from China has increased dramatically. The 2012 number of tourists was a 22.5% increase over 2011.¹¹⁹

South Korea, on the other hand, records no official tourist visits to North Korea after 2010. This is a sharp decline from the over two million who visited North Korea, primarily Mt. Kumgang in Gangwon-do, from the mid-1990s until the shooting death of a South Korean visitor at the site in 2008. See Figure 3.1 below:

Figure 3.1: South Korean Tourist Visitors to North Korea, 1999-2012¹²⁰



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118 Ibid.

119 Kristine Servando, "How North Korea is Coping with Uncouth Tourists from China," *South China Morning Post*, 5 August 2013, <http://www.scmp.com/news/china/article/1294269/coping-uncouth-behaviour?page=all>.

120 Statistics taken from the Republic of Korea's Ministry of Unification website, <http://eng.unikorea.go.kr/CmsWeb/viewPage.req?id=PG0000000541>.

There are no sanctions preventing Western visitors from traveling to North Korea or spending money there (unlike U.S. policy toward, for example, Cuba).¹²¹ Tourism is therefore a licit form of income for the North Korean regime.

Tourism provides hard currency income in two major ways. The first comes through tourism fees paid to the KITC, while the second comes in the form of in-country spending on items such as snacks and souvenirs. According to one Korean-Chinese manager working at a nearly deserted complex of shops in the Mt. Kumgang area in the summer of 2012, the Chinese tourists generally do not spend large amounts of money during their trips, which are quite short – often 48 hours, or weekend-length.¹²² Tour operators and tour leaders report that North Koreans often express a good deal of hostility toward the rude behavior of Chinese tourists; Koryo Tours' Simon Cockrell said in 2013 that "Chinese tourists are even less popular as individuals than Americans."¹²³ Both the official fees and souvenir spending are paid in foreign currency – Chinese yuan, U.S. dollars, or euros. One Korean expert recently estimated the income from tourism to be no more than \$100 million,¹²⁴ but noted that this should be considered a high estimate.

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121 Office of Foreign Assets Control, U.S. Treasury, "North Korea: An Overview of Sanctions With Respect to North Korea," 6 May 2011, <http://www.treasury.gov/resource-center/sanctions/Programs/Documents/nkorea.pdf>.

122 Author's interview, Kumgang area, July 2012; Author's interviews with Chinese tourists who had travelled to Beijing and Pyongyang, Summer 2009 and Summer 2012.

123 Alexander Abad-Santos, "North Korea Would Prefer if You (And Chinese Tourists) Don't Feed or Pet the Children," *The Atlantic*, 5 August 2013, <http://www.theatlanticwire.com/global/2013/08/north-korea-would-prefer-if-you-and-chinese-tourists-dont-feed-or-pet-children/67974/>.

124 Author's interview, Seoul, June 2013.

In late August 2013, North Korea announced ambitious plans to increase tourism to the otherwise-isolated country,¹²⁵ including the completion of a luxury ski resort at Masik Pass.¹²⁶ North Korea's previous attempts to attract tourism have encountered some stumbling blocks – witness the failure of a planned cruise line from Rason to Kungang on the east coast, and delays in finishing the infamous Ryugyong Hotel in Pyongyang. Sanctions on luxury goods temporarily blocked the import of materials necessary to complete the ski resort, but it opened in winter 2013-14. Whether the North Korean government's push to attract tourism will have its desired effect, however, is an open question that remains to be answered.

4. Export of Labor. During the years since the mid-2000s, North Korea has expanded its contract labor presence overseas. Both the number of locations and the total number of workers sent overseas have reportedly increased. The Committee for Human Rights in North Korea (HRNK) is currently gathering material for a report on this subject, and on the human rights and international legal issues that North Korea's overseas labor presence raises.

Workers have been employed doing a broad range of activities: from operating restaurants in China and Southeast Asia to construction and logging in the Russian Far East to construction and medical work in the Middle East and North Africa to factory work in the Czech Republic to building political statues and teaching taekwondo in African countries such as Mali, Benin, Botswana,

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 125 Mark Johanson, "North Korea Plots Bright Future for Tourism Industry, Despite Legacy of Failed Projects," *International Business Times*, 29 August 2013, www.ibtimes.com/north-korea-plots-bright-future-tourism-industry-despite-legacy-failed-projects-1401810.

126 Kim Tae-yong, "North Korea Rushes to Complete Lavish Ski Resort," *Associated Press / South China Morning Post*, 7 October 2013, <http://www.scmp.com/news/asia/article/1326421/north-korea-rushes-complete-lavish-ski-resort>.

Zimbabwe, Namibia, and Senegal.¹²⁷ There were also an estimated 200 North Korean workers in Libya – doctors, nurses, and construction workers – who were not allowed to return home after the outbreak of rebellion in that country and the fall of Qadhafi;¹²⁸ the author’s inquiries to the U.S. and South Korean governments produced no answer as to the fate of these workers. Many of these workers are also in China. In 2013, work visas for North Korean citizens to China alone increased 17%, according to recent statistics from China’s National Tourism Administration: a total of 93,300 (along with, interestingly, 206,600 tourist visas for visitors from North Korea).¹²⁹

Table 3.1 below shows the distribution of currently known locations of North Korean contract laborers overseas.

Table 3.1: Locations and Numbers of North Korean Overseas Workers¹³⁰

Area	Number of Workers	Industries
Russia	20-25,000	Lumber, oil, medicine, road/ waterway construction
China	7-8,000 ¹²⁸ 20,000 (Jilin)	Restaurants, construction, mining industry

127 Derek Henry Flood, “Symbolism Merges for Mali and North Korea,” *Asia Times*, 2 February 2013, <http://www.atimes.com/atimes/Korea/OB02Dg02.html>.

128 Workers in Egypt and Tunisia were reportedly also not allowed to return home either. *Yonhap*, 26 October 2011; author’s interviews, Seoul, June 2013.

129 Oliver Hotham, “Work Visas for North Koreans Going to China Up 17.2%,” *NKNews*, 22 January 2014, <http://www.nknews.org/2014/01/work-visas-for-north-koreans-going-to-china-up-17-2/>.

130 Data in this table is based on a report by the International Network for the Human Rights of North Korean Overseas Labor (INHIL), *Conditions of the North Korean Overseas Labor* (Seoul: North Korea Strategy Center, 2012), 17-18.

131 Note that this number differs from the number of work visas. The estimate in Table 1 is thought to reflect the number of workers who are indefinitely stationed in China, rather than those who visit for a few days on business.

Middle East & N. Africa	15,000	Construction, medicine
SE Asia	15,000	Restaurants, construction
Africa	7-8,000	Statue-building / construction, mining, medicine, taekwondo
Mongolia	5,000	Mining
E. Europe	5,000	Toll booth operations

One recent report by the North Korea Strategy Center (NKSC) and the International Network for the Human Rights of North Korean Overseas Labor (INHL) estimated that between 60,000 and 65,000 North Korean laborers are currently operating in 40 different countries (though the report only names 18).¹³² According to this report, each worker earns about \$200-\$250 per month, but interview data suggests that the regime takes somewhere between 50% and 90% of that amount for expenses and “loyalty offerings,” similar to the taxes reportedly imposed on workers’ wages earned at the Kaesong Industrial Complex.

Consistent with the previously-documented policy of institutional self-financing required of North Korean organizations such as embassies, a large number of agencies and government bodies inside North Korea appear to be involved in sending workers abroad, each of which then funnels money back to the center. In 2013, the National Defense Commission issued a new set of guidelines on making foreign currency offerings in support of *songun* (military-first) politics; the Korean Workers’ Party issues guidelines annually.¹³³

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 132 International Network for the Human Rights of North Korean Overseas Labor (INHL), *Conditions of the North Korean Overseas Labor* (Seoul: North Korea Strategy Center, 2012), 17-18.

133 “DPRK Issues Its Overseas Citizens with Guidelines for Foreign Currency Offerings,” *New Focus International*, 13 May 2013, <http://newfocusintl.com/exclusive-dprk-issues-guide-line-for-foreign-currency-offerings/>.

This report estimates that the use of exported laborers earns the North Korean regime between \$150 million and \$230 million dollars per year, though this estimate should probably be treated as an upper bound (it may be, for example, gross revenue rather than net income).¹³⁴ As with the income from the KIC, however, the majority of this income is confiscated by the regime, with a relatively small fraction going to workers who can transmit remittances back to families at home.

Box 3.1 below contains some testimony from overseas laborers.

Box 3.1: Experiences of North Korean Overseas Workers¹³⁵

“I lived in Pyongyang and worked with cement plastering. If you wanted to be dispatched abroad you had to believe in the ideological foundations of the regime (to make sure you wouldn’t run away) and you had to have over 2 children in your family. After this you had to have some sort of skill. The North Korean people prefer to go work abroad. There are also people that are sent abroad who might not have any skills but are also very loyal to the government. Many people also recur to using bribery...” (*Male, UAE*)

“Before 1985, you would be sent to work abroad in labor if you had committed a crime or for unfavorable conditions. It was little money. However in 1986, they began placing Party members in charge of overseas labor. After that, the people that would come back from Russia began wanting things such as refrigerators and TVs as people that would go abroad would start bringing them inside the country. Similarly, I started wanting those things too. The downside part was that you had to work under difficult conditions... While you work you could have an accident or you could even die. Even if it was dangerous, you could work and earn money so it was good.” (*Male, Russia*)

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134 International Network for the Human Rights of North Korean Overseas Labor (INHL), *Conditions of the North Korean Overseas Labor* (Seoul: North Korea Strategy Center, 2012), 17-18.

135 All testimonies excerpted from INHL, *Conditions of the North Korean Overseas Labor* (Seoul: North Korea Strategy Center, 2012).

"If you want to work abroad you must be married. You must also have something to bribe officials with. So if you are poor basically you can't go. There are some people that promise bribes once they come back from working abroad. There are some people that also borrow from others." (*Male, Kuwait*)

"Our monthly wage is of 360 dirhams. Actually, it should be 1,200 dirham but the government takes 700 dirhams and 100 dirham is for administrative expenses. (1 dirham is about 25 cents). We receive our wages and change it to dollar and then can send about 1 dollar to our family through someone. There is no such thing as having a personal account. I think that other foreign workers receive about 5,000 dirhams." (*Male, UAE*)

5. **Remittances.** Previously, the primary source of remittances sent into North Korea came from ethnically Korean residents of Japan. The total volume of these remittances has been the subject of some debate; they may have totaled as much as \$2 billion in the early 1990s, but may also have been much lower, below \$100 million.¹³⁶ However, a crackdown on the pro-Pyongyang association in Japan (Chosen Soren in Japanese) and their businesses, as well as increased restrictions imposed by the government on financial transactions with North Korea, have led the amount of remittances from Japan to dwindle. In the last three to four years, Japan's Finance Ministry has estimated the remittance flow to be closer to \$20 million.¹³⁷ Even by the most conservative estimates of previous flows, then, the volume of remittances from Japan has decreased significantly as a source of income; the remittances that do remain are sanctioned and monitored for legal compliance by the Japanese government.

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 136 Nicholas Eberstadt, "How Much Money Goes from Japan to North Korea?" *Asian Survey* 36:5 (May 1996): 523-542; Marcus Noland, *Avoiding the Apocalypse: The Future of the Two Koreas* (Washington: Institute for International Economics: 2000); Jennifer Lind, "Gambling with Globalism: Japanese Financial Flows to North Korea and the Sanctions Policy Option," *Pacific Review* 10:3 (1997): 391-406.

137 "Sanctions noose makes it harder for Japan's Koreans to help their own," *The Asahi Shinbun*, 28 March 2013, http://ajw.asahi.com/article/behind_news/social_affairs/AJ201303280015.

Recent estimates, however, suggest that the nearly 27,000 North Korean defectors now residing in South Korea (*talbukin*, or *talbukja*) are providing an increasing amount of remittance income to family members inside North Korea. Survey data and expert estimates suggest that at least half of the North Korean community in the South sends money to family members in the North, and that the size of these remittances ranges from under a million won a year (44%) to over four million won a year (20%).¹³⁸

These remittances have increased over time as more defectors arrive and make the transition into life in South Korea; in 2011, the estimated total flow of remittances exceeded \$11 million. Importantly, this money goes primarily to ordinary citizens rather than to the government—though there is no doubt that bribes to brokers, officials and border guards, as well as “loyalty offerings,” absorb some fraction of that total. One study estimated the percentage lost to these “transaction costs” to be around 30%.¹³⁹ Regardless, the impact on ordinary North Koreans has been significant; they now joke about the Hallasan line/stream (having family in the South) as an alternative to the Paektusan line (being well-off because of political connections in North Korea) or the Mt. Fuji line (having relatives in Japan).¹⁴⁰

Remittances from South Korea overwhelmingly travel through China to family in North Hamgyong province (81%), in rough

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138 This statistic and the ones that follow are taken from *2009/2010 Trends in Economic Activities Among North Korean Defectors* (Seoul: NKDB, 2011). On the number of defectors as of the end of 2013, see Jeyup S. Kwaak, “North Korean Refugee Flow Still Suppressed,” *The Wall Street Journal* (Korea Real Time blog), 14 January 2014, <http://blogs.wsj.com/korearealtime/2014/01/14/north-korean-refugee-flow-remains-suppressed/>.

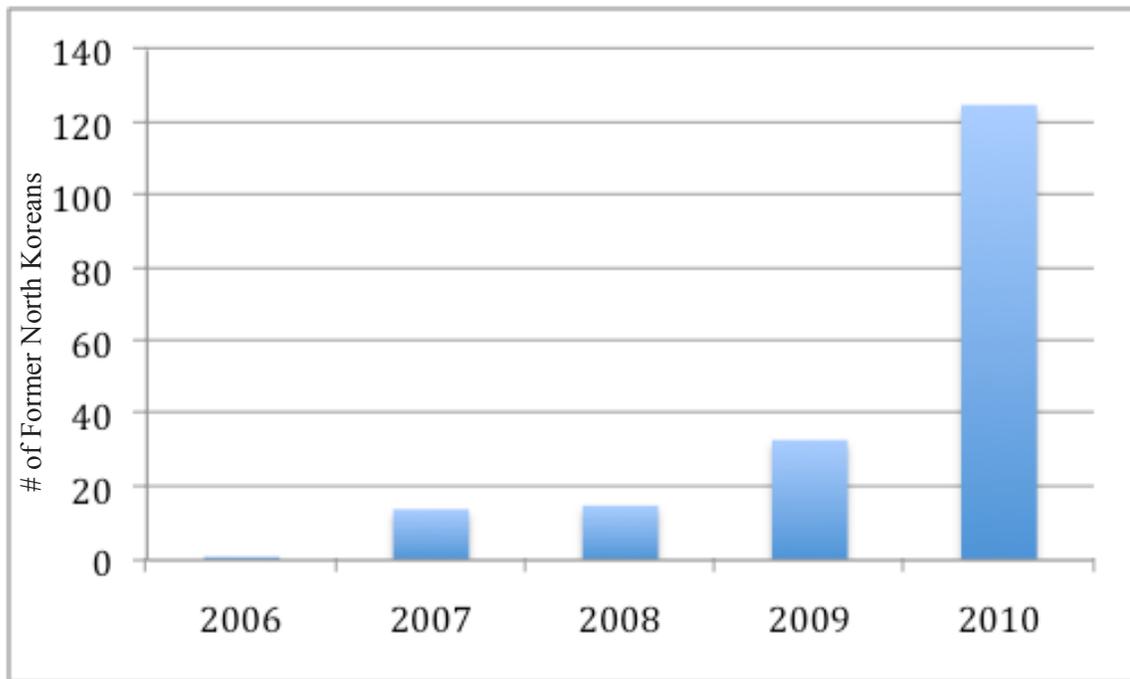
139 Chico Harlan, “North Korean defectors learn quickly how to send money back home,” *Washington Post*, 15 February 2012, http://www.washingtonpost.com/blogs/blogpost/post/north-korean-defectors-learn-quickly-how-to-send-money-back-home/2012/02/06/gIQAg-sEeFR_blog.html; Ju-min Park, “Insight: A secret plea for money from a mountain in North Korea,” *Chicago Tribune*, 11 July 2012, http://articles.chicagotribune.com/2012-07-11/news/sns-rt-us-korea-north-moneybre86a1ar-20120711_1_defectors-funds-flow-brother.

140 Author’s interview with a former resident of North Korea, Seoul, July 2013.

proportion with the percentage of *talbukin* who come from that area. Most commonly, the remittances are transmitted through a member of the Korean minority in China (*Chaoxianzu* in Chinese, *Joseonjok* in Korean, 65% of respondents). Over two-thirds of those surveyed in one 2010 study said that they had paid a 20-30% commission for the transfer. These transfers, however, appear to be highly reliable; 97% of those surveyed had verified that their families had received the money by calling them on the phone.

Figure 3.2 shows the results of a December 2010 survey of former North Korean residents in Seoul, asking them about monetary transfers to North Korea.¹⁴¹

Figure 3.2: December 2010 Survey: “When Was the Last Time You Sent Money to North Korea?”



Box 3.2 contains some descriptions from defectors on how the remittance process works.

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141 North Korea Database Center, 2009/2010 Trends in Economic Activities Among North Korean Defectors (Seoul: NKDB, 2011).

Box 3.2: Sending Money to North Korea

“The sign of a good son or daughter is defection, in order to send money back home.”¹⁴²

“You can send anything to North Korea these days. We joke that it’s just like using Korea Post. Dramas, cosmetics, rice cookers, music... Everything is possible.”¹⁴³

“The broker contacted me by phone and put me in touch with my younger brother. I sent the money to the account number provided, the broker confirmed that it had arrived, and handed the money to my brother there and then.”¹⁴⁴

“[When I still lived in North Korea, I managed to bribe an official to obtain a travel permit, so that I could go to a Partnership Bank where I could receive dollars. I went there by train. I was so happy to be getting the money that I didn’t mind the two-day journey. When I finally arrived in the early morning, I was told that according to Party regulations, I could only receive 15% of the money in dollars, and the rest was given to me in North Korean currency. Even the small amount of dollars I received was stolen by soldiers, security officials and even officers of my residential block. They said that it was a way for me to show loyalty to the Party.”¹⁴⁵

6. **Cell Phones.**¹⁴⁶ The North Korean regime’s recent acceptance of mobile phone and tablet technology has gathered a lot of media

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142 Kim Jin-uk, North Korean refugee from Hoeryong, cited in “Sending Money to North Korea: Official and Un-Official Commissions,” *New Focus International*, 28 June 2013, <https://newfocusintl.com/sending-money-to-north-korea/>.

143 Author’s interview, Seoul, July 2013.

144 Ms. Song, cited in “Sending Money to North Korea: Official and Un-Official Commissions,” *New Focus International*, 28 June 2013.

145 Kim Jong-hwa, cited in “Sending Money to North Korea: Official and Un-Official Commissions,” *New Focus International*, 28 June 2013.

146 For elaboration, see Sheena Chestnut Greitens, “Authoritarianism Online: What Can We Learn from Internet Data in Nondemocracies?” *PS: Political Science & Politics* (April 2013), 267. See also Yorho Kim, *Cell Phones in North Korea: Has North Korea Entered the Telecommunications Revolution?* (Washington, D.C.: U.S.-Korea Institute at SAIS-Voice of America, 2014).

attention of late. Mobile phone service in North Korea is offered by Koryolink, in which the North Korean Ministry of Post and Telecommunications has a 25% share (the other 75% is owned by Egyptian-based Orascom Telecom and Media and Technology Holding, OTMT). Domestic subscribers to Koryolink reached one million in February 2012, and by May 2013 were estimated at 2 million people: roughly 10% of the country's population.¹⁴⁷ Some experts, however, expressed doubt about whether these statistics were accurate or meaningful because of the cost structure of phone minutes, the number of inactive lines reserved for security reasons, and because at least 25% of these phones were designated for official use by party and government officials.¹⁴⁸ Originally available only to the most privileged party elites, the use of cell phones does, however, appear to be spreading further into the North Korean population. (Again, estimates of the exact size of the subscriber pool vary, in part because North Korea's rate plans – particularly the high charges for 'top-ups' if usage exceeds the basic subscription fee – may make it economically sensible to pay for two phones with a basic subscription rather than one phone plus top-up fees).¹⁴⁹ The primary deciding factor in whether an individual has a cell phone now is whether or not he/she can afford to pay for one, and cell phones have become a particularly important tool of trade on North Korea's markets.

Cell phone access has extended to foreigners as well. Since January 2013, foreign visitors have been allowed to carry cell phones inside the country, rather than being required to deposit them at the

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147 Martyn Willians, "Koryolink nears 2 million subscribers," *North Korea Tech*, 26 April 2013, <http://www.northkoreatech.org/2013/04/26/koryolink-nears-2-million-subscribers/>.

148 Yonho Kim, "A Closer Look at 'The Explosion of Cell Phone Subscribers' in North Korea," 38 *North* (blog), 26 November 2013, http://38north.org/2013/11/ykim112613/#_ftn1.

149 Kim, *Cell Phones in North Korea*, 14-15.

airport upon arrival,¹⁵⁰ and North Korean SIM cards are offered for sale to arriving visitors at the airport – though foreigners who have a Koryolink SIM card or cell phone still cannot call a North Korean citizen who has the same service provider.

Providing mobile phone and internet services is likely to help attract foreign investors who had previously complained about their absence.¹⁵¹ Even without foreign investors, the cell phone industry seems to be providing North Korea with a non-trivial, legal stream of income. In early 2013, the price of a mobile phone in North Korea began at around \$250 plus additional fees (and bribes) required for registration (or speedy registration) with one of the country's security agencies. Mobile phone users reportedly paid around \$13.90/month, but paying in foreign currency earns a user approximately three times as many minutes/texts as they would get by paying in North Korean won.¹⁵²

The North Korean regime appears to earn a considerable amount from the cell phone industry in two ways. First, they make money importing phone handsets and selling them at a markup (from a purchase price of less than \$100 in China to approximately \$300 inside North Korea); if domestic production takes off as the regime has stated it hopes will happen, this could further increase profits from the sale of phone hardware.¹⁵³

Second, the regime makes money from its stake in Koryolink. Extrapolating from the company's estimated 80% gross

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150 "North Korea Allows Foreigners in With their Mobile Phones," *The Guardian*, 21 January 2013, <http://www.theguardian.com/world/2013/jan/21/north-korea-foreigners-mobile-phones>

151 Stephan Haggard, Jennifer Lee, & Marcus Noland. 2012. "Integration in the Absence of Institutions: China-North Korea Cross-Border Exchange." *Journal of Asian Economies* 23 (2): 130–45.

152 Others report that the phone itself comes with 200 free minutes, but that top-up cards must all be purchased in foreign currency. See Kim, "A Closer Look."

153 Yonho Kim, *Cell Phones in North Korea*, p. 40.

margin—reported at \$33.1 million in one quarter of 2011 alone—and the North Korean Ministry of Post and Telecommunications’ 25% share in the company, the regime would have earned more than \$30 million in 2011 from its domestic mobile phone market alone. (Thus far, Orascom has been unable to repatriate its dividends because of North Korea’s currency control restrictions.)¹⁵⁴ This estimate of earnings is for a million-person subscriber pool, before visiting foreign tourists were offered the option of SIM cards and phone service; a reported profit of \$230 million for the first three quarters of 2013 would yield a North Korean regime take of \$60 million that year as well.¹⁵⁵ One report quotes South Korean experts estimating the regime’s profits to have been \$400-600 million as of late 2013.¹⁵⁶ Even if the more conservative estimates are used, cell phones are providing a substantial amount of hard currency to the North Korean regime—potentially in the same range as the amount provided by the Kaesong Industrial Complex, and perhaps much more.

7. Arms Sales. The seizure of a North Korean ship en route from Cuba through the Panama Canal has brought renewed public attention to North Korea’s participation in the global arms market. The United Nations Security Council (UNSC) has placed sanctions on North Korean arms imports and exports, and transactions of materials related to North Korea’s nuclear program. The most recent report by the United Nations Panel of Experts established pursuant to UNSC Resolution 1874 found in March 2014 that, rather than abiding by the restrictions imposed by the Security Council, the North Korean regime had continued its arms trading activities, using increasing degrees of sophistication. To evade the sanctions regime, it reported, North Korea

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154 “Egyptian Telecom’s Investment Frozen in North Korea,” *Chosun Ilbo*, 25 January 2014, http://english.chosun.com/site/data/html_dir/2014/01/23/2014012301394.html.

155 Ibid.

156 Yonho Kim, *Cell Phones in North Korea*, 40.

has made “increasing use of multiple and tiered circumvention techniques,” including document falsification, cargo concealment, strategic attempts to take advantage of lax regulations on transshipment and business ownership structure, employment of foreign-based individuals to assist with financial transactions, and the use of front and shell companies. The report also noted the involvement of North Korean embassies in skirting sanctions, and stated that North Korea had learned evasive financial measures from the practices “pioneered by drug trafficking organizations.”¹⁵⁷

In the 1980s and early 1990s, North Korea gained notoriety as an exporter of ballistic missiles and conventional arms to a wide range of countries and terrorist groups.¹⁵⁸ Since around 1993, however, North Korea has shifted toward exporting missile components rather than full systems and to working on joint development projects with a small handful of partner countries.¹⁵⁹ Moreover, in the past decade, Pyongyang’s arms exports have consisted less of ballistic missile systems or components and more of artillery and conventional weapons sales to countries in the Middle East and Africa.¹⁶⁰ The drop in missile exports can be attributable to two factors: 1) increased enforcement and attention to interdiction,

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157 Report of the Panel of Experts Established Pursuant to Resolution 1874 (United Nations, 6 March 2014). See also James Pearson, “Front Companies, Embassies Mask North Korean Weapons Trade – UN,” *Reuters*, 11 March 2014, <http://www.reuters.com/article/2014/03/11/us-korea-korea-un-idUSBREA2A08020140311>.

158 Joseph Bermudez, *The Armed Forces of North Korea* (London: I.B. Tauris, 2001).

159 See, for example, North Korea’s relationship with Iran in the sphere of ballistic missile cooperation; different reports characterize the cooperation (and particularly, who is helping whom with what) in different ways. Duncan Lennox, “Musudan (BM-25),” *Jane’s Strategic Weapon Systems*, 7 September 2012; “Iranian Officials ‘Observed North Korean Rocket Launch,’” *The Telegraph*, 16 April 2012, <http://www.telegraph.co.uk/news/worldnews/asia/northkorea/9206287/Iranian-officials-observed-North-Korean-rocket-launch.html>.

160 Joshua Pollack, “Ballistic Trajectory: The Evolution of North Korea’s Ballistic Missile Market,” *Nonproliferation Review*, 18:2 (July 2011). See also “North Korea’s shadowy arms trade,” *The Guardian*, 17 July 2013, <http://www.theguardian.com/world/2013/jul/18/history-north-korea-arms-dealing>; Carl Anthony Wege, “The Hizballah-North Korean Nexus,” *Small Wars Journal*, 23 January 2011, <http://smallwarsjournal.com/jrnl/art/the-hizballah-north-korean-nexus>.

especially in the wake of North Korea's nuclear tests, and 2) a drop in global demand.¹⁶¹

North Korea's conventional arms exports in recent years have included tanks, air-defense systems, artillery systems, and rocket-propelled grenades (RPGs), as well as shells and ammunition. The country also reportedly provides public security training, though information on this is limited and the market is unclear.¹⁶² Finally, the March 2014 Panel of Experts report notes North Korea's comparative advantage in the market for weapons refurbishment, particularly the maintenance of old Soviet equipment.¹⁶³

Estimating the income that North Korea receives from arms sales—conventional and otherwise—is very difficult given the lack of full information on products and pricing. This is especially true when one considers the possibility that some of this trade is taking place on barter terms, as highlighted by the Panama case.¹⁶⁴

8. Illicit Activities. As Chapter Two discussed at length, the North Korean regime has previously been involved in activities such as state-sponsored drug production and trafficking, counterfeiting

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161 This drop in demand reflects a number of developments. These range from a loss of interest from previous partners, such as Burma and other countries in the Middle East, as well as the fact that missile programs in some previous customers have reached a level of maturity that no longer requires North Korea's assistance (e.g. Iran and Pakistan).

162 For two examples, see "North Korean experts train Vietnamese police," *Tuoi tre news*, 23 March 2013, <http://tuoitrenews.vn/society/8144/north-korean-experts-train-vietnamese-police>; "Exclusive: North Korean minister inspects Ugandan Police Force", NK News, 13 June 2013, www.nknews.org/2013/06/exclusive-north-korean-minister-inspects-ugandan-police-force/.

163 *Report of the Panel of Experts Established Pursuant to Resolution 1874* (United Nations, 6 March 2014).

164 On barter trade, see Hugh Griffiths and Lawrence Dermody, "Shadow trade: how North Korea's barter trade violates United Nations sanctions," Sipri, 17 July 2013, <http://www.sipri.org/media/expert-comments/shadow-trade-how-north-koreas-barter-trade-violates-united-nations-sanctions>. On the Panama incident, see Hugh Griffiths and Roope Siirtola, "Full Disclosure: Contents of North Korean Smuggling Ship Revealed," *38North* (blog), 27 August 2013, <http://38north.org/2013/08/hgriffiths082713/>.

of U.S. currency, and counterfeit cigarette production.¹⁶⁵ Evidence suggests that North Korea continues to be a site for illicit activity, but also reveals substantially different trends than those that characterized the pre-2005 period. These data and the trends that they reveal will be analyzed in more detail in the second half of this chapter.

The above list of possible sources of income for the North Korean regime is not exhaustive. Other possibilities exist, particularly for a state that has been as adaptable and opportunistic about earning foreign currency as North Korea has been for decades.

Some of these possibilities are decidedly unconventional. For example, Ben Habib has explored the possibility that North Korea is using its engagement with the international environmental regime, and in particular opportunities for global carbon credit trading under the Clean Development Mechanism, to obtain hard currency. Though he judges the likelihood of this at present to be low, it is worth watching in the future.¹⁶⁶

Also worth watching is the prospect of Foreign Direct Investment (FDI) in North Korea. At present, FDI in North Korea is miniscule because of the obvious risks to and lack of protection for external investors. According to *The New York Times*, there were 305 cases of foreign investment in North Korea as of autumn 2012: two-thirds of them Chinese and fifteen Japanese. The disputed cases of Chinese mining company Xiyang Group, which invested \$40 million to build a mine and was then ejected from the country, and Egyptian company Orascom, which says that it has not been able to repatriate approximately \$400 million in profits from North Korea, are commonly cited examples of the risks that investors are

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165 Sheena Chestnut, "Illicit Activity and Proliferation: North Korean Smuggling Networks," *International Security* (2007).

166 Benjamin Habib, "The Systemic Consolidation Imperative: Exploring North Korea's Interactions with the UN Framework Convention on Climate Change," *working paper*, 30 September 2013.

vulnerable to when doing business in North Korea.¹⁶⁷ Even when joint ventures don't fall subject to expropriation by the North Korean authorities, there are serious business challenges, namely: the difficulty of understanding who in the North Korean system has the authority to make and enforce contracts, bribery costs in the case of misjudgment or dispute, low labor productivity (sometimes affected negatively by the human security conditions inside North Korea), and problems with consistent power and materials supply.¹⁶⁸

Dr. Marcus Noland and Dr. Stephan Haggard postulate that 2014 will mark a push by the North Korean regime for foreign investment: an attempt to emphasize the foreign sector as a substitute rather than complement to domestic reform.¹⁶⁹ The biggest potential for this effort to succeed is probably in resource extraction projects – which, if North Korea follows the precedent of authoritarian regimes elsewhere in the world – are likely to contribute directly to the regime's coffers, and offer relatively little by way of sustained and broad-based economic development. In 2012, SRE Minerals created a joint venture with the Korea Natural Resources Trading Company (called the Pacific Century Rare Earth Minerals Limited) to develop a site at Jongju.¹⁷⁰ North Korea has also shown interest in foreign support for the development of renewable energy.¹⁷¹ Attempts to attract FDI are also likely to be aided by President Park Geun-hye's suggestion that the Kaesong Industrial Complex (KIC) be internationalized, though

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167 Jane Perlez, "China-Korea Tensions Rise after Failed Venture," *The New York Times*, 20 October 2012, <http://www.nytimes.com/2012/10/21/world/asia/china-korea-tensions-rise-after-failed-venture.html?pagewanted=all>; Leslie Jones, "How to Do Business in North Korea," *NKNews.org*, 20 January 2014; "Egyptian Telecom's Investment Frozen in North Korea," *Chosun Ilbo*, 25 January 2014, <https://www.nknews.org/2014/01/how-to-do-business-in-north-korea/>.

168 Yaohui Wang and Justin Hastings, "North Korea Risky Business for Chinese Investors," *East Asia Forum*, 10 January 2014, <http://www.eastasiaforum.org/2014/01/10/north-korea-risky-business-for-chinese-investors/>.

169 Stephan Haggard, "What to Look For in 2014: The Push for Foreign Investment," *Witness to Transformation* (blog), 13 January 2014, <http://blogs.piie.com/nk/?p=12748>.

170 Stephan Haggard, "Rare Earths," *Witness to Transformation* (blog), 15 January 2014.

171 Kang Tae-jun, "North Korea Promoting Wind Energy," *NKNews.org*, 23 January 2014, <http://www.nknews.org/2014/01/north-korea-promoting-wind-energy-says-choson-sinbo/>.

the difficulties in restarting the complex after its April 2013 closure suggest that the internationalization of the KIC should not be assumed.¹⁷² Significant risks remain there as elsewhere, and the future of FDI in North Korea is uncertain.

Finally, humanitarian assistance may also provide direct income or patronage resources for the regime. In theory, humanitarian assistance should go exclusively to the people of North Korea. In theory, humanitarian assistance should go to the people of North Korea rather than to the regime. However, humanitarian groups have ceased to operate in North Korea in the past because of the difficulty in ensuring that this would actually happen, and because of the reported diversion of food aid to the military (an example of such assistance contributing to patronage).¹⁷³ Analysts have previously suggested that humanitarian assistance, though not traditionally considered a source of income, was creatively employed to adjust the balance of payments during the food crisis.¹⁷⁴ It is not clear, however, that the diversion of humanitarian aid is happening today on a sufficient scale to warrant inclusion in the above list of sources of current income for the North Korean regime. Certainly, North Korea's own behavior and willingness to terminate international aid projects suggests that it considers the economic benefits of humanitarian aid secondary to political considerations.

This survey is intended to provide a rough overview of North Korea's hard currency income in order to place the next section's discussion of the development of illicit activity in appropriate context. The text that follows explores the trends that are apparent from the survey data above.

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172 "Chinese Firms' Participation Key to Kaesong Industrialization: Expert," *Yonhap*, 19 November 2013, <http://english.yonhapnews.co.kr/national/2013/11/19/58/0301000000AEN20131119006651315F.html>.

173 L. Gordon Flake and Scott Snyder, *Paved With Good Intentions: The NGO Experience in North Korea* (Praeger, 2003).

174 Stephan Haggard and Marcus Noland, *Hunger and Human Rights: The Politics of Famine in North Korea* (Washington, D.C.: Committee for Human Rights in North Korea, 2005), 11. For a map that visualizes and documents humanitarian projects inside North Korea from 1995 to 2012, see www.EngageDPRK.org.

III. NORTH KOREAN INVOLVEMENT IN ILLICIT ECONOMIC ACTIVITY AFTER 2005

Chapter Two of this report reviewed what is known about North Korea's past involvement in criminal enterprises such as drug trafficking, counterfeiting currency, smuggling endangered species, and producing counterfeit cigarettes. In order to examine the state of this activity today, the author re-examined and collected new press and government reporting on incidents of illicit activity related to North Korea. This analysis expanded the original dataset from a total of 138 incidents to at least 175 incidents during the period through 2013. The majority of events in both datasets were drug-related: 80 incidents contained in the 2007 dataset and 107 analyzed here.¹⁷⁵ Some of the new incidents reflected new information on incidents from before 2005-06 that has recently come to light, particularly from Chinese sources, while others are new incidents that occurred between 2006 and 2013.

This data documents the continuing evolution of North Korea's involvement in illicit activities. Evolution can be observed along several dimensions: the location of the activities, the profile of the individuals involved, the likely role of the state or regime in the activities, and the domestic implications of the activities. The drug trade is the area in which these new trends are most obvious, while there is less evidence to suggest a major change in activities such as currency counterfeiting.

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175 The author qualifies this number by saying "estimated" because some incidents appear to be linked. It is therefore debatable whether counting seizure incidents (as was done here) or cases - which sometimes involve multiple, linked seizures from the same network - would produce a more accurate representation of North Korea's involvement. The report also uses "estimated" because new incidents also often come to light several years after they take place (for example, in court proceedings several years later); some data from recent years may therefore not have been made public yet).

Regional and Peninsular Concentration of North Korea-Related Drug Activity

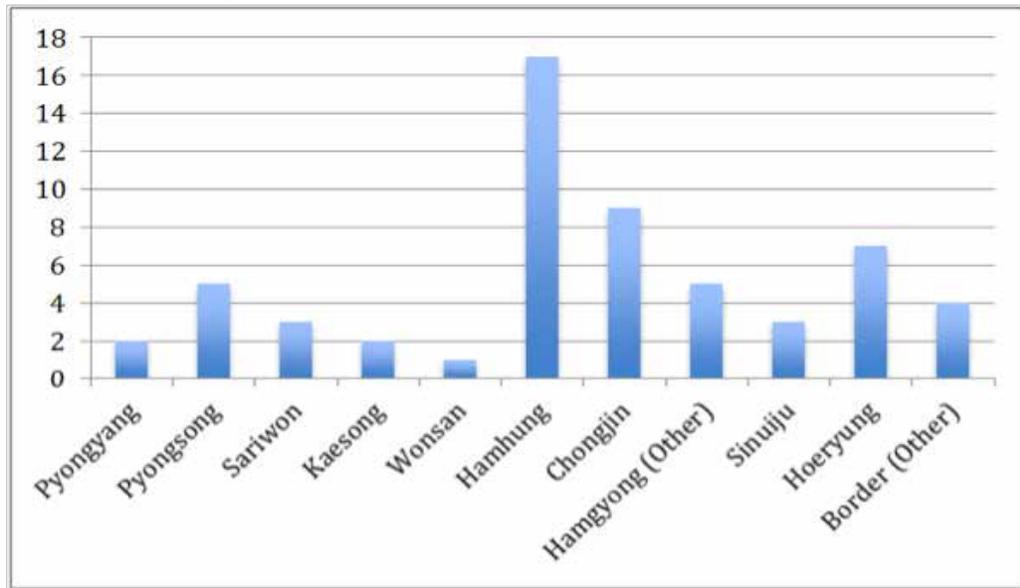
Past research on phases one and two documented a *regionalization* over time of North Korea's illicit activity in the Asia-Pacific region. The post-2005 data, on the other hand, show a trend that might be called *localization*; much of the activity, especially with respect to the drug trade, is occurring around the borders of North Korea itself. Of 27 new drug-trade incidents with a connection to North Korea, 13 took place in the two countries that share a border with North Korea; China and South Korea. The remaining incidents were in Japan, the Philippines, and Guam; the people arrested in Guam were North Korean defectors or refugees coming from Dandong, China. The incidents or seizures of other goods remained more geographically diverse, occurring in the United States, Greece, Scandinavia, India, Mozambique, Mongolia, China, and the Korean peninsula; the reasons for this will be explored further below.

Alongside this localization, there are increased reports of drug trafficking and smuggling incidents inside North Korea itself. The dataset does not include any incidents inside North Korea, as the sources on internal incidents are different and the evidence is more difficult to verify. However, reporting from inside North Korea is consistent in describing a rise in drug usage and drug incidents within the country. A report by Matthew Clayton, for example, documented a series of 58 drug-related incidents inside North Korea from 2006 through 2011.¹⁷⁶ These incidents took place in locations throughout North Korea, but were particularly concentrated in Hamhung (17 incidents), Chongjin (9), and along the Chinese-North Korean border (14). A list of locations documented in Clayton's report appears in Figure 3.3 below.

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¹⁷⁶ Matthew Clayton, "Drugs in the DPRK 2006-2011: A Quantitative Analysis," *working paper*, 2011.

Figure 3.3: Drug-Related Incidents Inside North Korea, 2006-2011

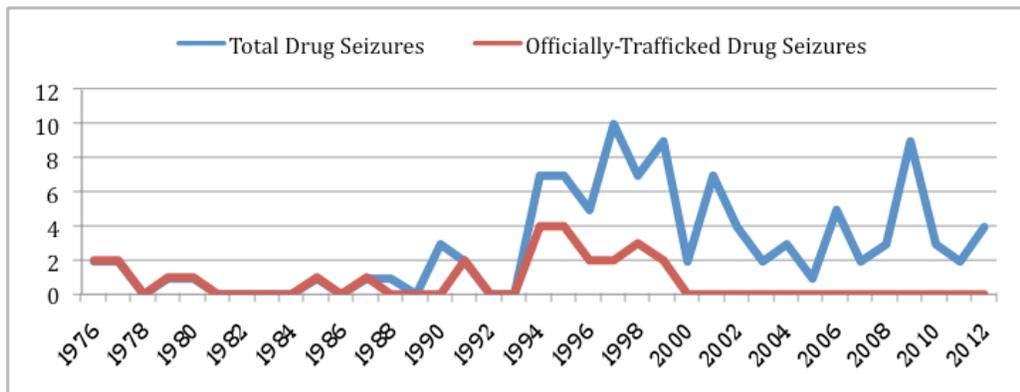


The sections below report in more detail on the development and effects of the domestic drug trade and domestic drug consumption.

The Identity of Drug Traffickers & the Regime's Changing Role

The other trend worth noting is the apparent change in the role of the North Korean regime. None of the drug cases mentioned above involve North Koreans with any known official designation (such as a diplomat or trading company official posted abroad). Figure 3.4 illustrates the trend with respect to official involvement in the trafficking component of North Korea's drug trade, extending the dataset from 1976 to 2013.

Figure 3.4: North Korean Official Involvement in Drug Trafficking



During the 2000s, there was a clear change in the identity of the traffickers who were apprehended with North Korean-linked drugs. Prior to 2006, the people commonly apprehended for trafficking North Korean-linked drugs were one of two types. They were either 1) North Korean diplomats or trading officials (the preponderance of cases from the 1970s to the early 1990s) or 2) citizens of another country with links to large criminal organizations in that country (the bulk of seizures from the mid-1990s to the mid-2000s).

A few of these kinds of incidents occurred after 2006. In late May 2008, Director General of the Philippine Drug Enforcement Agency, Dionisio Santiago, stated that his agents had seized a Vietnam-registered ship that had made port calls in North Korea attempting to enter Subic Bay with 700 kilograms of what they believed were North Korean-origin methamphetamines worth over \$100 million dollars. Santiago noted that the street price of methamphetamine had dropped from 6-8 million pesos per kilo to 3 million (\$68,000), and that—unlike the Philippines' home-grown meth, which is yellowish-brown in color—the recent seizures were “higher-grade methamphetamines in crystal-white form.”¹⁷⁷ The description of these methamphetamines matches the description of state-linked seizures in Japan and elsewhere in the late 1990s, which were comparatively high in purity and quality.

The 2013 case of five defendants who sought to move 100 kilograms of North Korean-origin methamphetamine from the Philippines to New York also fits this trend. This case, the most recent major episode of large-scale drug trafficking linked to North Korea, is currently pending in the state of New York.¹⁷⁸ In this case, the U.S. Drug Enforcement

177 “N. Korean Meth ‘Flooding Asia-Pacific,’” *Chosun Ilbo*, 2 June 2008, http://english.chosun.com/site/data/html_dir/2008/06/02/2008060261023.html.

178 United States District Court Southern District of New York, *United States v. Scott Stammers et al.*, November 2013, online at <http://www.justice.gov/dea/divisions/hq/2013/hq112013a.shtml>. See also Sari Horwitz, “5 Extradited in Plot to Import North Korean Meth to US,” *Washington Post*, 20 November 2013; Stephan Haggard, “More Breaking Bad: The DEA Meth Indictments,” *Witness to Transformation* (blog), 21 November 2013, <http://blogs.piie.com/nk/?p=12327>.

Administration (DEA) extradited five men from Thailand for attempting to smuggle 100 kilograms of methamphetamine made in North Korea and stockpiled in the Philippines into the United States, a deal worth an estimated \$6.5 million. Several of the features of the case – the membership of the traffickers in a Hong Kong-based criminal organization, the large quantity of methamphetamine being discussed for shipment, and the high quality (as evidenced by the price of \$65,000/kilo, much higher than average New York street prices of approximately half that, and the fact that some of the product samples tested at 99% pure) – indicate that this case is much more typical of the pre-2005 phase of North Korean criminal activity. Indeed, consistent with that observation, one of the men arrested in the case claimed that he was the only one capable of obtaining meth from North Korea, because the government had recently closed most of the official labs in an attempt to show the U.S. government that it was no longer producing drugs, and that because he could no longer get product out of North Korea, he had stockpiled it in the Philippines.

These kinds of incidents are now the exception rather than the rule. The most likely people to be arrested in today's "third phase" of drug trade activity linked to North Korea are "ordinary" North Koreans, generally in combination with Chinese Koreans, ethnic Chinese, or Japanese and South Korean nationals who have cooperated on a particular smuggling operation. In one prototypical incident, the Chinese police in November and December 2006 arrested a North Korean man selling drugs from North Korea to a Chinese gang leader named Xu Zongxian and detained a total of 28 suspects, including one South Korean national who arrived by plane from Hong Kong. Xu reportedly confessed to having brought in drugs more than twenty times over the course of the past year (since November 2005), in small increments – a total of 30 kilograms of methamphetamine with a street value of 7 million renminbi (approximately \$890,000). In a second case that month, police in Dalian and Dandong arrested six individuals – a North Korean, three Korean Chinese, and two Japanese suspects – who had been under surveillance since the summer

for potential collaboration with North Korean drug traffickers. The suspects were carrying 3.2 kilograms of methamphetamine upon their arrest and are suspected of having trafficked drugs previously as well.¹⁷⁹ These cases have become so common that the system has been nicknamed the “3-3-3 system,” for the teams that operate each part of the smuggling process: three North Koreans to bring drugs to the border, three Korean Chinese to pick it up and distribute it in China’s northeastern provinces, and three South Koreans or Japanese to bring it into their respective countries for resale.¹⁸⁰ In another incident, the Seoul Metropolitan Police Agency (SMPA) arrested a family of three North Korean defectors – two of them age 24 and a third age 27 – in South Korea, alongside 55 other South Korean citizens, for transporting 1.54 kilograms of methamphetamine. The people arrested told the SMPA they had transported the drugs – an estimated 50,000 doses and worth 5.1 billion won (\$5.5 million) in street prices – to stay out of poverty.¹⁸¹

The cases of contraband or illicit smuggling that have involved official North Korean personnel since 2006 involved products other than narcotics or amphetamine-type stimulants. They include:

- 1) A diplomat and his wife posted in Russia, who tried to smuggle 230,000 cigarettes into Sweden from Finland in late 2009;¹⁸²
- 2) Two North Korean diplomats in India, who were being investigated in May 2011 for an operation that smuggled used luxury

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179 Yong-an Zhang, “Drug Trafficking from North Korea: Implications for Chinese Policy,” *Brookings Institution Report*, 3 December 2010, <http://www.brookings.edu/research/articles/2010/12/03-china-drug-trafficking-zhang>.

180 “China Launches Crackdown on DPRK Drug Trafficking,” *Korea Times*, 8 July 2011, http://www.koreatimes.co.kr/www/news/nation/2011/07/116_90527.html.

181 “Three North Korean Defectors Arrested on Drug Smuggling Charges,” *Yonhap*, 8 May 2007, <http://m.koreaherald.com/view.php?ud=20121112000524&ntn=3>.

182 Jens Hansegard and Nick Vicocur, “Diplomats Arrested For Cigarette Smuggling,” *Reuters*, 20 November 2009, <http://www.reuters.com/article/2009/11/20/us-northkorea-odds-idUSTRE5AJ2Z420091120>.

cars and motorcycles, evading taxes of an estimated \$5 billion rupees (around one million dollars);¹⁸³

3) Two North Korean citizens, travelling on diplomatic passports, who were arrested in Mongolia for trying to smuggle North Korean health products into Mongolia in July 2013.¹⁸⁴

The sporadic nature of these schemes and the diversity of products involved do not suggest that these incidents are part of an organized and centrally directed state campaign in the same way that the long string of diplomatic incidents in earlier periods did. Rather, they appear to be the result of a continued policy of institutional “self-financing,” by which embassies and diplomatic personnel are supposed to earn the money to contribute to the support of their own operations and of their families, as well as to send money home to the regime as part of a loyalty offering.

What is (relatively) absent from the seizure data collected on the period from 2006 to 2012 is a type of incident that was prominent in the late 1990s and early 2000s: large-scale shipments of high-quality illicit products such as methamphetamines or counterfeit currency that seemed to involve some sort of organized collaboration between production agents based inside North Korea and criminal distributors outside. The large number of cases that fit this profile was a major reason why analysts concluded in the mid-2000s that the North Korean regime was engaged in state-sponsored organized crime. The overwhelming preponderance of evidence suggested that activity was taking place on a sufficiently large scale, over an extended period of time, and utilizing assets (such as military transportation) for which state control and direction were the most likely explanation.

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183 “North Korean Diplomats in India Investigated for Car Smuggling,” *Chosun Ilbo*, 17 May 2011, http://english.chosun.com/site/data/html_dir/2011/05/17/2011051700402.html.

184 M. Zoljargal, “Medicine Smugglers Caught at Border,” *The UB Post*, 22 July 2013, <http://ubpost.mongolnews.mn/?p=5048>. There was also a case in January 2012 in which the North Korean ambassador to Germany was caught fishing in Berlin’s Havel River without a license, but this does not appear to have been any kind of revenue-generating operation. See “North Korea’s Fishy Spat with Germany,” *The Telegraph*, 20 January 2012, <http://www.telegraph.co.uk/news/worldnews/europe/germany/9027832/North-Koreas-fishy-spat-with-Germany.html>.

The seizure data since 2006, however, does not necessarily lead to the same conclusion about these activities today. There is not clear evidence that state-sponsored production is absent, but there is an absence of evidence of state-directed activity. The majority of drug trade incidents linked to North Korea since the mid-2000s are small-scale incidents along the North Korea-China border, a qualitatively different pattern than prior to 2005. The testimony of one of the drug traffickers indicted in the New York case (see above) appears to confirm the suspicion that state-sponsored production in North Korea has decreased from its heyday between 1995 and 2005. If these activities are no longer predominantly or even majority regime-directed, the regime's profits from these activities may have declined as well. One recent economic analysis by Marcus Noland and Stephan Haggard uses a completely different methodology than that employed here to arrive at a similar conclusion: that North Korea may be obtaining less of its income from these activities than before.¹⁸⁵

Other expert analysis corroborates these conclusions. In 2011, the U.S. Department of State's *International Narcotics Control Strategy Report* (INCSR) stated that available evidence suggested "considerably less state trafficking, and perhaps even an end to it."¹⁸⁶ The 2013 INCSR noted that there have been "no confirmed reports of large-scale drug trafficking involving North Korean state entities since 2004." This most recent report notes the continuation of drug trafficking activity along the Chinese-North Korean border, as well as the need for precursor chemicals on such a large scale that official participation—such as through corruption—would probably be necessary. It also carefully reports that the absence of seizures may reflect either the cessation of state-sponsored activity or "that the DPRK regime has become more adept at concealing" its role in these activities,

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185 Marcus Noland, "North Korean Illicit Activities," *Witness to Transformation* (blog), 11 March 2013, <http://blogs.piie.com/nk/?p=9650>.

186 United States Department of State, *International Narcotics Control Strategy Report*, Vol. 1 (Washington, DC: United States Department of State, 2011), online at <http://www.state.gov/j/inl/rls/nrcrpt/2011/vol1/156362.htm>.

and suggests that there is not enough information available to make a firm judgment as to state sponsorship.¹⁸⁷

Academic research has also reached roughly parallel conclusions. An article by Minwoo Yun and Eunyoung Kim in 2010 likewise suggested that private citizens' participation in the drug trade inside North Korea had increased, shifting the locus of the activity away from state control and sponsorship.¹⁸⁸ In short, from 2006 to 2013, drug activity inside North Korea appears to have shifted away from an industry marked by regime sponsorship to one primarily characterized by quasi-private production and crony capitalism—consistent with broader developments in the North Korean economy in recent years.¹⁸⁹

What does this private production look like? A recent report by defector organization *New Focus International* argues that even “state-sponsored” production of drugs was never wholly regime-owned and operated. Rather, the report claims, the Ryugyong Corporation—run under the auspices of the Korean Workers' Party's Foreign Relations Department—handles the trade in exchange for providing large loyalty offerings to the party and the Kim family. The Ryugyong Corporation, it states, ran the opium trade from start to finish, managing every part of the process from the cultivation of poppy farms in the provinces of North and South Pyongan to the final point of sale. According to this account, Son Geon-ha led the operation. The Son family's close relationship to Kim Jong-il allowed them to set up the regime's first quasi-private enterprises in North Korea in the early 2000s with the “absolute support and full protection of the regime.”¹⁹⁰

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187 United States Department of State, *International Narcotics Control Strategy Report* (Washington, DC: United States Department of State, 2013), online version at <http://www.state.gov/j/inl/rls/nrcrpt/2013/vol1/204049.htm>.

188 Minwoo Kim and Eunyoung Kim, “Evolution of North Korean Drug Trafficking: From State Control to Private Participation,” *North Korean Review*, 6:2 (2010).

189 See for example, Yang Moon-soo's work on marketization in North Korea.

190 “The DPRK Is Capitalist When It Wants to Be: The Story of Drugs Incorporated (Parts 1&2),” *New Focus International*, 18 August 2012, <http://newfocusintl.com/the-dprk-is-capitalist-when-it-wants-to-be-the-story-of-drugs-incorporated-parts-12/>.

With respect to methamphetamine, rather than opium production, the details are less clear. It seems likely that these businesses are run along the lines of the kind of “public-private enterprises” that have recently emerged in more normal lines of business inside North Korea – for example, the restaurant industry. Andrei Lankov documents the rise of what Koreans sometimes refer to as “state-owned enterprises with private investors,” in which businesses are described as state-owned, but are in practice paid for and profited from by the holders of private capital – many of whom got that capital from privileged political access. The party or state agency under which the business technically operates then has justification to collect between 30% and 70% of the profits in an arrangement that is somewhere between a registration fee, profit sharing, and a bribe.¹⁹¹

The exact relationship between these various agencies and the central leadership remains unclear. What is known is that a wide variety of different organizations are required to raise revenue, and allowed fairly wide latitude in how they do so, both to support their own operations and to make “revolutionary fund” or “loyalty fund” contributions to the leadership and party center.¹⁹² Party, government, and military organizations, as well as elites, are allowed to run businesses and to make money as long as they provide a sufficient offering to the leadership. What is not known is whether these offerings are set by a formal quota system – in which decentralized operators are allowed to keep the spoils so long as they hit their centrally set “production targets” – or whether the requirements are less formal (and perhaps in that case, even more competitive). Lower-level citizens appear to be allowed some latitude to engage in private enterprise as well, albeit on a smaller scale, and with the added burden of providing bribes that support local regime actors who take a cut

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191 Andrei Lankov, “Marketization and its Limits: State and Private in Kimist North Korea,” *SinoNK.com*, 14 June 2013, <http://sinonk.com/2013/06/14/marketization-and-its-limits-state-private-enterprises-in-north-korea/>; Andrei Lankov and Kim Seok-hyang, “North Korean Market Vendors: The Rise of Grassroots Capitalists in a Post-Stalinist Society,” *Pacific Affairs*, 81:1 (2008).

192 This paragraph is informed by author’s interviews with two North Korea analysts, Seoul, June 2013.

of any “revolutionary fund” offering. Corruption, therefore, is becoming widespread at all levels of North Korean society.

The Rise of the Domestic Drug Trade

The final trends worth noting – the increase in the number of reports about the drug trade inside North Korea and the increase in reports on addiction and drug dependency among the country’s citizens – are complementary. There is an apparent increase in production directed at the domestic market, for consumption by the residents of North Korea, as well as for resale across the border to China. While not arguing strongly for state sponsorship, the 2013 *INCSR* noted that “a substantial volume of methamphetamine continues to be produced inside DPRK territory,” and the 2011 *INCSR* reported that this activity had increased sharply from the previous year’s reporting period. The report elaborated:

China National Radio reported that in the first six months of 2009, the province of Jilin, which covers much of the eastern part of the China-DPRK border, led all of China in the volume of drugs seized. Crystal Meth (“Ice”) seizures doubled in comparison to the first six months of 2008. Most of the recorded cases involved cross-border drug smuggling, and the total weight of all drugs seized during this six-month period was 6.1 MT. Another Chinese press report indicated that in response to increased cross-border drug trafficking, Chinese police initiated a boat patrol along the Tumen River which forms part of the DPRK-China border.¹⁹³

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193 U.S. Department of State, 2011 *INCSR*, www.state.gov/j/inl/rls/nrcrpt/2011/vol1/156362.htm.

The North Korean government, however, has denied all allegations of domestic drug production. In 1997, the Korean Central News Agency (KCNA) informed listeners:

For the purpose of granting authenticity to these ridiculous rumors, the South Korean puppet National Intelligence Agency has gone as far as making up ‘data’ to say that narcotics made in the North are exported to different countries through local drug organizations in Liaoning and Jilin Provinces of China.... This is part of the anti-DPRK smear campaign. North Koreans with healthy mental and moral qualities have no intention of turning out or exporting narcotics.¹⁹⁴

Note that the KCNA report actually goes beyond a denial of official involvement to say that no North Koreans of sound mental and moral health would produce narcotics. More recently, in March 2013, the KCNA blasted American media reports that North Korea had ordered its diplomats to traffic drugs. The editorial said:

The American paper *The Washington Post* is misleading the public opinion by releasing the fictitious story of “drug trafficking” by the DPRK, pursuant to the government authorities’ hostile policy toward it.

The newspaper on March 23 carried a false report that North Korea ordered its diplomats to become drug traffickers.

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 194 Cited in Debbie Jeong, “North Korean Drug Abuse Reportedly Spreading,” *NKNews*, 19 September 2013, <http://www.nknews.org/2013/09/north-korean-drug-abuse-spreads/>.

This is a groundless and absurd smear campaign against the DPRK.

This can never be overlooked as the U.S. and other hostile forces are now stoking hostility toward the DPRK as never before.¹⁹⁵

It further added, “The illegal use, trafficking and production of drugs which reduce human being into mental cripples do not exist in the DPRK,” and emphasized North Korea’s accession to various international drug control agreements.¹⁹⁶

The increase in private production inside North Korea has led to an increase in drug dependency and drug abuse among the North Korean population, particularly in the northern provinces of North and South Hamgyong.¹⁹⁷ Methamphetamine was widely used in Asia during the Second World War, particularly by Japanese military forces, whose kamikaze units mixed it with green tea powder in what were referred to as “storming tablets.” It was also included in Philopon (or hirropon), an over-the-counter drug sold in Japan in the 1940’s—and today, the term is still used occasionally to refer to amphetamine-type stimulants (ATS). The Japanese colonial period appears to have marked the introduction of methamphetamine to the Korean peninsula, and specifically to North Korea, whose military likewise provided ATS to its soldiers after the conclusion of the Second World War.¹⁹⁸ For several decades, the North Korean government manufactured methamphetamine at its factories—especially the Hamhung Pharmaceutical Plant in the city of the same name on North

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195 “KCNA Commentary Blasts Story of ‘Drug Trafficking’ by DPRK,” *Korean Central News Agency*, 26 March 2013, <http://www.kcna.co.jp/item/2013/201303/news26/20130326-34ee.html>.

196 Ibid.

197 Andrei Lankov and Seok-hyang Kim, “A New Face of North Korean Drug Use: Upsurge in Methamphetamine Abuse Across the Northern Areas of North Korea,” *North Korea Review*, 9:1 (Spring 2013).

198 Ibid., 49.

Korea's eastern coast, where the Japanese constructed major chemical-industrial facilities. Defector reports suggest that these stimulants were being officially produced, intended for two major purposes: export to foreign markets and official use by the military. As Chapter Two has documented, by the mid-1990s, Japanese authorities and others were making large-scale seizures of methamphetamines linked to North Korea.

Recent research by Lankov and Kim, however, suggests that domestic consumption of the drug did not accelerate until the early to mid-2000s, between 2003 and 2007. The downsizing of official production at that time created a surplus of knowledgeable people with the technical and scientific skills to manufacture drugs and a built-in set of facilities they could either use or replicate. The loss of a job and official rations motivated them to look for ways to repurpose their skills and to make a living doing what they knew how to do: manufacture drugs. As a result, Hamhung, formerly home to the state-run factories, became a site of illicit drug production. Box 3.3 includes statements from former residents of North Korea – many from North Hamgyong province – on the growth of the drug trade:

Box 3.3: The Drug Trade in North Korea

"They were researchers with PhDs and engineers, they knew the plant inside and out.... They were rather old people, and had nothing to do, and their lives were tough... Private entrepreneurs began to look for such people and give them money, employ them. And these people began to produce narcotics."¹⁹⁹

"Of course I know about *bingdu*. I'm from Hamhung; there's a lot of that kind of stuff there. I tried it – maybe, five times?"²⁰⁰

"The whole of North Korean society is being affected by illegal drugs. Some

199 Ibid., 51.

200 Author's interview, Seoul, June 2013.

wealthy people use them to lose weight, and other people take them to treat colds and fatigue. They are considered wonder cures in North Korea."²⁰¹

"He took [ice] and could speak well and move his hand five minutes later. Because of this kind of effect, elderly people really took to this medicine."²⁰²

"Selling ice is the easiest way to make money... [every defector] knows about ice.... There's so little hope in North Korea. That's why ice is becoming popular. People have given up."²⁰³

Abysmal health conditions inside North Korea and the lack of regular access to medicine and health care exacerbated the propensity toward use and addiction. As one NGO worker told *Newsweek* in 2011, "People with chronic disease take it until they're addicted.... They take it for things like cancer. This drug is their sole form of medication."²⁰⁴ One resident of Hamhung who had been involved in dealing drugs for several years told the *Good Friends Newsletter* in 2011, "[Ordinary people] are buying drugs to ease the pain they are enduring. Drugs here are considered a cure-all for all kinds of ailments like colds, headaches and diarrhea. People say we are selling opium, but we are really selling drugs."²⁰⁵ Chronic hunger and malnutrition in North Korea have also played a role, since meth reduces the appetite of individuals who ingest it.

As official production slowed, the use of "kitchen laboratories" to manufacture illicit methamphetamine blossomed. According to reports, two possible pathways are used to manufacture methamphetamine inside

201 Jeong, "North Korean Drug Abuse Reportedly Spreading."

202 North Korean defector, cited in Isaac Stone Fish, "North Korea's Meth Export," *Newsweek*, 19 June 2011.

203 Shin Dong-hyuk, cited in Isaac Stone Fish, "North Korea's Meth Export," *Newsweek*, 19 June 2011.

204 Fish, "North Korea's Meth Export."

205 "Protection from Judges Provides Dealers with Stable Income," *Good Friends newsletter*, 25 May 2011, http://goodfriendsusa.blogspot.com/2011/06/north-korea-today-no-404-may-25-2011_6579.html.

North Korea. One uses ephedrine (the most common precursor and method used to manufacture meth in the United States), and the other, seemingly less common, relies on a phenylacetone precursor instead of ephedrine.²⁰⁶ Both methods involve producing methamphetamine in a laboratory facility that, though it can be quite small, is difficult to hide because of the smell and gases produced during manufacturing. The methamphetamine is then either injected intravenously or burnt and snorted. The latter method of ingestion appears to be the most popular, perhaps simply because of the lack of needles for “shooting up” in North Korea.

Table 3.2: Common Names for Amphetamine-Type Stimulants in North Korea

Korean	English Meaning/Notes
Pingdu	Taken from Chinese “bingdu,” which means “ice drug”
Olum	Means “Ice”
Philopon/Hirropon	Taken from colonial terminology
Aisu	Transliteration of “ice”
Konaemi	Means “snortable”

Interestingly, there is debate about the addictiveness of the methamphetamine manufactured in North Korea. Methamphetamine made in North Korea typically sells in China for 300 yuan more per gram than the methamphetamine coming from Southeast Asia (which sells for 1200 yuan/gram, or about \$193), despite the higher transportation costs and risk associated with the latter place of origin.²⁰⁷ Chinese sources attribute this to the drug’s higher quality.

Methamphetamine doses appear to be much cheaper inside North Korea, where a gram may sell for as little as 70 Chinese yuan (approximately \$11).²⁰⁸ North Koreans involved with the drug trade, however,

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206 Lankov and Kim, 52.

207 “Ice Use Spreads.”

208 Ibid.

do not see the drug as particularly addictive, and its use is considered relatively less taboo. Box 3.4, below, illustrates a range of social attitudes toward drug use among the population of North Hamgyong province:

Box 3.4: Examples of Attitudes Toward Drug Use in North Korea

“When meeting people, we not infrequently swapped drugs to compare whose ice was more potent. We didn’t have the serious attitudes that South Koreans seem to have, we just did it naturally as if we were exchanging cigarettes. Among young women, it’s also common to sell their bodies for cash to buy drugs. And women still do drugs while pregnant.”²⁰⁹

“Methamphetamine has advantages... It pacifies. And I believe it does not have side effects.”²¹⁰

“If people in the countryside take ice, their back pain is cured.... And if you give it to people who have had a stroke, they recover.”²¹¹

“No, *bingdu* is not very addictive. Lots of people have tried it a few times.”²¹²

“People meet to savor drugs pretty much like they would meet to drink liquor in the past.”²¹³

“Doing ice was a social thing; it was a lot of fun. [The night I escaped], I inhaled about ten hits before I went to the river. I felt really focused, all I could think was go, go, go. I didn’t sleep for two days after that.”²¹⁴

209 “Drugs in North Korea: Even Greetings Have Changed,” *New Focus International*, 1 October 2013, <http://newfocusintl.com/drugs-north-korea-even-greetings-changed/>.

210 Lankov and Kim, 56.

211 Ibid.

212 Author’s interview, Seoul, July 2013.

213 Lankov and Kim, 57.

214 Jason Strother, “North Korea Grapples with Crystal Meth Epidemic,” *Wall Street Journal*, 20 August 2013.

Defector news organization *New Focus International* suggests that the question, “Do you want to do a nose?” has replaced “Do you want tea?” as a standard greeting question in parts of North Korean society. Several interviewees mentioned having tried methamphetamine a handful of times while they lived in North Korea. They consistently dismissed the idea that it was addictive; in this, they clearly differentiated ice from opium-based drugs, which they believed to be highly addictive and dangerous to an individual’s health (though sometimes necessary for medical reasons).²¹⁵ They also asserted that the drug had various medicinal benefits. Only recently have the costs of drug addiction—financial and health-wise—become more visible within North Korean society.

Use of the drug quickly spread beyond Hamhung—the epicenter of state-sponsored production—to Pyongyang and other locations, including along the northeastern coast of the country. While the precursor chemicals are more difficult to obtain, the technology to manufacture methamphetamine is relatively simple, and so it is not entirely surprising to see production becoming more geographically dispersed. Moreover, use of the drug appears to have spread across multiple strata and sectors of North Korean society. It began as a phenomenon among the rich and politically connected, who had access to the drugs and/or the hard currency to pay for them, particularly the individuals, predominantly middle-aged men, who worked in foreign trade. Access to methamphetamine has reportedly become a sign of status; one can ask for a dose of ice after a cup of coffee at one of Pyongyang’s new exclusive restaurants, or a man can show it off to a woman in order to demonstrate his socioeconomic status.²¹⁶ Gradually, however, the use of ice has spread outward and downward, reaching students and young people and a wider and wider swath of the population through market channels. Lankov and Kim categorize the stages of drug use inside North Korea as follows:

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215 Author’s interviews with two former residents of North Korea involved in the drug trade, Seoul, June 2013.

216 Lankov and Kim, 54.

Table 3.3: Stages of Methamphetamine Epidemics in North Korea²¹⁷

Stage	Years	Social Environment of Drug Abuse
First	2004-08	Mid-ranking state and party officials, police officers, smugglers, private entrepreneurs (males, ~35-40 years old)
Second	2007-10	White and blue-collar workers, small-scale market vendors (males and females, 20 to 50 years old)
Third	2009-present	Students and youth (males and females, late teens to 50 years old)

The widening scope of drug use and drug addiction was common knowledge to most former residents of North Korea interviewed during the course of this research. Box 3.5 contains some firsthand accounts of the spread of the drug trade inside North Korea.

Box 3.5: The Growth of North Korea's Drug Trade

"Drugs formerly produced in only a few cities are now being manufactured in places like Danchon and Pukchong."²¹⁸

"People who earned money from foreign trade nearly all used narcotics. Police officers, state security officers, party cadres, administrative officials, they all had their [supply] lines, and they spread it among their friends."²¹⁹

"Use of the drug by groups of secondary school and college students has now become especially conspicuous."²²⁰

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217 Ibid., 55.

218 Richard Finney, "Ice Use Spreads, Worsening North Korea's Drug Addiction Problem" *Radio Free Asia*, 19 September 2013, <http://www.rfa.org/english/news/korea/drug-09192013140211.html>.

219 Lankov and Kim, 54.

220 "Ice Use Spreads."

“Seventeen to twenty people will often share a gram among them, consuming the drug as a group rather than individually.”²²¹

“No matter how many inspections they do, they cannot root out drug use. Where I used to live, everybody does *bingdu*. Given that even agents from the People’s Safety Agency, the agency charged with cracking down, and their wives are doing drugs, the drugs crackdown is completely futile.”²²²

While Lankov and Kim estimate that as many as 40% of the residents of North Hamgyong province may be addicted to methamphetamine, this figure may be overstated. North Hamgyong province is not representative of the rest of the country in either its social or economic profile, and addiction rates should not be extrapolated from 22 interviews with former residents to either the province as a whole or especially to the rest of North Korea’s 22 million inhabitants. The fact that interviewees spoken to during research for this project, along with informants for Lankov and Kim’s article, stated that their experience did not lead them to believe the substance was particularly addictive raises questions about the appropriate threshold for defining both the addict population and an addiction epidemic.

It is worth noting that there are recent, unconfirmed reports of a new drug rising in popularity inside North Korea. Amidon, or methadone, is made from raw opium, which North Korea is known to have grown in large quantities previously. It is commonly used in the West to treat heroin withdrawal and as a painkiller, but is also highly addictive.²²³

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221 Ibid.

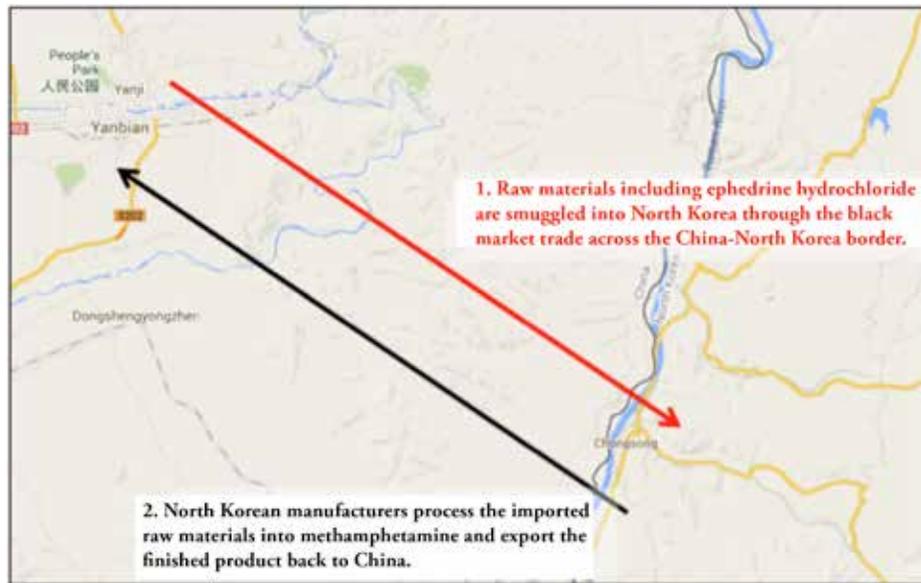
222 Lee Seok Jeong, “Kim Jong Eun Sticking with Doomed Drugs Crackdown,” *DailyNK*, 12 May 2011, <http://www.dailynk.com/english/read.php?cataId=nk01500&num=7672>.

223 Oh Hyun Woo, “Amidon’ Drug Wreaking Havoc in North,” *DailyNK*, 17 January 2014, <https://www.dailynk.com/english/read.php?num=11389&cataId=nk01500>; Geoffrey Cain, “North Korea’s New Drug Addiction,” *Global Post*, 26 March 2014, <http://www.globalpost.com/dispatch/news/regions/asia-pacific/north-korea/140325/north-korea-s-new-drug-addiction>.

Domestic Production and Cross-Border Trade

Because the precursors for making methamphetamine are not available naturally to local actors in North Korea, the drug trade has become entwined with the broader black-market trade occurring across the river border (especially the Tumen River) with China. According to interviewees, China provides the raw materials and manufacturers in North Korea send the finished product back for export across the river.²²⁴ According to national intelligence officials quoted by the South Korean media on a case involving three South Koreans facing the death penalty for drug charges in Yanbian in 2010, South Koreans often fund the drug trade, residents of Yanbian manufacture ephedrine hydrochloride, and it is sent across the border to be cooked into meth inside North Korea. Smugglers inside North Korea and across the border then return the finished product to China for sale. This process is shown in Figure 3.5.

Figure 3.5: Cross-Border Drug Trade Between China and North Korea



North Korean manufacturers charge between 150-200 yuan (\$22 to \$29) per gram to Korean Chinese middlemen, who re-sell it for a profit

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 224 Author's interviews, Seoul, June 2013.

margin that ranges between 200% and 400%. The size of the markup varies with the intensity of scrutiny from law enforcement and the resulting level of risk that smugglers undertake.²²⁵ Descriptions of this cross-border trade follow in Box 3.6.

Box 3.6: Descriptions of Cross-Border Trade

“Crossing the river was best in the winter, when it was frozen and you could just walk. The worst was the rainy season. If the water got too high, we couldn’t cross. I used to carry a lot of things, and my Chinese contact would bring the stuff that people in North Korea asked for. But once I started carrying drugs, I stopped the other stuff – the drugs were the best money... Every time the drug came to the border, I would try it to check the quality. I don’t even remember how many times I tried it.”²²⁶

“In most cases, drug smuggling takes place along the border. Foreign smugglers are usually in constant contact with operatives in China who work for them to transfer the drugs and collect money. These Chinese operatives are mostly residents in border areas and familiar with the local situation.”²²⁷

“Military units on the North Korean border are involved in drug smuggling with cadres. Without help from the military units, drug smuggling is impossible. My brother-in-law is a Chinese policeman. He said to be careful of drugs. They say tons of drugs are smuggled by North Korean military units.”²²⁸

“[The payment required to become a border guard] may be a large sum of money; however; it’s only a matter of time before officers recoup their

225 “Three South Koreans Face Drug Charges in China,” *Joongang Ilbo*, 15 June 2010.

226 Author’s interview, Seoul, June 2013.

227 Lin Guangjun, head of a Chinese border patrol team in Yanbian., cited in Li Cong, “Drugged by Comrades,” *Global Times*, 12 March 2013, <http://www.globaltimes.cn/DesktopModules/DnnForge%20-%20NewsArticles/Print.aspx?tabid=99&tabmoduleid=94&articleId=767651&moduleId=405&PortalID=0>.

228 “Finding Out What Freedom Is,” *Daily NK*, 21 October 2011, <http://www.dailynk.com/english/read.php?cataId=nk03900&num=8276>.

investment by taking in bribes from the smugglers. A smuggling or drug case that may be considered big in other regions can be resolved fairly easily if the right security officials are involved.”²²⁹

“For a lot of trading, you don’t have to cross the river. Drugs aren’t like other trade across the border. The goods are more valuable, so you have to meet in person to do the exchange, and you also have to check the purity of the products. It’s too expensive to risk.”²³⁰

The involvement of actors from the Chinese side of the border has drawn reluctant but increasing attention from Chinese authorities. In 2004, Yang Fengrui – China’s Deputy Secretary General of the National Narcotics Control Commission (NNCC) and Director-General of the Ministry of Public Security’s Narcotics Control Bureau – publicly confirmed the presence of drug trafficking from North Korea into China, though he stressed that it was small in comparison to the number of cases coming from the “Golden Triangle” in Southeast Asia.²³¹ In 2010, the Brookings Institution published a report by visiting Chinese scholar Zhang Yong-an, which highlighted the role that North Korea had played in rising rates of addiction and drug trafficking in Jilin province: from 44 addicts registered with public security in Yanji in 1991, to 2,090 in 2010, and over 10,000 in the province itself (perhaps as many as 5-6 times more than that). The report also noted that in contrast to the rest of China, where heroin is the drug of choice (70% of consumers), most addicts in China’s northeast (90%) use methamphetamine. Chinese scholar Cui Junyong asserted in 2010 that in the last three to five years, the majority of the methamphetamine consumed in Yanbian Korean Autonomous Prefecture had come from North

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229 “One Million Won Required for Obtaining a Position as a Hyesan City Police Officer.” *North Korea Today* (Seoul: Good Friends, No. 370, October 2010).

230 Author’s interview, Seoul, June 2013.

231 Jende Huang, “Spreading Meth Across the Chinese-North Korean Border,” *SinoNK.com*, 7 February 2012, <http://sinonk.com/2012/02/07/spreading-meth-across-the-chinese-north-korean-border/>.

Korea.²³² In 2011, media in Asia and the United States reported that China had confiscated an estimated \$60 million worth of drugs (presumably at street or market prices) coming in from North Korea.²³³

For political reasons, Chinese news reports often do not specifically name North Korea as the country of origin for the drugs seized. The implied origin and identity of traffickers, however, is usually clear by implication from the details of the case. For example, while the press consistently identifies South Korean and Japanese traffickers by their nationalities, it will then carry reports about “a foreigner named Kim” involved in a “cross-border smuggling ring,” or note that seizures have taken place in the town of Dandong, “a Liaoning Province city neighboring the Democratic People’s Republic of Korea.”²³⁴ In March 2013, the Chinese newspaper *Global Times* carried an article titled, “Drugged by Comrades,” highlighting the drug problem in Jilin. “Bordering North Korea” the editorial began, “the province has long been the gateway for an influx of foreign-manufactured narcotics.” It outlined a campaign, “Strong Wind,” that had arrested 2,400 suspects and seized over 262 kilograms of drugs in 2011 and 2012.²³⁵

The rise of domestic drug production has also become inextricably intertwined with the growth of market practices throughout North Korean society.²³⁶ The above-described trend away from centralized regime control over illicit economic activities reflects a general blurring between the

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232 Zhang Yong-an, “Drug Trafficking from North Korea: Issues for Chinese Policy,” *Brookings Institution Report*, 3 December 2010; see also Cui Junyong, “Drug Criminals Related to South Korean in Yanbian, China,” *Xueshu Jiaoliu*, No. 2 (2010), 55.

233 “NK’s Massive Drug Trafficking Angers China,” *Donga Ilbo*, 5 July 2011, <http://english.donga.com/srv/service.php3?biid=2011070521408>.

234 See, for example, “Police Bust Cross-Border Drug Smuggling Ring in NE China,” *Xinhua*, 11 June 2011, http://news.xinhuanet.com/english2010/china/2011-06/04/c_13910877.htm.

235 Li Cong, “Drugged by Comrades,” *Global Times*, 12 March 2013, <http://www.global-times.cn/NEWS/tabid/99/ID/767651/Drugged-by-comrades.aspx>.

236 I am grateful to Yang Moon-soo and Joseph Park for their discussions of the North Korean markets and market system with me. Any errors of interpretation are my own.

formal centrally planned and managed economy and the black market economy in North Korea in recent years, wherein something like crony capitalism has begun to take hold. North Korea's markets initially flourished in the cities. These were the places where famine had hit residents hardest; they were also areas in which people had surplus cash and goods in sufficient quantities to make creation of barter trading and eventually a market possible. These sites have developed into today's *jangmadang* (open market). The *jangmadang* is essentially a consumer market, and over 90% of the goods are brought in from China; therefore, much of North Korea's under-the-radar cross-border trade with China is directed at supporting these markets. Markets, however, have not yet contributed much to the development of domestic production since most of the goods are still brought in from China. The introduction of cell phone technology in the past several years has also facilitated the development of a national—rather than regional or provincial—market system, in that it provides opportunities for price comparison and harmonization. Box 3.7 contains some descriptions of the *jangmadang* from former participants.

Box 3.7: Markets in North Korea

“The free market, the black market, is a major lifeline for the people of North Korea, and an important part of society.”²³⁷

“We called the stalls our “seats” and mine was made of cement. Each vendor had a space limit—the width and breadth of a stall had to be not more than 40cm each. The stalls are so small because more and more people are interested in selling their wares, and the stalls have become smaller to fit everyone in. Of course, that increases the market administrators’ income, too. People with money buy multiple stalls under other people’s names and do business on a larger scale.”²³⁸

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237 Author’s interview, Seoul, June 2013.

238 Former Chongjin vendor Lee Joo-mi in “North Korea Implements Identity-Based Vendor System,” *New Focus International*, 29 July 2013, <https://newfocusintl.com/north-korea-implements-identity-based-vendor-system/>.

“As the *jangmadang* developed in North Korea, more goods were brought into the country that fit consumers’ demands. Traders came to be in tough competition with each other, and we had to be plugged into a logistical network in order to move our goods more efficiently. The mobile phone is an important tool for staying abreast of fluctuations in exchange rate and demand of goods.”²³⁹

“When I went to a market after settling in South Korea, I was amazed that the items on sale, as well as the methods used to sell them, were pretty similar to North Korea.”²⁴⁰

“People ... pay in yuan at the market for rice and other daily necessities.”²⁴¹

“The average person cannot survive without trading in the market, but the wives of Party officials still obtain rations from the regime. They therefore get fed. In addition, much of the time they engage in trade through associates who act as intermediaries.... [and sometimes] put their money into the market as private lenders.”²⁴²

“You must have a stall in order to sell goods in the *jangmadang*. If you want to trade according to the market regulations, you have to pay the stall-tax.”²⁴³

“Officials pick a fight over goods on sale or accuse traders of selling goods without the right permissions. They pocket the fines for themselves. Those who

239 Former trader Oh Ji-hyun, “North Korea’s Information Age Dawns in the Jangmadang,” *New Focus International*, 19 February 2013, <https://newfocusintl.com/the-dawn-of-north-koreas-information-age-jangmadang/>.

240 “North Korea’s Jangmadang Walls Are Growing Higher,” *New Focus International*, 3 October 2013, <https://newfocusintl.com/jangmadang-walls-are-growing-higher/>.

241 John Ruwitch and Ju-Min Park, “N. Korean Economy Surrenders to Foreign Currency Invasion,” *Reuters*, 2 June 2013, <http://www.scmp.com/news/asia/article/1326421/north-korea-rushes-complete-lavish-ski-resort>.

242 “In North Korea, Party Officials’ Wives Run the Money Market,” *New Focus International*, 30 September 2013, <http://newfocusintl.com/north-korea-party-officials-wives-run-money-market/>.

243 Mrs. Choi, a trader at Sunam market in Chongjin, cited in “Setting Up a Market Stall in North Korea,” *New Focus International*, 8 May 2013, <http://newfocusintl.com/setting-up-a-market-stall-in-north-korea/>.

can't pay the fines will have their goods confiscated, and these are then sold off to other traders."²⁴⁴

"[After Choi escaped, his] family, like many other families of those who have successfully escaped from North Korea, stepped up their presence in the *jangmadang*. Ironically, by conducting market activities prohibited by the state, they could hide the fact that one of their family had not only made it out of the country alive, but was sending home packets of money.... Their purpose isn't to make money, but to launder it."²⁴⁵

As the *jangmadang* has persisted and grown throughout the country, market practices have become more and more entrenched in North Korea's economy and society, leading to a blurring of the lines between state-owned business (the official economy) and private enterprise (the people's economy). In North Korea, it is now possible to operate a variety of businesses in a new business structure, pioneered by restaurants but spreading to other enterprises, in which private entrepreneurs with money invest in and profit from a technically "state-owned" enterprise in exchange for providing "revolutionary fund" or "loyalty offerings" of 30-70% back to the regime.²⁴⁶ These enterprises, as well as the more traditional state-owned enterprises, have been forced to use the *jangmadang* to keep equilibrium and to continue their operations—selling their excess and filling supply orders that the centrally-planned economy has been unable to provide. Box 3.8 describes the interdependence of ostensibly state-run farms with market systems:

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244 Mrs. Kim, from North Hamgyong province, cited in "Setting Up a Market Stall in North Korea," *New Focus International*, 8 May 2013, <http://newfocusintl.com/setting-up-a-market-stall-in-north-korea/>.

245 "Money Laundering in the Jangmadang of North Korea," *New Focus International*, 25 March 2013, <http://newfocusintl.com/why-families-of-north-korean-exiles-visit-the-jangmadang/>.

246 Andrei Lankov, "The Limits to Marketization: State and Private in Kimist North Korea," *Sino-NK* (blog), 14 June 2013; "Capitalist When it Wants to Be: The Story of Drugs Incorporated," *New Focus International*, 18 August 2012, <http://newfocusintl.com/the-dprk-is-capitalist-when-it-wants-to-be-the-story-of-drugs-incorporated-parts-12/>.

Box 3.8: Farms and Markets in North Korea

“North Korean farms do not receive any of the operational support from the authorities that they need, so they keep a portion of their rice yield each year. In February, when preparations for the year’s farming begin, farms sell their rice stocks to runners, and with that money they purchase fuel and plastic film... Because the farms are planning to sell their rice, they want to know not only the local market situation but also that of markets in other regions. Mind you, foreign currency-earning enterprises also import bulk rice and sell it to runners, so they are no less interested in rice price trends.”²⁴⁷

The other major development alongside the growth of the market is the increasing use of foreign currency rather than the North Korean won. Since the currency revaluation of 2009 wiped out much of the country’s private savings,²⁴⁸ the value of the North Korean won on the black market has tumbled. *DailyNK* estimates that the won has lost 99% of its value (from 30:1 to 8500:1 against the dollar since 2009).²⁴⁹ “Nobody puts [money] in the bank because nobody trusts the government,” said one Chinese source who regularly interacts with North Koreans across the border.²⁵⁰ Instead, people keep cash at home or in hiding, and U.S. dollars and Chinese renminbi (yuan) have taken the place of the North Korean won. Euros are also occasionally used, mostly in places frequented by foreigners. Near the border, estimates are that 80% of the market transactions in cities along the Chinese-North Korean border take place in Chinese currency, while the interior regions use a nearly even mix of U.S. dollars and Chinese yuan.²⁵¹ Not surprisingly, many of the most preferred jobs in

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247 Kim Yong Hun and Kim Kwang Jin, “The Visible Hand of State Meddling,” *Daily NK*, 5 March 2013, <http://www.dailynk.com/english/m/read.php?catald=nk02900&num=10361>.

248 On the motivations for and effects of the currency revaluation, see Stephan Haggard and Marcus Noland, “The Winter of their Discontent: Pyongyang Attacks the Market,” *Peterson Institute for International Economics*, January 2010, <http://www.piie.com/publications/pb/pb10-01.pdf>.

249 “Border Cities Love Chinese Yuan,” *Daily NK*, 17 April 2013, <http://www.dailynk.com/english/read.php?catald=nk03200&num=10496>.

250 Juwitch and Park, “N. Korea’s Economy Surrenders.”

251 Ibid.

North Korea are now those that allow the worker access to foreign hard currency.²⁵²

The growth in use of Chinese currency has been one of the biggest trends in the past few years.²⁵³ While elites continue to prefer U.S. dollars, ordinary people who depend on *jangmadang* (open market) trading linked to China increasingly seek Chinese yuan. It is this informal, “yuan-ized” economy that has grown rapidly relative to the official, state-run economy in recent years. According to analyst Dong Yong-seung at the Samsung Economic Research Institute (SERI), nearly \$2 billion in foreign currency is currently in circulation inside North Korea – about half in dollars, 40% in renminbi, and 10% in euros – and the informal economy may now exceed the formal economy in size.²⁵⁴ Defector organizations report that a small industry has sprung up of people who can repair or re-ink damaged currency to make it look more pristine.²⁵⁵

A symbiosis is therefore developing between state-run companies and essentially private enterprises, with political connections required for business to flourish and political actors benefitting from the activities of businesspeople. Reports about the recent trend of intermarriage between those with good political connections and those who have succeeded in making money on the market, if true, are likely to reinforce this trend.²⁵⁶ The North Korean regime and its people at various levels of the system obtain income from these arrangements – a revenue stream more

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252 Author’s interviews, Seoul, June and July 2013.

253 Chris Green argues that the trend toward yuanization began in 2002 and was accelerated by the events of 2009. See Chris Green, “In Mao We Trust: The increasing use of yuan in North Korea,” *NKNews*, 4 May 2013, <http://www.nknews.org/2013/05/in-mao-we-trust-the-increasing-use-of-yuan-in-north-korea/>.

254 Study by SERI’s Dong Yong-Seung, cited in Juwitch and Park, “N. Korea’s Economy Surrenders.”

255 “A Rising Trend in the North Korean ‘Financial Industry,’” *New Focus International*, 5 June 2013, <http://newfocusintl.com/north-korean-financial-industry/>.

256 Peter Ward, “Reining in Rent-Seeking: How North Korea Can Survive,” *SinoNK.com*, 2 July 2013, <http://sinonk.com/2013/07/02/reining-in-rent-seeking-how-north-korea-can-survive/>.

like economic rents than true taxation. The critical difference from before, however, is that North Korea used to extract this income primarily from actors and trading companies that operated outside North Korea, because that was where there was money to be made. The rise of the black market inside North Korea has meant the appearance of domestic income that the regime is now trying to tap.

Limited Evidence: Counterfeit Products and Counterfeit Currency

Anecdotal evidence suggests that product counterfeiting inside North Korea has continued. In 2006, the emergence of cigarette counterfeiting inside North Korea was a relatively new phenomenon. Defectors report that this activity is continuing, although some claim that it is happening at a decreased rate in part because of a changing relationship between North Korean authorities and the foreign groups that previously managed or supported these operations.²⁵⁷ There are now also reports of other counterfeit goods that are either circulating or being manufactured inside North Korea. In November 2012, for example, Japanese shoe manufacturer ASICS complained that North Korea had imported and created knockoff versions of its shoes, and tourists in summer 2012 observed display cases selling Marlboro cigarettes with the brand name misspelled.²⁵⁸

There is more limited evidence of continued North Korean involvement in currency counterfeiting. Media and United States government reports have described five cases of Supernote discovery since 2006 (two that year, one in 2008, and two in 2009), none of which involved North Korean officials.²⁵⁹ Defectors say that the North Korean regime continues

257 Author's interviews, Seoul, July 2013.

258 Author's interview, Seoul, July 2013; "North Korea Shows off Illegal Replica of Shoes as New Design," *Yonhap*, 16 November 2012, <http://english.yonhapnews.co.kr/northkorea/2012/11/16/14/0401000000AEN20121116007800315F.HTML>.

259 David Samuels, "Counterfeiting: Notes on a Scandal," *The Independent*, 24 August 2009, <http://www.independent.co.uk/news/world/asia/counterfeiting-notes-on-a-scandal-1776329.html>; Department of State, 2009 *International Narcotics Control Strategy Report (INCSR)*; "Fake N. Korean Supernotes Smuggled into SK," *Dong-a Ilbo*, 4 June 2009, <http://english.donga.com/srv/service.php3?biid=2009060449898>.

to produce the Supernotes,²⁶⁰ but relatively little new concrete information has come to light, especially on the regime's role. It is possible that these Supernotes were produced prior to 2006 but went undetected for some time; it is also possible that North Korea continues to produce the notes but is now circulating them in ways and in areas that are less likely to be detected, such as in northeastern China. Unlike the production of methamphetamine or counterfeit products, however, counterfeiting American currency requires complex and sophisticated equipment and materials that must be obtained from specific places abroad, including parts for intaglio presses, specialized ink, and specifically blended paper (all described in Chapter Two). As a result, it is much less likely that private actors in North Korea could have taken over currency production.

Changes in North Korean Enforcement: Rhetoric and Arrests

Also new since 2006 is the presence of signs that the North Korean government and authorities have begun to crack down on the drug trade within the country's borders. As early as 2006-2007, non-governmental organizations were reporting that the drug addiction rate inside North Korea was rising, and that the regime had increased its attempts to curtail drug production and trafficking.²⁶¹ This trend has continued through the time at which this report was written.

Arrests and executions for drug-related offenses have been reported with some regularity inside North Korea. In 2005, two men were reportedly arrested and executed in Chongjin for drug trafficking; in the fall of 2006, reports surfaced of over 150 people arrested in Pyongyang, North Hamgyong, and South Hamgyong for drug trafficking; and in March 2007, a Women's Union chairwoman in Hoeryong was arrested on drug

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260 Author's interview, Seoul, June 2013.

261 See Chestnut, "Illicit Activities and Proliferation," 96-97.

charges.²⁶² In 2011, the Ministry of Public Security arrested a North Korean chemistry professor, formerly employed at a college in the Hamhung area, who had been engaged in operating an illicit methamphetamine laboratory and selling drugs to brokers in Sinuiju.²⁶³ Despite harsh sentences on paper for any and all drug-related offenses – one report claims that anyone with over 1 kilogram of ice will be executed²⁶⁴ – drug activity does not appear to be consistently treated as an especially serious offense; of 327 offenders whose arrests were analyzed by Clayton, only 12% were reportedly executed – many of them soldiers or police officers.²⁶⁵ In most cases, reports indicate that offenders, especially small-time ones, can simply pay a bribe or protection fee and continue about their daily life.

Where North Korea does appear to take drug incidents seriously is in the cases where foreigners are alleged to be involved. Since at least 2007, North Korean authorities have detained several foreign citizens on the grounds of drug trafficking. In March 2011, North Korean authorities detained three Japanese men in Rason on grounds of drug trafficking and currency counterfeiting.²⁶⁶ In May, the Korean Central News Agency (KCNA) carried the following announcement about the charges against these men:

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262 “DPRK Intensifying Drug Trafficking Control,” *North Korea Today* (Seoul: Good Friends, 31 January 2007); “Decreases in Circulation of DPRK-made Illegal Products in China,” *Weekly Dong-A*, 25 April 2006; “Chairwoman of Women’s Union Caught with Drugs Unsettles Hoeryong,” *Daily NK*, 1 March 2007, <http://www.dailynk.com/english/read.php?cataId=nk00100&num=1731>; “15 kg. Drugs Found in Home of a Chairwoman of Women’s Union,” *Daily NK*, 28 February 2007, <http://www.dailynk.com/english/read.php?cataId=nk00100&num=1729>.

263 “A Scuffle Between Safety Agents and Middle School Students,” *Daily NK*, 28 February 2008, <http://www.dailynk.com/english/read.php?cataId=nk01500&num=3322>.

264 “Revision to Punishment for Ice-Related Crimes,” *North Korea Today* (Seoul: Good Friends, No. 112, February 2008).

265 Clayton, “Drugs in the DPRK,” 27.

266 On this case, see “North Korea detains two Japanese men: report,” *Yonhap / Korea Times*, 20 April 2011, <http://english.yonhapnews.co.kr/northkorea/2011/04/20/7/0401000000AEN20110420003900315F.HTML>; “Two Japanese Detained in North Korea Return Home,” *Associated Press*, 19 January 2012.

Masaki Furuya, former representative managing director of JP Dairin Co. Ltd., Hidehiko Abe, representative managing director of Realise Co. Ltd, of Japan, and Takumi Hirooka, managing director of Sugita Industrial Co. Ltd, of Japan, were put in custody by a relevant body on charges of drug trafficking and counterfeit after entering Rason City of the DPRK on March 14. They admitted their crimes and their gravity. Masaki Furuya had already been expelled from the DPRK and the two Japanese are called to legal accounts. What they did is a very grave violation of the law of the DPRK and international law and they will, therefore, face proper legal actions.²⁶⁷

The men were employees of a machine maintenance firm based in Tokyo, who went to the special economic zone to examine a food manufacturing factory, and were accused of hiding food in the canned goods to be exported to China. One of the detainees, an older man in his eighties, was allowed to return to Japan, while a large amount of money was demanded for the release of the other two, who were said to be in their thirties or forties. The men were released in January 2012; it was unclear whether or how much might have been paid for their return. At the time, media outlets also reported that North Korea had detained another man, also Japanese, for drug smuggling from 2003 to 2009, but no further information is publicly available.

The regime has also become more vocal about its anti-drug stance in both domestic and international rhetoric. In terms of international rhetoric, KCNA's vehement denials of the use and production of drugs by the North Korean government and citizens have already been mentioned. In terms

²⁶⁷ "Japanese Detained in DPRK for Their Crimes," *Korean Central News Agency*, 4 May 2011, <http://www.kcna.co.jp/item/2011/201105/news04/20110504-28ee.html>.

of domestic messaging, anti-drug posters have been sighted by visitors in Pyongyang.²⁶⁸ In 2011, *DailyNK* reported that the increasing public role of Kim Jong-un had coincided with a crackdown on drug production and smuggling.²⁶⁹ Additionally, in early 2012, the *Rodong Sinmun* carried a report about anti-drug campaigns in other countries and the mental and physical costs of drug addiction. It attributed the nefarious trade to the United States and imperialists who seek to plunder and prey on other societies; the report also mentioned a plot to use the American military to pump drugs into South Korea and accused American banks of laundering money for drug criminals worldwide.²⁷⁰ Weekly indoctrination sessions held as part of North Korea's daily life have also begun to stress the dangers of drug use.²⁷¹

Individuals who have participated in these sessions report, however, that the health consequences of addiction are rarely clearly communicated to listeners. The emphasis of educators is far more on the damage that drugs can do to the state (for example, facilitating foreign encroachment during the Opium War) than on the potential damage to individual members of society or their families.

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268 Jeong, "North Korean Drug Abuse Reportedly Spreading."

269 Lee Seok Jeong, "Kim Jong Eun Sticking with Doomed Drugs Crackdown," *DailyNK*, 12 May 2011, <http://www.dailynk.com/english/read.php?cataId=nk01500&num=7672>.

270 "Anti-Drug Campaigns Expanding," *Rodong Sinmun*, 10 February 2012, translation on *SinoNK.com*, <http://sinonk.com/2012/02/13/anti-drug-campaigns-expanding-rodong-sinmun-in-translation/>.

271 Lankov and Kim, 57.

CHAPTER 4

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SIGNIFICANCE OF NORTH KOREAN ACTIVITIES AND IMPLICATIONS FOR POLICY

Chapters Two and Three outlined North Korea's past history of involvement in illicit economic activities and summarized what is known about North Korea's relationship with a range of illicit activities today. Chapter Four analyzes the significance of the major changes and trends observed in these chapters and discusses their implications for policies toward North Korea, especially those aimed at improving the lives of ordinary North Korean people.

Several points about North Korea's post-2006 involvement in illicit activities and their role in the broader North Korean economy are worth highlighting here. These have to do with questions about the following: how much pressure the North Korean economy is under; the rise of new sources of income; the changing geographic focus of illicit activity; the consistent tendency toward adaptation on the part of North Korea; the possibility that camouflage rather than true changes in behavior explain the patterns observed; the implications of a shifting balance between illicit and licit sources of income; new human security issues that stem from changes to patterns of illicit activity; and the evolving contours of state-society relations.

First, there is an unresolved but important debate over the overall state of the North Korean economy.²⁷² Recent evidence suggests that the North Korean economy is improving; according to the South Korean government, North Korea reported its second consecutive year of growth in

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²⁷² This debate is understandable, given North Korea's lack of transparency on trade and other economic statistics. See Nicholas Eberstadt, *The End of North Korea* (Washington: AEI Press, 1999).

2012 (0.8% in 2011 and 1.3% in 2012).²⁷³ Drawing on food and nutritional statistics, a report by Seoul's Asan Institute also finds evidence of economic improvement.²⁷⁴ Finally, recent analysis suggests that North Korea may no longer be running a deficit, as it has previously; instead, for the past two years, the country may actually have run a current account surplus.²⁷⁵ Yet, not all North Korea experts appear to share this view; interviews with over fifty policymakers in Seoul and Washington produced repeated statements that North Korea was short of hard currency and economically desperate.²⁷⁶

While some confusion is understandable, establishing the general trend of the North Korean economy is important for understanding what incentives the regime does or does not face. Understanding the specifics of its hard currency situation would be even more helpful. If the country is running a surplus, then attempts to leverage North Korea's perceived need for hard currency – whether for nuclear nonproliferation goals or to improve North Korea's human rights situation – are less likely to be successful.

The second notable trend is the rise of new sources of income for the North Korean regime. The use of contract labor to generate revenues is particularly notable, as is the extraction of hard currency from the domestic informal economy through the cell phone industry. A number of interviewees speculated that these activities increased in order to substitute for income earned from illicit activities after those activities came under pressure in the early 2000s.

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273 In-soo Nam, "Did North Korea's Economy Expand Again?", *The Wall Street Journal* (blog), 12 July 2013, <http://blogs.wsj.com/korearealtime/2013/07/12/did-north-koreas-economy-expand-again/>.

274 Myong-hyun Go, "Economic Improvement in North Korea," Issue Brief No. 58, *The Asan Institute for Policy Studies* (June 2013).

275 Marcus Noland and Stephan Haggard, "North Korea Running a Current Accounts Surplus?" *Witness to Transformation* (blog), 18 March 2013, <http://www.pie.com/blogs/nk/?p=9647>. For another analysis of North Korea's trade statistics, see Lee Suk et al., *Analyzing and Reconstructing North Korea's Trade Statistics, 1990-2008* (Seoul: KDI, 2010), in Korean.

276 Author's interviews, Washington and Seoul, June and July 2013.

Third, alongside that development, there has been a shift in the geographic distribution of countries with which North Korea conducts its (mostly licit) economic exchange, as well as where most seizures related to illicit activity have been concentrated. Data suggest that outside of China and the Korean peninsula, North Korea's trade and business partners are now concentrated in the Middle East and North Africa. In these places, systematic data are harder to gather and the United States may have relatively less political influence, important points if one is seeking to examine where trade and economic sanctions might be better enforced or might have the most impact.

Fourth, these changes in sources and locations of income suggest a continued adaptability on the part of the North Korean regime, which has often previously been depicted as an ossified communist bureaucracy incapable of effective adaptation. From their inception, these illicit activities have been highly adaptive — in terms of products involved, manufacturing locations, shipment tactics, distribution partners and methods, financial infrastructure, and regime roles. The reasons for these shifts appear to have to do with changing market demands as well as changes in global, regional, and industry-specific enforcement patterns. Defectors report that Kim Jong-il specifically tasked people within the regime to study international sanctions, anticipate what might be directed at North Korea in the future, and figure out ways to bypass the measures that were implemented.²⁷⁷ This has occurred outside the realm of illicit activity as well; more than one report by the UN Panel of Experts has noted that North Korea has responded to proliferation sanctions not by changing its policy goals, but with adaptation and circumvention—for example, though the use of container shipping and air transportation.²⁷⁸

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 277 Author's interview, Cambridge, Spring 2010.

278 *Report by the Panel of Experts Established Pursuant to Resolution 1874* (New York: United Nations, 2013). On container shipping, see Hugh Griffiths and Roope Siirtola, "Full Disclosure: Contents of North Korean Smuggling Ship Revealed," *38North* (blog), August 27, 2013; on flights, see Chad O'Carroll, "Why is Tracking North Korean Aircraft So Difficult?" *NKNews*, 9 August, 2013, <http://www.nknews.org/2013/08/why-is-tracking-north-korean-aircraft-so-difficult/>.

As some of the regime's external sources of income, including illicit ones, came under pressure from the United States and the financial system in 2005, and again with the imposition of sanctions in 2010, Pyongyang appears to have been forced to look for new ways to make money to offset its losses. It has also clearly adapted its business practices to protect its commercial activities (licit and otherwise). For example, after learning that the international wire system opened its finances to certain vulnerabilities, the regime appears to have switched to a cash-and-carry basis. It has also concentrated its banking in places that are less vulnerable to U.S. and international scrutiny, including China and the Middle East.²⁷⁹ This ability to adapt in response to pressure suggests that academic work done on how adaptation enhances the resilience and survivability of other authoritarian regimes might also be applicable to North Korea.²⁸⁰ It also has important implications for the development of effective policies, which must include a robust information-gathering plan in order to keep track of these evolutions and adaptations. A failure to do that will mean that the United States could fundamentally mischaracterize the evolving incentive structure facing the North Korean regime and could miss significant opportunities for innovative policymaking.

Fifth, however, the adaptability of North Korea's operations also raises the possibility that some of the regime's illicit activities have simply become less visible rather than less frequent. After all, seizure data represents the interaction of underlying patterns of behavior with the tactics of enforcement.²⁸¹ It is therefore possible that the activity has continued at the same or similar scale, but that observers and researchers are seeing less of it—due either to a change in North Korea's concealment of its activities or to an undocumented change in our own enforcement.

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279 Author's interviews with two North Korea analysts, Seoul, June 2013.

280 Sebastian Heilmann and Elizabeth J. Perry, eds., *Mao's Invisible Hand: The Political Foundations of Adaptive Governance in China* (Cambridge, MA: Harvard University Asia Center, Contemporary China series, May 2011).

281 Peter Reuter and Edwin M. Truman, *Chasing Dirty Money* (Washington: Institute for International Economics, 2004); Peter Andreas and Kelly Greenhill, *Sex, Drugs, and Body Counts: The Politics of Numbers in Global Crime and Conflict* (Ithaca: Cornell University Press, 2010).

Continued anecdotal reports that officials are involved in aspects of illicit trade, paired with seizure data that suggest a decrease in the proportion of illicit activity that is state-controlled and state-operated, suggest that both explanations are probably at work. As above, the implication is that governments and researchers need to make a concerted effort to follow and collect information on these activities, and to assume that the activities will be dynamic rather than static.

Sixth, many of North Korea's new sources of income appear to be legal. Six of the eight major sources listed in Chapter Three are legal activities – criminal activities and proliferation/arms trading being the notable exceptions.²⁸² The present extent of illicit activities has a clear bearing on policy options vis-à-vis North Korea.

Some of the law enforcement tools previously used against North Korea – in particular, section 311 of the USA PATRIOT Act, which was applied to Banco Delta Asia (BDA) in Macau for laundering North Korean money – were predicated on the existence of criminal activity, which threatened the reputation of private sector financial institutions.²⁸³ Assessment of these reputational risks led the international financial community (rather than the U.S. government) to effectively cut North Korea off from the international financial system. These measures are what Peter Feaver and Eric Lorber have termed “conduct-based”; they target conduct that poses a risk to banks. Their effectiveness therefore depends on the credible presence of specific activities that place banks’ credibility and reputation in jeopardy; allegations of general bad behavior on the part of a regime are insufficient. The sanctions levied more recently against Iranian banks were predicated on similar legal thresholds (conduct surrounding

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282 Obviously, there is potential for otherwise-legal activities to be conducted in a way that makes these activities, or parts of them, illicit. For example, there are reports of the use of forced labor and labor standards violations in both North Korea's use of overseas workers, and its extractive industry. HRNK will discuss these issues in more detail in a forthcoming report on contract labor.

283 The following paragraphs rely heavily on Peter D. Feaver and Eric B. Lorber, *Coercive Diplomacy: Evaluating the Consequences of Financial Sanctions* (Legatum Institute, November 2010).

money laundering for drug organizations, terrorism, and proliferation), and achieved their results through similar reputational effects that drove changes in private sector behavior.

Several implications follow for North Korea. Unless there is clear evidence of criminal activity, financial measures such as those applied to Banco Delta Asia will be difficult to levy. Moreover, even if they are theoretically applicable, North Korea's vulnerability to these kinds of measures may be lower than we think, for two reasons. The first reason is that sanctions work best when they are unexpected.²⁸⁴ The fact that the BDA designation was unprecedented was part of its effectiveness; North Korea has now anticipated that it could be vulnerable to these kinds of measures and altered its operations accordingly. Second, and partly as a result of the preceding point, North Korea is less vulnerable to these types of measures than other countries against which the measures have been deemed effective, such as Iran. Unlike Iran, North Korea has no major foreign banks operating inside its territory, and its industries do not rely to the same extent on the dollar as an international reserve currency. Much of North Korea's banking today is done in China. This limits the regime's vulnerability to the global financial system at large, and means that for financial measures to be effective, not only the U.S. government but the larger international financial community would have to perceive a clear, risk-based self-interest in terminating relationships with major Chinese financial institutions and be willing to do so. It is simply unclear that this is realistic. Finally, applying the recommendations made in UNSC Resolution 2094 requires knowledge of North Korea's domestic banking structures; according to the most recent Panel of Experts report, this knowledge is lacking.²⁸⁵

Additionally, these financial measures are not "sanctions" in the usual sense of the word; they rely on specific legal thresholds for specific

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284 Nicholas Miller, "The Secret Success of Nonproliferation Sanctions," *International Organization*, forthcoming; Etel Solingen, ed., *Sanctions, Statecraft, and Nuclear Proliferation* (Cambridge: Cambridge University Press, 2012).

285 *Panel of Experts Report* (2014), 60.

criminal conduct that motivates private sector action. At present, and even with the UN Commission of Inquiry's recent report, human rights violations are not currently considered criminal conduct of the type that would trigger these financial measures. Moreover, trying to use these measures as tools in coercive diplomacy to achieve diplomatic objectives that are not directly related to the criminal conduct invoked, as was learned previously with BDA, is likely to undermine the very aspect of these measures that gives them power.

Seventh, the rise of domestic drug usage and addiction inside North Korea raises new issues for health and human security.²⁸⁶ Weak medical infrastructure, poor medical education, drug shortages, and prevalence of treatable ailments such as malnutrition, hepatitis, and tuberculosis are well-known problems, as are the limitations placed on organizations such as the International Committee of the Red Cross.²⁸⁷ To that already serious list should now be added the rising rates of domestic drug abuse, particularly methamphetamine addiction. Given what seems to be a lack of fundamental knowledge about the risks of drug addiction by local officials and the public health system in North Korea, international assistance could be critical in providing accurate information and education on the subject, as well as communicating about modern addiction treatment techniques and understanding the interaction of methamphetamine addiction with other medical issues. To the author's knowledge, there is currently no NGO work being done in North Korea to address this particular public health challenge. Additionally, knowledge of the domestic drug trade and the popularity of methamphetamines should be factored into unification planning

286 On human security, see Kyung-ae Park, ed., *Non-Traditional Security Issues in North Korea* (University of Hawaii Press, 2013). Unfortunately, the volume does not have a chapter addressing health issues, and the chapter on crime does not discuss the reported growing rate of domestic addiction.

287 Mimi Wiggins Perreault, "Health and Migration Concerns Increase for the Future of North Korea," panel discussion at the United States Institute of Peace, 22 October 2010, <http://www.usip.org/publications/health-and-migration-concerns-increase-the-future-north-korea>; Author's interview with medical personnel who had worked in North Korea, July 2012; see also L. Gordon Flake and Scott A. Snyder, eds., *Paved with Good Intentions: The NGO Experience in North Korea* (Praeger, 2003).

across a wide range of issues, such as law and order, criminal justice, and public health.²⁸⁸

The rise of the domestic drug issue also raises health and human security challenges with respect to policies toward the defector community in South Korea. Awareness of drug prevalence in the “sending communities” from which North Korean defectors originate should be strengthened among the government and non-governmental actors who facilitate these individuals’ transitions to life in South Korea.²⁸⁹ It is especially important to collect full and updated information on these issues, in order to adequately understand potential issues and provide appropriate treatments; it is unclear whether this is currently being done. At the same time, it is important that South Korean policymakers collect this information in ways that do not add to the stigma already experienced by the North Korean defector community in the South.

Eighth and finally, developments with respect to illicit activities appear to reflect a broader and deeper shift in the contours of the relationship between state and society inside North Korea. The North Korean regime has not only looked outward for new sources of income; it has looked inward, and sought ways to extract revenues from the growing domestic economy, including the black market. The regime’s decision to concentrate its provision of resources such as electricity in urban areas with more politically important residents has only increased reliance on market

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288 Victor Cha and David Kang, *Challenges for Korean Unification Planning* (Washington: CSIS, 2011), https://csis.org/files/publication/111221_Cha_ChallengesKorea_WEB.pdf.

289 The following paragraph draws on author’s interviews with officials in the Ministry of Unification and the Korea National Police Agency as well as with various defector organizations, Seoul, March 2011, June-July 2013. See also International Crisis Group, *Strangers at Home: North Koreans in the South* (2011). <http://www.crisisgroup.org/en/regions/asia/north-east-asia/north-korea/208-strangers-at-home-north-koreans-in-the-south.aspx>; mention of the study done by Hanawon psychiatrist Jeon Jin-young in Jason Strother, “North Korea Grapples with Crystal-Meth Epidemic,” *The Wall Street Journal*, August 20, 2013, <http://blogs.wsj.com/korearealtime/2013/08/20/north-korea-grapples-with-crystal-meth-epidemic/>; see also Simon Parry, “High Alert: North Korea’s Crystal Meth Epidemic,” *South China Morning Post*, 7 October 2013, <http://www.scmp.com/magazines/post-magazine/article/1323432/high-alert-north-koreas-crystal-meth-epidemic>.

mechanisms for survival.²⁹⁰ Reliance on these market mechanisms appears to be expanding rather than contracting, and the lines between public and private enterprise are increasingly blurred at all levels of the system.

This symbiosis between business and political resources inside the territory of North Korea is an important development; it is, arguably, the basis of power in contemporary North Korea. Previously, North Korea's previous illicit activities were structured in such a way that they insulated the regime from economic developments in society (as noted by the UN Commission of Inquiry). Private capital was therefore threatening, as evidenced by the February 2009 currency devaluation (and more recently the removal of Jang Song-taek).²⁹¹ Given the widespread growth of private capital, however, and the risk of a backlash like the one that accompanied the 2009 devaluation, the North Korean leadership may have decided to co-opt and extract rent from the domestic economy. To the extent that the North Korean leadership becomes dependent on its own citizens for economic survival, however, these actors may now begin to exercise pressure or to pose a threat to the North Korean leadership. It is possible that North Korea will follow China in blending private enterprise with authoritarian politics, but this is far from a sure bet.²⁹²

The growth of semi-private enterprise also allows for the emergence of some space between North Korean state and society in the economic realm, more so than appears to have been true previously. This gap opens the possibility that the international community might be able to reach North Korean society without going through the regime first. The North Korean regime will almost certainly see this as undesirable,

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290 For a study of electricity provision and its changes in response to sanctions, see Yong Suk Lee, "Unequal Geographic Impact of Economic Sanctions: Evidence from North Korea" working paper, 28 August 2013, <http://econ.williams.edu/people/ysl1>.

291 Blaine Harden, "North Korea Revalues Currency, Destroying Personal Savings," *Washington Post*, 2 December 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/12/01/AR2009120101841.html>.

292 Kellee S. Tsai, *Capitalism Without Democracy: The Private Sector in Contemporary China* (Cambridge: Cambridge University Press, 2007).

since it has predicated its existence and economic survival on its ability to impose isolation and economic hardship on its citizens while insulating itself from the cost of these actions. If it is in fact possible to bypass the regime to strengthen the economic and informational power of the North Korean people—something that Kim Jong-un’s tightening of control over the border may call into serious question—then this would be a form of engagement that pressures the regime more than conciliates it. In designing a containment policy to deal with the Soviet Union, George Kennan sought to craft a strategy that would, in the long term, exert the greatest possible pressure on the Soviet Union: the pressure imposed by the regime’s own internal contradictions. There is no question that North Korea possesses some of these same contradictions. The question is whether the United States and the international community now have an opportunity to shift the burden of these contradictions onto the regime itself, and in doing so, to create more favorable conditions for gradual transformation of the system from within.

