

## The Complex Relationship between Sanctions and North Korea's Illicit Trade

*Justin V. Hastings*

North Korea's illicit trade and sanctions have a complex relationship.<sup>1</sup> In this essay, I argue that while North Korean companies do engage in illicit trade to bypass sanctions, much of such trade is actually the result of the fundamental dysfunction of the Kim regime and how the North Korean economy has evolved in the past several decades. That said, North Korea has been forced by sanctions to adapt the way it does business inside and outside the country. Because much of the illicit trade does not benefit the regime directly, it may actually behoove the international community to encourage some types of illicit trade and to provide an outlet for the regime to make money other than through dealing in weapons and illicit goods.

### *Sanctions and the Illicit Economy*

North Koreans do indeed engage in illicit trade as a way of bypassing sanctions and sanction-enforcement mechanisms, specifically in buying or selling goods that have been declared off limits by UN Security Council resolutions. But there are two other main reasons that North Koreans engage in illicit economic activities and trade that have little to do with sanctions. First, the North Korean system at its most basic level encourages, and in many cases practically requires, economic activities to be illicit. In the years since the Arduous March killed a significant percentage of the North Korean population and citizens responded by going into business for themselves as a means of survival,<sup>2</sup> North Korea, particularly under Kim Jong-un, has developed a *modus vivendi* whereby the lines between formal

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<sup>1</sup> See, for example, Sheena Chestnut Greitens, *Illicit: North Korea's Evolving Operations to Earn Hard Currency* (Washington, D.C.: Committee for Human Rights in North Korea, 2014); and Paul Rexton Kan, Bruce E. Bechtol Jr., and Robert M. Collins, *Criminal Sovereignty: Understanding North Korea's Illicit International Activities* (Carlisle: Strategic Studies Institute, 2010).

<sup>2</sup> The Arduous March refers to the North Korean famine in 1994–98. For more on the famine, see Stephan Haggard and Marcus Noland, *Famine in North Korea: Markets, Aid, and Reform* (New York: Columbia University Press, 2007).

and informal status, state and nonstate trade, and licit and illicit economic activities are blurred.

Nearly every economic actor in North Korea is involved directly or indirectly in illicit trade, or more generally the illicit economy. Central state companies defy sanctions to export proscribed goods and import sanctioned items (which have long since ceased to be merely the technology that could be used in weapons programs). Other state companies with trading licenses go abroad (usually to China) to make money via whatever means they can. Private companies masquerade as state-owned companies by paying off state officials to buy and sell both legal and illegal goods, while state officials moonlight as entrepreneurs using their public positions. Private individuals use family members and other connections in China to move consumer goods and food across the border, often outside formal checkpoints or in violation of trade regulations.<sup>3</sup>

The North Korean economy as a whole functions as what has been called a “food chain,” where every level of society and the state must pay rents to their superiors for the right to operate, and Kim Jong-un and his circle serve as the apex predators collecting rents indirectly from everyone below them.<sup>4</sup> Because all private enterprise in North Korea is technically illegal, the state benefits from a system in which officials can collect bribes and fees to allow private and hybrid businesses to operate but have the legal leeway to crack down on them at any time. The state does not really care where the income to pay rents up the food chain actually comes from. This leads to a situation where the state (and officials) can indirectly benefit from what are often large-scale, institutionalized illicit economic activities without being directly involved. Drug trafficking, for example, likely has not been directly run by the North Korean government (in the sense of using central state-owned factories for production and ships for trafficking) since the mid-2000s, but the state continues to benefit indirectly from drug-trafficking profits.<sup>5</sup>

Second, many North Koreans engage in illicit economic activities, particularly trade, as a way of mitigating state-imposed political and

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<sup>3</sup> Justin V. Hastings, *A Most Enterprising Country: North Korea in the Global Economy* (Ithaca: Cornell University Press, 2016), 7–14, 104–17.

<sup>4</sup> Hyeon Jung Park, “Commercial Engagements of the Party-State Agencies and the Expansion of Market in the 1990s in North Korea,” *Journal of Korean Unification Studies* 20, no. 1 (2011): 214–15.

<sup>5</sup> Justin V. Hastings, “The Economic Geography of North Korean Drug Trafficking Networks,” *Review of International Political Economy* 22, no. 1 (2015): 162–93; and 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 Korean Review* 9, no. 1 (2013): 45–60.

economic risk and moving profits out of the country (such as through smuggling gold into China).<sup>6</sup> Because North Korea has few financial institutions or dispute-resolution mechanisms that encourage commerce, and because market actors must cultivate relationships with government officials (through bribes, gifts, and a cut of profits) as a way of getting any business done, regardless of the ostensible legality, the benefits of engaging in licit trade are not obviously higher. For example, while the government under Kim Jong-un has largely avoided cracking down on North Korean markets, it has increased the rate of purges and the speed with which it cycles border officials, requiring businesses to build new networks to expedite legal trade. North Korea also can change regulations and impose controls or bans on imports and exports without notice, leading to the collapse of legitimate business deals. Engaging in illicit trade, which necessarily entails bypassing border regulations and officials, allows market actors to continue trading through disruptive personnel and policy changes.<sup>7</sup>

### *The Impact of Sanctions*

Outside the country, North Korea has clearly altered some of its ways of doing business in response to sanctions. The illicit trade that is the bread and butter of central state companies—the production and servicing of conventional weapons and the development of nuclear and chemical weapons—is also the trade most affected by sanctions. UN resolutions have targeted not only trade in weapons, including weapons of mass destruction, but also state-owned ships and airplanes, as well as diplomatic outposts engaged in trade. While North Korea would likely prefer to use its state assets to negotiate deals and move goods around the world, sanctions have denied it the option to do so openly. Instead, as sanctions have tightened, the country has come to rely increasingly on third parties to engage in illicit trade and bust sanctions. North Korean ships and planes rarely transport goods anymore. Rather, North Korea has built a network of individuals and companies from other countries, particularly but not exclusively China, that move goods on its behalf.<sup>8</sup>

The result is that North Korean illicit trade looks a lot like licit trade outside North Korea. Except for obvious contraband such as drugs,

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<sup>6</sup> Interviews with Chinese businessmen, June 2016.

<sup>7</sup> Justin V. Hastings and Yaohui Wang, “Informal Trade along the China–North Korea Border,” *Journal of East Asian Studies* 18, no. 2 (2018) ~ <https://doi.org/10.1017/jea.2018.4>.

<sup>8</sup> Hastings, *A Most Enterprising Country*, 72–78.

counterfeit cigarettes, and the like, such trade is considered unlawful only because the supply chain starts or ends in North Korea (and thus the goods are sanctioned), not because the goods are illicit per se. What this means in practice is that much of the supply chain stretching to and from North Korea consists of legitimate companies engaging in what appears to be legitimate trade with legitimate items—by and large, the farther they are from the country, the more these illicit trade networks look like regular trade networks.

North Korea is forced to transport goods through regular commercial routes, using standard business methods and contracts, while masking its involvement through front companies that are not obviously North Korean. This represents a trade-off for North Korea. Exposing its businesses to third parties who may turn on them and letting its goods go through customs inspections in hostile countries raises the risk of interdiction if the North's involvement is discovered. At the same time, using mundane commercial methods means that, as long as the country's involvement is sufficiently masked, it is difficult for sanctions enforcers to detect such illicit trade.<sup>9</sup>

This is particularly true inasmuch as one of the responses of the North Korean state to sanctions has been to involve itself in transactions in which it is not implicated at all as a supplier or buyer. After decades of North Korean agents using front companies and other means of subterfuge to buy, sell, and transport illicit goods, Pyongyang has built a global network of contacts and a menu of methods to evade sanctions enforcement. In one arms-related shipment in 2010, for instance, front companies arranged for the transfer of components from the United States, Japan, Denmark, and other countries to Syria through Chinese transport firms in Dalian and Chinese brokerage companies. The goods never entered North Korea.<sup>10</sup>

Inside North Korea, sanctions really only have an economic effect to the extent that China enforces them. During the 2013 crisis, and again in 2017, China cracked down on North Korean trade so as to cause pain to be felt in Pyongyang and to signal Chinese disapproval to the Kim regime. This crackdown took a number of forms. In both periods, China slowed down its rate of processing shipments at border checkpoints for a period of time, ostensibly to check for sanctions violations. In practice, all trade was appreciably slowed, causing shortages and price increases in North Korea

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<sup>9</sup> Hastings, *A Most Enterprising Country*, 75–78.

<sup>10</sup> UN Security Council, "Report of the Panel of Experts Established Pursuant to Resolution 1874 (2009)," February 24, 2016, 32–33.

(imported food prices rose in 2013, for instance).<sup>11</sup> While China had long tolerated what it termed “good” smuggling—smuggling of items that were not weapons or drugs—beginning in the first quarter of 2017, it apparently warned smugglers on the border that there would be no distinction drawn between “good” and “bad” smuggling for a while. Chinese officials who aided and abetted smuggling across the border were transferred out, thus disrupting the networks that had supported illicit cross-border trade. The result was a temporary collapse of the North Korean markets that relied on trade with China.<sup>12</sup> At the same time, a crackdown on this illicit trade has costs for China, including not only heightened border security and increased inspections and personnel but also the lost profits by Chinese businesses in the northeastern provinces. Because it is doubtful that China will want to maintain a crackdown against North Korea indefinitely, we should not rely solely on China’s willingness to enforce sanctions to stop illicit trade.

### *Cracking Down on North Korea’s Illicit Economic Activity*

Given how North Korea has (or has not) responded to sanctions with illicit trade, and how sanctions have (or have not) affected North Korea, how can the country’s illicit economic activities be stopped? As with everything related to North Korea, this question has a complicated answer.

First, it is not clear that all illicit trade should in fact be stopped. Illicit trade is a double-edged sword for the Kim regime and its political stability. Much of this illicit trade is a way to get around restrictions that benefit the regime and politically connected elites, and it functions as something of a lifeline for many ordinary North Koreans. We should not assume that all smuggling into and out of North Korea is part of a larger plan by Kim Jong-un and his cronies to bypass sanctions. Some of the smuggling across the border with China, for instance, is actually North Korean businesses importing food and prescription medications because the government has limited the supply of both within the country.<sup>13</sup>

The illicit trade that is not conducted directly by central state companies but rather by private individuals, hybrid firms, and moonlighting officials also provides a revenue stream for citizens that is not

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<sup>11</sup> Justin V. Hastings, David Ubilava, and Yaohui Wang, “The Economic Effects of Sanctions: Evidence from North Korean Markets,” University of Sydney, Working Paper, 2017.

<sup>12</sup> Hastings and Wang, “Informal Trade along the China–North Korea Border”; and author interviews with Chinese businessmen, October 2017.

<sup>13</sup> *Ibid.*

wholly dependent on the Kim regime's munificence. Even illicit exports of sanctioned items, such as minerals and seafood, do not necessarily benefit the central state directly, as it is not unheard of for lower-level officials to export goods illegally to make money for themselves.<sup>14</sup> Some of this illicit trade arguably should be encouraged by outsiders, as it damages the levers of state control that rely on complete economic dependence and harms the legitimacy of the Kim regime.

Second, because much of the illicit trade across the China–North Korea border is a way of dealing with the dysfunctional Kim regime, as well as terrible trade infrastructure and regulations, encouraging the two countries to streamline trade, and encouraging North Korea to develop trade infrastructure and a functional regulatory environment (complete with dispute-resolution mechanisms, clear laws, and operational credit institutions), would help reduce the need for some types of illicit trade.<sup>15</sup> Since many traders are capable of using their networks for licit as well as illicit goods, and even switch between the two depending on the risks and benefits, any policies that make trade in licit items more profitable and hassle-free are likely to encourage a move away from illicit trade.

Third, for the illicit trade that is of greatest concern to the international community—conventional and nonconventional weapons and dual-use components traded by central state companies—continued vigilance is necessary. But it is also important to rethink who and what really needs to be sanctioned. Although the days of state-owned ships moving missiles directly to the Middle East without being interdicted are probably over, given heightened surveillance of North Korean assets, front companies operating outside North Korea could still serve as brokers or use third-country go-betweens in their transactions. Gradually denying space for North Koreans to set up front companies, including in Southeast Asia, will likely make it difficult for state-owned companies to bust sanctions, but ultimately weapons buyers, all of whom are states seeking cheap or otherwise prohibited weapons, need to be discouraged from buying from or through North Korea.

It is unlikely that North Korea has an ideological commitment to selling weapons. As with drug trafficking in the past, whether it continues

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<sup>14</sup> Interviews with Chinese businessmen, June 2016 and October 2017.

<sup>15</sup> Stephan Haggard, Jennifer Lee, and Marcus Noland, "Integration in the Absence of Institutions: China–North Korea Cross-Border Exchange," *Journal of Asian Economics* 23, no. 2 (2012): 130–45; and Stephan Haggard and Marcus Noland, "Networks, Trust, and Trade: The Microeconomics of China–North Korea Integration," Peterson Institute for International Economics, Working Paper, May 2012.

to sell weapons is a matter of costs and benefits. How state companies make money is to a certain extent irrelevant to them. Thus, incentivizing trade in less harmful goods, even if they are traded by central state companies that are closely tied to the Kim regime or to the Korean People's Army, while continuing to crack down on trade related to WMDs, might be one way forward. Even though banning trade in seafood, minerals, and textiles, for example, may cut off revenue to the regime that could theoretically be used for WMD and missile programs, it also cuts off revenue to the North Korean military that could be earned in lieu of revenue from selling weapons technology. If the diplomatic offensive that North Korea has pursued since January this year bears any fruit in terms of substantive progress toward denuclearization, following its commitment to denuclearization of the Korean Peninsula made at the summits with South Korea in April and the United States in June, the international community may want to consider revisiting sanctions. ◆

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