North Korea's Second Nuclear Test: Implications of U.N. Security Council Resolution 1874

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Summary

The United Nations Security Council unanimously passed Res. 1874 on June 12, 2009, in response to North Korea's second nuclear test. The resolution puts in place a series of sanctions on North Korea's arms sales, luxury goods, and financial transactions related to its weapons programs, and calls upon states to inspect North Korean vessels suspected of carrying such shipments. The resolution does allow for shipments of food and nonmilitary goods. As was the case with an earlier U.N. resolution, 1718, that was passed in October 2006 after North Korea's first nuclear test, Res. 1874 seeks to curb financial benefits that go to North Korea's regime and its weapons program. This report summarizes and analyzes Res. 1874.

On the surface, financial sanctions aimed solely at the Democratic People's Republic of Korea (DPRK, the official name of North Korea) and its prohibited activities are not likely to have a large monetary effect. Governments will have to interpret the financial sanctions ban of the resolution liberally in order to apply sanctions to the bank accounts of North Korean trading corporations. A key to its success will be the extent to which China, North Korea's most important economic partner, implements the resolution. In summary, the economic effect of Resolution 1874 is not likely to be great unless China cooperates extensively and goes beyond the requirements of the resolution and/or the specific financial sanctions cause a ripple effect that causes financial institutions to avoid being "tainted" by handling any DPRK transaction. A ban on luxury goods will only be effective if China begins to deny North Korea lucrative trade credits.

Provisions for inspection of banned cargo on aircraft and sea vessels rely on the acquiescence of the shipping state. In the case of North Korean vessels, it is highly unlikely that they would submit to searches. Resolution 1874 is vague about how its air cargo provisions are to be implemented, in contrast to the specific procedures set forth regarding inspecting sea-borne cargo. While procedures are specified for sea interdictions, the authority given is ambiguous and optional. Further, DPRK trade in small arms and ammunition is relatively insignificant, and therefore the ban on those exports is unlikely to have a great impact.

Other CRS Reports may be useful in conducting research on this issue: CRS Report RL30613, *North Korea: Terrorism List Removal*, by Larry A. Niksch; CRS Report RL33590, *North Korea's Nuclear Weapons Development and Diplomacy*, by Larry A. Niksch; CRS Report R40095, *Assistance to North Korea*, by Mark E. Manyin and Mary Beth Nikitin; CRS Report RL32493, *North Korea: Economic Leverage and Policy Analysis*, by Dick K. Nanto and Emma Chanlett-Avery; CRS Report RL33324, *North Korean Counterfeiting of U.S. Currency*, by Dick K. Nanto; CRS Report RL34256, *North Korea's Nuclear Weapons: Technical Issues*, by Mary Beth Nikitin; and CRS Report RL32097, *Weapons of Mass Destruction Counterproliferation: Legal Issues for Ships and Aircraft*, by Jennifer K. Elsea.

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Introduction

Since the breakdown of the Six-Party Talks over verification issues in December 2008, North Korea has carried out a series of increasingly provocative acts that have challenged the Obama Administration and the world community. In January and February, North Korea presented the newly inaugurated Obama Administration with a tough set of negotiating positions. North Korea reportedly did not respond to subsequent overtures by the United States to restart talks. On April 5, 2009, North Korea launched a long-range ballistic missile, the Taepo Dong 2, over Japan, but failed to achieve a complete test of the system or place a satellite into orbit. This test led to United Nations Security Council (UNSC) condemnation. In response, North Korea said it would abandon the Six-Party Talks, restart its nuclear facilities, and conduct a nuclear test. It asked international and U.S. inspectors to leave the country.

On May 25, 2009, North Korea conducted an underground nuclear explosion.[1] In response, the UNSC on June 12 unanimously passed Res. 1874,[2] which puts in place a series of sanctions on North Korea's arms sales, luxury goods, and financial transactions related to its weapons programs and calls upon states to inspect North Korean vessels suspected of carrying such shipments. The resolution does allow for shipments of food and nonmilitary goods. As was the case with an earlier resolution, 1718, that was passed in October 2006 after North Korea's first nuclear test, Res. 1874 seeks to curb financial benefits that go to North Korea's regime and its weapons program. This report summarizes and analyzes Resolution 1874.

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On June 26, 2009, senior administration officials stated that the White House is forming an interagency team to coordinate sanctions efforts against North Korea with other nations. The team is to be led by Philip S. Goldberg, a former ambassador to Bolivia, and consist of representatives

[1] http://www.dni.gov/press_releases/20090615_release.pdf

[2] For full text, see http://www.un.org/Docs/sc/unsc_resolutions09.htm.

from the State Department, the White House, the National Security Agency, the Treasury Department, and others.[3]

Main Provisions of Resolution 1874

Resolution 1874 condemns the May 25 nuclear test, demands that North Korea not conduct additional nuclear tests or ballistic missile tests, says North Korea should suspend its ballistic missile program and re-establish the missile launch moratorium, calls on the DPRK to abandon all nuclear weapons and existing nuclear programs in a "complete, verifiable and irreversible manner," and calls on North Korea to return to the Non-Proliferation Treaty (NPT) and the Six-Party Talks.

The resolution includes a ban on all arms transfers from the DPRK and all arms except small arms or light weapons to the DPRK. As with past UNSC resolutions, this ban includes weapons of mass destruction (WMD) or missile-related technology. The resolution also provides for new economic and financial sanctions on the DPRK. It calls on states not to provide grants, assistance, loans, or public financial support for trade if such assistance could contribute to North Korea's proliferation efforts. It also calls on states to deny financial services, including freezing assets, where such assets could contribute to prohibited DPRK programs. The resolution is not an embargo, however, and explicit exclusions are made for humanitarian and denuclearization aid. These are broad and far-reaching sanctions, if effective, but several problems arise in implementation (discussed below).

Due to concerns over North Korea's past track record on proliferation of nuclear and missile technology, the Security Council deliberations focused on ways to interdict North Korean shipments of banned items. Past Security Council resolutions (1718 (2006) and 1695 (2006)) have tackled this issue, but the new resolution includes specific guidelines for inspecting and interdicting ships that transport banned materials. Resolution 1874 calls on all states to "inspect, in accordance with their national legal authorities and consistent with international law, all cargo to and from the DPRK, in their territory, including seaports and airports," if that state has information that the cargo is prohibited by UNSC Resolutions. Res. 1874 does not, however, provide the authority to do so without the flag state's consent.[4] Reportedly due to objections by Russia and China, the resolution does not authorize the use of force if the inspection is refused.[5] In that case, the requesting state is asked to report the matter to the Security Council.

If a suspect ship is on the high seas, U.N. member states are "called upon" to request the right to board and inspect. If refused, the resolution obligates the flag state to direct their vessel to port for inspection. The resolution "authorizes" seizure of banned items. The resolution prohibits "bunkering services" such as refueling or servicing of a ship with suspected cargo. This is

[3] Michael D. Shear, "U.S. Interagency Team to Focus On Sanctions Against N. Korea," *The Washington Post*, June 27, 2009, p. A7.

[4] "Flag state" refers to the country that exercises regulatory control over a commercial ship that has registered under its flag. Some states may allow foreign vessels to register under their flag, known as "flag of convenience."

[5] Blaine Harden, "North Korea Says It Will Start Enriching Uranium," *Washington Post*, June 14, 2009. The resolution is under Chapter 7, Article 41 of the U.N. Charter, and does not authorize use of force during interdiction attempts. The full text of Article 41 follows: "The Security Council may decide what measures not involving the use of armed force are to be employed to give effect to its decisions, and it may call upon the Members of the United Nations to apply such measures. These may include complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations."

significant because North Korea reportedly ships most goods under its own flag and typically uses small vessels that would need refueling.

Resolution 1874 also establishes reporting mechanisms on the implementation of the resolution. Within 45 days of the resolution's adoption, all U.N. member states are to report to the Security Council on "concrete measures" they have taken to implement the arms embargo and financial measures. The Sanctions Committee, established by UNSC Res. 1718, will submit a proposed agenda for its work covering "compliance, investigations, outreach, dialogue, assistance and cooperation" to the UNSC by July 15, 2009. The resolution also asks the U.N. Secretary-General to establish a Panel of Experts, with a maximum of seven experts, to analyze reports and make recommendations regarding implementation of Resolutions 1874 and 1718.

Implementation of Sanctions[6]

The Obama Administration faces several key decisions regarding the U.S. role in enforcing Resolution 1874 and applying new U.S. sanctions against North Korea. The Administration faces a decision on how assertive to be in confronting North Korean ship traffic to attempt searches. It also faces a decision on the U.S. role in enforcing the ban on WMD-related North Korean financial transactions. Officials have said that the Administration is considering a resumption of the Bush Administration's financial sanctions policy of 2005-2007 in which U.S. Treasury Department officials visited numerous countries in order to pressure banks to freeze the accounts of North Korea's trading companies.[7] Administration officials also have said that they are considering reinstating North Korea on the U.S. list of state sponsors of terrorism; the Bush Administration removed North Korea from the list in October 2008.[8] Finally, the Administration may have to calculate the degree of pressure to apply to China if Beijing does little to enforce the Security Council sanctions, as was the case following Resolution 1718.

The Hyundai Economic Research Institute of South Korea has estimated that if U.N. members enforce the sanctions in Resolution 1874 against North Korea, North Korea could lose between $1.5 billion and $3.7 billion. Other estimates place the loss close to $4 billion.[9] However, Resolution 1874 does not make enforcement of sanctions mandatory but instead "calls on" U.N. members to take enforcement steps. If sanctions are to have this kind of impact, several key countries will have act forcefully and will have to interpret the sanctions language of the resolution liberally.

There appear to be four key areas of sanctions enforcement.

[6] This section was prepared by Larry Niksch.

[7] "US to Impose Financial Sanctions on N.Korea—report," *Reuters News*, June 5, 2009.

[8] "U.S. Mulls Relisting N. Korea As State Sponsor of Terrorism," *Asia Pulse*, June 8, 2009. See CRS Report RL30613, *North Korea: Terrorism List Removal*, by Larry A. Niksch.

[9] "North Korea to Face Huge Losses from U.N. Sanctions: Report," *Asia Pulse*, June 11, 2009. Yun Deok-min, "China's Nuclear Headache," *JoongAng Daily Online*, June 16, 2009.

1. The Ban on Financial Transactions Related to North Korea's Trade in Weapons of Mass Destruction (WMD) and Weapons of Mass Destruction Technology

North Korea's state trading companies are key vehicles for transferring WMD and WMD technology to other countries and for transmitting the foreign exchange earnings back to Pyongyang. The trading companies conduct these transactions through accounts maintained in banks in numerous countries around the world. The trading companies are particularly active in China and undoubtedly have accounts throughout the Chinese banking system.[10] In order to shut down these financial transactions, governments and banks in a number of countries will have to freeze these bank accounts. However, they face the dilemma that the trading companies conduct other transactions through the same accounts. These include the financing of legitimate commerce but also laundering money acquired through North Korea's smuggling of counterfeit products, including counterfeit U.S. dollars and U.S. products. Neither of these activities are banned by Resolution 1874. Governments will have to interpret the financial sanctions ban of the resolution liberally in order to apply sanctions to the bank accounts of the trading corporations. Alternatively, the U.N. Security Council's sanctions committee will have to expand the number of North Korean trading companies subject to sanctions considerably beyond the three companies it designated at the end of April 2009. Japan and the United States had recommended 10 and 14 trading companies to be sanctioned at points in the sanctions committee's deliberation, but China and Russia reportedly objected. The number finally was scaled back to three, two trading companies and one North Korean bank.[11] The sanctions committee is supposed to make a new list of companies within 30 days of the passage of Resolution 1874.

2. Search of Sea-Borne Traffic

The specific provisions set out in Resolution 1874 appear to give the United States and allies the means to gain access to North Korean ships and thus shut down WMD-related ship traffic.[12] This will be dependent on a number of countries cooperating with the United States, particularly in applying the resolution's provision for searching North Korean ships in their ports and denying provisions of fuel and supplies to North Korean ships that refuse to be searched. China is particularly important, since North Korean ships frequently visit Chinese ports. Singapore, Indonesia, and Malaysia would be important with respect to North Korean ships that seek to pass through the Singapore and Malacca Straits that connect the Pacific and Indian Ocean, the route to the Middle East and Burma. Middle East-bound ships also stop at ports in India and Pakistan. India has searched North Korean ships in the past. Pakistan's cooperation may be more uncertain, since it has had close relations with North Korea in past years, including purchases of North Korean missiles and missile technology.[13]

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[10] John S. Park, *North Korea, Inc., Gaining Insights into North Korean Regime Stability from Recent Commercial Activities*, U.S. Institute of Peace, USIP Working Paper, Washington, DC, April 22, 2009.

[11] "3 Entities Subject to Asset Freeze Over N. Korea Nuke, Missile Program," *Kyodo News*, April 24, 2009.

[12] David E. Sanger, "U.S. to confront, not board, North Korean ships," *New York Times* (internet), June 17, 2009.

[13] Paul Kerr, "Iran, North Korea Deepen Missile Cooperation," *Arms Control Today*, January/February 2007, http://www.armscontrol.org/act/2007_01-02/IranNK.

3. Inspecting North Korea's Air Cargo

Resolution 1874 is vague in how its air cargo provisions are to be implemented, in contrast to the specific procedures set forth regarding inspecting sea-borne cargo. However, many experts believe that North Korea uses air traffic much more than sea traffic in order to transfer and exchange WMDs, WMD technology, and WMD scientists and technicians.[14] The key to inspections of North Korea's air cargo is the air traffic between North Korea and Iran. North Korea and Iran have extensive collaboration in the development of ballistic missiles.[15] It appears that much of the $1.5 billion that North Korea reportedly earns annually from missile sales and collaboration with other countries in developing missiles comes from Iran.[16] Iranian and North Korean aircraft on the Tehran-Pyongyang route use Chinese and Russian air space. A weakness of Resolution 1874 is that it does not specify inspection of North Korea-related cargo in aircraft that use the airspace of U.N. members. However, aircraft on the Tehran-Pyongyang route reportedly refuel at Chinese airports. Thus, China has a special responsibility for enforcing the provision for searches of air cargo.

4. The Ban on Financial Support for Trade with North Korea Except for Humanitarian Goods

Resolution 1874 reaffirmed Resolution 1718 of October 2006, including the ban on the export of luxury goods to North Korea. Luxury consumer goods are a key benefit to North Korea's elite, the core support group of the Kim Jong-il regime. In the past, the major sources of luxury goods have been Europe and China. Chinese traders report a high demand for Chinese consumer goods by the North Korean elite.[17] An analysis of Chinese trade statistics for 2008 indicates that Chinese exports of luxury consumer goods to North Korea was between $400 million and $500 million, about 20%-25% of China's total 2008 exports of $2 billion to North Korea. Moreover, most of China's exports are reportedly financed by Chinese trade credits to North Korea, which have generous long-term repayment provisions.[18] In short, there is evidence that a portion of Chinese goods come into North Korea largely cost-free to the North Korean government. Thus, this sanction will not be enforced unless China's begins to deny North Korea these lucrative trade credits.

[14] Paul Eckert, "Anti-proliferation Group Only Symbolic Without China," *Reuters News*, May 27, 2009.

[15] There is also speculation that the two countries may cooperate in the nuclear field, but little evidence to date. Two CRS Reports lay out extensive information on North Korean-Iranian collaboration: RK 33590, *North Korean Nuclear Weapons Development and Diplomacy* and RL 30613, *North Korea: Terrorism List Removal*.

[16] "What's Behind the New U.N. sanctions on N.Korea?" *Reuters News*, June 12, 2009.

[17] Robert J. Saiget, "China, DPRK Trade Said Booming Despite Rocket Tensions," *Agence France Presse*, April 6, 2009.

[18] Ibid.

Implications of Resolution 1874

Trade and Finance[19]

The DPRK is really two economies.[20] The first is that of the military, the Korean Workers Party, and the governing elite. This economy has considerable industrial capacity and first priority for resources, but much of it is parasitic. It lives off the production from the second economy, the rest of the country. This economy consists mostly of agriculture, services, light manufacturing, and the range of economic activity typical of a less developed nation. As a whole, the DPRK economy is one of the world's most isolated and moribund. It is in dire straits with a considerable share of its population on the edge of starvation and in need of outside food aid. Without humanitarian aid and trade with China, many of its people would starve. For 2009, the Food and Agriculture Organization and World Food Program estimated that the DPRK is facing a cereal deficit of about 836,000 tons—enough to leave 8.7 million people in need of food assistance.[21] The industrial side of the economy also faces problems with antiquated equipment, lack of raw materials, and unreliable electrical supply.

The challenge in implementing the U.N. economic and financial sanctions lies in separating funds and transactions that are related to the military from the normal economic and financial transactions of the country. Even though the economy as a whole is in shambles, the military and ruling elite are able to command sufficient resources to pursue their nuclear and ballistic missile programs. For example, officials from the Korean Peoples Army (KPA) reportedly have been authorized to acquire any material, resource or item from other commercial projects for use in North Koreas' nuclear programs.[22] The Army also has reportedly taken over some trading companies.

The U.N. sanctions target outside resources flowing into the DPRK. These include loans, assistance, finance, and certain exports and imports. Since most official development assistance is to meet basic human needs, much of it is likely to continue as humanitarian aid that is permitted. As for loans, the extent of borrowing from western commercial banks by the DPRK is relatively small. In December 2008, consolidated claims on the DPRK by banks that report to the Bank for International Settlements totaled $2.0 billion, down from a peak of $4.2 billion in June 2008. All reporting banks with claims on North Korean entities were from Europe, with France accounting for nearly half of the total.[23] These figures, however, do not include Russia or China. How much of this lending activity is purely commercial and how much went to North Korea's prohibited activities is unknown. Also, funds are fungible. A loan to a commercial activity in one sector may free up resources that then can be used for military purposes. China's trade credits to North Korea thus may free up to $2 billion in foreign exchange. The potential impact of the U.N. sanctions on this activity, therefore, is also unknown, but its upper limit would be around $2 billion in lending.

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[19] This section was prepared by Dick Nanto.

[20] For details, see CRS Report RL32493, *North Korea: Economic Leverage and Policy Analysis*, by Dick K. Nanto and Emma Chanlett-Avery

[21] World Food Programme, *8.7 Million North Koreans Need Food Assistance*, December 10, 2008.

[22] John S. Park, *North Korea, Inc., Gaining Insights into North Korean Regime Stability from Recent Commercial Activities*, U.S. Institute of Peace, USIP Working Paper, Washington, DC, April 22, 2009.

[23] Bank for International Settlements, *Consolidated banking statistics, Table 9D: Consolidated foreign claims of reporting banks - ultimate risk basis*, accessed June 17, 2009.

Loans for financing international trade transactions also could fall under the U.N. sanctions. Since the DPRK is not a member of the World Bank or Asian Development Bank, it is not eligible to borrow for trade finance from these international financial institutions. Export-import banks also do not fund trade in prohibited items. Over the period 2005-2007, the 21 industrialized nations that form the Development Assistance Committee of the Organisation for Economic Cooperation and Development reported no bank credits for trade for the DPRK. Gross non-bank trade credits amounted to $6 million in 2005, $110 million in 2006, and $17 million in 2007.[24] These data also do not include credits from China or Russia. How much of these trade credits went for nuclear or ballistic missile programs is unknown, but the gross amounts involved are small.

On the surface, therefore, financial sanctions aimed solely at the DPRK's prohibited activities are not likely to have a large monetary effect. The total amounts of such activity are not large, and what can be attributed to nuclear or missile activity would be even smaller. Still, as can be deduced from the 2005 Banco Delta Asia sanctions (see text box below), if financial institutions are put in a position in which they have to choose between dealing with the United States or dealing with the DPRK, they often will close the North Korean accounts, even if those accounts are for legitimate purposes. The BDA sanctions also showed that even amounts as relatively small as $25 million are important to Pyongyang. A BDA-type strategy, therefore, might be to let financial institutions know that any prohibited financial activity related to the U.N. sanctions could bring their whole institution under scrutiny and possible sanctions similar to those imposed on the BDA. The financial institution may then terminate all transactions with the DPRK because it feels unable to separate out the legitimate and prohibited transactions.

[24] Organisation for Economic Cooperation and Development, *Development Statistics*, DAC Private Flows to the DPRK, Non-bank gross export credits, http://stats.oecd.org.

The Banco Delta Asia Sanctions

On September 15, 2005, the U.S. Treasury imposed USA PATRIOT Act Section 311 designations against Banco Delta Asia (BDA) in Macau. In the action, Treasury stated that the bank was a "primary money laundering concern" because, among other findings, sources indicated that senior officials in Banco Delta Asia were working with DPRK officials to accept large deposits of cash, including counterfeit U.S. currency, and agreeing to place that currency into circulation. On September 20, 2005, the Financial Crimes Enforcement Network of Treasury imposed special measures against Banco Delta Asia that prohibited U.S. institutions or agencies from opening or maintaining correspondent accounts on behalf of BDA and required covered financial institutions to exercise due diligence to ensure that no correspondent account is being used indirectly to provide services to BDA. Some $25 million in North Korean assets were frozen.

The U.S. action against BDA generated an avalanche of responses both in financial and political circles. It caused such a run on accounts at the bank that the government of Macau had to take over BDA's operations and place a temporary halt on withdrawals. According to press reports, the Macau government shut down all North Korea-related accounts including those belonging to nine DPRK banks and 23 DPRK trading companies. These reportedly included accounts from the core organs of the North Korean Regime.

The financial effects of the BDA action were larger than expected. The crackdown also spread around the region, with Chinese, Japanese, Vietnamese, Thai, and Singaporean banks increasing their scrutiny of North Korean account holders. In Macau, the North Korean trading firm used by Pyongyang as a *de facto* consulate rolled up its operations as the Macau government placed BDA into receivership. Not only did the action deprive major DPRK companies of an international financial base and cut into the secret personal accounts of the Pyongyang leadership, but it appears to have obstructed some legitimate North Korean trade. Banks from other nations (such as the United Overseas Bank of Singapore and the Korea Exchange Bank of South Korea) also moved to sever contacts with North Korea, fearing that they, too, could face U.S. legal action.

On February 13, 2007, a new Six-Party Talks agreement on North Korea's nuclear program and energy needs was concluded. In announcing this agreement, Assistant Secretary of State Christopher Hill pledged to settle with North Korea within 30 days the issue of U.S. financial sanctions against BDA and the freezing of North Korean accounts of $25 million. After several failed attempts to transfer the $25 million, the DPRK recovered its funds in June 2007 when the New York Federal Reserve Bank agreed to transfer them through its facilities to a bank in Russia.[25]

On June 18, 2009, the Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury Department issued an advisory for all U.S. financial institutions to take risk mitigation measures against the possibility that the DPRK would use deceptive financial practices to hide illicit conduct. Specifically, FinCEN noted that with respect to correspondent accounts held for North Korean financial institutions, as well as their foreign branches and subsidiaries, there is now an increased likelihood that such vehicles may be used to hide illicit conduct and related financial proceeds in an attempt to circumvent existing sanctions, particularly those of U.N. Resolution 1874. FinCEN advised financial institutions to apply enhanced scrutiny to any such

[25] CRS Report RL33324, *North Korean Counterfeiting of U.S. Currency*, by Dick K. Nanto.

correspondent accounts and to avoid providing financial services for North Korea's procurement of luxury goods. In order to assist in applying enhanced scrutiny, FinCEN supplied a list of North Korean banks. It also encouraged financial institutions worldwide to take similar precautions.[26]

The U.N. sanctions also ban exports of North Korean arms, including small arms and light weapons. Stopping exports of large armaments will depend on the effectiveness of interdictions and threats of interdictions of shipments by cooperating countries discussed elsewhere in this memorandum. DPRK trade in small arms and ammunition is relatively insignificant. Recently reported purchases of such items from the DPRK included imports of $45.5 thousand by Brazil in 2007, of $3.1 million by the United Arab Emirates in 2006, and $364.4 thousand by Ethiopia and $121.4 thousand by Mexico in 2005.[27] The small arms export ban, therefore, is not likely to have a large effect on the economy of the DPRK.

With respect to overall trade, the DPRK may actually be in the process of sanctioning itself. More than half of North Korea's exports and a third of its imports have been with South Korea, primarily through activities in the Kaesong Industrial Complex located in North Korea just north of the DMZ. Following the negative response by South Korea to North Korea's second nuclear and missile tests, Pyongyang announced that all of the contracts regarding wages, taxes, and usage fees for Kaesong were void and insisted that the monthly wage for North Koreans be raised from $75 to $300 and the monthly leasing fee be raised from 1.5 to 7 million won ($1,200 to $5,598). One of the 106 South Korean companies there is already pulling out, and others may follow. If the industrial complex is closed, it will essentially halt most South Korean trade with the DPRK. If Pyongyang's gamble pays off, a sufficient number of South Korean companies will pay the higher costs of operating at Kaesong. If not and North-South relations continue to deteriorate, North Korea may lose a significant source of foreign exchange and investment.[28]

As for DPRK trade with the rest of the world, between a half and three-quarters of its imports and exports are with China. The United States and Japan have virtually no trade with North Korea. The vast majority of China's imports from the DPRK, however, is in non-prohibited items such as ores, coal, iron/steel, apparel, fish, and minerals. The top six imports in **Table 1** account for about 85% of China's total imports from North Korea. The ores, coal, and fish/seafood originate primarily from Chinese investments in enterprises in the DPRK.

[26] Financial Crimes Enforcement Network, U.S. Department of the Treasury, *North Korea Government Agencies' and Front Companies' Involvement in Illicit Financial Activities*, Advisory FIN 2009-A002, Washington, DC, June 18, 2009, http://www.fincen.gov/statutes_regs/guidance/html/fin-2009-a002.html.

[27] United Nations COMTRADE database.

[28] See CRS Report RL34093, *The Kaesong North-South Korean Industrial Complex,* by Dick K. Nanto and Mark E. Manyin.

Table 1. China's Major Imports from the DPRK

($million)

Commodity	Description	2003	2004	2005	2006	2007	2008
	Total	395.5	582.2	496.5	467.7	581.5	754.0
26	Ores, Slag, Ash	15.0	58.9	92.3	118.4	164.0	212.7
27	Mineral Fuel, Oil	17.2	53.0	112.2	102.3	170.0	207.6
72	Iron and Steel	46.8	75.0	72.2	35.2	45.2	78.4
62	Woven Apparel	52.2	49.1	58.3	63.3	60.4	77.3
03	Fish and Seafood	207.0	261.2	92.4	43.3	29.9	40.0
25	Salt; Sulfur; Earths and Stone	0.7	1.1	1.3	4.2	7.5	19.3

Source: Congressional Research Service with Data from Global Trade Atlas

Notes: Commodity numbers are 2-digit Harmonized System Codes

As shown in **Table 2**, China's major exports to the DPRK include mineral fuels (petroleum), machinery/boilers, electrical machinery, knit apparel, plastic, vehicles, man-made filaments, and cereals. With the exception of knit apparel, these exports are essential to the functioning of the North Korean economy. It is noteworthy that China exports less in cereals to North Korea than it imports in fish and seafood, contradicting the general impression that trade in food is primarily one-way from China to the DPRK. With respect to the U.N. sanctions, the links between these exports and Pyongyang's nuclear and missile programs are indirect at best. Nevertheless, the $400 million-$500 million in Chinese exports of luxury consumer goods to North Korea may be essential to help maintain elite loyalty to the regime.

China, however, recognizes the leverage it wields through its exports of petroleum to the DPRK. According to a news report from Japan, following the DPRK's second nuclear test, China imposed its own "sanctions" on the DPRK by reducing crude oil shipments through its pipeline with North Korea. Previously, following the DPRK's missile test on April 5, 2009, China had tightened inspections of weapons-related exports to North Korea.[29]

[29] "China Imposes Own 'Sanctions' on DPRK by Reducing Crude Oil Shipment, Stepping Up Customs Inspection on Exports to the DPRK," *Asahi Shimbun (in Japanese)*, June 13, 2009, Translation in U.S. Forces Korea J2, Korea, Open Source Digest, Volume II, Issue 114, June 16, 2009.

Table 2. China's Major Exports to the DPRK
($ million)

Commodity	Description	2003	2004	2005	2006	2007	2008
	Total	628.0	794.5	1,084.7	1,231.9	1,392.4	2,033.2
27	Mineral Fuel, Oil	180.7	204.4	285.7	347.5	402.0	586.0
84	Machinery; Reactors, Boilers	27.0	39.6	77.1	83.0	103.8	145.5
85	Electrical Machinery, Etc.	39.6	45.8	56.6	97.6	69.3	100.6
61	Knit Apparel	3.6	4.8	6.2	10.1	23.8	87.0
39	Plastic	24.6	32.0	52.2	52.0	54.6	80.0
87	Vehicles, Not Railway	8.4	18.3	28.3	28.0	53.7	67.3
54	Manmade Filaments	14.6	18.0	28.9	38.6	52.3	55.0
10	Cereals	50.0	15.3	50.3	16.9	36.5	34.9

Source: Congressional Research Service with Data from Global Trade Atlas

Notes: Commodity numbers are 2-digit Harmonized System Codes

Since the sanctions under Resolution 1874 are narrowly focused on items related to the North Korean nuclear and missile programs, pressure from China would entail using broader trade tools.

In summary, the economic effect of Resolution 1874 is not likely to be great unless:

- China cooperates extensively and goes beyond the requirements of the resolution, and/or
- the specific financial sanctions create a ripple effect that causes financial institutions to avoid being "tainted" by handling any DPRK transaction.

North Korea's Proliferation, Nuclear and Missile Programs[30]

At a press conference on June 16, President Obama stated that "North Korea also has a track record of proliferation that makes it unacceptable for them to be accepted as a nuclear power. They have not shown in the past any restraint in terms of exporting weapons to not only state actors but also non-state actors."[31] North Korea is known to have sold ballistic missiles and associated materials to "several Middle Eastern countries, including Iran, and, in our assessment, assisted Syria with the construction of a nuclear reactor," according to DNI Admiral Dennis Blair's testimony to Congress.[32] North Korea appears not to simply export missile technology, but to collaborate with Iran and perhaps others in missile development.[33] Resolution 1874 may bolster the ability of the international community to prevent North Korea from proliferating its WMD and missile technologies to other countries and to halt supply of North Korea's programs

[30] This section was prepared by Mary Beth Nikitin.

[31] http://www.whitehouse.gov/video/President-Obama-and-President-Lee-of-the-Republic-of-Korea-Talk-to-the-Press/

[32] http://intelligence.senate.gov/090212/blair.pdf

[33] "North Korea's Nuclear and Missile Programs," *International Crisis Group*, June 18, 2009.

only to the extent that countries are willing to sanction relevant entities, share sensitive information and stop suspicious shipments.

Some analysts point out that the measures authorized under the resolution will not prevent the proliferation of nuclear material or sensitive information such as test data or weapons design due to their portability. However, other analysts and the Obama Administration contend that if all countries implement what is called for in the resolution, at the minimum North Korea would be discouraged from attempting to ship or procure sensitive goods. Others point out that, generally, increased monitoring and sharing of information about North Koreans' activities abroad may improve U.S. intelligence related to WMD programs.

As evidenced in the reports to the UNSC Sanctions Committee for Res. 1718, many countries have existing laws or participate in multilateral export control regimes that prohibit trade in WMD and missile-related technology. The Proliferation Security Initiative (PSI) has facilitated international cooperation on WMD interdiction issues.[34] However, the extent to which countries are now willing to sanction their own companies involved in such transactions by placing them on the UNSC sanctions list (as discussed above) will be a key determinant.

Pyongyang has had an active procurement network for its nuclear program for decades.[35] Pyongyang may need to procure items from abroad for further advances. Therefore, increased international vigilance, stopping of shipments, and financial pressures combined may have a limiting effect on North Korea's own programs as well as on its proliferation to others. This may largely depend on China's willingness to curb traffic, as discussed in the "Implementation of Sanctions" section above.

North Korea's Policies and Internal Situation[36]

As with all analysis that involves the secretive regime in Pyongyang, the impact of the resolution on North Korea's domestic situation is nearly impossible to gauge with authority. However, North Korea's recent actions have provided observers with some clues about the internal dynamics of Kim's government. In the past, North Korea's provocations tended to be viewed by the majority of analysts as ploys to strengthen its negotiating position at the Six-Party Talks. In the 1990s, severe food shortages and U.S. offers of food aid seemed to moderate North Korean behavior. Pyongyang's recent behavior, however, has generally shifted the predominant view among Korea-watchers: it now seems that North Korea is determined to be a nuclear state, even at the price of angering its closest allies.

Financial sanctions were designed to target the country's elite and military enterprises. Most analysts suggest that the regime has proven quite resourceful at remaining firmly in power despite a bevy of sanctions in past years. Even at the expense of large swathes of the general population, the inner circle of elites has been kept happy with limited resources. However, some argue that if sanctions are carried out effectively, they may have an impact on internal power struggles as elites vie for resources. Some suggest that the sanctions levied against Banco Delta Asia in 2006

[34] China does not participate in PSI. South Korea announced its participation shortly after the May 2009 North Korean nuclear test. See also CRS Report RL34327, *Proliferation Security Initiative (PSI)*, by Mary Beth Nikitin.

[35] "Nuclear Black Markets: Pakistan, A.Q. Khan and the Rise of Proliferation Networks," *IISS Strategic Dossier*, 2007.

[36] This section was prepared by Emma Chanlett-Avery.

appeared to be effective at targeting the regime, and that the pain inflicted by those sanctions led to North Korea's return to the nuclear negotiations. Others point out, however, that this return was followed by North Korea's first nuclear test, indicating that effective sanctions may simply strengthen the hardliners' resolve.

Further complicating assessments of how the resolution may affect North Korea's internal policies is the assumption that officials in Pyongyang are contemplating a transfer of power. Kim Jong-il's reported stroke in August 2008 has elevated attention among international observers to the question of succession in the North Korean regime. North Korea's behavior since Kim's reported stroke has been characterized as provocative and aggressive, which may be an attempt to project confidence in the face of uncertainty. If a power struggle is playing out in Pyongyang as a result of Kim's illness, it appears that hardline elements are holding sway in decisions such as the missile launch, nuclear test, and withdrawal from the Six-Party Talks. Potentially, sanctions could lead to a more inward-looking, hostile government in Pyongyang. Observers point to indications that the military leadership is taking a more dominant role in policy-making in the past several months: the General Staff of the military issued a statement in April 2009 that did not mention Kim Jong-il and strongly suggested that the military played a decisive role in North Korea's decision to withdraw from talks and that the military would control future policy regarding nuclear programs.

Because decision-making within the regime remains opaque, it is not clear how elites in Pyongyang may be considering Beijing's reaction in their calculations. In the past, it seems that North Korean elites were able to depend on China ultimately to ensure their survival. If North Korea has actually alienated some influential players in Beijing with this round of provocations, enhanced Chinese enforcement of the sanctions regime could inflict more pain than earlier attempts. However, some analysts believe that China, recognizing that different parties within North Korea are competing for influence, may feel even more restrained from pressuring North Korea for fear of alienating a future power base.

Assessments of UNSC Resolution 1718 (2006)[37]

UNSCR 1874 tightens, expands, and adds to many of the existing restrictions that were included in UNSC Resolution 1718, which the Security Council unanimously passed on October 14, 2006, five days after North Korea's first nuclear test.[38] As with 1874, Resolution 1718 was passed in the hope that it would curb financial inflows that went to North Korea's regime and its weapons programs, while imposing minimal humanitarian hardships on the broader North Korean population.

Less than three weeks after the UNSC passed Resolution 1718, North Korea announced it would return to the Six-Party Talks that it had been boycotting for nearly a year. The announcement came after secret meetings with U.S. and Chinese officials. While it is possible that Kim Jong-il's

[37] This section was prepared by Mark Manyin.

[38] Resolution 1718 called on North Korea to abandon its nuclear and missile programs and imposed sanctions on several types of activities. The resolution banned trade with North Korea in materials related to ballistic missiles or weapons of mass destruction, and barred exports of luxury goods to the DPRK. It also banned trading with North Korea in large weapons systems. It also froze funds and other financial assets owned by people connected with North Korea's unconventional weapons program and banned travel by such people.

government planned to quickly return to the talks after its nuclear test, it is also possible that the speedy passage and unanimous support of 1718 spurred the regime's decision.

However, most analysts consider Resolution 1718 ineffective in economically penalizing North Korea. The coverage of the provisions was relatively limited, provisions enforcing transparency on sanctioning countries were relatively weak, military enforcement options were not included in the resolution, and there was no defined list of the prohibited products. Instead, creating the lists was left to individual countries, who then reported them to the U.N. Sanctions Committee. This administrative feature of the sanctions regime allowed countries to avoid or soften implementation of the resolution. China and South Korea appeared to soften implementation with North Korea's decision to return to the Six-Party Talks. Neither country, for instance, published detailed lists of the luxury goods they planned to sanction. Together, the two accounted for 61% and 75% of DPRK trade in 2006 and 2007, respectively.

There is strong evidence that China did not rigorously implement the resolution's provisions.[39] According to an analysis by the Peterson Institute's Marcus Noland, for instance, it appears that exports from China increased after 2006.[40] In 2007, North Korea-China trade in general increased by 13%, followed by a 41% increase in 2008. In those years, Chinese exports to North Korea rose by 13% and 46%, respectively.[41] While this rise in overall trade is not necessarily indicative of an increase in luxury goods shipments, it appears to indicate that the sanctions either had no or little deterrent effect on Chinese enterprises' normal commerce with their North Korean counterparts.[42]

As for South Korea, in the aftermath of North Korea's test, it halted humanitarian assistance. Food aid shipments from Seoul dropped from 400,000 in 2005 to 100,000 in 2006.[43] However, overall trade between the Koreas jumped by 33% in the calendar year after Resolution 1718 was adopted.[44] Much of this increased trade was due to the expansion of the Kaesong Industrial Complex (KIC), a facility in North Korea in which South Korean manufacturers employ North Korean workers. The North Korean government derives tens of millions of dollars from the complex, from rental fees and the portion of the workers' wages it collects.[45]

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[39] Trade in heavy weapons systems such as missiles generally are not recorded, complicating any assessment of 1718's arms embargo.

[40] Marcus Noland, "The (Non) Impact of U.N. Sanctions on North Korea," Peterson Institute for International Economics, Working Paper 08-12, 2008.

[41] Global Trade Atlas using Chinese data.

[42] For more on this point, see Noland, "The (Non) Impact of U.N. Sanctions on North Korea," p. 5, 9-10.

[43] South Korean Export-Import Bank's "DPRK Support Fund," provided via South Korean Ministry of Unification.

[44] South Korean Ministry of Unification.

[45] See CRS Report RL34093, *The Kaesong North-South Korean Industrial Complex*, by Dick K. Nanto and Mark E. Manyin.

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