

# Countering DPRK Illicit Activities

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Corruption is an unwelcome but common feature of bureaucracy, from local to national to multinational. Nonetheless, North Korean criminality stands apart. It is quite rare to encounter a state that purposefully adopts policies that enmesh its official institutions, political organizations, and their members in a routine of criminal conduct.<sup>2</sup>

Instances of criminal activity carried out by North Korean officials date back a number of years, at least to the mid-1970s and likely long before. From the 1970s through the mid-1990s, the “who” and the “what” of these crimes roused strong suspicions that, rather than being cases of officials gone wrong (as DPRK authorities invariably would explain), the state itself was behind many of the offenses. Even so, foreign governments in public usually avoided alleging DPRK government culpability. North Korean’s law-breaking mostly was handled as a police matter, not a political issue. Prosecutors treated those caught as ordinary crooks rather than raising the thorny prospect that they were DPRK agents acting under orders. Because of diplomatic immunity or decisions to handle matters quietly, some offenders were not prosecuted but simply sent home or allowed to flee.

Since the mid-1990s, the growing frequency and scope of detected illicit activities swirling around North Koreans overseas, particularly narcotics trafficking, made state involvement more difficult to conceal. From time to time, quiet but futile efforts were pursued using political channels to persuade the DPRK leadership to end its criminal activities. In recent years some victim governments finally shook off restraints of self-censorship to make explicit references to DPRK official direction of illicit activities. Even so in notorious cases securing a conviction could prove elusive as shown by the “not guilty” verdict rendered by Australia’s Supreme Court jury in the trial of the captain and three senior officers of the DPRK MV *Pong Su* for aiding in the smuggling of AU \$168 million worth of heroin.<sup>3</sup>

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<sup>1</sup> This brief discussion proceeds on the basis that more than 30 years of accumulated evidence, even if some is circumstantial or anecdotal, is sufficient to make the case for North Korean involvement in illicit activities. It does not offer fresh arguments to those who reject allegations of DPRK counterfeiting and narco-trafficking without the revelation of more convincing and detailed proof. (Even they, however, surely must wonder how DPRK representatives overseas, uniquely among diplomats, have for years been able to gain access to wide varieties and large quantities of contraband, to include narcotics, other controlled substances, and counterfeit currency.)

<sup>2</sup> On this point and for an extensive, nuanced discussion of evidence about North Korea’s criminal activities, see Sheena E. Chestnut’s award-winning thesis, The “Sopranos State”? North Korean Involvement in Criminal Activity and Implications for International Security; Honors Program for International Security Studies, Center for International Security and Cooperation, Stanford University, 20 May 2005.

<sup>3</sup> According to various Australian press accounts published after the trial ended, the jury was not allowed to hear testimony on the DPRK’s history of international drug smuggling, including first-hand accounts from defectors, or about direct radio communication between the ship and North Korea. One of these messages instructed the *Pong Su* captain to disguise any involvement with North Korea by telling Australian authorities it was a Tuvalu-registered ship. Another example is the acquittal of Japanese Red Army member Yoshimi Tanaka on a charge of distributing counterfeit US currency when he finally was brought

The DPRK condones, encourages, and directs a wide range of crimes--from the petty, embassy officers’ smuggling and sales of untaxed alcohol and controlled substances to pay the rent and fund local expenditures; to the audacious, staging of multi-million dollar insurance frauds; to the contemptible, provision of naval craft, weapons, ammunition, and even engineering services to terrorist groups. The DPRK’s longest running criminal undertaking was the manufacture and distribution of narcotics, though possibly DPRK authorities several years ago stopped the country’s participation in the trade. Judging by reported incidents, the focus originally was on opium and heroin with occasional trafficking in cocaine and marijuana. The bulk of the narcotics trade over the decade ending in 2005 was in methamphetamines—by the shipload—mostly to Japan but also to Taiwan and the United States.<sup>4</sup>

North Korea produces and distributes high quality counterfeit currency, notably the so-called supernotes that are difficult to distinguish at the retail level from genuine U.S. \$100 and \$50 Federal Reserve Notes. Concerns have surfaced that the DPRK also is counterfeiting currencies of several Asian countries but no one is known to have made available suspect notes for forensic analysis that might substantiate the existence of such an ambitious currency counterfeiting program. In public governments generally deny that their currency could be counterfeited in ways that would defy normal detection efforts. They are wary of issuing strong warnings about counterfeit, especially high quality fakes, to avoid undermining the public’s confidence. The U.S. experience provides examples that anxiety over the fragility of public confidence is not misplaced. Discovery and subsequent extensive press coverage in the Philippines, Thailand, Taiwan, and Peru that large quantities of counterfeit US \$100 FRNs had been placed in circulation in each case triggered a run on the US dollar. In some of those countries, a few banks for a time refused to handle US notes.

Since at least the mid-1990s, the DPRK has engaged in the manufacture of counterfeit cigarettes along with packaging and tobacco revenue stamps of various countries.<sup>5</sup> It reportedly hosts similar foreign-operated counterfeit cigarette ventures. Tobacco industry investigations conducted several years ago identified 10-to-12 active plants and determined that the DPRK military and the “internal security service” operated at least

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to trial in Thailand three years after being arrested at the Cambodian-Vietnamese border in a North Korean embassy car while trying to flee from authorities.

<sup>4</sup> For a cautious but detailed view of DPRK illicit activities and examples of narco-trafficking, see *Statement of Peter A. Prahar, Director, Office of Africa, Asia and Europe Programs, Bureau for Narcotics and Law Enforcement Affairs, Department of State before the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Homeland Security and Government Affairs Committee; April 25, 2006.*

<sup>5</sup>“A 1995 Associated Press article reported the seizure by Taiwanese authorities of 20 shipping containers of counterfeit cigarette wrappers destined for North Korea. According to officials of the cigarette company whose label and trademark were being violated, the seized materials could have been used to package cigarettes with a retail value of \$1 billion.” Quotation extracted from testimony of William Bach, Director, Office of African, Asian, and European Affairs, Bureau for International Narcotics and Law Enforcement Affairs, Department of State on May 20, 2003 at a *Hearing on Drugs, Counterfeiting and Arms Trade: The North Korean Connection* before The Senate Committee on Governmental Affairs, Subcommittee on Financial Management, the Budget, and International Security.

one plant each.<sup>6</sup> This is an attractive business for the DPRK: legal penalties are light and potential profits are large. Tobacco industry investigators judged that at detected rates of production North Korea could gross between \$520 million and \$720 million annually.<sup>7</sup> "Made in North Korea" counterfeit cigarettes are marketed throughout Asia, especially Taiwan and Indonesia, and in the United States. More recently, North Korea began making counterfeit pharmaceuticals, in particular Viagra, for foreign distribution, mostly Japan and South Korea.

The DPRK through the years has worked closely with transnational criminal gangs to smuggle and sell drugs and counterfeit. The DPRK ship *Pong Su*, which was seized by Australian authorities after a lengthy chase, transported and landed on the Australian coast several ethnic Chinese gangsters and 150 kilograms of heroin.<sup>8</sup> Over the past few years, highly publicized cases, like the *Pong Su* incident and Japan's earlier sinking of a suspected North Korean drug-running ship, may have led the regime to limit risks of further unwelcome exposure by curtailing direct involvement and acting mainly as a wholesaler.<sup>9</sup> It may even have gotten out of the drug business. Japanese police have noted that the supply of methamphetamines has risen sharply over the past year (dating from the conclusion of the Beijing Olympics).<sup>10</sup> Going solely by reports of confirmed incidents, over the past few years DPRK narco-trafficking appears to have dried up.<sup>11</sup>

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<sup>6</sup> See Coalition of Tobacco Companies Report, "Production of Counterfeit Cigarettes in the Democratic People's Republic of Korea (DPRK)," June 29, 2005.

<sup>7</sup> Ibid.

<sup>8</sup> Often reported as 125 kilograms; 25 kilograms were lost in rough surf in an attempted landing on the Australian coast that cost the life of one of the drug smugglers.

<sup>9</sup> Japanese divers recovered evidence connecting the sunken ship with Yakuza figures who were prosecuted in 2006. See *footnote 11*.

<sup>10</sup> Reports on seizures have not disclosed information on the purity of the drugs; methamphetamines that were sourced to the DPRK typically were purer than those provided by Chinese suppliers and others.

<sup>11</sup> According to the U.S. Department of States' annual *International Narcotics Control Strategy Report (INCSR)*, issued March 2007, by the Bureau of International Narcotics and Law Enforcement Affairs, "There were no confirmed instances of drug trafficking involving North Korea or its nationals during 2006. Anecdotal evidence suggests that trafficking and drug abuse in the DPRK and along its border with China continues. There also continued to be press, industry and law enforcement reporting of DPRK links to counterfeit cigarette trafficking and counterfeit U.S. currency. In May 2006, Japanese authorities charged several individuals with a 2002 narcotics trafficking incident, based, in part, on evidence found on a sunken DPRK patrol boat. In August 2006, a defendant in a California criminal case told the court that he had promised to provide \$2 million in counterfeit "supernotes" originating in the DPRK to undercover U.S. agents, and investigators seized that amount. The Department is of the view that it is likely, but not certain, that the North Korean government has sponsored criminal activities in the past, including narcotics production and trafficking, but notes that there is no evidence for several years that it continues to traffic in narcotics. The most recent INCSR, issued February 27, 2009, provided similar statements. "There were no confirmed instances of large-scale drug trafficking involving the DPRK or its nationals during 2008. ... [A]lmost six years have passed since the last seizure of drugs anywhere in the world with a clear link to a DPRK state entity, it appears possible that the DPRK has abandoned its involvement in drug trafficking. The Department has no evidence to support a clear finding that state trafficking has either stopped or is continuing. The absence of any seizures linked to DPRK state institutions, especially after a period in

Besides supplying and partnering with organized crime groups to help hide the DPRK's role, North Korea has established front companies to assist in smuggling and money-laundering operations. One such company in Macau, International Finance and Trade Joint Company, for years was able to operate undetected as a "bank within a bank" until it was exposed during the investigation of Banco Delta Asia. Among other dealings, this company was used by the DPRK to launder nearly US \$3 million sent to several DPRK embassies by the Foreign Trade Bank's surreptitious use of a UNDP account.<sup>12</sup>

Illicit activities ensnare government ministries, party organizations, military outfits, security and intelligence service units, and state-owned banks, business conglomerates, and even small provincial and locally-operated firms. As illustrated by the involvement of the DPRK Foreign Trade Bank in money laundering, North Korea's criminal businesses routinely make use of many of the nation's key organizations. The Korea National Insurance Company (KNIC), according to a recent account by Mr. Kim Kwang-jin who was the company's representative in Singapore, has embraced fraud as its business model.<sup>13</sup> Much of the DPRK's narcotics trafficking, counterfeiting, and probably gun-running, most likely is run by the intelligence services, which involve others as needed. Operations Department head, General O Kuk-ryol was recently identified as the manager of the DPRK's counterfeit currency program.<sup>14</sup> Several of his family members also were said to be involved.

As Kim Kwang-jin and other defectors have reported, many who were dispatched overseas were tasked with raising sizable sums for Kim Jong-il. Those who would fail to send enough cash to Kim's Office 39, which handles fund-raising, could face recall. Similarly, most embassies are underfunded, and staff somehow must make up the difference between the limited funds allocated and the large stack of bills that come due. Embassy and other representatives posted overseas are also expected to contribute to annual "loyalty" payments raised for delivery to Kim on his birthday. Defectors who had served overseas speak about how a trip home could impoverish them from outlays of cash

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which such seizures involving very large quantities of drugs occurred regularly, does suggest considerably less state trafficking, and perhaps a complete end to it. On the other hand, the continuing large-scale traffic in counterfeit cigarettes from DPRK territory suggests that enforcement against notorious organized criminality is lax. It is also possible that a lucrative counterfeit cigarette trade has replaced a riskier drug trafficking business as a generator of revenue for the DPRK state."

<sup>12</sup> See *United Nations Development Program: A Case Study of North Korea*; Staff Report, Permanent Subcommittee on Investigations, United States Senate; Released January 24, 2008.

<sup>13</sup> See "Global Insurance Fraud by North Korea Outlined;" *The Washington Post*; June 18, 2009.

<sup>14</sup> See "N. Korea General tied to forged \$100 bills;" *The Washington Times*; June 2, 2009. The article names General O as a recently promoted member of the country's powerful National Military Commission. A 2009 chart prepared by the Open Source Center lists General O as head of the Operations Department. A separate report discussing General O's appointment also named him as head of the Operations Department and stated that oversight of this 2000-person strong espionage service was transferred from the Korean Workers Party to the NDC. (See "In North Korea, Ailing Kim Begins Shifting Power to the Military;" Fox News; May 1, 2009.) South Korean press in 2002 linked the North Korean ship sunk by Japan to the Operations Department.

and luxuries they were expected to provide superiors. Results were what counted towards a favorable rating and retaining a post, not methods employed in raising cash.

North Koreans are caught up in a culture that is conflating privilege with corruption and oppression. One of the features of this system is that the DPRK has created a “criminal class” overwhelmingly comprised of the families of elites, who receive educational and occupational advantages and favoritism in selection for coveted foreign postings. The uncomfortable (and inconvenient) truth about DPRK illicit dealings is that many DPRK counterparts in Six Party Talks, North Korean participants in financial working group meetings, officials in charge of foreign investment, trade, bank, and insurance company representatives abroad, and senior serving diplomats are tainted by superintending, facilitating, or participating in criminal acts. Those who may somehow have evaded complicity would certainly not be able to avoid a general awareness of officially directed illicit activities.

And, crime pays. Revenues from illicit activities and sales of weapons are estimated to cover a large portion of the DPRK’s sizable annual trade deficit. Authorization to undertake illicit foreign-currency-earning activity likely is particularly prized by cash-strapped North Korean organizations and businesses. Despite apparent substitutability between dollars earned from selling counterfeit cigarettes and dollars received from exporting DPRK-banded smokes, there is an important distinction between selling contraband and legitimate goods—profits of the former escape the national budget process and potentially provide a larger residual payoff to those involved, particularly if part of the hard currency earnings can be banked abroad and put to work. Kim can use proceeds funneled to his coffers to cement loyalty of elites, further work on nuclear and other WMD projects, and supplement funds available to the security services that shore up his regime.

Crime provides less tangible payoffs as well. The regime, especially the DPRK military, could tap into well-developed criminal connections to help it acquire advanced technologies for WMD programs, assist in covert transportation of proliferation-related materials, and influence foreign government officials.<sup>15</sup>

U.S. bilateral and multilateral negotiations to persuade the DPRK to abandon its nuclear programs and give up its nuclear weapons and weapons-grade material, halt sales of ballistic missiles, and prevent further DPRK proliferation of WMD programs, routinely have failed to take fully into account the criminal nature of the state. Instead, the assessment of how to deal with the DPRK appears to proceed from an underlying premise that objectives can be ranked hierarchically; that crime (or human rights) is strategically less important than DPRK development of nuclear weapons; and that holding North Korea to account for its criminal conduct would distract from and probably be

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<sup>15</sup> A lengthy treatment of the nuclear smuggling risks of a DPRK crime-proliferation nexus can be found in Sheena Chestnut “Illicit Activity and Proliferation: North Korean Smuggling Networks;” International Security, Vol. 32, No. 1, pp. 80-111.

detrimental to successful nuclear negotiations. This has the effect of yoking objectives together in tandem, and allowing the one on which least progress is made to set the pace.

Effective law enforcement efforts to counter DPRK criminality must have an international scope and unambiguous, top-level political support to gain the full and willing (in some cases, grudging) cooperation of foreign government, police, and judicial authorities. With political support lacking or flip-flopping enough to call commitment over the long term into question, the most vigorous law enforcement efforts would likely achieve modest results. Because of resource constraints, law enforcement officials must constantly decide if continuing the game is worth the candle. This weighing of investigative costs versus chances of getting a conviction gives additional leverage to those who might want inconveniently timed investigations to be put on the back-burner.

A similar test could be run of the rationality of continuing to follow a strategy based on prioritization, with its implicit trade-offs. The calculation would estimate a subjective risk/reward ratio that weighed costs of quiet acquiesce to *certain* ongoing criminal conduct versus the *probability* of attaining nuclear negotiation objectives at some distant future date. The negotiating record of the past two decades suggests that the probability of success is quite low.<sup>16</sup> If so, making a devil’s bargain would be a very bad bet indeed, and continuing to conduct negotiations based on a shaky strategic assumption would demand substitution of a leap of faith for cold calculation. Moreover, assisting the DPRK in avoiding the moral hazard of its choices reinforces the regime’s own notions that significant gains can be achieved through extortion and that consequences of egregious acts can be evaded by reaching a “political” understanding. Finally, North Korea’s increasingly desperate economic condition, the uncertain outcome of looming leadership succession, and the possibility that the leadership’s ability to control the scale of criminal activity might lessen or be lost gives urgency to making strong efforts now to push back and counter DPRK illicit activities.

Obtaining close international law enforcement cooperation to develop evidence and put North Korea’s leaders on trial for their crimes, like Noriega and Milosevic, may be pleasant to contemplate but is not a realistic goal. Prosecutors likely would have to content themselves with putting smaller fish on trial, eliciting testimony about the complicity of higher-ups, seeking asset forfeiture, and disrupting links between the DPRK and transnational criminal organizations. The shrinking DPRK involvement in narco-trafficking indicates a likely sensitivity to exposure that could be exploited to induce North Korea’s leaders to suspend or withdraw from other ventures, such as counterfeiting. The murky historical record of the decades-long supernote investigation and the higher evidentiary threshold media now demands of the U. S. to substantiate allegations probably would require both development of incontrovertible evidence and a

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<sup>16</sup> At best, the Agreed Framework for a time got the DPRK to shift to a slower path of weapons-development but did not dissuade them from seeking the capability to produce nuclear weapons. North Korea’s willingness to assist Syria in constructing a reactor—cooperation that evidently dates back some years--suggests that the DPRK may have calculated it could use offshore sourcing to work around the agreed upon constraints on domestic production of weapons-grade plutonium.

well-executed communications plan. Additionally, an out-of-court settlement could be offered that would exchange dropping the counterfeiting case for surrender of counterfeiting wherewithal—plates, paper, ink, and existing stock.

Recent publicity given to insurance fraud should cause the DPRK, at least for a while, to stop staging “accidents” but also will likely lead re-insurers to steer clear of brokers offering North Korean business. This would put yet another burden on the economy which needs insurance to assist with managing frequent mishaps due to the DPRK’s aged and poorly maintained plant and equipment. Re-insurance also has been collected to reimburse the state for crop losses and flood damage to infrastructure.

Increased exposure probably would prove of less value in convincing the DPRK to halt its counterfeiting of cigarettes and pharmaceuticals. The stigma and penalties of conviction are relatively low compared with the profits that can be earned. Results of tobacco company investigations show that collecting actionable intelligence on the counterfeit cigarette trade is easier than on dealings in supernote and narcotics. It is likely that informers could be developed who could support a step-up in interdictions and seizures. Improvements in exchange of law-enforcement information and toughened rules on cargo inspections would also be useful in helping contain the problem.

Finally, financial sanctions offer another promising tool to help counter DPRK illicit activities. North Korea is especially vulnerable to financial measures. First, it is a poor country and loss of access to relatively small amounts of funds can cause distress. Second, by engaging in illicit activities, North Korea becomes the subject of international law enforcement investigations that can leverage open otherwise protected financial information and put a crimp in illicit earnings. Third, the DPRK has isolated itself from the international financial community, and the DPRK must either courier cash or draw upon balances held in bank accounts abroad to pay for imports of goods and services.

Treasury for years has labored successfully to strengthen international anti-money laundering efforts, particularly through support of the Financial Action Task Force. The adoption of tougher “know your customer” rules has complicated DPRK use of money-center banks to move proceeds of illicit activities and proliferation. Treasury’s Office of Foreign Assets Control (OFAC) has employed financial sanctions against narco-traffickers.<sup>17</sup> While it is doubtful that drug-kingpin sanctions could be used against North Korean persons and companies, providing Treasury with similar sanctions authorities for other major crimes could be useful. Much like what Treasury does now to name persons and businesses which pose proliferation risks, this kind of action is more than symbolic and would give Treasury the ability to put foreign governments and financial institutions globally on notice about DPRK-linked persons and businesses that pose criminal risks. Foreign governments should find these lists useful in determining who might be candidates for lists they themselves maintain.

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<sup>17</sup> Law enforcement reports about the scale of the DPRK’s cultivation, production, and distribution of narcotics and information about the figures who are its drug kingpins evidently never was sufficient to name anyone in the DPRK to OFAC’s list of specially designated narcotics traffickers (SDNT).

In a matching of wits, North Korean employment of countermeasures to dodge sanctions is a well-honed skill. The U.S. has used various trade sanctions against the DPRK since the beginning of the Korean War, and North Korea long ago set up networks of front companies to acquire restricted goods and technologies. Financial sanctions, when first adopted, seemed to catch North Korea by surprise but likely by now the DPRK has begun to adapt by changing names and nationalities used to hold accounts, searching out localities and banks that are lax about enforcing anti-money laundering regulations, and making more use of cash couriers instead of transferring funds via banking channels. Nevertheless, North Korea has not yet been able to regain the degree of access to the international financial system it enjoyed prior to the Section 311 action against Banco Delta Asia that made bankers aware of reputational risks of doing business with the DPRK.

There is substantial room to do more with financial sanctions through enhanced international communication and sharing of information. The adoption of stronger financial sanctions against North Korea, however, must proceed from a realization that the power of this tool derives from an ongoing transition in the international financial environment to rules-based behavior. It is proper to use financial sanctions to help enforce UN Security Council resolutions and discourage DPRK proliferation and illicit activities. But, it would be unhelpful to view all financial sanctions that target the DPRK solely as a way to pressure the regime or to calibrate enforcement to progress, or lack of it, in Six Party Talks or whatever might take their place. The credibility of the Treasury Department and its sanctions authorities would be eroded if rules about dealings with the DPRK were to shift sharply from one day to the next as dictated by changes in the negotiating atmosphere or bargaining tactics. The U.S. stake in maintaining the credibility of its sanctions decisions is broader than the transitory gains to be had in using financial sanctions against North Korea. Banks and other financial institutions which are the front line defenders against money laundering must have confidence that costly administrative requirements imposed upon their operations are neither ill-founded nor arbitrary.