SANCTIONS EVASION AND THE EMERGENCE OF THE INFORMAL ECONOMY IN NORTH KOREA

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Olivia C. Enos, B.A.

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Olivia C. Enos, B.A.
Thesis Advisor: Victor D. Cha, Ph.D.

ABSTRACT

This paper seeks to answer core questions about the development of the informal economy. More specifically, it asks why the leadership in North Korea allows informal economic activities to continue despite the fact than an emerging market economy poses a potentially existential threat to the survival of the Kim regime?

Scholars have traditionally posited one of two theories to explain the emergence of North Korea’s informal economy. The first argument suggests that North Korea permitted informal economic activity to address food shortages in the wake of the famine. The second argument, which is not necessarily contradictory to the first suggests that the Kim regime’s inconsistent attempts to quash market activity were unsuccessful, therefore the elimination of the informal economy is outside the control of the Kim regime.

While neither aforementioned explanation is wholly incorrect, a third, but little explored, alternative explanation contributes to a more comprehensive understanding of the Kim regime’s response to North Korea’s emerging acceptance of the informal economy. This paper proposes that the primary motivation behind the Kim regime’s presently tacit acceptance of the informal economy is due to the regime’s need to evade United States and United Nations (UN) sanctions.

A close look at the timeline of U.S. and UN sanctions suggests a correlation between fluctuations in a crackdown on the informal economy and tacit acceptance of its existence.
Furthermore, a look at trade figures between China and North Korea, and data on the development of markets in North Korea suggests a correlational, if not causal, relationship between sanctions and the emergence of North Korea’s informal economy.
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Introduction

The emergence of informal economic activities in North Korea in the early 1990s was a surprise to the international community. Kim Il-Sung and Kim Jong-Il were known for their dictatorial grip on power, which included a strictly managed economy.¹ That began to slowly change after the conclusion of the famine, also known as the Arduous March period.

This paper seeks to answer core questions about the development of the informal economy. More specifically, it asks why the leadership in North Korea allows informal economic activities to continue despite the fact that an emerging market economy poses a potentially existential threat to the survival of the Kim regime?

Scholars have traditionally posited one of two theories to explain the emergence of North Korea’s informal economy. The first argument, championed by Marcus Noland and Stephan Haggard, suggests that North Korea permitted informal economic activity to address food shortages in the wake of the famine.² Scholars that concur with this theory will note that food provided through the informal market economy relieves pressure on the Public Distribution System (PDS) which the Kim regime has used intermittently to provide food for the North Korean people. This argument is also furthered by evidence that suggests that informal economic

activity has contributed substantially to growth in North Korea’s Gross Domestic Product (GDP).³

The second argument, which is not necessarily contradictory to the first, suggests that the Kim regime’s inconsistent attempts to quash market activity were unsuccessful.⁴ Therefore, the elimination of the informal economy is outside of the control of the Kim regime.

While neither aforementioned explanation is wholly incorrect, a third, but little explored, alternative explanation contributes to a more comprehensive understanding of the Kim regime’s response to North Korea’s emerging informal economy. This paper proposes that the primary motivation behind the Kim regime’s presently tacit acceptance of the informal economy is due to the regime’s need to evade United States and United Nations (UN) sanctions. A close look at the timeline of U.S. and UN sanctions suggests a correlation between fluctuations in a crackdown on the informal economy and tacit acceptance of its existence. Furthermore, a look at trade figures between China and North Korea, and data on the development of markets in North Korea suggests a correlational, if not causal, relationship between sanctions and the emergence of North Korea’s informal economy.

This paper will first define two key terms: informal economy and illicit economy. Second, it will evaluate the strength of the alternative explanations, 1) the emergence of the informal economy as a response to famine and a desire for economic growth and 2) the emergence of the informal economy because the Kim regime has lost control over this component of the economy. Third, this paper will explore the evidence for its primary thesis, that sanctions evasion is a primary explanation for the emergence of the informal economy in North

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⁴ Ibid., Lankov.
Korea. Finally, the paper will conclude with an explanation of the significance of this new finding and its policy implications.

Defining the Informal and Illicit Economies in North Korea

Illicit and informal economic activities are difficult to define and the term informal economy should be understood with a degree of fluidity and flexibility.

For the purposes of this paper illicit economic activity includes activities that the international community deems illegal. This activity is considered “legally unregulated processes of income generation”, but it is more pernicious because it usually negatively impacts the rights of the North Korean people. This paper would contend that the activities deemed illicit are considered illegal by the international community because of these harmful effects. In other words, the international community considers these activities illegal because they are harmful. Examples of harmful illicit activities include human trafficking, drug trafficking, arms trafficking, and counterfeiting currency or goods. The terms illicit and illegal economic activity will be employed interchangeably in this paper.

For the purposes of this paper, informal economic activity constitutes activities that are both unregulated by the state, as well as activities the North Korean government has intermittently deemed to be illegal, but the international community consistently considers as legal activity. An example of this would be North Korea’s 장마당 (jangmadang), or black market, which is intermittently considered illegal economic activity by the North Korean

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6 Ibid., Cheng and Gereffi, p.1.
government, but in any other country its operation would be considered a normal part of the free market.

The term illicit economy will not be used interchangeably with informal economy. The two concepts should be viewed as distinct from each other with the primary distinguishing factor being whether or not the international community deems the activity illegal.

**Alternative Explanations**

*Economic Growth, Famine, and the Informal Economy*

Haggard and Noland convincingly argue that informal economic activity in North Korea began during the famine and post-famine period. It is almost certainly true that the North Korean people’s involvement in informal market activities initially began as a coping mechanism in response to the famine in the 1990s which took the lives of between 600,000 to 1 million North Koreans.\(^7\)

The informal economy is a particularly valuable source of food for North Koreans.\(^8\) One study estimated that “30 percent of major cities in the developing countries depend on the informal sector for 30-50 percent of their food supply and distribution, and more than 20 percent of the cities in the developing countries depend on the informal sector for 50-80 percent of their food supply and distribution.”\(^9\) The informal market has played a particularly important role in providing food for North Koreans where “[i]t is said that after the famine, most farmers

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substantially expanded the scale of private farming. Although the size of kitchen gardens was limited to 100-165m2 by law, there was testimony that “most defectors from rural areas farmed 330-990m2 on average, in addition to the legally permitted gardens, and sometimes paddies of up to 3,300m2”. In fact, it is estimated that at some points, the informal economy constituted as much as 78 percent of the North Korean people’s income. The North Korean people have a clear motive to be involved in the informal economy; their primary goal was survival and the informal economy was sometimes the only place where they could reliably acquire food.

Where Haggard and Noland go wrong is in ascribing the same motive to the North Korean regime as they ascribe to the North Korean people. For example, Haggard and Noland claim that North Korea’s tacit acceptance of the informal economy may be because food supply from the informal economy relieves pressure from the Public Distribution System (PDS).

“Our analysis of the PDS serves one additional purpose. The collapse of the PDS marked a fundamental change in the socialist system of entitlements. Local political officials and households responded by developing a variety of coping strategies, from the diversion of food by cooperative farmers to the stripping of enterprise assets, to the internal migration and foraging, to various forms of trade. When the famine had run its course, the government sought to reassert control. But as a consequence of both policy and these coping strategies, the market began to play an increasingly important role in the allocation of food.”

It is unquestionably in the North Korean people’s interest to acquire food for survival, but Haggard and Noland never explain why it is in the interest of the Kim regime to provide that food. While most governments acknowledge that it is their role to protect and defend the rights of its people, the Kim regime has done no such thing. The findings of the UN Commission of

13 Ibid., Haggard, Noland, Sen, p. 52.
Inquiry (COI) on Human Rights in the Democratic People’s Republic of Korea presented evidence that North Korea may be found guilty of committing, and continues to commit, crimes against humanity. A significant section in the report examined the North Korean people’s right to food and evaluated the Kim regime’s historical policy toward food. Most notably, the COI evaluated violations of the right to food and found

“that aggravated mass starvation, death and other suffering and physical harm resulting from it formed part of a systematic and widespread attack against the civilian population that was based on the State policy to sustain the political system and its leadership at all costs, even at the expense of aggravating starvation and sacrificing a substantial part of the population.”\(^\text{14}\)

Further evidence from the COI suggests that the Kim regime did not care about feeding its people. First, while the Kim regime may have tacitly allowed the emergence of the informal economy after it temporarily abolished the PDS system in 1996, especially after the Kim regime began to encourage the people to assume primary responsibility for their food, the regime’s motive is likely not to supplement the PDS system, but rather to evade its duties of providing food for its own people.\(^\text{15}\) This transition away from the PDS system resulted in mass starvation and a severe deterioration in access to food.\(^\text{16}\) The regime’s allowance of growth in the informal economy was not because it felt any responsibility to feed its people or to augment the PDS system, but rather to shift the risk of providing food from the government to the people.

\(^\text{15}\) Ibid., p. 152.
Second, the COI emphasizes that the Kim regime has historically pursued a policy of *Juche*, or economic self-sufficiency.\(^{17}\) Permitting the emergence of the informal economy, especially if the motive was to supplement the PDS system, completely contradicts the over-arching *Juche* philosophy of the Kim regime.

Furthermore, today, the Kim regime technically has the resources it needs to feed its own people.\(^{18}\) According to one report, the amount of money that North Korea imports in luxury goods and spends on its nuclear and missile programs would be more than sufficient to feed its own people.\(^{19}\) North Korea spent $300 million on luxury facilities, $644 million on luxury goods, and an estimated $1.3 billion on its missile program in 2012 alone.\(^{20}\) In 2015, the U.N. World Food Program asked foreign donors for only $111 million in contributions. This suggests that the Kim regime is willfully depriving its people of the food and resources they need to survive.

This argument, however, should not be dismissed out of hand. Even if Haggard and Noland’s argument regarding the PDS system is unconvincing, the insinuation beneath it – that the Kim regime cares about economic growth and development – is likely an accurate one. Andrei Lankov, for example, estimates that the emerging market economy may account for

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\(^{20}\) Ibid., Stanton.
between 30 to 50 percent of North Korea’s GDP.\textsuperscript{21} The informal economy in North Korea no doubt serves as an engine of economic growth.

\textit{The Informal Economy as Outside the Kim Regime’s Control}

Implicit in Noland and Haggard’s arguments is the notion that marketization and the development of the informal economy was, to some extent, outside of the control of the Kim regime. Supporters of this argument highlight a few key trends.

First, Noland and Haggard highlight that the PDS system began collapsing long before the famine in the early 1990s.\textsuperscript{22} The government’s inability to salvage the PDS system seems to portend an overall loss of control over the broader mechanisms in the economy. Hence, during this time, informal market activities emerged to fill the gap on food distribution.

Second, supporters of this argument point to the Kim regime’s fluctuating policies toward the informal economy. In the early 1990s and during the famine period, for example, the Kim regime did little to crackdown on informal market activities.\textsuperscript{23} This seems to suggest that the regime turned a blind eye toward these activities due to its preoccupation with other challenges. While markets were largely considered illegal in the 1990s, in 2003 the Kim regime legalized the black markets.\textsuperscript{24} But shifting policies in the early 2000s represented the Kim regime’s move toward clamping down on market activities. During this period, especially between 2003 to 2005, the Kim regime intermittently targeted individuals involved in market activities and had a

\begin{itemize}
\item \textsuperscript{22} Stephan Haggard, Marcus Noland, and Amartya Sen, \textit{Famine in North Korea: Markets, Aid, and Reform} (New York: Columbia University Press, 2007), 52.
\item \textsuperscript{24} Ibid., Kim and Moon.
\end{itemize}
stated policy of animosity toward markets. But after this time frame, it once again returned to tacit acceptance of markets and since then has only intermittently prohibited market activities. This seemingly schizophrenic response to market activities, seems to suggest that the Kim regime could not find a way to control markets, so it has accepted their existence.

While it may be true that the Kim regime lost control over growing markets, possibly even that it could not thwart the desires of the people to gain greater access to food, outside information, and goods, this can only partially explain the Kim regime’s permissiveness of markets. The next section will explore the role that external factors, namely sanctions, may have played in the formation of the continued existence of the informal economy in the DPRK.

**The Kim Regime, Sanctions Evasion and the Informal Economy**

The Kim regime’s primary interest is the survival of the regime, and in its mind, the survival of the regime is contingent on North Korea having the weapons capability to defend itself. At present, the primary obstruction to achieving those ends, are U.S. and UN sanctions which were first levied against North Korea in the early 1990s and have continued to ramp up in the present.

An evaluation of the timeline of U.S. and UN sanctions reveals a few key trends. This paper will look primarily at the alleged shift in policy toward the informal economy starting in 2005 and conclude with what we should expect to see as sanctions increased into the mid-2000s.

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Sanctions and the Informal Economy in 2005

One of the Kim regime’s most significant shifts in policy toward the informal economy occurred in 2005. At this time, the North Korean leadership began actively undermining the informal economy and attempted to stem the tide of marketization that began in the 1990s. Interestingly, this change in policy occurred around the same time as the U.S. undertook one of its most significant actions to undermine the North Korean leadership’s access to illicit currency.

On September 15, 2005, the U.S. Treasury Department designated Banco Delta Asia (BDA), a bank in Macao guilty of laundering money for the Kim regime, as a “primary money laundering concern”.26 The use of targeted financial measures against BDA froze about $25 million in North Korean funds.27 Treasury’s primary money laundering concern designation had a chilling affect on the international financial system, and in fact, many other banks from Japan, China, Korea, and the European Union quickly pulled funding and refused to do business with BDA – effectually ending BDA’s operations and substantially curtailing the Kim regimes access to financing.28 Scholars have said that in private conversations with North Koreans, North Korean officials acknowledge that BDA had an impact on the government’s ability to gain access to funding, and not just for their weapons and missile technology programs.29

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29 Private conversations with scholar on North Korea.
In 2002, the Kim regime announced a new economic policy, the Economic Management Improvement Measure, that culminated in a number of economic reforms.\textsuperscript{30} In 2003, the regime implemented the Socialist Market for Goods Exchange which de facto legalized many of the emerging markets for goods.\textsuperscript{31} There is some disagreement over when that policy shifted, but Kim and Moon and Lankov reference a period between 2005 and 2007 when the Kim regime began intermittently cracking down on the markets.\textsuperscript{32} Lankov says that he believes that despite North Korea’s stated intention of cracking down on the markets, in reality, this had very little effect on the North Korean people’s ability to continue informal economic activities.\textsuperscript{33}

“[F]rom 2005 to 2009, the authorities actively took steps to undermine the private economy. In most cases, they did not crack down on the country’s nouveau riche, limiting themselves to administrative restrictions on private sector activities. However, in most cases these restrictions could not be consistently enforced.”\textsuperscript{34}

The assertion that the Kim regime’s crackdown had little to no impact on the growth of markets in North Korea is corroborated by Benjamin Katzeff Silberstein in his study of market growth in North Korea.\textsuperscript{35} Katzeff Silberstein’s findings suggest that between 2003 and 2014 most market growth was marginal. However, in Sinuiju, for example, markets grew by as much as 114 percent.\textsuperscript{36} Katzeff Silberstein’s findings – that market growth continued – are notable

\textsuperscript{31} Ibid, Kim and Moon, p. 19.
\textsuperscript{34} Ibid., Lankov.
\textsuperscript{36} Ibid., Katzeff Silberstein, p. 7.
particularly because the study was conducted in a period when markets should, hypothetically, have contracted due to the crackdown and evolving policies of the North Korean government. Kim and Moon characterized it best; in the early 2000s, “the North Korean regime’s attitude towards the market changed from tolerance to utilization, and it acknowledged markets as a place for trading consumer goods.”

If Lankov and Katzef Silberstein are correct and markets really did continue growing in spite of the government’s crackdown, then why did the regime announce any crackdown at all? Could it be that the regime was incapable of controlling the markets? This is one potential explanation, but a likelier explanation seems to be that the continued growth of markets was a component of the Kim regime’s strategy – possibly in response to the recent levying of BDA sanctions. Since it is an established fact that the Kim regime’s primary interest is in the continued survival of the DPRK, then it would make sense that market activity would be tolerated if it furthers that cause.

At first glance, it may appear that there is little to no linkage between the Kim regime’s policies toward the informal economy and sanctions. However, there are two core linkages that explain the Kim regime’s policy toward the informal economy at this time.

First, when the U.S. levied sanctions against BDA, North Korea was in the midst of Six Party Talks, negotiating with the U.S. over nuclear proliferation issues. The regime sought concessions from the West, hence it was important for North Korea to at least appear to discontinue its pursuit of nuclear weapons activity, among other illicit activities. Since the informal economy is perceived internationally as being connected to illicit or illegal economic

37 Ibid., Kim and Moon, p. 18.
activities, the Kim regime’s decision to crackdown gave the appearance that it was addressing illegality, like money laundering and illegal weapons trafficking, by cracking down on the informal economy.

Second, and most convincingly, the Kim regime needed access to these informal markets to continue its own illicit economic activities. If it cracked down on the mom-and-pop free market activities, which it may very well have done on a small scale, it could increase the market space for its own illegal operations. However, due to the stated crackdown, suspicions of such activities could be decreased. While this may seem like speculation, this hypothesis is corroborated by evidence that North Korea shifted its operational posture toward illicit activities.

According to Sheena Chestnut-Greitens, an expert in North Korea’s illicit economy, 2005 marked a transition in the Kim regime’s illicit economic activities.\(^3^9\) In particular, Chestnut-Greitens draws linkages between the Kim regime’s shifting involvement in illicit activities and the implementation of BDA sanctions.\(^4^0\) In addition to BDA, she notes that the U.S. undertook other efforts to threaten the profits of the Kim regime, including Operation Royal Charm and Golden Dragon which targeted illicit activities and organized criminals in North Korea. All of these operations sent a clear message to the Kim regime – that the U.S. would not tolerate money laundering and other criminal activities which facilitated North Korea’s weapons programs.

Chestnut-Greitens highlighted a number of key changes in how North Korea undertook illicit activities, the most significant for this paper’s purposes include 1) a shift from centralized illicit activities to decentralized activities which shifted the risk of engaging in illicit activities from the government to organized crime groups operating in the informal economy, 2) a new


\(^4^0\) Ibid., Chestnut Greitens, p. 43-44.
geographic distribution of activities that extended beyond the traditional diplomatic routes used by North Korean officials and now shifted to locations where organized criminals were active (like the informal economy), and 3) the participation of more members of North Korean society. In other words, it wasn’t just elites engaged in these illicit activities on behalf of the regime. These shifts are synonymous with the overall thesis that the Kim regime began to make greater use of informal channels, especially the informal markets, and average people, to act as surrogates for the government to seek funding for its continued nuclear and weapons development program.

This decentralization of illicit activities as a response to sanctions is further corroborated by John Park. Park contends that due to sanctions, North Korea has had to find more innovative ways to procure weapons and has therefore resorted to using State Trading Companies (STC)’s – effectively, Chinese middlemen – to do its bidding. While sanctions have driven up the cost of doing business in North Korea, Park contends that they have failed to achieve their original intent (denuclearization) and instead have caused North Korea to work smarter despite the fact that sanctions increased the cost of doing business. Park and Jim Walsh extend this argument in their most recent research, suggesting that North Korea continues to develop coping mechanisms in response to sanctions. Park and Walsh point to BDA and sanctions levied in 2009 after the DPRK conducted a nuclear test as a catalyst for developing such coping mechanisms – including an increasing reliance on markets to evade the effects of sanctions.

“As the DPRK sends people abroad to engage in procurement, more North Koreans learn how international markets work… Some of these markets are legitimate. Others are black, gray, or underground, but they are markets nonetheless… One effect of this process is that an increasing number of North Korean managers are forming their own businesses on the side.”

In short, Park and Walsh’s discussion of “North Korea, Inc.”, or North Korea’s coping mechanisms in response to sanctions, contributes to a greater understanding of the Kim regime’s motives in engaging in the informal economy and lends additional support to the thesis that North Korea permits market activities to bolster its ability to evade sanctions and continue weapons procurement. Contrary to Park and Walsh’s thesis that sanctions have not worked, this author asserts that increasing costs to doing business demonstrates support for rather than against the effectiveness of sanctions. Furthermore, if sanctions act as a facilitator of free market activities, then perhaps sanctions unintended consequences of marketization are on balance a net positive, especially if they positively impact the rights of the North Korean people.

Sanctions Impact on Cross-Border Informal Trade Between China and the DPRK

Park and Walsh’s arguments are further strengthened when viewed in the context of overall trade between China and North Korea. Trade figures support the notion that North Korea has increasingly resorted to coping mechanisms that involve informal economic linkages between China and North Korea. An analysis of trade figures suggests that when the U.S. and the UN institute sanctions against the DPRK, trade between China and North Korea increases. It is a well-known fact that North Korea’s ability to cope with international sanctions has stemmed in part from its alliance and economic relations with the People’s Republic of China. It is also true that much of the informal economic activity that occurs in North Korea is spurred on by cross-

44 Ibid., Park and Walsh, 40.
border exchanges between the Chinese and North Korean peoples.\textsuperscript{45} Haggard and Noland coined the term “marketization from below”, which refers to the development of bilateral trade between China and North Korea in the informal economy.

“This “marketization from below” led to a dramatic expansion in bilateral trade, but in a cross-border setting characterized by the apparent absence of traditional property rights protections, formal dispute adjudication mechanisms, even a published tariff schedule – in short, all of the institutions deemed necessary for efficient exchange.”\textsuperscript{46}

Trade figures between China and North Korea presented by Haggard and Noland in the same paper seem to correlate directly with the implementation of U.S. and UN sanctions.


For example, trade spiked after 1992 when the U.S. implemented targeted financial measures against North Korean manufacturer, Lyongaksan Machineries and Equipment Export Corporation and Changgwang Sinyong Corporation, for their involvement in missile proliferation. These sanctions were some of the earliest implemented by the U.S. against North Korea and they correspond with the initial spike in trade in 1993. The increase in trade in 1997 may also correspond with sanctions implemented by the U.S. against Iran and North Korea on May 24, 1996 for missile technology transfers. The next spike in trade occurred in 2005, which also seems to correspond with sanctions, as discussed earlier in this paper, against Banco Delta.

Source: Figure 1: Haggard and Noland, Integration in the Absence of Institutions: China-North Korea Cross-Border Exchange, p. 28

48 Ibid., Davenport.
Asia.\textsuperscript{49} The significant increases in trade between 2003 and 2009 correspond with an increase in sanctions implementation, this time by both U.S. and UN bodies.\textsuperscript{50} Of particular note are the substantial increase in UN Security Council actions against North Korea which began in 2006 with UN Security Council Resolution 1675 and then in October 2006 when the UN Security Council adopted Resolution 1718.\textsuperscript{51} During the implementation of UN sanctions, total trade between North Korea and China increased rapidly.

Additional support for the connection between sanctions and cross-border trade between China and North Korea is derived from the periods where trade dipped. For example, the dip in Chinese imports from North Korea in 2007 corresponds with the U.S. decision to unfreeze the $25 million in assets the U.S. froze from BDA.\textsuperscript{52}

While this analysis is not perfect, and correlation does not equal causation, analysis of trade figures lends insight into the potential linkage between sanctions implementation and resulting marketization. It also lends insight into the Kim regime’s motives for marketization. In short, trade figures suggest that North Korea resorts to cross-border trade (both informal and formal) as a coping mechanism in response to sanctions.

It is worth noting that many sanctions were implemented during this time period and, as a general rule, spikes only resulted when certain types of sanctions were instituted. Increases in trade between North Korea and China primarily happened when targeted financial measures were instituted (for example, Banco Delta Asia) and when UN multi-lateral sanctions were implemented. This growth in informal market activities during these time frames may lend

\textsuperscript{49} Ibid., Davenport.
\textsuperscript{50} Ibid., Davenport.
\textsuperscript{51} Ibid., Davenport.
\textsuperscript{52} Ibid., Davenport.
support to those who contend that targeted financial measures and multilateral sanctions are more effective than unilateral trade-based sanctions in their application against the DPRK.

It is also worth noting that growth in the informal economy as a correlate of sanctions is not unique to North Korea. In fact, studies suggest that U.S. sanctions implemented against South Africa, Iran, and Afghanistan had a similar impact on growth in the informal sector.\(^5^3\) Sanctions often force people and governments to resort to alternative means of provision – sometimes this results in growth in the illicit economy, sometimes in the informal economy, but most often, it results in growth in both.

*What to Expect in the Future*

This paper primarily evaluates the historical impact of sanctions, with a special emphasis on the 1990s and 2005 period of sanctions implementation. However, if the Kim regime really engages the informal economy to hedge against the impacts of sanctions, then as sanctions increase, we should expect to see an increase in marketization in North Korea.

Immediately following North Korea’s cyber attack on Sony Pictures, the Obama administration ramped up sanctions against North Korea, even going so far as to designate Kim Jong-Un for his human rights abuse.\(^5^4\) It is too soon to tell first whether these sanctions resulted in growth in the informal economy or caused the Kim regime to resort to illicit economic activities in the informal economy. It is also too soon in the Trump administration to tell whether

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the new president will continue to implement strong sanctions against the Kim regime. However, if strong sanctions continue to be implemented, the U.S. expect to see growth, even if marginal, in the informal economy.

**Conclusion**

As outlined above, substantive academic research seems to suggest that the Kim regime has allowed the continuation and even growth in the informal economy in order to evade sanctions. Since sanctions pose a severe threat to the regime, particularly its ability to pursue nuclear and missile proliferation, the regime seems to permit informal market activity. If this is the case, it should have significant implications for future policy toward the DPRK.

**Substantive Trends and Policy Implications**

**Key Trends**

This paper sheds light on a number of trends stemming from the Kim regime’s permissive treatment toward the informal economy in response to sanctions. These findings have implications for future policy and could shape how experts view the use of sanctions.

If the Kim regime uses the informal economy to evade sanctions, then sanctions, when used carefully, have the potential to encourage marketization in North Korea. While Park and Walsh are generally critical of sanctions, using their analysis of North Korea’s employment of coping mechanisms to critique the use of sanctions, this paper asserts that sanctions positive unintended consequences have the potential to offset some of their perceived failures. While Park and Walsh are correct to assert that sanctions have not entirely prevented nuclear or missile proliferation in the DPRK, they too quickly dismiss the potential benefits that stem from the coping mechanisms
undertaken by the North Korean government and people that result in overall growth, or at least
the allowance, of informal market activities.\textsuperscript{55}

This paper does not directly answer questions regarding the effectiveness of sanctions. However, if sanctions evasion is a key motivation behind the Kim regime’s permissiveness
toward the informal economy, then sanctions, in facilitating growth in the informal economy,
have positive, unintended consequences for the rights of the North Korean people. Growth in the
informal economy alleviates hunger, provides an alternative source of income for North Koreans,
and enables outside information to penetrate the information firewall erected by the Kim regime.
On average, the North Korean people’s activities in the informal economy have served to
advance their rights and serve as an alternative to the draconian policies of the Kim regime.

In addition to the benefits listed above, the opening of the informal economy has three clear
benefits for the North Korean people. First, informal markets expand freedom of movement.
Numerous defector reports suggest that North Korean border guards can be bribed to look the
other way as ordinary North Korean citizens cross the border to China to operate informal cross-
border businesses.\textsuperscript{56} This has expanded access to opportunity, but also increased opportunities
for defection. Over 30,000 refugees have fled North Korea and today reside in South Korea.\textsuperscript{57}
According to South Korea’s Ministry of Unification, defections rose between 2005 and 2009

\textsuperscript{55} John Park and Jim Walsh, “Stopping North Korea Inc.: Sanctions Effectiveness and Unintended
Consequences,” MIT Security Studies (August 2010): 20,

\textsuperscript{56} Byung-Yeon Kim and Yu Mi Koh, “The Informal Economy and Bribery in North Korea,” MIT Press Journal, 
Asian Economic Papers 10, no. 3 (2011): 1, accessed May 1, 2017, 
http://www.mitpressjournals.org.proxy.library.georgetown.edu/doi/pdf/10.1162/ASEP_a_00092. And Kim

\textsuperscript{57} “Number of North Korean Defectors in South Tops 30,000”, Yonhap News, November 13, 2016,
(during a period of heightened sanctions), but fell between 2011 and 2015 due to the Kim regime’s intermittent tightening of border security. In short, growth in the informal economy is empowering the North Korean people and improving freedom of movement for North Koreans.

Second, growth in the informal economy increases the availability of food and goods. As discussed earlier in the paper, the informal economy served as an important source of food for the North Korean people during the famine period, and greatly increased the income of average North Korean families. It is also a valuable conduit for goods like radios, cell phones, televisions, and USBs, which (as will be discussed further) improves access to information.

Third, access to the informal economy increases the availability of outside information. Increased access to information has historically been a key driver of change in authoritarian regimes. Beyond that, in North Korea, many defectors cite access to outside information as a key driver behind their decision to defect. For example, famed North Korean refugee Yeonmi Park said that watching the film, The Titanic, led her to realize the discrepancies in wealth between North Korea and the outside world and was a catalyst for her decision to defect. Apart from the informal economy, many North Koreans might never gain access to outside information.

58 Ibid., Yonhap.
As highlighted in this paper, growth in the informal economy can increase the incidence of criminal activity like human trafficking, drug trafficking, counterfeiting in money, illegal weapons transfers, and weapons trafficking, among other nefarious activities. Acknowledging the existence of illicit activities occurring in the informal sector is critical to developing policies that advance the economic benefits derived from marketization in the informal sector. This insight should inform future U.S. policy towards sanctions and the informal economy in North Korea.

Policy Implications

If the Kim regime permits growth in the informal economy in order to evade sanctions, there are a number of policy implications that should follow.

First, the U.S. government and the international community should consider ways that it can encourage the growth of marketization in the informal economy in North Korea without encouraging illicit activity. Clearly, the informal economy is a potentially important force for positive change in the DPRK. And the porous nature of some parts of the North Korean border, provide opportunities for U.S. policy to expand information operations. The U.S., South Korea, and other influencers in the international community should take advantage of the opening in the North Korean economy to improve information access in the Kim regime. The U.S. and South Korea should continue efforts to spread information through the use of radio and other technologies. In particular, foreign governments should explore options for application of emerging technologies, including expanding the availability of Wi-Fi and further dissemination of information through thumb drives, among other means of improving information access.  

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The U.S. and South Korea should also increase funding for radio broadcasts and hone their messaging and tactics to ensure that such efforts effectively reach North Koreans. While access to information alone cannot lead to regime change, it does have the positive side-effect of empowering the people of North Korea to make decisions for themselves regarding whether they will stay in North Korea and be a force for change within the country, or flee the Kim regime to seek freedom abroad.

Second, the U.S. and the international community should more closely monitor and evaluate growth in the informal economy. Such studies could inform the U.S. and the UN about the effectiveness of sanctions. If markets are growing, for example, this could be an indication that the Kim regime has had to change its behavior in response to sanctions and is seeking alternative pathways to acquire weapons and funding for weapons programs. Such studies could inform additional pathways for the use of sanctions implementation and serve as a sort of barometer for determining sanctions effectiveness. Such studies could also inform the international community about which sanctions are effective and which ones are not. For example, this study seems to suggest that targeted financial measures and multilateral sanctions are more effective than unilateral trade-based sanctions.

Third, any efforts undertaken to strengthen the informal economy should acknowledge the potentiality for such marketization to be misused by organized criminals or the Kim regime themselves. The porous nature of the informal economy presents opportunities to the North

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Korean government to use and abuse the informal economy to engage in illicit economic activities, including human, drug, and weapons trafficking. It also provides additional markets for money laundering and the counterfeiting of currency and goods. Of course, as highlighted in this paper, it can also be used to continue the proliferation of nuclear and missile technologies. Hence, the very market that could be a force for positive change for the North Korean people could also be turned and misused by authorities in the DPRK. Any U.S. policies that seek to enhance the informal economy should recognize the potentialities for the Kim regime to exploit market forces for its own nefarious purposes and implement policies that shift the risk calculus of the Kim regime without challenging the people’s access to outside information and goods.

Fourth, this paper tells us something about the potential effectiveness of sanctions. While the purpose of this paper is not to answer whether sanctions are an effective tool for achieving denuclearization or ending North Korea’s missile proliferation, it does highlight some of sanctions impacts. For one thing, this author believes that Park and Walsh ignore critical aspects of their own paper which acknowledges that while sanctions policies may not yet have achieved their original goals – the prevention, and now dismantlement of North Korea’s nuclear and missile weapons programs – sanctions resulted in a shifting risk calculus that forced the Kim regime to expend more time and resources in their quest for nuclear and missile technology. Park and Walsh’s argument – that North Korea has adopted coping mechanisms in response to sanctions – at the very least acknowledges sanctions ability to influence behavior and at best is an argument in favor of, rather than against sanctions. This should cause the U.S. government to more carefully consider how it can better influence the Kim regime’s behavior.
Conclusion

There are many reasons that the Kim regime permits the existence of the informal economy. Since the Kim regime primarily desires the survival and continuation of the DPRK, it makes sense that the regime’s decision-making paradigm would be partially dictated by actions taken to threaten its viability.

A close look at U.S. and UN sanctions policy reveals particular shifts in the Kim regime’s behavioral responses to sanctions, which it views as a direct threat to the regime. An especial focus on the Kim regime’s response after the U.S. levied sanctions against BDA demonstrates a shifting risk calculus – one that permits the existence of the informal economy so long as it furthers the goals of the regime. In order to ensure its survival, the regime must engage in illicit activities and has used the informal and illicit economies to accomplish those ends.

This paper contributes positively to the policy conversation by lending additional insight into the Kim regime’s risk calculus and use of the informal economy to evade sanctions. Most notably, in highlighting the Kim regime’s changing stance toward the informal economy in response to sanctions, this paper lends insight into the type of sanctions that have the greatest ability to influence the regime’s actions.

Armed with this information, the U.S. should seek to better its sanctions policy in a way that encourages growth in the informal economy and benefits the people of North Korea without inadvertently strengthening the Kim regime. The pursuit of such policies may require a shift in sanctions policies that targets entities engaged in illicit activities in the informal market while still encouraging the conduct of legal business. To undertake such a shift in policy has the potential to advance the rights of the North Korean people.
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