

Sanctions and Consequent Effects on North Korea's Trade

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I. Introduction

The international community's sanctions against North Korea (DPRK) have been tightened since 2006, as the DPRK continuously implemented nuclear tests through which smaller and technologically advanced nuclear bombs and ICBMs were tested out. When the DPRK conducted its 1st nuclear test in October 2006, the international community needed only less than a month to draw an agreement which aimed to deter the DPRK from conducting further nuclear tests, and began to put pressure on the DPRK to suspend all nuclear-related activities via UN Security Council Resolution 1718 (UNSCR 1718). When the DPRK conducted its 5th nuclear test on September 9, 2016, circumstances changed. This time it took the international community more than two months to determine what measures should be applied to pressure the DPRK to cease any additional nuclear provocations. Eventually the UN passed UNSCR 2321 on November 30, 2016. However, circumstances related to the nuclear program in the DPRK and the responses of neighboring countries to it have changed.

As the DPRK continues to develop its nuclear program, the characteristics of sanctions against the DPRK have changed as well. The 1st sanction against the DPRK was characterized by so-called targeted or smart sanctions, limited to regulating suspicious people, funds, and trade items that are directly related to the nuclear program. Thus the existing UN sanctions against the DPRK were largely considered to have had no significant impact on its economy. However in 2016, UNSCR 2321 sanctions against the DPRK have been transformed into pressurized sanctions that could directly impact DPRK exports beyond the smart sanctions, and the DPRK's economy is expected to encounter serious economic difficulties due to these measures in 2017.

UNSCR 2321 was not the only sanction that impacted the DPRK economy. In the past, neighboring countries' bilateral sanctions against the DPRK, including complete suspension of trade with the DPRK, had a direct impact on the DPRK economy, beginning with Japan in 2006 and South Korea in 2010. The neighboring countries' bilateral sanctions, which are separate from the smart sanctions of the UN, had a direct impact not only on the

economy but also the lives of its citizens due to their prohibition of any economic relations with the DPRK. Since then DPRK trade has undergone fundamental changes, including an increased trade dependence on China and a reduction in the variety of export items such as coal, iron ore, and textiles.

This paper aims to show how neighboring countries' bilateral sanctions have changed the trade patterns of the DPRK, and how extensive they are. We can see how much the DPRK has sacrificed its potential growth to pursue its nuclear program, and how it would recover if the DPRK freezes its nuclear program and sanctions by its neighbors are subsequently eased or lifted.

II. Sanctions and consequent changes in DPRK's trade

Sanctions against the DPRK caused changes in trade patterns, which is referred to as trade diversion. The sanctions sender cuts off economic relations including trade to achieve its goal, and the sanctions target country diversifies its trade routes to minimize the negative effects of sanctions.

Trade diversion can be decomposed into four categories: trade suspension, trade substitution, detour (bypass) trade, and trade creation. The DPRK's changes in trade are an exemplary case of trade diversion after bilateral sanctions were imposed by Japan (in 2006) and South Korea (2010).

The most drastic form of change in the DPRK's trade had been trade suspension after the sanctions have been imposed. Roughly, about \$189 million's worth of trade was suspended between the DPRK and Japan after

2006, and about \$298 million has been suspended in inter-Korean trade after 2010 (Table 1). To maximize the effects of sanctions, trade suspension in particular, the sanctions sender country would utilize all economic means such as secondary sanctions by penalizing foreign companies' trade with the target country. However, Japan and South Korea have not yet applied secondary sanctions to sanction the DPRK.

Table 1. Trade Suspension after Bilateral Sanctions

Unit: million USD, (million USD)

	DPRK's Annual Trade (Average)		
	2004-2006	2007-2009	2010-2012
Japan	189 (0)	7 (-182)	0 (-7)
South Korea	232 (0)	373 (+75)	75 (-298)
China	1,555 (0)	2,483 (+928)	5,049 (+2,566)

Source: Choi, Lim, Rhee, and IM. (2016). P.60

Trade substitution is the next significant change in the DPRK's trade, in which the target country increases trade with existing trade partners other than the sanctions sender countries. In the case of the DPRK, after Japan's bilateral sanctions, South Korea and China became target countries of its trade substitution. In 2006, inter-Korean trade soared by 113.1%, and trade between the DPRK and China increased by 95.2%, substituting its previous trade with Japan. In 2010, trade between the DPRK and China increased by 195.0% due to South Korea's sanctions.¹ The DPRK's trade dependence on China has exceeded 90% since 2014, mostly driven by bilateral sanctions by Japan and South Korea.

¹ This is an approximate estimate, since it may also include non-sanctions related increases.

Detour (bypass) trade is the unintended effect of sanction. Regardless of the sanctioned country's intentions, even after the sanctions the target country's trade with sanctions sender country is likely to be maintained due to preexisting economic relations via a third country, instead of direct trade between sanctions sender and target countries. However, detour trade does not always violate the sanctioning country's legal or institutional restrictions. With the development of global value chains, products from the sanctions target country could be traded with the sender country through an import-processing-export sequence via a third country, and it is almost impossible for the sanctioning country to regulate all these activities. After Japan's bilateral sanctions against the DPRK in 2006, the average annual detour trade between the DPRK and Japan via China is estimated to be about 2.1% of the total trade between the DPRK and China during 2007-2009. We were not able to estimate detour trade between the DPRK and Japan via South Korea due to data constraint. After South Korea's bilateral sanctions against the DPRK in 2010, the average annual detour trade between the DPRK and South Korea via China accounted for 5.6% of the total trade between DPRK and China during 2010-2012, and those between the DPRK and Japan via China accounted for 2.6% of the total trade between the DPRK and China.

Trade creation refers to the commencement of trade with a third country other than existing trade partners after sanctions are imposed. The DPRK has not had a sizeable amount of trade creation with a third country due to economic sanctions by the international community.

III. Prospects for Sanctions: Tighter or Looser?

Changes to the sender countries' sanctions against the DPRK would take the form of either tightening or loosening of the sanctions. If the DPRK would continue to implement nuclear missile tests or develop other weapons of mass destruction (WMD), sanctions would not only continue, but also are likely to be strengthened, as can be seen in the recent UN-SCR sanctions mandate adding 15 DPRK individuals and 4 entities in the sanctions blacklist in early June. Further missile tests may entail strengthened sanctions such as secondary sanctions via limiting financial transactions, and further limitations on exportation of DPRK main export items such as coal and iron ore, as well as its revenue generating items such as textile and seafood items. Such measures would also aim to deter foreign currency inflow through tighter monitoring and sanctions against overseas labor dispatch, which had been already mentioned in previous UN sanctions.

However, in order for the sanctions to be effective, the cooperation of the DPRK's major trade partner and key patron, China, is imperative. In order to induce China to actively join in on sanctions against the DPRK, several conditions need to be met. First, there needs to be a consensus among South Korea, the US, and China regarding the future path of the Korean Peninsula. The reason why China is showing lukewarm action in sanctioning the DPRK is because of the fear of damage to its geopolitical interests in the event of sudden collapse or instability of the DPRK. In order to induce China to actively participate in the sanctions, it needs to be confident that a unified Korea would not harm its geopolitical interests in any way. Second, one of the big-

gest obstacles against a security consensus among South Korea, the US, and China regarding the DPRK issue is the lack of trust on security policies, as exemplified in the recent THAAD placement on the southern part of the peninsula. South Korea and the US are trying to convince China that this is only a measure to deter the DPRK's nuclear threat, but China construes it to be an excessive measure and as a threat to its own security in disguise. The DPRK's geopolitical value to China increases as diplomatic and security uncertainty increases on the Korean Peninsula. Therefore for a strategic consensus among the parties involved, there first needs to be reconciliation and talks regarding the THAAD placement on the peninsula. Third, in order to enforce secondary sanctions there needs to be an agreement between the US and China regarding the extent to which and the specific objects that sanctions may apply. For example, they may be able to agree on sanctioning entities or financial institutions that engage the DPRK, but limit sanctions against the parent companies.

Conditions for loosening sanctions would require the DPRK's suspension of its development of WMDs, including its nuclear weapons program. There are largely three types of sanctions imposed against the DPRK. First is sanctions that are direct responses to the DPRK's WMDs, such as the UNSC resolutions first initiated in 2006. If the DPRK relinquishes its development of WMDs, the sanctions would be lifted and the sanctions imposed after 2006 may be gradually lifted. Second, there are sanctions that have been imposed in response to events that had no direct relation to WMDs, such as South Korea's 5.24 measures or suspension of the Geumgang Mountain tourism. These sanctions would not be lifted by the DPRK's terminating development of WMDs, but they may serve as useful economic levers in terms of South Korea's or Japan's bi-

lateral relationship with the DPRK. Third, there are sanctions that were imposed as a response not only to the DPRK's WMD programs but also to other various issues. Examples would be South Korea's closure of the Gaesung Industrial Complex, or Japan's sanctions. The US's bilateral sanctions also are based on multifaceted issues that require the DPRK not only to relinquish its WMD programs but also to improve the situation of being a security threat to US allies, as well as to reform its non-market system and improve dire human rights conditions in the country.

Despite the fact that causes for sanctions are multi-faceted, the main impetus for any easing of existing sanctions would come from the DPRK's suspension of its WMD development, including its nuclear weapons program. Since the DPRK has allegedly already developed WMDs, a future denuclearization process should follow three steps: a. freezing and declaration of its nuclear weapons development program, b. inspection, verification, removal of nuclear material, and disposal of nuclear weapons, c. demolition of nuclear facilities and nuclear programs. In response to the DPRK's freezing and declaration to the IAEA of its nuclear weapons programs, the international society can respond as follows: a. South Korea can resume the operation of Gaesung Industrial Complex, restart the Geumgang Mountain tourism, and lift the 5.24 measures; b. Japan can lift the sanctions it had imposed in response to the DPRK's 4th nuclear tests and ease its July 2014 sanctions; c. the US can remove the sanctions related to DPRK's development of WMDs; d. the UN can lift sanctions related to DPRK exports of minerals and/or supply of jet fuel. Pending the IAEA's subsequent completion of inspections of nuclear development facilities and confirmation of disposal of nuclear materials and weapons, the international society can respond as fol-

lows: a. the UN can lift all sanctions against the DPRK except the trade of 7 major conventional weapons; b. South Korea and Japan can lift all sanctions against the DPRK; c. the US can lift the 2006 North Korea Sanctions and Policy Enhancement Act, and begin to lift other sanctions against the DPRK according to its domestic legal procedures. In the event that the IAEA verifies the complete dismantlement of DPRK nuclear facilities and programs, the UN and US can lift all remaining sanctions against the DPRK.

Strengthening the sanctions would directly impact the DPRK economy and cut off most of its trade with the outside world, which would result in shortages of food and daily necessities. China would also be impacted by the sanctions, especially in its northeast provinces. However, China's economic damages would be insignificant compared to its potential political and symbolic damages. In the case that sanctions are eased, the DPRK's bilateral trade with South Korea and Japan would increase dramatically, while existing detour trade via China would decrease.

IV. Policy Implications

Sanctions against the DPRK have been effective in some aspects but also entailed unexpected results. Due to sanctions, higher pressure from the international society has mounted upon the DPRK economy, and it has been increasingly difficult for the DPRK to generate foreign currency. It has also seen a decrease in its variety of trade items, especially in terms of its detour trade. Although it is difficult to determine whether this was solely the result of sanctions, such a trend has been acting as a pressure on the DPRK economy. However, on the flipside, despite sanctions, the DPRK's total trade volume has continuously increased, and its trade dependency on

China has intensified. Detour trade, especially textile trade, has continued to increase despite sanctions, and items are constantly being exported to and imported from sanctions sending countries such as South Korea and Japan via bonded trade zones in China.

Therefore, in order to increase the effectiveness of the sanctions, China's contribution is critical. If sanctions continue to be imposed without China's active participation, what is left of the existing inter-Korean economic cooperation is likely to shift completely to other neighboring countries, namely China and Russia. In order to avoid this scenario, there needs to be close cooperation and consensus among South Korea, US, Japan, and China, especially on the imminent THAAD issue. Also, in China's case, in the event that the DPRK conducts a nuclear or long-range missile test, it has been imposing short-term trade sanctions (lasting about 2-3 months). South Korea can also adapt such short-term sanctions, such as temporarily closing down the operation of the Gaesung Industrial Complex rather than permanently burning bridges, which completely terminates future bargaining options.

Without the sanctions, South Korea is naturally the biggest trading partner of the DPRK. Although detour trade via China existed prior to sanctions, its volume has increased drastically after sanctions. If sanctions are lifted, inter-Korean trade will increase significantly and DPRK trade with China will comparatively decrease. Maintaining economic cooperation between the two Koreas is extremely important not only from a political perspective, but also in the aspect of preparing for unification in the long term. Although at the present fully resuming inter-Korean economic cooperation is impossible due to the DPRK's continued development of WMDs, it is imperative to gradually resume economic exchanges as an

exchange for the resumption of negotiations to freeze WMD programs and/or full-fledged denuclearization. A small step towards this would be informal talks to draw out the DPRK to the six-party talk framework, such as the informal meeting between US and DPRK government officials in Malaysia last October. South Korea should also take the initiative and actively engage in such informal talks in order to participate in the discussion that would shape the future of the peninsula. **KIEP**

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