Cause for optimism? Financial sanctions and the rise of the Sino-North Korean border economy

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Cause for Optimism? Financial Sanctions and the Rise of the Sino-North Korean Border Economy[1]

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Introduction

North Korea is one of the most heavily-sanctioned states in the world. Indeed, since the breakdown of negotiations after the Leap Day Agreement in 2012, sanctions have become the primary means whereby the United States, its allies and the broader international community via the United Nations Security Council have sought to exert pressure on the North Korean regime. Increasingly stringent sanctions have, however, failed to dissuade Pyongyang from developing weapons of mass destruction (WMD) or from engaging in illicit activities designed to support their development. As the broader literature on international sanctions suggests, this failure should not be surprising. Sanctions analysts have long argued that target states find it relatively easy to circumvent sanctions, and that sanctions can actually serve to strengthen rather than undermine the domestic political authority of the target state.

More recently, however, a more optimistic body of literature has emerged that has enthusiastically celebrated financial sanctions as an effective means of imposing broad economic costs on targeted states (Zarate 2013; Arnold 2016; Torbat 2005; Loeffler 2009).

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Such measures work by explicitly proscribing third party banks from engaging in financial dealings with target state entities, and more broadly, by enforcing global norms and standards on international banks regardless of their geographical location. Banks that fail to adhere to these standards face the possibility of being shut out of the dollar-based international financial system. As such, the potential profits to be made through sanctions evasion are outweighed by the costs of being labelled a "money-laundering concern." Here, the case of North Korea has frequently been cited as a successful instance of this approach. The US Treasury's action against Macao's Banco Delta Asia (BDA) in 2005 ostensibly demonstrated the extent to which it was possible to exert pressure on a third-party private financial entity to cut its ties with so-called “rogue regimes.” As Juan Zarate notes, as a result of the actions against BDA, "... North Korea found its bank accounts and illicit financial activity in jeopardy. A North Korean deputy negotiator at the time quietly admitted to a senior White House official, 'You finally found a way to hurt us'" (Zarate 2013).

In this article, we challenge this optimistic assessment of financial sanctions through a re-examination of the North Korean case. On the one hand, the case for North Korea as testament to the efficacy of financial sanctions is undermined by the straightforward fact that the strengthening of those sanctions and the isolation of the country from the international financial system has not led to any significant macroeconomic impact on the North Korean economy. Conversely, the strengthening of financial sanctions has coincided with an increase in North Korea's external trade and gradual improvement in several industrial sectors. This challenges the case for financial sanctions since although such measures are in the first instance aimed at targeting illicit financial dealings, their effectiveness is also deemed to be related to the fact that they are able to isolate the target state completely from the international financial system and, by doing so, exert considerable economic pressure on the target state.

This argument is made through an analysis of the relationship between financial sanctions and the Sino-North Korean border economy. The reasons for this focus are twofold. First, it is no exaggeration to say that the Sino-North Korean border economy has become central to North Korea's economic survival. As our analysis suggests, however, financial sanctions are, as with more traditional and smart sanctions, susceptible to evasive strategies. Our focus on the Sino-North Korean border economy is also advantageous in methodological terms. In contrast to more overtly illicit activities aimed at supporting Pyongyang's WMD programme, it is considerably easier to conduct a reliable analysis of North Korea's external economic relations through examining Chinese customs statistics and conducting field research in the Chinese border regions.[2] Indeed, the fact that Sino-North Korean trade now accounts for the vast majority of North Korea's total external trade means that the impact of financial sanctions on the country can be more accurately examined. Specifically, we ask the question of what impact financial sanctions have had on methods of trade settlement and transactions within the border economy. As we argue, the failure of financial sanctions to exert any discernible macroeconomic pressure on the North Korea economy is largely a result of the manner in which they have encouraged the use of cash and barter in trade settlement as well as the persistence of certain forms of smuggling. Moreover, the tightening of financial sanctions has also meant that North Korean financial institutions have themselves increasingly utilised informal cross-border networks. The case study of the Sino-North Korean border economy thus challenges the optimism of the financial sanctions literature and calls for greater consideration of how actors are able to deploy strategies of evasion.

Before we proceed, it is necessary to briefly discuss issues relating to the generalisability of the case study. On the one hand, the failure of financial sanctions to have any marked impact on North Korean elites' might not come as a surprise to the majority of sanctions analysts. The authoritarian nature of the regime, the apparent elite unity over the pursuit of nuclear weapons, and the limited nature of the country's integration into the global

[2] This analysis is based in part on field research in China's northeast cities of Dandong, Shenyang, Yanji, Hunchun and their neighbouring regions between 2009 and 2016, involving in-depth semi-structured interviews with Chinese business people engaged in trade and investment with North Korea, and several Chinese government officials and researchers. The identities of the interviewees have been kept confidential due to their concerns regarding potential negative repercussions vis-à-vis both the Chinese and North Korean authorities.

economy all serve to make North Korea a least likely case for the efficacy of conventional sanctions. Our objective here, however, is to analyse the prior issue of the impact of sanctions on the target state's external relations and the failure of financial sanctions to exert economic pressure on the country's leadership. Clearly the case study possesses a number of idiosyncratic features. For example, China's lax enforcement of trade sanctions is often considered to be central to the broader failure of international sanctions against North Korea. The financial sanctions literature claims, however, that such measures are capable of enforcing compliance of otherwise reluctant third party countries. This, combined with the prominence of North Korea within the broader literature on financial sanctions, serves to underline the importance of the case study with regards to debates concerning the efficacy of financial sanctions.

From Trade to Financial Sanctions

The mainstream sanctions debate has produced a sizable literature focusing on the question of whether sanctions are effective tools of statecraft or not. “Effectiveness” here is understood to denote the extent to which sanctions are capable of altering the behaviour of the target state, or more ambitiously, of facilitating regime change within the target state (Hufbauer et al. 1990; Pape 1997; 1998; Elliott 1998). Commonly regarded as representative of the optimistic camp in terms of the effectiveness of sanctions, Hufbauer et al. conducted a study of 115 cases of largely trade-based sanctions between 1914 and 1990, and found that sanctions were at least partially successful in just 34 per cent of all the cases. As such, they concluded that sanctions are of limited utility in achieving foreign policy goals aimed at compelling a target country to take actions it resists, though they noted that the success rate varied in accordance with the type of policy or governmental change sought (Hufbauer et al. 1990, pp.92–93). Other accounts have argued that even this analysis overstates the success rate of sanctions. Robert Pape, for example, re-examined Haufbauer et al.'s database and argued that almost none of the claimed 40 cases of effective economic sanctions can realistically be interpreted as "successful." According to Pape's analysis, 18 of Hufbauer et al.'s cases were in reality settled either by the direct or indirect use of force. In a further eight cases, Pape found that there was no evidence that the target state made the demanded concessions, six cases did not qualify as instances of economic sanctions, and a further three were indeterminate. As a result, only five of Hufbauer et al.'s 115 cases can properly be regarded as "successes" (Pape 1997, p.93).

There are many reasons for the low efficacy of trade-based sanctions. These include, for example, the relative ease with which target states are able to evade sanctions. In Galtung's study of Rhodesia in the 1960s, the latter's extensive land borders and opportunities for smuggling played a key role in undermining the impact of multilateral sanctions (Galtung 1967, p.398). Indeed, as Hufbauer et al. themselves point out, "... a sieve leaks like a sanction. Ingenious new trading relationships, devised by domestic and third-country firms, flower because it is difficult to trace the origin and destination of traded goods" (Hufbauer et al. 1990, p.106). Such evasion strategies may also have more deleterious outcomes. In the case of the Federal Republic of Yugoslavia in the 1990s, for example, trade-based sanctions contributed to the criminalisation of the state, economy, and civil society of both the targeted country and its immediate neighbours, thereby fostering a symbiosis between political leaders, organised crime, and transnational smuggling networks (Andreas 2005). Comprehensive trade sanctions have also been criticised due to their excessive human costs, as demonstrated in Iraq during the 1990s (Halliday 1999). Indeed, the fact that it was military action that ultimately toppled Saddam Hussein only served to increase the general pessimism towards trade sanctions as a tool of foreign policy.

The poor record of trade sanctions at achieving their stated objectives as well as their significant secondary effects led in the 1990s to a shift in emphasis towards so-called "smart sanctions" that include measures such as travel bans and asset freezes that are directed more towards key individuals in the target regime leadership (Cortright & Lopez 2002). Smart sanctions have, however, similarly come under increasing critical scrutiny in recent years. This is in part a result of the questionable theoretical assumptions that underpin them. As Lee Jones has argued, comprehensive trade sanctions were founded on the liberal understanding of human subjects as rational utility maximisers and the related assumption that if sanctions produced enough suffering within the target society, popular discontent would force the ruling elite to change their policies. Smart sanctions, on the other hand, reverse that assumption in viewing human subjects as incapable of exerting pressure on their governments and as vulnerable victims of the regime (L. Jones 2015, p.19). However, it has been argued that the very fact that smart sanctions do not aim to impose significant costs on the target economy means that they have been even less successful in generating policy concessions than comprehensive embargoes (Drezner 2015). As such, the fact that smart sanctions have not proved demonstrably more effective than traditional sanctions (Elliott 2002) has contributed to increased pessimism towards such measures.

An exception to this pessimistic view of sanctions efficacy has been the increased popularity of financial sanctions in the post-9/11 era, which are deemed capable of inflicting considerable costs on the economies of target states (Torbat 2005). Financial sanctions work by pressuring banks rather than governments to act as agents of international isolation. Typically, the US Treasury issues watch lists and banks are then expected to block suspected assets and transactions, thereby cutting individuals and organisations off from the global financial system. Reputational concerns regarding the danger of being labelled a "money laundering concern" mean that even non-US banks have strong motivations to adhere to Treasury watch lists even when they are not required to do so by domestic or international law (Loeffler 2009).

As such, the efficacy of financial sanctions is understood to stem from the hegemonic position that the US occupies in global finance. As Drezner notes, international actors need access to US capital markets and particularly to US dollars in order to conduct cross-border transactions. This access matters more to banks and non-bank financial actors than any potential profit that may come from violating Treasury warnings. This means that whereas market forces tend to weaken trade-based sanctions, they serve to strengthen financial sanctions (Drezner 2015). Thus, as Zarate has argued, financial sanctions have become indispensable in targeting and isolating rogue regimes and actors whose criminal behaviour poses a security threat to the US and have redefined the way the US government engages in financial warfare (Zarate 2013). Furthermore, given their claimed effectiveness, they have increasingly been multilateralised through their inclusion in UN Security Council resolutions (Eckert 2008, p.104).

In the emerging literature, North Korea has frequently been cited as a successful case of the use of financial sanctions. As noted in the introduction, in September 2005, the US Treasury accused Macao's Banco Delta Asia of facilitating North Korean money laundering as well as trafficking in counterfeit currency. This accusation alone led the Macao banking authorities to freeze 52 North Korean accounts worth US$ 24 million. Although the amount involved was not particularly large, this led to a run on the bank's deposits by its other customers. In the longer term, it made foreign businesses and banks increasingly wary of having any dealings with North Korea, even with regards to legal business ventures, for fear of being designated complicit in North Korean money laundering (Klingner 2007). This was indeed the intended effect of the Treasury's action against the BDA. Following the accusations against the bank, Senior Treasury Department officials travelled the world to meet with their foreign counterparts and with foreign bankers to warn them of the risks of doing business with North Korea. Around two dozen financial institutions in Asia and Europe subsequently began to close down or limit their North Korean bank accounts (Wertz 2013, pp.73–74).

Framed as aimed at “safeguarding the international financial system,” these measures had a devastating impact on North Korea's ability to engage with the global financial system. Due to the resulting pressure on North Korea, it has been claimed that the BDA designation was successful in bringing the country back to negotiations over Pyongyang’s WMD programme (Eckert 2008). As Arnold (2016) notes, the US government's designation of BDA as a money laundering concern had initially derailed an agreement made a month earlier to abandon Pyongyang’s nuclear programme and to rejoin the Non-Proliferation Treaty. However, this derailment was only temporary. Washington subsequently agreed to release the frozen funds and to ease sanctions more broadly, thereby reviving the stalled diplomacy and encouraging North Korea to begin disabling its Yongbyon nuclear plant.

Though the Six Party Talks broke down again in late 2008, Arnold argues that "... it was clear that the financial sanctions had prevented the regime of Kim Jong-il from financing its illicit activities" (Arnold 2016). Indeed, as Zarate argues, the cutting of funding flows to countries such as North Korea can restrict their ability to operate and force them to make not only budget decisions, but also strategic choices (Zarate 2013).

Pyongyang's continuation of nuclear and missile tests in 2016 suggests that the ability of financial sanctions to dissuade Pyongyang from pursuing its WMD programme has been exaggerated. More crucially, however, financial sanctions have failed to exert any tangible macroeconomic impact on the country's economy at all. Instead, the strengthening of financial sanctions against North Korea has coincided with the gradual recovery of the economy amidst the expansion of its economic ties with China. Comprehensive Japanese and South Korean trade embargoes along with China's own economic rise and the related boom in global commodity prices have massively expanded the role of the Sino-North Korean border economy in North Korea's external economic relations. This border economy is characterised by a vast network of informal trade based on smuggling, barter, and the use of cash for trade settlement and investment. These informal strategies serve both as a means of evading sanctions as well as avoiding customs duties and cumbersome procedures. They also reflect the fact that financial sanctions have undermined attempts by the Chinese government to establish a more robust cross-border financial system. As such, we argue for more nuanced analysis of how financial sanctions are contingent upon geo-economic specificities and are, as with other forms of sanctions, susceptible to evasive practices. We proceed by examining how financial sanctions have been situated within a broader array US, Japanese, South Korean, and multilateral UNSC sanctions.

Bilateral and Multilateral Sanctions Against North Korea

Sanctions applied to North Korea include a range of bilateral and multilateral measures. The US, for example, has for nearly seven decades applied stringent bilateral trade sanctions against North Korea on a number of pretexts including North Korea's activities related to the proliferation of WMD, regional provocations, terrorism, narcotics trafficking, undemocratic governance, and illicit activities such as money laundering, the counterfeiting of goods and currency, and bulk cash smuggling (Rennack 2011, p.1). The earliest sanctions date back to the outbreak of the Korean War, when the Export Control Act of 1949 was applied to North Korea, imposing a total embargo on US exports to the country. The Export-Import Bank Act of 1945, which denies guarantees, insurance, credit or other Bank programmes to Marxist-Leninist countries, was also applied. Furthermore, the Trading with the Enemy Act was implemented in December 1950 to freeze North Korean assets under US jurisdiction and place broader restrictions on US trade and investment relations with the country. The 1951 Trade Agreement Extension Act prohibited giving Most Favoured Nation status to North Korea, thereby effectively blocking the latter from exporting to the US and denying it the possibility of preferential treatment under the Generalised System of Preferences introduced under the Trade Act of 1974. The Foreign Assistance Act of 1961 served to prohibit non-humanitarian assistance to communist countries, and following North Korea's 1988 bombing of Korean Air Lines Flight 858, the country was added to the State Sponsors of Terrorism list under the Export Administration Act of 1979, bringing further sanctions on trade, travel and financial transactions. Inclusion on the list also required the US to oppose economic assistance to North Korea from the International Monetary Fund and the World Bank.[3]

In the 1990s, North Korea's deepening humanitarian crisis, the Agreed Framework reached in 1994 following the nuclear crisis, and Pyongyang's agreement to a moratorium on missile testing in 1999 all led to a relaxation of US sanctions against the country. However, renewed tensions over the North's nuclear programme in the 2000s led the George W. Bush administration to impose further sanctions, including financial sanctions. As noted, US Treasury accusations against Macao's Banco Delta regarding its involvement in North Korean counterfeiting and money laundering activities led financial institutions around the world to avoid dealings with North Korea. A temporary breakthrough following the February 13th Agreement in 2007 at the Six-Party Talks along with Pyongyang's

[3] For a detailed account of US sanctions against North Korea, see Chang (2003) and Lee and Choi (2008).

subsequent move to disable its Yongbyon nuclear facilities led the US to remove North Korea from its State Sponsors of Terrorism list in October 2008. However, with North Korea's repeated missile and nuclear tests since 2009, the US has applied a range of "smart sanctions" on individuals and organisations suspected of involvement in arms and drug trafficking (OFAC 2016). Finally, on the 1st of June 2016, the US Treasury labelled the entire jurisdiction of North Korea as a money laundering concern, a move that requires US banks to implement additional due diligence measures to ensure that they do not do business directly with North Korean companies or indirectly through front companies.

In the post-Cold War era, North Korea has also been subject to multilateral UN Security Council (UNSC) resolutions. Following missile tests in July 2006, UNSC Resolution 1695 called upon UN member states to prevent the transfer of missile and missile-related materials and technology to the country.[4] Furthermore, as a result of North Korea's nuclear test the following October, Resolution 1718 banned the sale to North Korea of conventional arms and WMD-related materials as well as the provision of related technical training or assistance. It also banned North Korean exports of such items. Resolution 1718 also marked the increasing shift towards smart and financial sanctions, calling upon member states to freeze the assets of individuals and entities associated with North Korea's WMD programme as well as to impose a travel ban on associated personnel. The resolution authorised states to inspect cargo shipments for WMD-related materials, though with no obligation to do so and banned the export of dual-use and luxury goods to North Korea.

Following North Korea's second nuclear test in May 2009, Resolution 1874 extended the ban on North Korean arms exports to all arms and related assistance. Member states were allowed to export small arms to North Korea, but only with prior notification to the Security Council. The Resolution also obliged member states to inspect and destroy all banned cargo to and from North Korea, whether on the high seas, in ports, or at airports, if they have reasonable grounds to suspect a violation. There were strengthened measures

[4] For UN documentation on Security Council Resolutions, see http://www.securitycouncilreport.org/dprk-north-korea/index.php?page=1

aimed at preventing financial assistance to North Korea's WMD programme, and member states and international financial institutions were called upon not to enter into new commitments for grants, financial assistance, or concessional loans to North Korea, except for "humanitarian and developmental purposes", or for the promotion of denuclearisation.

In 2013, two further resolutions, 2087 and 2094, were passed in response to the 12th of December 2012 missile test and the 12th of February 2013 third nuclear test respectively. Resolution 2087 strengthened previous resolutions by clarifying the right of states to seize and destroy WMD-related materials suspected of heading to and from North Korea. It also called for increased monitoring of individuals and financial institutions in their own territories engaged in North Korean-related activities. Resolution 2094 imposed further sanctions on North Korean banking, travel, and trade. Finally, in March 2016, the UNSC passed resolution 2270 in response to the latter's nuclear and missile tests earlier that year. The sanctions included mandatory inspections of cargo shipments entering and leaving North Korea, the prohibition of sales of all conventional weapons to the country including small arms, a ban on North Korean exports of coal, iron ore, gold, and other mineral products, and a ban on sales of jet fuel to the country. However, potential buyers are only obligated to turn back shipments of minerals when there are grounds to believe that the proceeds would benefit North Korea's military, raising questions regarding the levels of proof required. Furthermore, the sanctions do not affect trade being conducted for "livelihood and humanitarian purposes," leaving a great deal of discretion to countries such as China as to how far to enforce the ban on North Korean mineral exports (Babson 2016).

Japanese and South Korean bilateral sanctions have also had significant implications for North Korea's external economic relations. Following the collapse of the Soviet Union, Japan became North Korea's second largest trade partner after China, with annual bilateral trade reaching approximately US$ 400-500 million in the 1990s, amounting to around 25 percent of North Korea's total external trade (Eberstadt 1996, pp.523–524). However, Kim Jong Il's public admission during his 2002 summit with Japanese Prime Minister Junichiro Koizumi that North Korea had kidnapped 11 Japanese citizens in the late 1970s and early

1980s led the Japanese government to halt its humanitarian assistance to the country later that year. Moreover, North Korea’s first nuclear test in 2006 led Tokyo to further strengthen sanctions against the country, including a ban on North Korean imports, the freezing of North Korean financial assets in Japan, the suspension of cash remittances, the imposition of stringent export controls on dual use technologies, and a ban on Japanese visits and charter flights and vessels to North Korea (International Crisis Group 2010, pp.3–4). As a result, Japan's trade with North Korea saw a decline from US$ 464 million in 2000 to a mere US$ 9 million in 2007. Furthermore, on the 18th of June 2009, following Pyongyang's second nuclear test, Tokyo imposed a complete embargo on exports to North Korea.

Bilateral sanctions imposed by South Korea have been similarly stringent. For most of the post-war era, inter-Korean trade was non-existent. However, owing to the engagement strategy pursued by the South's Kim Dae-Jung and Roh Mu-Hyun governments, the volume of inter-Korean trade rose from US$ 333 million in 1999 to US$ 1.82 billion in 2008. An important feature of this growing trade was the rise of consignment-based processing (CBP) arrangements between South Korean manufacturers and North Korea, whereby the bulk of the materials used in the manufacturing process are supplied by South Korean companies as a result of inadequate industrial supply networks within North Korea itself. This CBP-based manufacturing grew sharply after the opening of the Kaesong Industrial Complex (KIC) in December 2004. However, the sinking of the Cheonan naval ship in 2010 led the Lee Myung-Bak government to enact the so-called "May 24th" measures, which included the banning of North Korean vessels from South Korean territorial waters and ports; the suspension of all inter-Korean trade with the exception of the KIC; the banning of all travel to the North by South Korean citizens, as well as the restriction of contacts with North Koreans, though again with the exception of the KIC; the banning of investment in new and ongoing cooperation projects in North Korea. Existing investments in the KIC were allowed to continue, but no new investments were permitted, and the number of South Korean personnel in the complex was to be restricted (Ministry of Unification 2010). From May 2010, inter-Korean trade consisted solely of the inflow of raw materials into the KIC and the outflow of manufactured goods back to South Korea. However, following North Korea's fourth nuclear test in January 2016, the South Korean authorities closed down the KIC, leading to an almost complete halt in inter-Korean economic exchange.

As can be seen, North Korea has been subject to a stringent set of bilateral and multilateral sanctions. As Pyongyang's fourth and fifth nuclear tests in 2016 suggests, these sanctions have failed to achieve their explicit objective of inhibiting the country's nuclear ambitions. Furthermore, there is little evidence to suggest that they have had elicited any significant macroeconomic shock to the North Korean economy (Noland 2009). Indeed, the severe external shocks experienced by North Korea in recent years have resulted mainly from the end of the country's favourable trading relationships with the Soviet Union and China in the early 1990s rather than through decades-long international sanctions. Nonetheless, the stringent Japanese and South Korean sanctions combined with the more targeted UNSC sanctions alongside China's lax enforcement of the latter have led to a re-orientation of North Korea's external economic relations towards China (Haggard & Noland 2013). As will be discussed below, this shift has facilitated the increasing importance of the Sino-North Korean border economy and, as a consequence, the prominence of informal trade practices within North Korea's external economic relations more broadly. In the following section, we provide an overview of the scope of this emerging border economy and the key actors involved, before going on to discuss the specific impact of financial sanctions.

The Rise of the Sino-North Korean Border Economy

The combined impact of bilateral and multilateral sanctions against North Korea has left China as the country's most important trade and investment partner. In 2003, North Korea's trade with China surpassed US$ 1 billion for the first time. By 2013, however, this bilateral trade had grown to US$ 6.54 billion. The share occupied by China in North Korea's external trade increased from 39 percent in 2006 to 57 percent in 2010.[5] By 2013, North

[5] These figures include inter-Korean trade and are drawn from statistics released by the Korea Trade-Investment Promotion Agency (KOTRA) and the Ministry of Unification. It should be noted, however, that

Korea's total external trade was estimated at US$ 8.48 billion, with China's share amounting to around 77 percent.[6] However, as will be discussed below, the prominence of informal practices within Sino-North Korean economic exchange means that the actual scale of bilateral economic relations is likely to be far greater than these official statistics suggest.

<Figure 1 near here>

A noticeable feature of this growth in bilateral trade has been the increase in North Korean exports of minerals, and to a lesser extent, clothing. The rise in North Korean mineral exports to China is a direct result of the latter's rapid economic growth and demand for natural resources alongside the associated global commodity boom. As shown in Figure 2, while anthracite had not been a major North Korean export prior to the mid-2000s, anthracite exports to China thereafter saw an annual increase of 190 percent, reaching a value of US$ 1.14 billion in 2011. In addition, there have been increasing exports of North Korea's rich reserves of iron ore, gold and copper. This rapid increase in mineral exports to China underlines how sanctions have contributed towards the restructuring of North Korea’s external economic relations in a manner that resembles the mineral export dependent seen in other developing countries' relations with China (Lee & Gray 2016).

While North Korea's mineral export earnings have since 2014 seen a downturn as a result of the end of the global commodity boom, North Korean apparel exports (HS codes 61-62) to China have continued to grow, from a value of US$ 186 million in 2010 to US$ 799 million in 2015. The share of apparel in North Korea's total exports to China has increased from 15.7 percent to 32.2 percent during the same period. The bulk of this increase has

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since 2010, inter-Korean trade has been centred around the Kaesong Industrial Complex and consists mainly of the inflow of raw materials and outflow of CBP-based figures, thereby elevating the trade figures. If inter-Korean trade is excluded, China's share in North Korea’s foreign trade was estimated to reach 89.1 percent in 2013, while further rising to 90.1 percent in 2014 and 91.3 percent in 2015.

[6] In 2015, China's recorded total share of North Korea's external trade seemingly declined to 63.7 per cent, though this is closely related to the fact that Chinese Customs stopped recording crude oil exports to North Korea in 2014. With the closure of the Kaesong Industrial Complex and thus all North-South trade, China's share of North Korea's total external trade is likely to increase significantly in 2016.

been driven by outsourcing from Chinese companies through CBP arrangements, thereby reflecting the emergence of labour shortages and rising wages in China's own apparel sector in recent years. However, South Korean bilateral sanctions have also played a role. Following Seoul's May 24th sanctions, Chinese companies took over much of the CBP-based trade in apparel from South Korean companies who were banned from engaging in North Korean production outside of the KIC. Some of the Chinese companies and merchants that had previously acted as intermediaries between Southern firms and Northern clothing companies simply proceeded to engage in North Korean production directly.[7]

<Figure 2 near here>

Beyond machinery and materials used in mining and apparel production, the kind of goods that China exports to North Korea ranges from basic necessities and foodstuff to industrial equipment and crude oil. Although North Korean imports of Chinese grain have declined in recent years as a result of the partial recovery of its agricultural sector, North Korea has increased imports of machinery parts, electrical equipment, vehicles, plastic products, and chemical goods from China. Since the late 2000s, North Korea has also increased its imports of building materials as a result of the government's modernisation and homebuilding efforts in several major cities. Imported Chinese goods are also being used for the restoration of production and transport facilities. This influx reflects ongoing processes of marketisation within the North Korean economy, whereby China-sourced goods are supplying the country's burgeoning informal markets (Smith 2009). Furthermore, despite widespread negative perceptions regarding North Korea’s investment environment (Jung & Rich 2015), Chinese firms have invested in export-oriented mining and apparel sectors as well as manufacturing for the local market and in services. Official data provided by China's Ministry of Commerce estimates that Chinese investment in North Korea has as a result reached an annual level of US$ 100 million in recent years (PRC Ministry of

[7] Interviews with Chinese firm owners engage in trade business and CBP (November 2012, March 2013 and July 2016 in Dandong and Shenyang).

Commerce 2014, p.132), though as with trade, actual levels of investment are likely to be higher than these official statistics suggest.

<Figure 3 near here>

The fact that the Chinese government condones and even promotes this border trade with weak regulatory oversight has been a key factor in the manifest ineffectiveness of the multilateral sanctions regime (Oh & Ryu 2011; Noland 2009; C. Jones 2015; Whitty et al. 2006; Kim & Martin-Hermosillo 2013). In terms of motivations, it has been argued that Beijing's engagement with North Korea reflects growing China-US strategic competition in East Asia alongside a desire for a buffer state on China's northeastern borders (Ji 2001, p.398; Moore 2008). However, the Chinese government has also sought to encourage the growth of cross-border exchange as a means of revitalising its less-developed border regions, and in this sense, Beijing's approach to economic relations with North Korea shares much in common with its approach to other border regions. Trading companies and merchants in key Liaoning and Jilin provincial border cities, for example, receive preferential treatment from the Chinese authorities in terms of import duty reduction as well as the government’s allocation for export quotas and state licenses for controlled "strategic goods" such as grain, flour, coke and petroleum products (Hong 2006, p.197; Kim & Jung 2015, p.28). The Chinese authorities have also made significant investments in border infrastructure to further facilitate the growing cross-border exchange. Though diplomatic relations have cooled in recent years due to tensions surrounding Pyongyang's nuclear programme, this emphasis on economic cooperation has not subsided despite the seemingly slow progress of some key projects, particularly in the Dandong city region. This proactive role of the Chinese state in promoting the cross-border economy reflects the fact that while North Korea accounts for a relatively small proportion of China's overall trade, China's northeastern border cities have increasingly benefited from the cross-border exchange. For example, about 40 percent of Dandong’s foreign trade takes place with North Korea (Zhang 2012, p.40).

In terms of the entities involved, there has been a shift from the situation until the 1990s when border trading rights for local firms and residents were tightly controlled by the provincial authorities and the trade itself conducted largely by SOEs. With Beijing's easing of restrictions on cross-border trade in the early 2000s, the number of private firms engaging in the North Korean trade has risen sharply. Again, in the case of Dandong, there are around 6,700 registered trading companies, with more than a third of these estimated to be involved in economic exchange with North Korea.[8] Several of these companies have grown from small private traders to become major companies dealing with the large-scale import and export of coal, metals, fertiliser, foodstuff, machinery, vehicles and building materials.[9] A good example of this is Dandong Hongxiang Industrial Development Corporation. Established in January 2000, this company emerged as one of North Korea's most prominent trading partners, reporting an annual trade volume of US$ 100 million in recent years. There are also many smaller-scale Chinese traders and merchants based in Liaoning and Jilin provinces involved in various types of trade and investment activities. Some of these act as trade agents for North Korean firms and for Chinese enterprises in other provinces. Thus, while the Chinese and North Korean governments have encouraged the development of this cross-border economy, the majority of the entities involved are profit-seeking private businesses, thus displaying a marked contrast to the politicised pattern of inter-Korean economic cooperation (Haggard & Noland 2013, p.555).

On the North Korean side, the principle actors are state-owned trading companies and agents working for factories and distribution organizations, reflecting the fact that North Korea officially still maintains its Soviet-style system of foreign trade licences and quotas. However, with the collapse of the central planning mechanism, trading firms and their agents have increasingly used their trading rights to operate individual firms and engaging in commercial activities with Chinese enterprises in order to sell imported goods on the domestic market. Moreover, considerable numbers of private traders and merchants have taken up positions in trade firms or state-owned enterprises, wearing a "red cap" so to speak,

[8] Interviews with local government officials, Dandong City, November 2012.
[9] Interviews with the managing staff of several trading companies in Dandong, November 2012 and July 2016.

in order to conduct foreign trade with China and to increase domestic business opportunities (Kim & Yang 2014). Production facilities and state-owned stores in North Korea are also sold or rented out to emerging rich entrepreneurs, known as *donju*. These *donju* businesses range from money-lending, foreign currency sales and restaurants to wholesale, construction, manufacturing, mining, and transportation businesses. Indeed, this recent emergence of an entrepreneurial class has both been tolerated by the regime and even promoted by new economic management policies under the Kim Jong Un government. These policies have conferred greater managerial rights on enterprises and discretion over purchase and trade in raw materials, the sales of output, recruitment of workers, and the utilisation of profits (Gray & Lee 2017; Yang 2016). In this sense, the growing border trade with China reflects and contributes to the broader double-edged sword of marketisation within North Korea. While the expansion of economic exchange with China and growth of profit-seeking private activities has increased the revenues and necessary materials accrued to the North Korean state, they have also contributed towards the growth of private economic forces and increasing social differentiation within North Korea. Though the interests of the state and individuals engaging in private economic activities have at times been in contradiction with each other, as seen during the 2009 currency reform, the Kim Jong Un government appears to have a relatively stable and increasingly symbiotic relationship with marketising processes in North Korea (Yang 2016).

As we have argued, while the Chinese central and local governments have sought to promote border trade with North Korea, the key agents on the Chinese side have been profit-seeking private economic actors who have for the most part engaged in informal practices outside of the oversight of the state. On the North Korean side, official entities such as trading companies and even the banks themselves resorting to the use of informal methods. In the following section, we will first provide a qualitative overview of informal economic practices in the cross-border region and how these have been shaped by the broader sanctions regime before going on to examine the impact of financial sanctions specifically.

Informal Dimensions of Sino-North Korean Border Economy

Stringent South Korean and Japanese sanctions along with the more targeted UN Security Council sanctions and Beijing's lax enforcement of the latter have led to a shift in emphasis in North Korea's external economic relations towards China. Given the long land border between China and North Korea, this geo-economic shift has increased the prominence of informal trade activities such as smuggling, barter, and the widespread use of cash transactions. To simply reduce practices such as smuggling entirely to sanctions evasion would, however, be an over-simplification. Widespread border smuggling dates back at least to the economic collapse and famine of the 1990s, when North Korean smugglers bartered scrap metals, copper, seafood, antiques and other goods in exchange for food and basic necessities. The latter were then smuggled into North Korea, often with the cooperation of the North Korean authorities (Son 2007, pp.35–37). However, in the early 2000s, the Chinese government strengthened its policing of its land and river borders with North Korea, as could be seen in the installation of barbed wire, the increased supervision by border guards, and the strengthening of penalties imposed on smugglers. As a result, Chinese trading companies and merchants became increasingly reluctant to engage in large-scale smuggling across the Sino-North Korean land border, though small-scale smuggling reportedly still takes place despite period crackdowns by the North Korean authorities (see Lee 2015).

Nonetheless, widespread smuggling of goods into China continues to take place across the open waters of the Yellow Sea, often with the assistance of Chinese professional trafficking organisations.[10] These smuggled goods include North Korean seafood and medicinal herbs, for which there has been increasing demand in China in recent years. Indeed, fishery products became a key North Korean export item in the late 1990s. While Japan had previously been the main market for such goods, this trade was reoriented towards China following Japanese sanctions. An analysis of Chinese customs data gives some indication

[10] Interviews with local government officials and merchants based in Dandong, June 2009 and November 2012.

as to the extent of this smuggling. As shown in Figure 4, China's official seafood imports from North Korea fell from US$ 261 million in 2004 to just US$ 29.9 million in 2007, though by 2014, this had seen a partial recovery to US$ 143 million. Given that at the same time the North Korean government placed emphasis on the development of the fishery sector, that Chinese investment in North Korean fish farms was rising, and that considerable amounts of North Korea-labelled seafood were reportedly being sold in northeast Chinese markets, these low official figures suggest that significant amounts of fishery products were being smuggled into China. Again, the primary motivation of this smuggling has not been to evade sanctions but to avoid China's strict quarantine procedures required for fishery products. Nonetheless, the broader reorientation of North Korea's seafood trade towards China as a result of Japanese and South Korean sanctions has increased the role of smuggling in North Korea's broader external economic relations.

<Figure 4 near here>

Smuggling also continues to take place at official customs points along the land border, and has increased in line with the growth in trade overall. Merchants from both countries take advantage of lax customs inspections in border cities such as Dandong, Hunchun, Tumen, and Ji'an. Limited manpower at Chinese customs points means that typically only about one cargo vehicle in ten goes through any kind of inspection, with inspections usually taking the form of a simple visual check. Here, however, the link with sanctions is more direct. While false declarations are made for the purposes of tax evasion and the avoidance of burdensome customs, they are also made for the purposes of evading sanctions on dual use and luxury goods. In order to export such goods into North Korea, Chinese traders frequently make false customs declarations and load undeclared and prohibited goods onto container trucks together with permitted goods.[11] Furthermore, the expansion of the Sino-

[11] Chinese merchants and trade agents interviewed in both Yanji in Jilin Province and Dandong in Liaoning Province discussed these lax customs inspections and informal customs practices during in-depth interviews. The loading of undeclared goods and equipment onto the vehicles are also frequently carried out by owners and staffs of Chinese firms investing in North Korean mines and engaged in CBP-based clothing manufacturing in North Korea.

North Korean cross-border economy has been coupled with the increasing visits of North Koreans along with the growing movement of materials to border cities of Liaoning and Jilin. When returning from China, North Koreans often carry significant amounts of luxury goods as well as concealed foreign currency in their personal luggage without making the requisite customs declarations. Such luxury goods include everyday consumer items such as cameras, TVs and computers, and are often brought into the country to be sold in North Korean markets.

As can be seen then, bilateral and multilateral sanctions have directly and indirectly led to evasive strategies across the Sino-North Korean border. A key question then is how specifically sanctions have impacted upon modes of trade settlement. Settlement across the Sino-North Korean border primarily takes place through two mechanisms. As noted above, cross-border trade during the 1990s frequently took the form of barter, though much of this was eventually monetised as the array of both goods and actors became increasingly diverse (Haggard et al. 2012, p.131). Barter has, however, remained a key feature of cross-border trade settlement. Interviewed Chinese merchants reported, for example, that they would normally receive around 80 percent of payment for their exports in cash with the remaining 20 percent is paid for with goods from North Korea due to the latter's shortage of hard currency. These imported goods would typically include mineral resources, seafood, and agricultural products, which are then sold in the domestic Chinese market. Furthermore the scope of this barter trade can be quite large. According to one Chinese interviewee, in May 2009, a Chinese trading company provided a North Korean partner with corn in exchange for 100,000 tons of coal, which was then shipped to Shandong Province. Needless to say, this barter trade takes place without the requisite customs declaration and the involvement of financial institutions, thus remaining hidden from the official China Customs statistics.

Cash payment, however, forms the most common form of trade settlement. While smaller scale trade tends to be conducted in Renminbi, both Chinese and North Korean traders typically prefer larger scale trade to be settled in US dollars or in Euros. The use of cash is encouraged by several factors. First, North Korea's poor regulatory environment means that much Sino-North Korean trade takes the form of spot trading of goods rather than through more typical methods of letters of credit and foreign exchange remittances via banks. This helps Chinese traders negotiate the risk of arbitrary changes in rules and practices as well as the lack of a reliable mechanism of dispute resolution (Haggard et al. 2012, p.132). A further reason why official bank transfers are not used is that China's foreign exchange rules do not allow individuals to transfer more than US$ 50,000 per year overseas without permission from the relevant financial authorities. In addition, foreign exchange regulations stipulate that when a private enterprise opens a bank account for the purposes of conducting foreign trade, the financial institution is required to evaluate the enterprise's financial accounts and examine supporting trade documents before allowing the transfer of money out of the country.

That this poor regulatory environment has encouraged informal methods of trade settlement is not surprising. It is important to note, however, that financial sanctions have further encouraged the use of informal methods of trade settlement as an evasive strategy. The predominance of the US in the global financial system amidst the growing "weaponisation of finance" has meant even before the US Treasury took overt actions against financial institutions dealing with North Korea, the Pyongyang authorities adopted defensive measures that created strong disincentives for traders to use the official banking system. In an attempt to reduce its dependence on US dollar-based international payment system, North Korea has since 2002 adopted the Euro as its official trading currency. A consequence of this is that when a North Korean firm requests a Korean bank to make a money transfer to a Chinese partner, the Pyongyang office of that bank first has to make a conversion into Euros before contacting its branches in China. The Chinese branch then duplicates the process by converting Euros into Dollars or Renminbi before making the payment to the Chinese enterprise. Unsurprisingly, this results in excessive bank fees being charged. One Chinese merchant cited an example of fees amounting to US$ 500 being charged on a remittance of US$ 6,000 from North Korea. Traders also complain about the slowness of the official banking transfer system. It typically takes a minimum of three to seven working days and, in some cases, more than fifteen days for Chinese enterprises to receive payments from North Korea into their local bank accounts in China.[12] These high fees and the complicated system of bank transfers of foreign exchange between the two countries thus further encourages the reliance on cash for trade settlements instead.

Even when the official banking system is used, the growing use of financial sanctions has meant that bank transactions do not necessarily take place separately from the informal cash economy. In contrast to ordinary international financial remittances, when Chinese enterprises receive payments for exports through a North Korean financial institution, many remittances occur not through the use of wire transfer between banking institutions but through the physical transfer of cash from the headquarter office of the North Korean bank in Pyongyang to its branch office in China.[13] Thus, when North Korean importers request a financial institution such as Kwangson Bank in Pyongyang to make a payment to a Chinese company, the Pyongyang headquarters of the bank simply asks its Dandong branch office to pay the company. An undeclared physical transfer of cash then takes place between the bank's headquarters in Pyongyang and its branch in China (Lee 2011, p.109). The bank in Pyongyang thus physically sends parcels of Chinese renminbi and dollars to their representative offices in Dandong. As noted, however, the settlement of trade through North Korean and Chinese financial institutions remains at a low level. Although there is no official data on foreign currency flows between China and North Korea, a survey conducted by the People's Bank of China reported that in 2006 reported that only 21 percent of exports from the Dandong region were settled via bank accounts designated for China-North Korea trade (Finance Association of Liaoning Province 2008, p.161). Furthermore, Kim and Jung's (Kim & Jung 2015) study of Chinese firms in Dandong

[12] Based on interviews with Chinese merchants in Dandong, November 2012.

[13] In the 2000s, the North Korean government reportedly opened representative offices of North Korean banks in several Chinese cities, including Beijing, Dalian and Shenyang, as well as in key border cities. In Dandong, representative offices were opened by Kwangson Bank, Hana Bank, Korea United Development Bank, and Koryo Bank. For example, Kwangson Bank, an affiliated financial institution of North Korea's Foreign Trade Bank, reportedly established its representative office in Dandong in 2002. The function of its Dandong office was expanded to mainly dealing with trading companies and merchants in Chinese border regions in the mid-2000s following the US Treasury's action against the BDA in Macao. The Pyongyang government also established the Golden Triangle Bank in North Korea's Rason SEZ as well as a representative office in Hunchun, Jilin Province, as a means of promoting Chinese investment into the zone.

shows that only 15 percent of 176 surveyed firms used the official banking system for trade settlement with North Korea. Instead, 59 percent of firms used cash payment, 22 per cent used a mixture of cash and barter, and 4 percent relied solely on barter.

As can be seen, cash remains the preferred method of settling Sino-North Korean trade, thus placing the bulk of the border trade settlement beyond the reach of financial sanctions. This is the case even with transactions amounting to the value of hundreds of thousands of US dollars.[14] North Korean firms and government agencies purchase products in Chinese border city markets through cash payments either directly or via Chinese intermediaries.[15] Ethnic Chinese traders from North Korea are also able to bring Chinese goods to North Korean markets through cash payments with the help of relatives or other contacts residing in China. In addition to Chinese importers, companies and merchants investing in North Korean mining and engaging in CBP-based outsourcing also tend to make cash payments to their North Korean partners to avoid the use of official financial institutions. This preference for cash payments means that large amounts of currency are physically carried across the border, often by the staff of North Korean trading companies or government agencies. However, a certain portion of the cash paid for North Korean imports or CBP-related fees typically remains in China as operating funds for North Korean firms or for the purchase of additional Chinese goods. Some of these funds are likely to be deposited into the accounts of North Korean companies or their Chinese intermediaries held at Chinese banks. Again, such methods help to evade financial sanctions, with the funds being deposited for future use by the North Korean authorities when needed.

As can be seen, bilateral Japanese and South Korean sanctions have increased North Korea's reliance on China as its key economic partner. The fact that UN multilateral sanctions have been less stringent and that China has in any case been more lax in its

[14] Interviews with Chinese merchants engaging in trading business with North Korea on several occasions in June 2009, April 2011 and November 2012.
[15] Chinese intermediaries are individuals who reside in Chinese bordering regions and work for North Korean trading companies or government agencies. These intermediaries often engage in cash transfers between Chinese importers and North Korean firms, and by doing so, receive a commission.

enforcement of them has meant there have been increased opportunities for traders on both sides of the border to engage in informal evasive practices. The growing prevalence of financial sanctions has led to the failure of the cross-border banking system to develop in line with the expansion of cross-border trade and investment. As we argue in the next section, while the growing informal cross-border economy has been of increasing concern to the Chinese authorities, attempts to encourage traders' use of the official banking system has increasingly come into conflict with Beijing's concerns regarding the explicit targeting by the US Treasury of banks doing business with North Korea.

Financial Sanctions and Regulation of the Cross-Border Economy

Given that informal trade and investment practices tend to impede the monitoring of flows and statistical reporting and facilitates smuggling and tax evasion (Reilly 2014, p.929), there have been increased attempts by the Chinese authorities at improving the official cross-border financial system. Though the Chinese government traditionally maintained stringent restrictions on the flow of Renminbi outside of China, in 2003 Beijing adopted a policy of encouraging the use of the official banking system in border trade through allowing the Renminbi to be used in cross-border trade valuation and settlement. This was achieved initially through enacting the "Management Measures for Foreign Exchange in Border Trade," the aim of which was to encourage the settlement of trade through utilising China's regional commercial banks and the banking systems of neighbouring countries. In October 2004, the Chinese and North Korean central banks thus signed "the Agreement on the Settlement of Payment between the People’s Bank of China and the Central Bank of the Democratic People's Republic of Korea." Based on this agreement, in April 2005, the representative office of North Korea’s Kwangson Bank in Dandong was permitted to operate exclusive bank accounts that would allow Chinese enterprises and merchants doing business with North Korea to settle trade in Renminbi, US dollars, Euros, Japanese yen or Hong Kong dollars. In 2006, similar accounts were set up at a branch office of China Construction Bank at Dandong, one of China's major state-owned commercial banks. As such, it became possible to transfer money from China to North Korea to pay for imports, CBP-related fees, and to send investment-related funds to business accounts at a specified North Korean bank in Pyongyang (Finance Association of Liaoning Province 2008, pp.160–162).

However, attempts by the Chinese government to regularise cross-border financial transactions have been increasingly undermined by international financial sanctions imposed both on North Korean banks and on foreign banks involved in financial dealings with North Korea. As noted above, the action against BDA had a chilling effect on the willingness of Chinese and international banks to business with the bank. More recently, the US has imposed sanctions on North Korean banks directly, which has served to undermine the willingness of Chinese banks to do business with North Korean financial institutions. Following the adoption of UNSC Resolution 1874, the US Treasury provided a list of North Korean banks suspected of deploying "deceptive financial practices." In August 2009, it added Kwangson Bank to this list. Although the measure ostensibly applied only to US citizens and to foreigners based in the US, its overall result was the further isolation of North Korean banks from the international banking system. Furthermore, in March 2013, following UNSC Resolution 2094, the US Treasury Department put in place sanctions against North Korea's Foreign Trade Bank (FTB), the key North Korean institution in charge of foreign banking transactions and foreign exchange. The fact that these latter sanctions targeted North Korea's main foreign exchange bank distinguished the action from previous financial sanctions. As has been argued, due to the dollar's status as the world's reserve currency and the fact that it accounts for over 85 per cent of the world's foreign exchange transactions, banks are more or less compelled to make use of a US-based dollar payment system, meaning also that their transactions have to go through a US bank. The US Treasury's demand that US banks refrain from conducting business with the FTB means that other foreign banks will also stay clear of it (The Hankyoreh 2013).

Spurred by their own risk assessments, four major state-owned Chinese banks subsequently cut ties with the FTB. The Chinese authorities also reportedly shut down the Dandong branch of North Korea's Kwangson Bank (Wertz 2013, pp.75–76). The overall impact of these actions on North Korea’s ability to engage in financial dealings with the outside world has been marked. Even UN agencies and European NGOs conducting humanitarian work in North Korea have been affected, as many of these organisations had relied on Chinese or European banks to make transfers to the FTB for routine payments related to their work. Indeed, many banks now avoid doing business with the FTB due to reputational risk (Wertz 2013, pp.76–77). Furthermore, in March 2013, just ten days after the passing of UNSC Resolution 2094, Beijing imposed a freeze on certain transactions by the Dandong branch of the China Construction Bank. The CCB has had strong ties with Kwangson Bank since 2008, when Kwangson Bank opened a trade settlement account denominated in Chinese Renminbi at the Dandong branch of the China Construction Bank (Zhang 2012, p.40).

As such, despite the Chinese government's earlier efforts to expand the use of official financial institutions, settlement of Sino-North Korean trade through financial institutions has remained limited. The CCB reported that there were only 235 cases of border trade settlements with North Korea in the first half of 2012, amounting in total to just US$ 33.3 million. This represents a decline of 39 per cent over the same period the year before (Zhang & Jin 2012). As a result, following intensification of international sanctions, the North Korean government has increasingly relied on secretive financial transactions as an evasive measure. For example, following North Korea's third nuclear test in early 2013, the representative office of North Korea’s Kwangson Bank was reportedly shut down by the Chinese government, and following North Korea's fourth nuclear test in 2016, Chinese banks were reported to have closed down bank accounts held under North Korean names (Donga Daily 2016). In the meantime, however, North Korea has sought to evade financial sanctions through utilising Chinese intermediaries (Park 2014). These have been used to set up personal bank accounts on behalf of North Koreans in Chinese banks. It has been reported that there were around 70 North Korean dummy corporations based in China in 2012 for the purposes of facilitating illegal business transactions, with around 150 to 170 associated illegal bank accounts (Kim & Shin 2012). At the request of their North Korean partners, some Chinese enterprises engaged in business with North Korea make payments to Chinese bank accounts belonging to North Korean enterprises or Chinese intermediaries, rather than transferring payments to North Korea directly. As Chinese intermediaries convert the payment in cash and hand it over to the relevant North Korean agents, the North Korean authorities are thereby able to evade the financial tracking of the Chinese banking authorities, and thereby, mitigate the impact of international sanctions.

Conclusion

The manifest failure of financial sanctions to induce North Korea to abandon its nuclear weapons programme is perhaps not surprising given the nature of the North Korean regime and its unwavering commitment to developing WMD. Our focus here has, however, been on the prior question of why such sanctions do not appear to have exerted any significant macroeconomic pressure on the country and how financial sanctions have conversely contributed towards the deepening the role of informal trade settlement practices in North Korea's broader external economic relations. Sino-North Korean economic exchange has been increasingly characterised by the widespread use of cash and barter as a means of trade settlement. North Korean traders have actively utilised secretive methods in order to avoid using the official financial system to carry out transactions. Chinese trading companies and investors in the border regions have also adapted to such business methods, utilising informal customs and practices to evade sanctions as well as minimise expenses and engage in tax evasion. Pre-emptive measures taken by the North Korean authorities to avoid financial sanctions, such as the adoption of the Euro as the country's official foreign exchange currency, have added to the cumbersome nature of cross-border financial transfers, further encouraging resort to the use of cash and barter in trade settlement. Furthermore, attempts to regularise cross-border economic exchange by the Chinese authorities have been adversely affected by financial sanctions, meaning that such informal practices are likely to remain a dominant feature of North Korea’s external economic relations.

Questions can, of course, be raised about how representative the North Korean case may be and whether the lessons learnt here can be more widely generalised. Contextual factors such as China's lax enforcement of multilateral sanctions have often been cited as a fundamental weakness in the international sanctions regime directed at North Korea. As noted, however, a key claim of the financial sanctions literature is that such measures are capable of forcing compliance where conventional trade sanctions fail to do so. Financial sanctions have indeed been highly effective in forcing the Chinese financial sector to break its dealings with North Korean entities. As we have argued, however, such measures have done little to temper the growth of informal trade and investment relations between the two countries, and as a result, have done little to put any serious degree of pressure on the North Korean regime. This may have much to do with the geo-economic specificities of the Sino-North Korean border, which has played an important role in enabling actors on both sides of the border to resort to informal methods of trade and investment as a means of evading sanctions. As such, we suggest that analyses of the efficacy of financial sanctions need to be sensitive to specificities such as the precise combination of conventional and trade sanctions, the spatial dimensions of the target state's existing and potential external economic partners, and the willingness and capacity of third countries to enforce sanctions. At the very least, however, we argue that the North Korean case suggests that the new-found optimism towards the use of financial sanctions needs to be re-examined.

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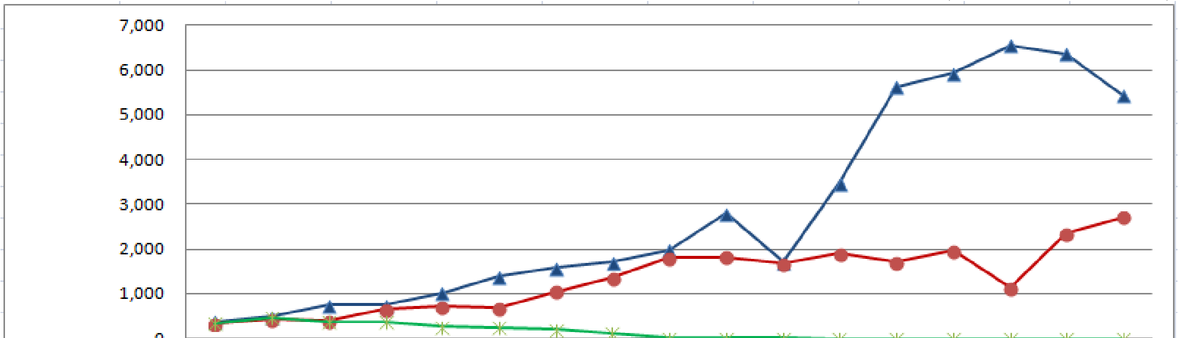
Figure 1. North Korea's Trade with China, South Korea and Japan

(Unit: Million US$)



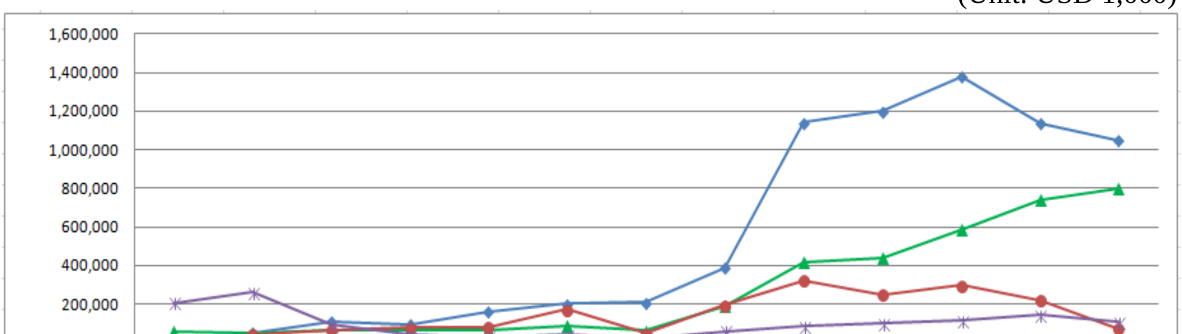
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
China	371	488	738	738	1,024	1,377	1,582	1,700	1,974	2,787	1,711	3,466	5,629	5,931	6,545	6,364	5,430
South Korea	333	425	403	642	724	697	1,056	1,350	1,798	1,820	1,679	1,912	1,714	1,971	1,136	2,343	2,714
Japan	350	464	367	368	266	253	195	122	9	8	3	0	0	0	0	0	0

Sources: Drawn from Chinese and Japanese customs data and from the South Korean Ministry of Unification.

Note: North Korean data between August and November 2009 has not been appeared in statistics of China Customs. It can be therefore assumed that trade this year in reality either continued as normal or increased. There is also an export data omission of crude oil in China's official trade statistics for an unknown reason since 2014.

Figure 2. North Korea's Major Exports to China

(Unit: USD 1,000)



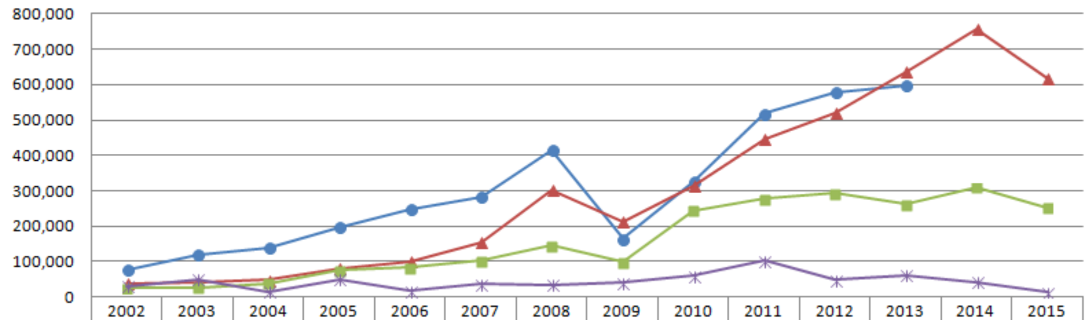
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Coal	15,428	49,085	108,273	96,651	162,619	201,273	208,633	390,405	1,140,909	1,198,492	1,379,790	1,135,702	1,049,785
Apparel	54,437	52,644	63,276	67,552	66,652	87,728	61,196	186,417	414,452	439,604	587,084	741,019	799,303
Iron ore	6,942	44,521	66,521	76,594	79,952	172,259	48,480	194,316	324,454	248,576	298,653	221,889	72,767
Fishery	206,931	261,231	92,396	43,266	29,936	40,000	21,595	59,530	82,756	100,534	113,809	143,257	108,476

Source: China Customs data drawn from the Korea International Trade Association (KITA.NET) database.

Note: the data of coal is drawn from HS Code 2701; the data of iron ores is from HS Code 2601; the data of apparel is based on HS Code 61 and 62, the data of fishery is from HS Code 03.

Figure 3. North Korea's Major Imports from China

(Unit: USD 1,000)



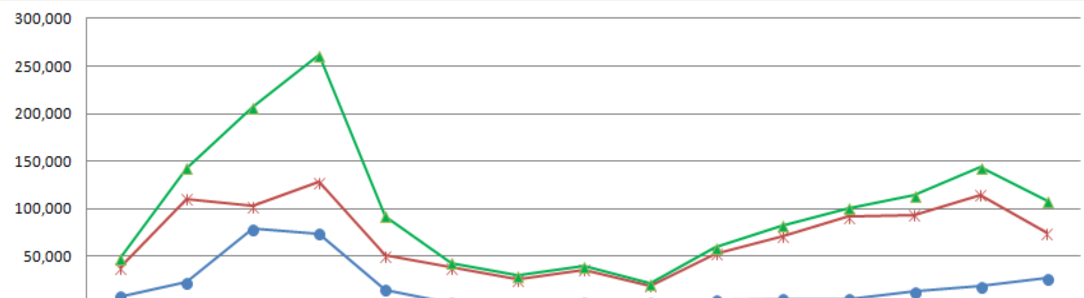
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Crude oil	76,468	121,004	139,326	197,675	246,898	281,979	414,310	164,192	325,774	518,361	577,896	598,134	n/a	n/a
Textile	38,572	40,455	47,554	81,773	100,303	152,748	303,622	211,305	312,926	447,321	521,051	636,320	756,747	616,293
Machinery	26,439	27,044	39,585	77,052	83,047	103,813	145,486	98,986	245,192	277,320	292,695	263,163	310,260	252,094
Cereals	29,910	49,961	15,275	50,291	16,852	36,511	34,875	40,622	59,794	102,344	47,887	61,033	43,406	13,863

Source: China Customs data drawn from KITA.NET database.

Note: China's export of crude oil in 2014 and 2015 is not available due to trade data omission in China Customs statistics.

Figure 4. China's Imports of North Korean Seafood

(Unit: USD 1,000)



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Crustaceans	7,889	22,534	78,652	74,135	15,382	1,406	527	834	1,916	4,190	5,322	5,202	12,955	18,300	27,407
Molluscs	38,125	110,557	102,950	128,148	51,140	38,177	25,798	36,064	19,342	53,218	71,292	91,439	94,039	114,872	74,566
Total fishery	47,977	143,016	206,931	261,231	92,396	43,266	29,936	40,000	21,595	59,530	82,756	100,534	113,809	143,257	108,476

Source: China Customs from the KITA.NET database (www.kita.net).

Note: The data of total fishery are based on HS Code 03; the data of crustaceans is drawn from HS Code 0306, the data of molluscs is from HS Code 0307.