

Testimony Before the House Foreign Affairs Committee
Subcommittee on Asia, the Pacific, Central Asia, and Nonproliferation

Hearing on

“The Way Forward on U.S. North Korea Policy”

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Introduction

Chairman Bera, Ranking Member Chabot, Distinguished Members of the Subcommittee, thank you for the opportunity to appear before you to share my thoughts on the way forward on U.S. North Korea policy.

As requested by the Subcommittee, I will be discussing: (1) a major factor undermining the effectiveness of the sanctions regime imposed on North Korea, (2) the rapidly emerging way in which North Korea has evaded sanctions, (3) areas to prioritize in order to address latest sanctions evasion techniques, and (4) what the United States can get from a realistic sanctions policy.

My remarks today are rooted in the earlier research that my MIT colleague, Dr. Jim Walsh, and I conducted to assess the unintended consequences triggered by the U.S. application of targeted sanctions aimed at halting the North Korean regime’s nuclear and ballistic missile programs. Based on interviews with former managers of “North Korea, Inc.”—the network of state trading companies that the regime operates to procure licit and illicit items—we mapped its practices, partners, and pathways.¹

(1) What Factor has been Undermining the Effectiveness of North Korea Sanctions?

Divergent U.S. and Chinese approaches to dealing with North Korea over the past fourteen years have created significant maneuvering space for North Korea. This loophole space has been a major factor undermining the effectiveness of North Korea sanctions. Specifically, North Korea, Inc. has thrived inside the Chinese economy with no strings attached to denuclearization progress. By prioritizing regime stability, China has unintentionally de-incentivized the North Korean leadership from engaging in sustained denuclearization negotiations.²

For context, it is helpful to understand the origins of this factor, which is grounded in each country’s approach to sanctions.

For North Korea, a key dilemma for leader Kim Jong Un is economic. While U.S.-China divergence provides valuable room to maneuver, it only presents a limited coping mechanism for him. The lack of a nuclear deal means that the United States will not lift denuclearization-linked sanctions, which, in turn, means no viable opportunity for the Kim regime to build up the national economy. Kim, whether ill-prepared or overconfident, sought at the 2019 Hanoi Summit the lifting of five of the eleven UN sanctions resolutions that would have reportedly benefited the civilian economy and people’s livelihood. In the aftermath of that failed attempt, pathways to large-scale

¹ John Park and Jim Walsh, “Stopping North Korea, Inc.: Sanctions Effectiveness and Unintended Consequences,” MIT Security Studies Program, August 2016.

https://drive.google.com/file/d/0B_ph0c6i87C_eGhCOGRhUVFaU28/view

² John Park, “Where Do Divergent U.S. and Chinese Approaches to Dealing with North Korea Lead?” in *The China Questions II: Critical Insights into U.S.-China Relations* (Harvard University Press, forthcoming in August 2022).

economic expansion remain firmly blocked. The ongoing self-imposed national quarantine has severely compounded this predicament.³

After testing new capabilities in 2017, Kim defended his nuclear weapons program as a “treasured sword” ensuring North Korea’s independence. In light of these advancements, the United States and China continue to share the goal of the peaceful denuclearization of North Korea. The two countries, however, have employed vastly different approaches to achieving that goal.⁴

For the United States, the dominant approach has been economic coercion. Following prior nuclear agreements that did not reach full implementation, Republican and Democratic administrations’ use of targeted sanctions has grown significantly since the mid-2000s. They used these sanctions as the central policy tool to shape the North Korean regime’s decision making and block its procurement of items to advance its nuclear weapons and ballistic missile programs. Despite applying stringent sanctions, the United States has not been able to halt major progress in North Korea’s nuclear and missile programs.⁵

What has China been doing? Since the late 2000s, China has deepened its economic engagement with the North Korean regime. Through the relationship between the Chinese Communist Party (CCP) and its counterpart the Workers’ Party of Korea (WPK), the two parties have cultivated and monetized political ties. Doing so has provided a powerful mechanism through which the Kim family regime—leaders of North Korea’s ruling and prosperous 1 percent—has shored up stability and thrived. At the invitation of the CCP, the WPK created sophisticated commercial networks that it has embedded inside the Chinese economy.⁶

Beijing’s “Sunshine Policy with Chinese Characteristics”—an ongoing CCP policy of granting the Kim regime access to the Chinese marketplace as a way for North Korea to follow a development path that gradually lowers the priority focus on the nuclear card—has created a host of unintended consequences. First and foremost, it creates a sanctions loophole. By free-riding off of China’s financial and domestic marketplace systems, North Korea can conduct vital commercial transactions beyond the reach of American sanctions. China consistently declares its adherence to UN Security Council sanctions, but adamantly opposes implementing a foreign country’s laws (e.g. U.S. sanctions) within Chinese jurisdiction. Second, this lifeline allows North Korea to bide its time and creates options for the regime. As a country possessing a nuclear arsenal and full access to the Chinese marketplace, North Korea can have its nuclear cake and eat it too.⁷

By prioritizing the stability of the North Korean regime over denuclearization in its policy actions, China created a loophole in which the North Korean regime could enjoy economic benefits without having to do denuclearization work. Beijing thus impeded the development of a connection to a larger process in which major denuclearization activity would be paired with major economic and diplomatic concessions.⁸

³ Ibid.

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

⁷ Ibid.

⁸ Ibid.

(2) What is the Rapidly Emerging Way in Which North Korea Has Evaded Sanctions?

North Korea, Inc. has gone virtual. North Korean cyber actors have increasingly targeted “financial institutions and cryptocurrency firms and exchanges.”⁹ In doing so, they have expanded a recurring revenue stream for the North Korean regime, which has bolstered its ability to evade sanctions.¹⁰ According to Chainalysis, a blockchain analysis firm, North Korean cybercriminals extracted nearly \$400 million worth of digital assets on cryptocurrency platforms in 2021. These cybercriminals primarily stole from investment firms and centralized exchanges, and carefully initiated a laundering process to mask their movements and cash out.¹¹

This trend has increased with another cyber heist by North Korea reported in March 2022. The Treasury Department posted details of a North Korea-linked hacking group’s massive theft from the Ronin Network, a crypto service built to support a gaming site. The Ronin Network announced that the North Korea-linked group stole the equivalent of \$620 million worth of Ethereum and USDC tokens from its network bridge to the Axie Infinity game.¹²

Based on the complex tactics and techniques employed by North Korean cybercriminals, the cybersecurity researcher community has characterized them as advanced persistent threats (APTs). A case in point is APT 38, more commonly referred to as “Lazarus Group,” which is led by the Reconnaissance General Bureau, North Korea’s main intelligence agency that the United States and UN have sanctioned.¹³

Initially breaking onto the global stage with its Sony Pictures and WannaCry cyberattacks, entities like Lazarus Group pivoted to highly lucrative cryptocurrency crimes. Starting in 2018, Lazarus Group substantially expanded its exploits and laundered virtual currencies exceeding \$200 million each year. The UN Panel of Experts reported that the group’s cybercriminal activities fund North Korea’s nuclear weapons and ballistic missile programs. Chainalysis estimates that from 2020-21, “the number of North Korean-linked hacks jumped from four to seven, and the value extracted from these hacks grew by 40%.”¹⁴

⁹ UN Panel of Experts, S/2022/132, 1 March 2022, p. 80. <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N22/252/09/PDF/N2225209.pdf?OpenElement>

¹⁰ For a structured analytical approach to assessing sanctions, see Markus V. Garlauskas, “A New Framework for Assessing Sanctions Is Vital for Any New US Strategy on North Korea,” 38 North, 22 October 2020. <https://www.38north.org/2020/10/mgarlauskas102220/>

¹¹ “North Korean Hackers Have Prolific Year as Their Unlaundered Cryptocurrency Holdings Reach All-time High,” Chainalysis, 13 January 2022. <https://blog.chainalysis.com/reports/north-korean-hackers-have-prolific-year-as-their-total-unlaundered-cryptocurrency-holdings-reach-all-time-high/>

¹² Brady Dale, “\$620 million crypto theft linked to North Korea,” Axios, 14 April 2022. <https://www.axios.com/2022/04/14/north-korea-crypto-theft-620>

¹³ “North Korean Hackers Have Prolific Year as Their Unlaundered Cryptocurrency Holdings Reach All-time High,” Chainalysis, 13 January 2022. <https://blog.chainalysis.com/reports/north-korean-hackers-have-prolific-year-as-their-total-unlaundered-cryptocurrency-holdings-reach-all-time-high/>

¹⁴ Ibid.

(3) What Areas Should the United States Prioritize to Address North Korea’s Rapidly Emerging Cyber Operations-enabled Sanctions Evasion Techniques?

I join my colleagues Jason Bartlett (Center for a New American Security), Priscilla Moriuchi (Harvard Kennedy School), and Alex O’Neill (Harvard Kennedy School) in advocating greater cooperation among countries’ law enforcement bodies.¹⁵ Doing so can reduce the space in which North Korean cybercriminals operate. Governments’ predominant policy tools resided in the intelligence community. However, as North Korean cyber operations shifted more to revenue generation via ransomware and cryptocurrency theft, the pre-existing authorities that law enforcement agencies possessed were better suited to efforts to shut down cybercriminals’ activities.

Moriuchi’s earlier research at Recorded Future, a Somerville, MA-based cybersecurity firm that specializes in the collection, processing, analysis, and dissemination of threat intelligence, focused on the North Korean regime’s organic development of cybercrime expertise. As she pointed out in a 2021 interview, “North Koreans understand criminality. They are integrated in many, many places with this criminal and gray underground world. And so it’s natural to overlay this new technology, the Internet. It connects criminal organizations and smugglers with one another.”¹⁶

As other cybersecurity experts also note, North Korean hackers’ growing connections with global criminal organizations present more opportunities to map these hackers’ practices, partners, and pathways. In his March 2022 report titled *Cybercriminal Statecraft: North Korean Hackers’ Ties to the Global Underground*, O’Neill, who is an Associate with Harvard’s Korea Project, observed how “North Korean financially motivated hackers often behave in cyberspace more like criminals than traditional state actors.”¹⁷

In his February 2022 report titled *Following the Crypto: Using Blockchain Analysis to Assess the Strengths and Vulnerabilities of North Korean Hackers*, Bartlett makes a compelling case for applying Treasury’s Financial Crimes Enforcement Network (FinCEN) to the crypto space by drawing on Europol’s 2018 cryptocurrency-focused conference on law enforcement. The goal of

¹⁵ See Alex O’Neill, “Cybercriminal Statecraft: North Korean Hackers’ Ties to the Global Underground,” Korea Project Report, Belfer Center for Science and International Affairs, Harvard Kennedy School, March 2022.

<https://www.belfercenter.org/sites/default/files/files/publication/Cybercriminal%20Statecraft%20-%20Alex%20O%27Neill.pdf>; Jason Bartlett, “Following the Crypto: Using Blockchain Analysis to Assess the Strengths and Vulnerabilities of North Korean Hackers,” Center for a New American Security, February 2022. <https://s3.us-east-1.amazonaws.com/files.cnas.org/documents/BlockchainAnalysisEES.pdf?mtime=20220216090240&focal=none>

¹⁶ Ed Caesar, “The Incredible Rise of North Korea’s Hacking Army,” *The New Yorker*, 19 April 2021. <https://www.newyorker.com/magazine/2021/04/26/the-incredible-rise-of-north-koreas-hacking-army>

¹⁷ Alex O’Neill, “Cybercriminal Statecraft: North Korean Hackers’ Ties to the Global Underground,” Korea Project Report, Belfer Center for Science and International Affairs, Harvard Kennedy School, March 2022.

<https://www.belfercenter.org/sites/default/files/files/publication/Cybercriminal%20Statecraft%20-%20Alex%20O%27Neill.pdf>

Bartlett's proposed application of FinCEN would be to foster multinational law enforcement cooperation on blockchain-enabled financial crime.

Despite North Korea's growing sanctions evasion activities via cybercriminal means, it still has to contend with the difficulty of converting stolen cryptocurrency into fiat. This difficulty provides an opportunity for robust law enforcement cooperation.

(4) What Can the United States Get from a Realistic Sanctions Policy?

North Korea has recently endured far worse than U.S. sanctions. Since January 2020, North Korea has persisted through a severe protracted clampdown of its economy, triggered by the North Korean regime's self-imposed quarantine to prevent the spread of the COVID-19 into the country. North Korea's track record in surviving this economic turmoil raises serious doubts about depending on U.S. and U.N. Security Council sanctions as an economic pressure tool. (Although the North Koreans reportedly allowed a few train shipments in January 2022, the overall border closure remains in place due to a COVID-19 outbreak in nearby Chinese cities.) North Korea's trade with China plunged by 75 percent in 2020 versus the previous year.¹⁸

At present, what may be realistic for the United States is exploring an arrangement with North Korea for a nuclear and ballistic missile testing moratorium in exchange for an easing of key sanctions. Based on recent research interviews with former U.S. negotiators who dealt with the North Koreans, it is clear that this arrangement could meet the respective near-term national interests of the two countries. For the United States, the moratorium halts one aspect of North Korea's advancement of its nuclear arsenal and addresses the thorny issue of verification. With respect to the latter, in-country inspections are not required as a moratorium itself would be an objective indicator.

For North Korea, sanctions easing in key areas could provide a dedicated relief valve for members of the 1 percent as well as the 99 percent. The continuation of the moratorium would pair with the continuation of selected sanctions easing and vice versa. Conversely, the end of one would result in the end of the other. This potential snapback feature could help both sides stay on track.

Overall, this mutually agreed pause could create room for further negotiations. A small deal could lead to a larger deal.¹⁹ An unconstrained North Korean nuclear weapons testing and development program reduces options for a feasible negotiated arrangement.

¹⁸ John Park, "Building a Flywheel: The Biden Administration's Opportunity to Forge a New Path with North Korea," Center for a New American Security, 28 February 2022. https://s3.us-east-1.amazonaws.com/files.cnas.org/documents/BuildingaFlywheel_Final.pdf?mtime=20220228155336&focal=None

¹⁹ Ibid.

Conclusion

The North Korean nuclear issue has mutated into a much more complex security challenge that no longer fits into past policy molds that rely heavily on sanctions implementation. The United States needs to recognize that North Korea under Kim Jong Un has become highly resilient to the core American policy tool of sanctions—largely due to far-reaching advancements in the relationship between the Chinese Communist Party and the Workers’ Party of Korea as well as the earlier migration and embedding of North Korea, Inc. deep inside the Chinese national economy.²⁰

There is a way forward on U.S. North Korea policy, but the space for it is dwindling quickly.

Thank you.

²⁰ Ibid.