

CRS Report for Congress

North Korean Crime-for-Profit Activities

February 16, 2007

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**Prepared for Members and
Committees of Congress**

Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE 16 FEB 2007		2. REPORT TYPE N/A		3. DATES COVERED -	
4. TITLE AND SUBTITLE North Korean Crime-for-Profit Activities				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Congressional Research Service The Library of Congress 101 Independence Ave, SE Washington, DC 20540-7500				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release, distribution unlimited					
13. SUPPLEMENTARY NOTES The original document contains color images.					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT SAR	18. NUMBER OF PAGES 17	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

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Summary

Strong indications exist that the North Korean (Democratic People's Republic of Korea or DPRK) regime is involved in illicit drug production and trafficking, as well as production and trafficking in counterfeit currency, cigarettes, and pharmaceuticals, with drug trafficking likely decreasing and counterfeiting of cigarettes expanding. Overall, the reported scale of this activity is significant and arguably provides important foreign currency resources to the military-oriented North Korean state. Media reports also indicate that North Korea may engage in insurance fraud as a matter of state policy. DPRK crime-for-profit activities are reportedly orchestrated by a special office charged with bringing in foreign currency under the direction of the ruling Korean Worker's Party.

With the caveat that dollar value estimates of clandestine activities are highly speculative, conservative/mainstream estimates suggest North Korean criminal activity generates as much as \$500 million in profit per year, with some estimates reaching the \$1 billion level. A core issue is whether the income from the DPRK's reportedly widespread criminal activity is used to finance the acquisition of weapons of mass destruction, thereby strengthening the DPRK's ability to maintain what many view as its — to date — truculent, no-compromise position on curbing its aggregate level of criminal activity. Moreover, the DPRK has on numerous occasions linked its ongoing participation in the Six-Party Talks to the lifting of U.S. restrictive measures against Banco Delta Asia which are designed to sanction the Macau-based bank for its reported longstanding role in facilitating the money laundering of proceeds linked to DPRK criminal activity.

Policy analysts in the past have suggested that North Korean crime-for-profit activity has been carefully controlled and limited to fill specific foreign exchange shortfalls. However, increasing concern exists that North Korean crime-for-profit activity is becoming a "runaway train," gaining momentum, and possibly out of control. As the DPRK's crime-for-profit activity becomes increasingly entrenched, and arguably in some cases decentralized, analysts question whether the Pyongyang regime (or any subsequent government) would have the ability to effectively restrain such activity, should it so desire. Moreover, some suggest that simply replacing DPRK crime-related income with legitimate-source income would ignore the need of the current regime to divert funding to slush funds designed to sustain the loyalty of a core of party elite numbering in the tens of thousands and to underwrite weapons development programs. They argue, therefore, that prospects for a decrease in crime-for-profit activity do not bode well for the current regime as it appears to be neither willing nor able to change its dependence on income that is unaccountable.

A challenge facing policymakers is how to balance pursuing anti-drug, counterfeiting, and crime policies *vis-a-vis* North Korea against effectively pursuing other high priority U.S. foreign policy objectives including (1) limiting possession and production of weapons of mass destruction; (2) limiting ballistic missile production and export; (3) curbing terrorism, and (4) addressing humanitarian needs. This report may be periodically updated.

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North Korean Crime-for-Profit Activities

Overview

Allegations of North Korean (Democratic People's Republic of Korea or DPRK) drug production, drug trafficking, and crime-for-profit activities have become the focus of increased attention in Congress, the Administration, and the press, as well as in the diplomatic community.¹ Areas of DPRK criminal activity commonly cited include production and trafficking in: (1) heroin and methamphetamines; (2) counterfeit cigarettes; (3) counterfeit pharmaceuticals (for example "USA" manufactured Viagra®); and (4) counterfeit currency (e.g., U.S. \$100 bill "supernotes").² Media reports also indicate that North Korea may be engaged in insurance fraud as a matter of state policy.³

Strong indications exist that the North Korean regime is heavily involved in illicit drug trafficking, as well as trade in counterfeit cigarettes and pharmaceuticals — with illicit drug trafficking and production declining and counterfeiting of cigarettes expanding. The estimated aggregate scale of this activity is significant and arguably provides important foreign currency resources to the military-oriented North Korean state. DPRK crime-for-profit activities are reportedly orchestrated by a special office charged with bringing in foreign currency under the direction of the ruling Korean Worker's Party.

¹ See generally CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael Perl, and CRS Report RL33324, *North Korean Counterfeiting of U.S. Currency*, by Raphael Perl and Dick Nanto.

² Note that in addition to citing the likelihood of past DPRK state involvement in illicit drug production and trafficking, the U.S. Department of State in its March 2006, *International Narcotics Control Strategy Report* (INCSR) states that:

Indictments in the United States issued in 2005 and the ongoing work of several corporate investigative teams employed by the holders of major United States and foreign cigarette and pharmaceutical trademarks have provided compelling evidence of DPRK involvement in trademark violations carried out in league with criminal gangs around the world, including trafficking in counterfeit cigarettes and Viagra. The DPRK is also associated with production of high-quality counterfeit U.S. currency ("supernotes").

On the issue of counterfeiting of U.S. currency, in July 2004, for example, the U.S. Secret Service reportedly uncovered a network selling counterfeit North Korean made cigarettes, pharmaceuticals, and \$100 bills. See Frederik Balfour et al., "Fakes," *Business Week*, February 7, 2005. Criminal indictments subsequently ensued. See generally *BBC News*, "What is a superdollar?", June 20, 2004.

³ See section on insurance fraud, *supra*.

North Korean drug trafficking, trade in counterfeit products and the counterfeiting of U.S. currency, to the extent that it does indeed exist, is a matter of growing concern in Asian, European, and U.S. law enforcement, foreign policy, and national security communities. At least 50 documented incidents, over decades, many involving arrest or detention of North Korean diplomats, link North Korea to drug trafficking. Such activity, particularly production and trafficking of methamphetamine and trade in counterfeit cigarettes, appears to be on the rise.⁴

With the caveat that dollar value estimates of clandestine activities are highly speculative, conservative/mainstream estimates suggest North Korean criminal activity generates as much as \$500 million in profit per year, with some estimates reaching the \$1 billion level. The Korea Institute for Defense Analysis reportedly stated that North Korea earns between \$700 million and \$1 billion per year from exporting weapons and trading drugs and counterfeit money.⁵ In 2003, an official from U.S. Forces Korea reportedly stated that North Korea's annual revenue from exports of illegal drugs was estimated at \$500 million and from counterfeit bills at \$15-\$20 million. The official also stated that in 2001, North Korea exported ballistic missiles worth \$580 million to the Middle East.⁶ The \$1 billion figure for illicit exports also can be inferred from international trade data and from observations that in Pyongyang, markets have ample supplies of imported foreign goods. In both 2004 and 2005, North Korea is estimated to have incurred a trade deficit of about \$1.8 billion. In 2005, exports were about \$1.7 billion and imports \$3.6 billion.⁷ Some of this imbalance is financed through food and other aid, but since Pyongyang does little borrowing on international markets and Tokyo has been cracking down on remittances from ethnic North Koreans in Japan, the other \$1 billion or so must come from somewhere. It is often surmised that this must be financed by illicit activity.⁸

Such events, in the context of ongoing, credible allegations of large-scale state sponsorship of crime-for-profit enterprises, raise serious issues for the United States and America's allies, especially those engaged with the United States in the Six-Party Talks with the DPRK to eliminate the DPRK's nuclear weapons program. A core issue is whether the income from the DPRK's reportedly widespread criminal activity finances the acquisition of weapons of mass destruction, thereby strengthening the

⁴ For more details, see CRS Report RL33324, *North Korean Counterfeiting of U.S. Currency*, by Raphael Perl and Dick Nanto, and CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael Perl.

⁵ PSI 'Will Hit N. Korea Where It Hurts,' *The Chosun Ilbo* [digital version], October 27, 2006.

⁶ USFK Details DPRK's Drug, Missile Exports, Counterfeit Bills. *Chosun Ilbo* (Internet Version-WWW), May 12, 2003. Translated by Open Source (Article No. KPP20030514000056).

⁷ See generally CRS Report RL32493, *The North Korean Economy: Background and Policy Analysis*, by Dick Nanto and Emma Chanlett-Avery.

⁸ For example, see Statement of David L. Asher, Ph.D. Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Homeland Security and Government Affairs Committee, April 25, 2006. Footnote 2.

DPRK's ability to maintain truculent, no-compromise positions on the issue of its nuclear weapons program, should it so choose.

A challenge facing policymakers is how to balance pursuing anti-drug, counterfeiting, and crime policies *vis-a-vis* North Korea against effectively pursuing other high priority U.S. foreign policy objectives including (1) limiting possession and production of weapons of mass destruction; (2) limiting ballistic missile production and export; (3) curbing terrorism, and (4) addressing humanitarian needs.

The role of Congress in this issue includes oversight of U.S. policy, eliciting information and raising public awareness of the issue, and balancing U.S. interests when foreign policy goals may conflict with anti-crime activities. Counterfeiting, copyright and trademark violations, and other illicit activity occur in virtually all countries of the world, but what makes the North Korean case special is apparent state sponsorship. In this view, if the DPRK is to join the larger international community of nations, it would be expected to cease state-sponsorship of such activities and to take appropriate measures against private parties engaged in such production and/or distribution.

On February 13, 2007, the United States, North Korea, China, Japan, South Korea, and Russia reached what is called the Six-Party Agreement (North Korea — Denuclearization Action Plan). This includes commitments by North Korea to abandon its nuclear weapons and existing nuclear programs in exchange for energy and other assistance. It also provides for the initiation of dialogues on establishing bilateral ties (normalizing diplomatic relations) between the DPRK and the United States as well as between the DPRK and Japan.⁹ The U.S. side also reportedly pledged to resolve within 30 days the Banco Delta issue in which the U.S. Treasury took action against a bank in Macau suspected of laundering North Korean profits from illicit activities. The Banco Delta action apparently played an important role in bringing Pyongyang back to the bargaining table and in reaching an agreement.¹⁰ North Korea's illicit activities are likely to be further addressed in the bilateral working team established under the agreement that is to pursue the normalization of relations between the DPRK and the United States.

⁹ U.S. Department of State. Initial Actions to Implement Six-Party Joint Statement, February 13, 2007. Li, Jing. The Six-Party Talks Enters a Substantive Stage; the Joint Document Opens the Road to Denuclearization in the Korean Peninsula. *Zongguo Xinwen She* (Beijing), February 13, 2007. Reported by BBC Monitoring Asia Pacific, London, February 14, 2007, p. 1.

¹⁰ Kessler, Glenn and Edward Cody. U.S. Flexibility Credited in Nuclear Deal with N. Korea. *The Washington Post*, February 14, 2007, p. A.11. King, Neil Jr. and Evan Ramstad. Politics & Economics: What Drove the North Korea Deal; U.S. Hungered for Diplomatic Victory, Pyongyang for Financial Relief. *Wall Street Journal*, February 14, 2007, p. A.4.

Illicit Drug Production and Trafficking

Allegations of State Involvement

There is growing evidence that the North Korean government has supported drug production and trafficking as a matter of state policy. Since 1976, North Korea has been linked to more than 50 verifiable incidents involving drug seizures in at least 14 countries. A significant number of these cases has involved arrest or detention of North Korean diplomats or officials. In 1999, substantial seizures of North Korean methamphetamine occurred in Japan (35% of the total methamphetamine seizures in Japan that year). Large seizures of heroin and methamphetamine with a link to the DPRK have since then occurred in Taiwan, and in April of 2003, the “Pong Su,” a DPRK state enterprise-owned, sea-going vessel of around 4,000 MT apparently delivered a large quantity of DPRK-trafficked and also possible DPRK-origin heroin to Australia. Although members of the vessel’s North Korean crew were subsequently acquitted on charges relating to the smuggling of the drugs, experts have little doubt of a North Korean connection to the drug shipment.¹¹

Since 2003, however, no incidents definitively and directly linking the DPRK State apparatus to such drug trafficking activity have come to light. Many analysts suggest that any decline in DPRK state-linked drug trafficking activity would likely be in response to enhanced international attention paid to such activity in the wake of the April 2003 seizure of heroin carried on the North Korean Vessel the “Pong Su.” Others, however, remain skeptical and offer an alternative explanation. They suggest that this decline in seizures being identified as DPRK origin is because North Korean source methamphetamine is now regularly being mistakenly identified as “Chinese source,” given growing links of Chinese criminal elements to North Korea’s drug production/trafficking activities. In line with such a conclusion are press reports in late 2006 of the arrests in China in differing locations of North Korean nationals involved with Chinese criminals in the trafficking of methamphetamines. However, it is not clear from the reports whether the drugs were of DPRK origin or whether the North Koreans arrested had links with DPRK officials.¹²

Concerns about North Korean drug trafficking and production were initially expressed in the *Report of the International Narcotics Control Board* in 1997, which referred to such reports as “disquieting.” Moreover, the State Department’s March 1, 2006 *International Narcotics Control Strategy Reports* [INCSR] stated that the Department had again reached the conclusion that:

¹¹ Notable here is the DPRK registry of the Ship, the DPRK nationality of its crew, and the presence on the ship of as least one DPRK non-crew political officer. For more detail see CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael Perl.

¹² See China Busts Huge N. Korean Drug Ring, *Bangkok Post*, January 11, 2007 [DPA report]. Note, however, that it is not clear from the reports whether the drugs were of DPRK origin or whether the North Koreans arrested had links with DPRK officials.

For decades, North Koreans have been apprehended trafficking in narcotics and engaging in other criminal behavior and illicit activity, including passing counterfeit U.S. currency and trading in copyrighted products. This year there were no public reports of specific incidents of narcotics trafficking with clear, demonstrable DPRK (Democratic People's Republic of Korea) links. However, given developments during 2005 that linked the DPRK to other forms of state-directed criminality, the Department reaffirms its view that it is likely, but not certain, that the North Korean government sponsors criminal activities, including narcotics production and trafficking, in order to earn foreign currency for the state and its leaders.¹³

Reported Scope of Illicit Drug Activity

Opium Cultivation and Processing. According to press reports and North Korean defectors, farmers in certain areas are ordered to grow opium poppies. Looking at available cultivation estimates, an estimate of 3,000-4,000 hectares cultivated would appear reasonable, but, nevertheless, is based on indirect and fragmented information. With the caveat that conclusive "hard" data is lacking, U.S. government investigative agency sources estimate North Korean raw opium production capacity at 50 tons annually. North Korean government pharmaceutical labs reportedly have the capacity to process 100 tons of raw opium per year.¹⁴

Methamphetamine Production. North Korea's maximum methamphetamine production capacity is estimated to be 10-15 tons of the highest quality product for export. This coincides with a time when markets for methamphetamine are dramatically expanding in Asia, especially in Thailand, Japan, the Philippines, and more recently in Cambodia and China.¹⁵

Drug Certification Issues. North Korea could well find itself on the State Department's drug "majors list," at some point, especially if opium production in North Korea in excess of 1,000 hectares could be confirmed. This would make Pyongyang subject to the drug certification process applicable to "major" producers and potentially liable to discretionary trade sanctions and restrictions on non-humanitarian aid, but with a proviso for "National Interest" waivers of those sanctions.¹⁶

¹³ U.S. Department of State, *International Narcotics Control Strategy Report* (INCSR), March 2006.

¹⁴ See generally, *INCSR*, March 2000, p. VIII-39 and CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael Perl, pp. 8-9.

¹⁵ See generally, *INCSR*, March 2006 and CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael Perl, pp. 8-9.

¹⁶ For drug certification procedures generally see *INCSR*, March 2006 and "Certification Process" section of CRS Report RL33582, *International Drug Trade and U.S. Foreign Policy*, by Raphael Perl.

Rising DPRK Private Domestic Drug Production and Abuse?

An emerging genre of reports, yet to be substantiated, suggests that as state control of drugs in the DPRK becomes looser, a growing amount of stimulants for domestic sale and consumption are being produced privately by scientists in the DPRK and funded by private investors. Some reports suggest drug abuse is becoming widespread among senior military officials and also among the poor as a means to dull hunger. Others suggest that drug addiction is spreading among cadres such as the officer corps of the People's Army Security Department and high-ranking party officials. A scenario is being presented of drugs sold openly at farmers markets, at times being used instead of currency in transactions.¹⁷

Manufacture and Distribution of Counterfeit U.S. Currency

In addition to the production and distribution of illicit drugs, the DPRK appears to be involved in the production and distribution of counterfeit foreign currencies as a means of generating foreign exchange.¹⁸ The United States has accused the DPRK of counterfeiting U.S. \$100 Federal Reserve notes (supernotes) and passing them off in various countries. Many incidents and evidence link the DPRK to the production and distribution of bogus supernotes. However, because counterfeiting is a form of clandestine criminal activity and North Korea is a closed society, such information is incomplete at best.

Incidents Linking the DPRK to Counterfeiting Activity

At least thirteen reported incidents since 1994 show North Korean involvement in counterfeiting and smuggling/distributing U.S. currency. All of these incidents occurred in either Asia or Europe. The use of DPRK diplomatic passports and the involvement of DPRK diplomats, embassy personnel, and employees and officers of DPRK state-owned and -operated trading companies connect most of these incidents to the government of North Korea in varying degrees. Taken collectively, the link is seen as even stronger. Of these 13 incidents, 6 have occurred since 1999.¹⁹

Counterfeiting of foreign currency is apparently a phenomenon that is not new to the government of North Korea. Seoul's War Memorial Museum reportedly contains DPRK-manufactured South Korean currency from the 1950s, the production of which reportedly continued into the 1960s. South Korean media reports cite a

¹⁷ See Widespread Drug Use in North Korea; Drug Control; Domestic Circulation, Alternative to Food Shortage, *Sankei Shimbun* (Internet Version), June 20, 2006, TO3:13:10Z.

¹⁸ For detail, see CRS Report RL33324, *North Korean Counterfeiting of U.S. Currency*, by Raphael F. Perl, and Dick K. Nanto.

¹⁹ See "The 'Soprano State?' North Korean Involvement in Criminal Activity and Implications for International Security," by Sheena E. Chestnut (hereinafter cited as *Chestnut*), Stanford University Honors Thesis, May 20, 2005, p. 144-145.

1998 South Korean National Intelligence Service (IS) Report to the effect that North Korea forges and circulates U.S. \$100 banknotes worth \$15 million a year. Subsequent reports to the South Korean National Assembly in the same year and in 1999 are cited in the media as stating that North Korea operates three banknote forging agencies and that more than \$4.6 million in bogus dollar bills had been uncovered on thirteen occasions since 1994.²⁰

Arrests and indictments point to DPRK trafficking in bogus U.S. currency as recently as 2005. In August 2005, federal law enforcement authorities completed two undercover operations which focused on the activities of members of China's Triad criminal syndicates. The operations, named Royal Charm and Smoking Dragon, reportedly netted some \$4 million in supernotes believed to be of North Korean origin. Illicit narcotics, and counterfeit brand cigarettes and pharmaceuticals were seized as well. U.S. government authorities indicate there is the potential that ensuing trials and/or the plea bargaining process will reveal direct links between some of the smugglers and North Korean officials or government entities.²¹

Banco Delta Asia

U.S. policy toward the alleged counterfeiting is split between law enforcement efforts and political and diplomatic pressures. On the law enforcement side, the Banco Delta Asia bank in Macau (a territory of China) has been named as a primary money laundering concern under the Patriot Act²² resulting in a proposed order imposing special measures against Banco Delta Asia.²³ This order led to banks, not only from the United States but from other nations as well, refusing to deal with even some legitimate North Korea traders. North Koreans appear to be moving their international bank accounts to Chinese banks and seeking to use other banking

²⁰ See "Seoul's U-Turn on N. Korean Counterfeiting Could be Fatal," *Chosun Ilbo* (English Edition), December 25, 2005. The title of the 1988 report is cited as "A New Threat in the 21st Century: Realities and Responses to International Crimes."

²¹ See generally, remarks of Acting Assistant Attorney General, John C. Richter of Aug. 22, 2005. [http://www.usdoj.gov/criminal/press_room/speeches/2005_4193_rmrksOprSmokngDrgnNroylChrm082405O.pdf]

²² The Department of the Treasury. Treasury Designates Banco Delta Asia as Primary Money Laundering Concern under USA Patriot Act. Press Release JS-2720. September 15, 2005. See *Federal Register*, Vol. 70 No. 181, Sept. 20, 2005(Notices), p. 55214. The finding asserts that at least one regular North-Korean-front client of BDA was widely reported to be conducting "numerous illegal activities, including distributing counterfeit currency and smuggling counterfeit tobacco products" for over a decade. See also Department of the Treasury Press Release of September 15, 2005, (JS-2720) on Treasury Designation of Banco Delta Asia as a Primary Money Laundering Concern and Treasury Dept. FINCEN Advisory of December 13, 2005, on Guidelines to Financial Institutions on the Provision of Banking Services to North Korean Government Agencies and Associated Front Companies Engaged in Illicit Activities which encourages financial institutions worldwide to take precautions that they are not used as a conduit for the laundering of proceeds of DPRK illicit activities.

²³ See *Federal Register*, Vol. 70 No. 181, Sept. 20, 2005 (Notice of Proposed Rulemaking), p. 55217ff.

institutions including those in Austria and Switzerland.²⁴ Pyongyang has cited the Banco Delta Asia action in the past when it refused to return to the Six-Party Talks on its nuclear program and reportedly received a pledge by the United States as an aside in the process of negotiating the Six-Party Agreement of February 13, 2007, to resolve the Banco Delta issue.²⁵ The issue with North Korea seems not to be so much the \$24 million in funds frozen at Banco Delta but the wider ripple effect of the freezing of the funds on the way the international banking community treats DPRK accounts. If the issue is resolved, for North Korean traders and others, will the situation return to “business as usual,” business with caution,” or remain as “no business at all” (except for accounts with a few banks)?

Amount of Counterfeit Currency Reportedly Produced or in Circulation

The amount of alleged DPRK-produced counterfeit currency in circulation is unknown. In 2006, U.S. officials cited the figure of \$45-\$48 million detected or seized since 1989.²⁶ Officials familiar with the bogus currency in question, note its exceptional quality — so good that many cashier-level bank personnel would likely not be able to detect the forgeries.

The amount of money that the bogus supernotes allegedly bring to the coffers of the North Korean government is unknown as well. Hence, estimates of the profit such transactions bring to the Pyongyang regime — to the extent they are based on open source material — are speculative at best. Amounts commonly cited, which take into account many factors, range from \$15 million to \$25 million in profit per year. It has been reported that in the North Korean counterfeit currency market, a printed counterfeit \$100 bill trades at 30% of its face value while electronically copied currency made with color copy machines trades at 10% of its face value.²⁷

²⁴ Major Chinese Banks Refrain From Dealing with N. Korean Firms. *Kyodo News*, March 13, 2006.

²⁵ King, Neil Jr. And Evan Ramstad. Politics & Economics: What Drove the North Korea Deal; U.S. Hungered for Diplomatic Victory, Pyongyang for Financial Relief. *Wall Street Journal*, February 14, 2007, p. A.4. The Banco Delta action was taken partly under the Bush Administration’s Illicit Activities Initiative. See David L. Asher, Statement Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Homeland Security and Government Affairs Committee, April 25, 2006.

²⁶ See Pan, Esther. *North Korea’s Capitalist Experiment*. Council on Foreign Relations Backgrounder, June 8, 2006. David L. Asher, Statement, April 25, 2006, op. cit. Statement of Peter A. Prahar, Director, Office of Africa, Asia and Europe Programs, Bureau for Narcotics and Law Enforcement Affairs, Department of State, Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Homeland Security and Government Affairs Committee, April 25, 2006.

²⁷ “Smuggler’s Tale: The Chinese Connection.” *Dong’A Ilbo* (Internet version) January 27, 2006. Reported by Open Source Center.

Counterfeit Pharmaceuticals, Cigarette Knock-Offs, and Insurance Fraud

Counterfeit Pharmaceuticals

North Korea has an advanced pharmaceutical industry, and it is widely believed that large-scale production of expertly packaged pharmaceuticals such as knock-off erectile enhancement drugs (particularly, Viagra® and Cialis®) has been orchestrated by Pyongyang. However, public source data on such alleged activity is sketchy. At issue is not the existence of the knock-off drugs, but whether the DPRK is indeed the manufacturer with some speculating that China may be the source of production.²⁸

Counterfeit Cigarettes

In contrast to pharmaceuticals, it is well documented that the DPRK produces counterfeit cigarettes for export, and production of seemingly genuine Japanese brand cigarettes (Mild Seven) and U.S. brands such as Marlboro appears to be flourishing. According to the *Wall Street Journal*, U.S. authorities seized more than a billion of the “fake smokes” in California in 2005. Millions more packs of fake Marlboros, Mild Sevens, and other cigarettes made in North Korea have been seized in Taiwan, the Philippines, Vietnam, and Belize.²⁹ Officials from Philip Morris, which launched a major undercover operation to investigate the trade, have been cited as stating that DPRK-made knock-offs of its Marlboro brand have been discovered in more than 1,300 places: “From New York to Oklahoma City, Forth Worth, Seattle, and Los Angeles.” They cite DPRK knock-off cigarette production capacity as being in the range of more than two billion packs a year, making Pyongyang one of the largest producers of such contraband in the world.³⁰

Press reports cite a confidential report prepared by a consortium of tobacco manufacturers to the effect that the DPRK regime could be earning some \$80 to \$160 million in payoffs alone from manufacturers of such counterfeits. Gross revenues from such sales, according to the report, could generate between \$520 and \$720 million annually. One of the main hubs of such activity is reportedly Rajin, a free trade zone port city on North Korea’s east coast. Many of the cigarette factories in Rajin are reportedly owned and financed by Chinese criminal groups. According to

²⁸ Note that “knock- off” Viagra® and Cialis® are readily available in China, notably in Dandong on the DPRK border. For allegations/reports linking the DPRK in the past to such activity, see Statement of David L. Asher before the Subcommittee on Federal Financial Management, Government Information, and International Security of the Senate Homeland Security and Government Affairs Committee, April 25, 2006. See also, *U.S. News and World Report*, White House Week, May 30, 2005.

²⁹ See “Dispatch: Export boom: Tobacco Companies Trace Fake Cigarettes to North Korea,” by Gordon Fairclough, *Wall Street Journal*, January 27, 2006.

³⁰ Ibid. Note that legal cigarette production and distribution in North Korea is done partly by a joint venture between the British American Tobacco company and Sogyong General Trading Corporation, a Pyongyang-based state trader. (Saalman, Lora. Smoke Signals From BAT’s North Korea Venture. *Online Asia Times*, February 8, 2006.)

the report, the DPRK regime allows specific deep-sea smuggling vessels to use its ports for such smuggling and provides the gangs with a secure delivery channel.³¹ North Korean state-owned enterprises, mostly located in the Pyongyang area, also reportedly produce contraband cigarettes.³²

Media reports indicate that Greek authorities seized some four million cartons of contraband cigarettes through the fall of 2006, of which three million were aboard North Korean vessels. For example, on September 25, 2006, Greek officials detained a North Korean freighter that was carrying 1.5 million cartons of contraband cigarettes and arrested the seven seamen on board. According to information from Greek customs authorities, the ship's load of counterfeit, duty-unpaid cigarettes would have brought 3.5 million euros in taxes.³³

Insurance Fraud

Media reports in late 2006 suggest that the DPRK may be involved in insurance fraud as a matter of state policy. Concern in the reinsurance industry is that property damage being claimed is vastly overstated; circumstances of accidents are being altered; and that deaths for which insurance is being claimed are not accident related.³⁴

A recent example cited in media reports of possible DPRK state involvement in insurance fraud involves a ferry accident that reportedly occurred in April 2006 near the coastal city of Wonsan. After the accident, North Korea declared that 129 people had died, all of whom were provided life insurance coverage when they bought a ticket. It was claimed that most of the victims had died of hypothermia, although weather data apparently indicated that temperatures were warmer than reported by Pyongyang's Korea National Insurance Corporation.³⁵ In another case, in July 2005, a medical rescue helicopter apparently crashed into a government owned disaster supply warehouse setting it on fire. It reportedly took the DPRK

³¹ See *Production of Counterfeit Cigarettes in the Democratic People's Republic of Korea* (DPRK), June 29, 2005, potentially available from Philip Morris, USA, the American tobacco unit of New York-based Altria Group, Inc. Note that the report does not touch upon the potential role played by South Korean authorities, who, whether by design or lack of customs, law enforcement resources, or political will, may facilitate or countenance the trade.

³² Fairclough, Gordon. Dispatch: Export boom: Tobacco companies trace fake cigarettes to North Korea, *Wall Street Journal*, January 27, 2006.

³³ Note that the Greek Merchant Marine Ministry reported that the ship, the *Evva*, was discovered about eleven kilometers southwest of the port of Katakolo on the Peloponnesus Peninsula in southern Greece. The cargo appeared to be destined for Greece. See N. Korean Ship with Contraband Cigarettes Nabbed, *Chosun Ilbo*, September 26, 2006.

³⁴ See Russell, George, North Korea Suspected of Collecting Millions in Reinsurance Fraud, *Fox News* report of December 4, 2006 which cites Michael Payton, an attorney representing several of the insurance companies involved with the DPRK.

³⁵ Ibid. See also North Korea's Insurance Fraud, *Dong-A Ilbo*, 22:23 GMT, December 5, 2006.

authorities only ten days to file a claim which included a detailed inventory of hundreds of thousands of items — a task which insurance industry officials say normally takes most governments many months.³⁶

Although a practice of North Korean state initiated insurance fraud has not been definitively confirmed, criminal conduct of this nature would appear consistent with a well-established pattern of DPRK crime-for-profit activity. One industry source estimates that the extent of fraudulent DPRK insurance claims may well exceed \$150 million.³⁷

Policy and Prospects

U.S. policy addresses North Korea's crime-for-profit activities through two tracks: law enforcement and diplomacy. Although the two tracks overlap considerably, each has a different focus.

On the law enforcement side are actions such as the prosecution of criminal behavior and those resulting from the Bush Administration's Illicit Activities Initiative (IAI). The IAI was established in 2003 as an interagency effort aimed at curtailing North Korean involvement in narcotics trafficking, counterfeiting, and other illicit activities. The major purposes of the initiative have been to provide policy support for the Six-Party Talks and to hold North Korea to internationally accepted standards of behavior by enforcing relevant U.S. and other laws. The IAI has come to involve fourteen different U.S. government departments and agencies, and it has received cooperation from fifteen different governments and international organizations.³⁸ The Banco Delta Macau action stemmed partly from the work of the IAI.

The diplomatic (political/security) track attempts to stop the crime-for-profit activities by tying them to other needs of the DPRK and by raising the costs of such activity to Pyongyang. The strategy is to use law enforcement measures to induce movement on the diplomatic front in fora such as the Six-Party Talks and to use the nuclear talks to also address issues such as North Korea's illicit activities.

Following the February 2007 Six-Party Agreement, a policy challenge for the United States as it negotiates the details of actual action is to obtain concurrence by Pyongyang to address the issue of its alleged crime-for-profit activities and to receive a commitment to curtail them. A likely vehicle for this discussion may be the working team on the normalization of diplomatic relations between the DPRK and the United States. Since Japan, South Korea, and China also have considerable

³⁶ Ibid.

³⁷ Russell, George. North Korea Suspected of Collecting Millions in Reinsurance Fraud, *op. cit.*

³⁸ See David L. Asher, Statement Before the Subcommittee on Federal Financial Management, Government Information, and International Security Senate Homeland Security and Government Affairs Committee, April 25, 2006.

interest in protecting themselves from North Korean illicit activity, it also may be addressed in the working team on normalizing relations between the DPRK and Japan as well as in other negotiations. The Six-Party Talks, however, have a history of hitting snags and not going anywhere for long periods of time.³⁹

The United States and other nations also are taking direct measures to halt shipments of illicit cargo from North Korea. The Proliferation Security Initiative (PSI), for example, is aimed at stopping shipments of weapons of mass destruction, their delivery systems, and related materials by tracking and searching suspected ships or other conveyances transporting such cargo. Fourteen nations have signed on to the PSI, and many more have endorsed the principles.⁴⁰ Although not directed at illicit activities per se, the prospect of ships being inspected complicates North Korean efforts to smuggle items such as illegal drugs, fake pharmaceuticals, and counterfeit currency.⁴¹ A weakness of the PSI, however, is that the DPRK's immediate neighbors, China and South Korea, have not joined the effort.

The role of Congress in this issue includes oversight of U.S. policy, eliciting information and raising public awareness of the issue, and in balancing U.S. interests when foreign policy goals may conflict with anti-crime activities. Congress also may be asked to provide funding for energy and food assistance to North Korea as part of a resolution of the DPRK's nuclear weapons program. Additional supplies of energy and food could reduce the need to rely on illicit activities in some North Korean quarters. Congressional action also could be required to enable North Korea to earn more foreign exchange through an increase in its legitimate exports or by attracting investments from U.S. businesses. This could include, for example, granting the DPRK normal trading nation status (most favored nation status) with respect to U.S. import duties,⁴² or by allowing goods from North and South Korea's Kaesong Industrial Complex to be included in the proposed Korea-U.S. Free Trade Agreement now being negotiated.⁴³

³⁹ For the status of current and ongoing political developments involving the DPRK see CRS Report RL33567, *Korea-U.S. Relations: Issues for Congress*, by Larry Niksch and CRS Report RL33590, *North Korea's Nuclear Weapons Development and Diplomacy*, by Larry Niksch.

⁴⁰ U.S. Department of State. *The Proliferation Security Initiative*, June 2004. [<http://usinfo.state.gov/products/pubs/proliferation/>]

⁴¹ The White House. Proliferation Security Initiative, Fact Sheet. September 4, 2003. U.S. Department of State. U.S. Notes First Anniversary of Proliferation Security Initiative. Press Release, June 1, 2004.

⁴² Only Cuba and North Korea do not have normal trade relations (NTR) status with the United States. Usually, countries first normalize relations with the United States, then sign a trade agreement that provides temporary NTR status, and then seek permanent NTR status. Without NTR, imports are assessed the duties that were applied to U.S. imports in the 1930s before being reduced by various rounds of multilateral negotiations and other agreements..

⁴³ See CRS Report RL33435, *The Proposed South Korea-U.S. Free Trade Agreement (KORUS FTA)*, by William H. Cooper and Mark E. Manyin.

Counterfeiting, copyright and trademark violations, and other illicit activity occur in virtually all countries of the world, but what makes the North Korean case special is apparent state sponsorship. If the DPRK is to join the larger international community of nations, it would be expected to cease state-sponsorship of such activities and to take appropriate measures against private parties engaged in such production and/or distribution.

For those assuming that the Pyongyang regime wants to curb its crime-for-profit activity, an important question yet unresolved is the degree to which the leadership will be able to do so. Analysts point out that in nations or regions where the crime has become institutionalized, income from such activity often becomes “addictive” to those involved in the criminal conduct. In such instances, a class of criminal entrepreneurs is created and, in the case of North Korea, analysts point to the systematic criminalization of the state, over years, and its growing intimate relationships with organized crime elements throughout Asia.⁴⁴ That is not to say that North Korean criminals, like other criminals, would not be able to switch emphasis from risky criminal activity, such as narcotics trafficking, to less risky and potentially even more lucrative large-scale manufacture and trade in counterfeit cigarettes and pharmaceuticals — a trend which may well be underway. Indeed, state countenanced — if not state sponsored — production of seemingly genuine Japanese and U.S. cigarettes appears to be flourishing, as may large scale production of expertly packaged pharmaceuticals such as Viagra®.

Whereas the capacity to produce opium is dependent on the availability of suitable land and climatic conditions, methamphetamine production and a wide range of counterfeiting activities are not limited by agricultural production constraints. Reports of substantial DPRK imports of ephedrine — an essential precursor for methamphetamine production — support the theory that the DPRK has developed a significant production capacity for methamphetamine. Such activity is occurring at a time when (1) North Korea desperately needs foreign currency, and (2) the southeast Asian methamphetamine market continues to expand.

Some see promise in the efforts by the international community to entice and/or pressure Pyongyang into reducing its involvement in crime-for profit activity.⁴⁵ Others, however, argue that the more legitimate the source of income, the greater would be the pressure for accountability on the regime, since revenue from illicit activities does not usually enter official records. Hence, they maintain that simply replacing crime-related income generated by the DPRK with income from legitimate sources would ignore the need of the current regime to divert funding (some from

⁴⁴ Note that in the case of drug trafficking relationships, indications are mounting that the DPRK is using Chinese criminal groups to traffic in — and mask the source of — DPRK produced drugs. See for example, China ‘Ailing’ from North Korean-Made Drugs — Drugs now bigger problem than North Korea Escapees by Kang Ch’ol-hwan, Seoul *Chosun Ilbo* (Internet Version), October 9, 2004.

⁴⁵ For information on the internal dynamics and situation in the DPRK, see *Assessing Internal North Korea* by Larry A. Niksch, a paper prepared for a conference on North Korea sponsored by the Keck Center for International and Strategic Studies, Claremont McKenna College, October 26-27, 2006.

crime-for-profit activities) to sustain the loyalty of a core of thousands of party elite and to underwrite weapons development programs. They suggest, therefore, that prospects for a decrease in crime-for-profit activity are not good and that the current regime is likely to be neither willing nor able to change its dependence on income where no accountability is involved.