

## SECTION 4: CHINA AND NORTH KOREA

### Introduction

On September 9, 2016, North Korea conducted its fifth nuclear test—its second in 2016 and most powerful to date. The test follows a period of increased provocations under Kim Jong-un in defiance of the international community and North Korea's neighbor and closest partner, China. Since 2012, when Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping assumed leadership and Kim Jong-un emerged as the leader of North Korea, China-North Korea relations have become increasingly strained. This downturn has largely been due to the Kim regime's increased belligerence and rejection of the international community's efforts to coax North Korea to denuclearize. Since then, bilateral relations have been characterized by growing frustration and downgraded diplomatic ties. In response to Pyongyang's fourth nuclear test in January 2016, China in March increased pressure on North Korea by agreeing to the most stringent UN resolution on North Korea to date.<sup>1</sup> As of the publication of this Report, the UN Security Council was negotiating a new resolution, which appears likely to further tighten economic sanctions, presenting Beijing with another opportunity to join the international community in meaningfully punishing Pyongyang's behavior.

It is too soon to fully evaluate China's implementation of the March sanctions, but apparent gaps in enforcement have already emerged. Moreover, the decision by South Korea and the United States to deploy the United States' Terminal High Altitude Area Defense (THAAD) ballistic missile defense system in South Korea by late 2017 has led China to interrupt what had been a period of increasingly friendly China-South Korea relations and obstruct international and regional cooperation on North Korea, though the long-term effects of the THAAD deployment are unclear.<sup>2</sup> Despite Pyongyang's increasingly aggressive behavior, the overall direction of Beijing's North Korea policy is unlikely to change. China has consistently sought to manage relations with North Korea, prioritizing stability by supplying Pyongyang with critical resources and hard currency, and helping to preserve the Kim regime in order to maintain a strategic buffer between China and U.S.-allied South Korea. This divergence between U.S. and Chinese strategic objectives on the Korean Peninsula is why perpetual U.S. hopes that China will use its supposed leverage to compel change in North Korea have not been fulfilled.

This section discusses the basis of the China-North Korea relationship, drivers of China's North Korea policy, China's evolving policies and perceptions regarding North Korea, China's enforcement of UN sanctions and its economic ties with North Korea, and the implications of the changing relationship for the United

States.\* It is based on open source research and analysis and consultations with U.S. and foreign nongovernmental experts.

### Overview of Contemporary China-North Korea Relations

Contemporary diplomatic relations between China and North Korea (the Democratic People's Republic of Korea, or DPRK) are founded on the shared experience of fighting against Japan starting in the 1930s, Communist Party ties dating back to the 1920s, shared wartime camaraderie from fighting together during the Korean War (1950–1953), and the 1961 Treaty of Friendship, Co-operation and Mutual Assistance.<sup>3</sup> The treaty states that each party should “adopt all measures to prevent aggression against either [country] by any state,” and it includes a mutual defense clause, though some Chinese observers question China's commitment to North Korea's defense in a contingency.<sup>4</sup> Each country is the other's only formal treaty ally. The relationship is based on party-to-party ties, shared distrust of the West, and proximity, among other factors.<sup>5</sup>

China's economic, diplomatic, and military support for North Korea is driven by its overarching goal of maintaining sufficient stability in North Korea to ensure the Kim regime's survival and preserve a strategic buffer between itself and U.S.-allied South Korea (the Republic of Korea, or ROK).<sup>6</sup> In terms of economic support, China provides North Korea with most of its critical energy and food resources.<sup>7</sup> It also funds and operates free trade zones near the border and supports infrastructure projects designed to improve connectivity between the two countries (for more on economic relations, see “North Korea Remains Economically Dependent on China,” later in this section).<sup>8</sup> As for diplomatic support, China uses its position on the UN Security Council to protect North Korea from international criticism and to reduce the impact of economic sanctions, and often opposes unilateral U.S. sanctions, as well as regional and international condemnations against the North.<sup>9</sup> In terms of dual-use and defense assistance, Chinese firms have sold components and materials to North Korea that could be used for military applications, including ballistic missiles.<sup>†</sup><sup>10</sup> (See “Gaps in China's Enforcement of UNSCR 2270” for more information on recent dual-use transfers to North Korea.)

\* For the Commission's previous reporting on China-North Korea relations, see Michael Pilger and Caitlin Campbell, “Diminishing China-North Korea Exchanges: An Assessment,” *U.S.-China Economic and Security Review Commission*, March 23, 2015; U.S.-China Economic and Security Review Commission, Chapter 3, Section 2, “Recent Developments in China's Relationship with North Korea,” in *2014 Annual Report to Congress*, November 2014, 446–469; U.S.-China Economic and Security Review Commission, *2013 Annual Report to Congress*, November 2013, 228–229; and U.S.-China Economic and Security Review Commission, *2011 Annual Report to Congress*, November 2011, 241–252.

† For example, in October 2015, North Korea displayed guided artillery rockets mounted on vehicles imported from China. The Chinese government claimed the vehicles were exported with a clause stating the vehicles were only for “forest area operations and timber transportation.” The UN Panel of Experts tasked with investigating sanctions enforcement against North Korea reaffirmed the recommendation it made in its 2013 report—involving a similar case of a Chinese vehicle being sold and converted into a transporter-erector-launcher—that member states should “exercise vigilance” over exporting heavy vehicles. UN Security Council, *Report of the Panel of Experts Established Pursuant to Resolution 1874* (2009), February 24, 2016, 39–40; UN Security Council, *Report of the Panel of Experts Established Pursuant to Resolution 1874* (2009), June 11, 2013, 26–28.

From North Korea's perspective, while it needs Chinese support—particularly economic assistance—for the survival of the Kim Jong-un regime, Pyongyang resents this near complete dependence and has longstanding frictions with Beijing.<sup>11</sup> North Korea distrusts China, which it feels has abandoned Marxist-Leninist principles and become morally corrupted by capitalism and its relations with South Korea and the United States.<sup>12</sup> For its part, China views North Korea as a backward country.<sup>13</sup> Beijing resents the accumulation of Pyongyang's provocations—particularly nuclear and ballistic missile tests violating UN resolutions—which it fears will lead to further instability on the Korean Peninsula and could heighten the risk of a major conflict in the region.<sup>14</sup> Relatedly, Beijing likely views North Korea's continued belligerence against South Korea as strengthening Seoul's alliance with Washington and bolstering the U.S. military presence in Northeast Asia.<sup>15</sup> While these frictions persist, Beijing's aversion to punishing Pyongyang—even in the face of increasing provocations—conveys China's perception that the preservation of the North Korean state and the Kim dynasty is essential to China's interests.

### **Recent Developments in China-North Korea Relations**

Since President Xi took office in late 2012, persistent North Korean belligerence has contributed to a noticeable downturn in China's relations with North Korea. This trend continued in 2016 when, after North Korea's fourth nuclear test, China supported the most stringent UN Security Council resolution to date on North Korea. Beijing also condemned North Korea's September nuclear test and pledged to work with the United States and other UN Security Council members to further tighten North Korea sanctions. Alongside China's support for increased sanctions, a sustained drop in high-level contacts between China and North Korea has continued, and unlike in years past, public statements disseminated in the media and by government officials on both sides do not appear to convey an impression of particular closeness or cooperation. These developments suggest China has grown increasingly frustrated with North Korea's behavior in recent years. However, the recent decision by South Korea and the United States to deploy a THAAD ballistic missile defense system battalion in South Korea appears to be reinforcing Beijing's long-held suspicion of U.S. intentions on the Korean Peninsula.

### ***North Korea Continues Provocations and Conducts Its Fourth and Fifth Nuclear Tests***

The China-North Korea relationship has deteriorated during the Xi Administration, attributable largely to Pyongyang's weapons-testing-related activities: North Korea launched a satellite using ballistic missile technology in December 2012 and conducted its third nuclear test several months later; both activities occurred during China's sensitive leadership transition and despite Beijing's repeated warnings to Pyongyang against such provocations.<sup>16</sup> According to Scott Snyder, senior fellow at the Council on Foreign Relations, China downgraded bilateral ties in 2013 from a "special"

relationship to “normal relations between states.”\* Persistent tests of short- and medium-range ballistic missiles and systems using ballistic missile technology followed, violating UN resolutions.<sup>17</sup> Then in January 2016, North Korea conducted its fourth nuclear test, another violation of UN sanctions.<sup>†</sup><sup>18</sup> Notably, unlike it did with previous nuclear tests, Pyongyang did not give Beijing advance warning about the fourth test.<sup>19</sup>

Following a series of missile and weapons systems tests demonstrating alarming progress (discussed in detail later in this section), in September 2016 North Korea conducted its fifth nuclear test, which was the most powerful to date.<sup>‡</sup> Previously, North Korean nuclear tests were conducted once every three to four years.<sup>20</sup> Beijing did not confirm or deny that Pyongyang provided it advance notice of the fifth test, but some analysts suspect a high-level North Korean diplomat who traveled to Beijing just prior to the test warned Chinese officials.<sup>21</sup>

Beijing’s initial diplomatic reaction to North Korea’s January 2016 nuclear test was restrained and similar to its reaction to North Korea’s 2013 test: China issued a statement expressing its opposition to the test and summoned the North Korean ambassador.<sup>22</sup> Beijing also appeared cautious in applying further pressure on North Korea. Several weeks after the nuclear test, Chinese Foreign Minister Wang Yi agreed with U.S. Secretary of State John Kerry that new sanctions were necessary but that China believed the resolution “should not provoke new tensions.”<sup>23</sup> In February 2016, after Wu Dawei, China’s Special Representative for Korean Peninsula Affairs, traveled to Pyongyang and was reportedly unable to convince Kim Jong-un to stop provocations, President Xi had a phone conversation with South Korean President Park Geun-hye—the first consultation between leaders of the two countries following a North Korean nuclear test—but reportedly disagreed with the South Korean president on how to proceed.<sup>24</sup> In contrast to the January nuclear test and other previous tests, China’s initial response to the September 2016 nuclear test was more forceful, though at the time this Report was published China had yet to take concrete steps to punish Pyongyang. Beijing summoned the North Korean ambassador<sup>25</sup> and issued a statement expressing its opposition to the test just as it did earlier. However, Beijing’s statement for the first time called on North Korea to “comply with the relevant resolutions adopted by the United Nations Security Council” in addition to stating that China would “work together with the

\* After the downgrade in relations with Pyongyang, Kim Jong-un’s purge and execution of his uncle and high-level official Jang Song-taek in December 2013 caused further deterioration in China-North Korea ties. Mr. Jang’s purge was reportedly due to his support for China-like economic reforms in North Korea and his increasing influence in the North Korean leadership. Mr. Jang was particularly close to China and important in facilitating North Korea-China economic ties. Scott A. Snyder, “Will China Change Its North Korea Policy?” *Council on Foreign Relations*, March 31, 2016; U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 449.

† Pyongyang claimed it successfully tested a hydrogen bomb, but nuclear experts denied the claim and confirmed the bomb’s yield was just slightly more powerful than previous tests. Stella Kim, Eric Baculinao, and Jason Cumming, “North Korea Says It Successfully Conducted Hydrogen Bomb Test,” NBC News, January 6, 2016.

‡ North Korea claimed that the test demonstrated its ability to miniaturize warheads to mount atop ballistic missiles, and analysts largely concurred with Pyongyang’s claims. Seyoon Kim, Hooyeon Kim, and Shinhye Kang, “North Korea Says Tested Nuclear Bomb, Can Miniaturize Arms,” Bloomberg, September 9, 2016; Zack Beauchamp, “The Textbook Definition of Unstable: Why North Korea’s Newest Nuclear Test Is Scary,” *Vox*, September 9, 2016.

international community to steadfastly push forward the goal of denuclearization.”<sup>26</sup> Several weeks after the nuclear test, Chinese Premier Li Keqiang met with U.S. President Barack Obama, and they agreed to strengthen coordination on achieving denuclearization of the Korean Peninsula by bolstering cooperation on North Korea in the UN Security Council and “in law enforcement channels.”<sup>27</sup>

### ***UN Security Council Responds to North Korea’s January 2016 Nuclear Test***

After weeks of negotiations, China in March 2016 joined the United States and other UN Security Council members to unanimously pass UN Security Council Resolution (UNSCR) 2270—the toughest set of sanctions on North Korea to date.<sup>28</sup> Upon signing on to the resolution, a spokesperson from the Ministry of Foreign Affairs stated China’s reasoning for supporting the sanctions: “The Chinese side believes that the DPRK’s recent nuclear test and satellite launch violated [UN Security Council resolutions]. It is necessary for the UN Security Council to pass a new resolution on curbing the DPRK’s capabilities to develop nuclear and missile programs.”<sup>29</sup> China’s representative to the UN Liu Jieyi also reiterated that another reason for agreeing to the new set of sanctions was to compel North Korea to resume dialogue and negotiations on its nuclear program.<sup>30</sup>

Several factors and perceptions may have influenced China’s decision: (1) impatience with Pyongyang’s belligerence—particularly in the face of Chinese requests to halt provocations—and fear that further provocations would invite unwanted enhancements in the U.S., South Korean, or Japanese military position in the region; (2) desire to avoid perceptions that it is shielding North Korea or is out of step with the international community, which unanimously and vociferously condemned the launch; and (3) concern about the impact a viable North Korean nuclear threat would have on stability on the Korean Peninsula. According to Balbina Hwang, a visiting professor at Georgetown University and American University, “The primary driver behind China’s decision to sign on to UN sanctions had little to do with North Korea itself; rather, Beijing saw an opportunity to ameliorate the U.S.-China relationship, which had been experiencing high levels of tension related to developments in the South China Sea and cyber espionage.”<sup>31</sup> As of the publication of this Report, the UN Security Council was deliberating over a new UN resolution on North Korea, and these same factors and perceptions almost certainly will influence Beijing’s negotiations and decision regarding the probable resolution.

UNSCR 2270 targets North Korea’s diplomatic and commercial activities that are used to fund and help conceal its nuclear and ballistic missile activities, and includes the following key components that expand on previous resolutions:\*

- *Requires cargo inspections and enhanced maritime procedures:* All countries are obligated to inspect cargo to and from North

\*For a list of each component of UN Security Council Resolution 2270, see United States Mission to the United Nations, *Fact Sheet: DPRK Resolution 2270 (2016)*, March 2, 2016. For the full text of the resolution, see UN Security Council, *Resolution 2270 (2016)*, March 2, 2016.

Korea. The resolution also bans North Korean chartering of ships and planes.

- *Bans trade of key energy and mineral resources:* The resolution bans the export of coal, iron, and iron ore from North Korea, except those for “livelihood purposes” (those determined not to generate revenue for North Korea’s nuclear and ballistic missile development). Although the vague “livelihood purposes” language presents a significant loophole, as it is nearly impossible to prove or disprove whether these export revenues are augmenting prohibited North Korean activities,<sup>32</sup> the resolution marks the first time these commodities have been included in UN Security Council sanctions on North Korea.<sup>33</sup> Rare earth element exports from North Korea are also banned, in addition to the transfer of aviation fuel (including rocket fuel) to North Korea.
- *Targets North Korean proliferation networks:* The resolution requires countries to expel North Korean diplomats engaged in activities that violate UN resolutions. It also includes a requirement for countries to expel foreign nationals who aid North Korea in evading sanctions and to close offices of designated North Korean entities and expel their representatives.
- *Imposes financial sanctions targeting North Korean banks and assets:* Countries are prohibited from allowing North Korean banks to open branches (or any related activity) and from allowing their own banks to operate in North Korea. The resolution also restricts a range of public and private financial support for North Korea and requires countries to close any North Korean financial institutions or affiliates that could contribute to its nuclear or ballistic missile programs or violations of UN resolutions.<sup>34</sup>

#### **Overview of Unilateral U.S. Sanctions on North Korea in 2016 and Implications for China**

Alongside UNSCR 2270, the Obama Administration, in accordance with the North Korea Sanctions and Policy Enhancement Act of 2016 (which became law in February 2016),<sup>35</sup> announced several sets of unilateral sanctions on North Korea in 2016, targeting the North Korean leadership and the country’s access to the global financial system. In June, the U.S. Treasury Department designated North Korea a “primary money laundering concern” under the Patriot Act, prohibiting non-U.S. banks and entities from processing U.S. dollar-denominated transactions on North Korea’s behalf.<sup>36</sup> This will primarily impact Chinese banks that do business with North Korean entities, and serves to tighten restrictions on North Korea’s foreign trade, although the impact of the measure is unclear at this time (the sanctions entered force in August 2016). In response to the sanctions, a spokesperson for the Chinese Embassy in Washington stated China’s opposition to unilateral sanctions, saying the sanctions should avoid aggravating tensions on the Korean Peninsula and

**Overview of Unilateral U.S. Sanctions on North Korea  
in 2016 and Implications for China—Continued**

“must not affect and harm the legitimate rights and interests of China.”<sup>37</sup>

Another set of sanctions, which appear to have a minimal impact on Chinese interests, are the July blacklisting of Kim Jong-un, ten other senior North Korean officials, and five North Korean government entities for overseeing crimes against humanity. The sanctions, resulting from findings in the U.S. State Department’s 2016 North Korea human rights and censorship report, freeze any assets of these officials and entities in the United States and ban any U.S. interaction with them.<sup>38</sup> The sanctions will have a minimal impact on North Korea—the targets have few, if any, assets in the United States—but they could lead other countries to impose similar sanctions on North Korea in the future. China previously attempted to block the UN Security Council from even discussing North Korea’s human rights abuses.<sup>39</sup>

In September 2016, the U.S. Department of the Treasury for the first time sanctioned Chinese entities and individuals with economic ties to North Korea. Treasury designated Dandong Hongxiang Industrial Development Co. and four Chinese nationals who directed and managed the firm for sanctions evasion activities, froze their assets, and prohibited U.S. citizens from conducting business with them.<sup>40</sup> In addition, the U.S. Department of Justice indicted the individuals and entity for sanctions violations, conspiracy, and money laundering. It also filed a civil forfeiture action for funds in 25 Chinese bank accounts allegedly belonging to the firm and its front companies, effectively confiscating the money. Dandong Hongxiang Industrial Development Co. allegedly used front companies established in offshore jurisdictions and Chinese bank accounts to conduct U.S. dollar financial transactions with sanctioned North Korean entities through the U.S. banking system.<sup>41</sup> (For more details on the case, see “Gaps in China’s Enforcement of UNSCR 2270,” later in this section.) Such actions could compel Beijing to increase regulatory measures on Chinese firms doing business with the Kim regime. However, China is also unlikely to severely cut off economic ties with North Korea, as doing so could lead to instability or regime collapse in the North (see “Differences between China and the United States on North Korea Policy,” later in this section).

Although it is still too early to judge the extent of China’s sanctions enforcement, certain areas of progress and gaps are evident thus far (detailed in “Gaps in China’s Enforcement of UNSCR 2270,” later in this section).

***UN Security Council Formulates New Resolution Following North Korea’s September 2016 Nuclear Test***

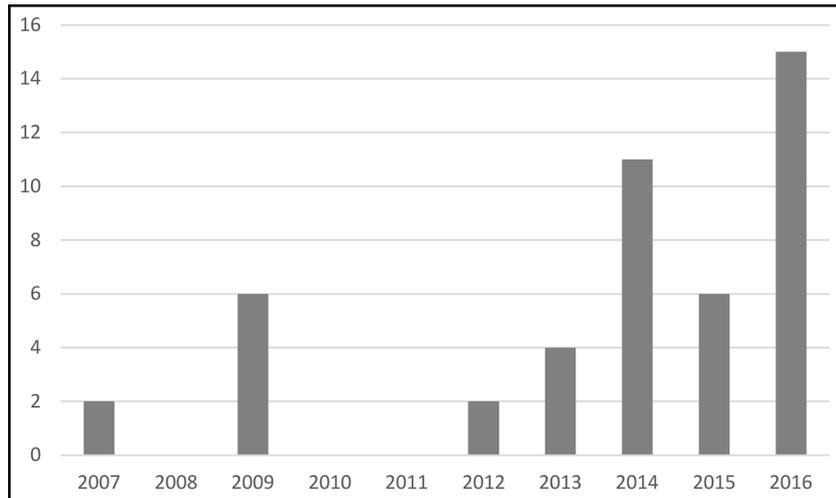
As of the publication of this Report, the UN Security Council was deliberating a new round of sanctions. It is almost certain that the new UN resolution will include measures beyond UNSCR 2270 to

increase pressure on Pyongyang. Some areas the resolution reportedly may target include closing the “livelihood purposes” loophole and preventing North Korea from sending its workers abroad, which are some of the largest sources of hard currency for the Kim regime.<sup>42</sup>

### ***North Korea Increases Frequency of Missile Tests***

Since the January 2016 nuclear test, North Korea has conducted at least 19 missile tests involving 40 projectiles (as of October 20, 2016); among these tests, at least 15 have used ballistic missile technology—the most such tests in a single year in the past decade—and therefore violated UN resolutions (see Figure 1).<sup>43</sup>

**Figure 1: North Korea Missile Tests Violating UN Resolutions, 2007–October 2016**



*Note:* Missile tests in this figure are defined as including all launches using ballistic missile technology in a single day. Tests in 2016 are current as of October 20, 2016.

*Source:* Ju-min Park and Eric Walsh, “Another North Korea Missile Test Fails after Launch, Says U.S. and South,” Reuters, October 20, 2016; Associated Press, “US, S. Korea Say Latest N. Korea Missile Launch Fails,” October 15, 2016; Victor Cha, “North Korean Provocations & US-ROK Military Exercises Dataset,” *CSIS Beyond Parallel Original Datasets*, September 2016. <http://beyondparallel.csis.org/database/>; and Japan’s Ministry of Defense, *North Korea’s Missile Launches in 2016*, September 9, 2016. Staff translation. [http://www.mod.go.jp/j/approach/surround/pdf/dprk\\_bm\\_20160909.pdf](http://www.mod.go.jp/j/approach/surround/pdf/dprk_bm_20160909.pdf).

In February 2016, before UNSCR 2270 was passed, North Korea launched a satellite—ostensibly for earth observation purposes—using ballistic missile technology, prompting a UN Security Council statement that condemned the launch for violating UN resolutions.<sup>44</sup> After North Korea’s submarine-launched ballistic missile test and failed intermediate-range ballistic missile tests in April 2016, Chinese state-run media accused North Korea of “sabre-rattling,”<sup>45</sup> and Beijing—together with its partners on the UN Security Council—pushed all parties to “strengthen implementation of the measures imposed in [UNSCR 2270].”<sup>46</sup>

Although many of its tests in 2016 appeared to fail, in June North Korea alarmed U.S. observers and allies in Asia when it conducted an apparently successful launch of its Musudan intermediate-range ballistic missile,\* which traveled 400 kilometers (250 miles). Following four failed Musudan tests earlier in the year, this launch demonstrated advancing capabilities that could eventually threaten Guam and other U.S. territories.<sup>47</sup> Meanwhile, China issued a mild rebuke in line with most of its responses to North Korean weapons tests, stressing that “relevant parties should avoid taking actions that may escalate the tension and make joint efforts to safeguard regional peace and stability.”<sup>48</sup> Demonstrating similarly significant progress in its missile development, North Korea in August conducted a submarine-launched ballistic missile test; the missile traveled over 500 kilometers (310 miles), covering a longer distance than previous tests and landing for the first time within waters inside Japan’s exclusive economic zone.† During the same month, North Korea launched an intermediate-range ballistic missile traveling approximately 1,000 kilometers (621 miles) into waters below Japan’s air defense identification zone.‡ These launches elicited strong concerns in Tokyo.<sup>49</sup> After reportedly blocking a UN Security Council statement condemning the first test that landed in Japan’s exclusive economic zone,<sup>50</sup> Beijing eventually conceded to join a statement denouncing both tests and several others from earlier in the year.<sup>51</sup>

### ***High-Level Contacts between China and North Korea Remain Limited, but Engagement Efforts Persist***

During the Xi Administration, high-level contacts§ between China and North Korea have been significantly less frequent than in previous years. According to open source reporting, only five high-level contacts have occurred between the two countries since the beginning of 2015<sup>52</sup>—a decline from the seven contacts over the previous two-year period (which was already significantly lower than in years prior).¶<sup>53</sup> Meanwhile, President Xi has yet to meet with Kim Jong-un, which is particularly notable given that since taking office President Xi has conducted eight summit meetings with President Park and has expended considerable effort to ex-

\*The Musudan has an estimated range of 3,500 km (2,175 mi). According to John Schilling, an expert on North Korea’s missile force at the Aerospace Corporation, a federally funded research and development center, at a minimum, the missile is accurate enough to hit Guam but does not have precise targeting capabilities. John Schilling, “A Partial Success for the Musudan: Addendum,” *38 North* (U.S.-Korea Institute blog), June 28, 2016; John Schilling, “A Partial Success for the Musudan,” *38 North* (U.S.-Korea Institute blog), June 23, 2016.

†An exclusive economic zone is a 200-nautical-mile zone extending from a country’s coastline, within which that country can exercise exclusive sovereign rights to explore for and exploit natural resources, but over which it does not have full sovereignty. UN Convention on the Law of the Sea, “Part 5: Exclusive Economic Zone,” Jun Ji-hye, “N. Korea Missile Lands in Japanese Waters,” *Korea Times* (South Korea), August 3, 2016.

‡An air defense identification zone, or ADIZ, is a publicly declared area, established in international airspace adjacent to a state’s national airspace, in which the state requires that civil aircraft provide aircraft identifiers and location. Its purpose is to allow a state the time and space to identify the nature of approaching aircraft before those aircraft enter national airspace in order to prepare defensive measures if necessary. Kimberly Hsu, “Air Defense Identification Zone Intended to Provide China Greater Flexibility to Enforce East China Sea Claims,” *U.S.-China Economic and Security Review Commission*, January 14, 2014.

§For the purposes of this Report, meetings in which at least one participant holds vice-ministerial rank or higher are considered high-level contacts.

¶According to open-source reporting, 30 high-level meetings occurred between 2011 and 2013. U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 451–452.

pand China-South Korea ties.<sup>54</sup> The steady decline in high-level contacts between China and North Korea in recent years is probably attributable to China's downgrading of relations in 2013 from a special relationship to normal state-to-state ties, as well as distrust between President Xi and Kim Jong-un.<sup>55</sup>

Nevertheless, Beijing appears to have pursued some level of renewed diplomatic engagement since late 2015. Several prominent examples include the following:

- In October 2015, Chinese Politburo member and propaganda chief Liu Yunshan visited North Korean leader Kim Jong-un, the highest-level visit to Pyongyang by a Chinese official since 2013. During the visit at a military parade marking the 70th anniversary of the Workers' Party of Korea, the two held hands. The visit was interpreted as a sign of improved relations.<sup>56</sup>
- In December 2015, North Korea's most famous pop band—whose members were reportedly handpicked by Kim Jong-un—had a series of concerts in Beijing canceled at the last minute, in what would have been the most prominent high-level cultural exchange between China and North Korea in years. According to Chinese observers, Kim Jong-un may have canceled the shows due to a lack of high-level Chinese officials planning to attend following his claim a day earlier that North Korea had developed a hydrogen bomb.<sup>57</sup>
- In June 2016, North Korean envoy and Vice Chairman of the Central Committee of the Workers' Party of Korea Ri Su-yong made a surprise visit to Beijing and met with President Xi—the first such meeting between President Xi and a senior North Korean official since 2013.<sup>58</sup> The meeting occurred despite a failed North Korean intermediate-range ballistic missile launch a day earlier,<sup>59</sup> and Mr. Ri's provocative remarks the previous day in a meeting with other CCP officials that North Korea would continue to expand its nuclear arsenal and would not denuclearize.<sup>60</sup> During the meeting, President Xi said that China “attached great importance to developing a friendly relationship with North Korea” and was pursuing “calm” on the Korean Peninsula.<sup>61</sup>

These recent high-level contacts between China and North Korea suggest Beijing is seeking to inject some stability into the bilateral relationship to avoid further deterioration. The June 2016 meeting between President Xi and Mr. Ri was particularly telling of China's motivations, given the events immediately preceding the meeting. With growing international pressure on Pyongyang, Beijing likely will continue to pursue renewed diplomatic efforts to maintain stable bilateral ties in the near term, especially as China attempts to ease increasing tensions on the Korean Peninsula and bring North Korea to the negotiating table on denuclearization and a peace treaty (see “China's Increased Emphasis on Denuclearization,” later in this section).

***The United States and South Korea Announce Ballistic Missile Defense System Deployment***

Hours after North Korea's February 2016 satellite launch test using ballistic missile technology, South Korea announced it would pursue formal talks with the United States to deploy THAAD in South Korea due to the increased security threat posed by North Korea (see textbox later in this subsection for technical details of the system).<sup>62</sup> In July, the two countries announced the decision to proceed with the deployment of a THAAD battery in South Korea by late 2017, at an estimated cost of \$1.6 billion.<sup>63</sup> Under the Status of Forces Agreement between the United States and South Korea, the United States will fund the battery's deployment and maintenance costs and contribute the necessary forces for operations, while South Korea will provide the land and facilities needed.<sup>64</sup>

Beijing, which had been highly critical of the idea ever since media reports first mentioned U.S. officials were considering the deployment in May 2014,<sup>65</sup> appeared to be caught by surprise. In response to the THAAD announcement, a spokesperson for China's Ministry of Foreign Affairs said,

*China has expressed strong dissatisfaction with and firm opposition to the decision and has summoned the ambassadors of the U.S. and the ROK to lodge our representations. The deployment of the THAAD system by the U.S. and the ROK will in no way help achieve the goal of denuclearization on the Peninsula and maintain peace and stability of the Peninsula. It runs counter to the efforts by all parties to resolve the issue through dialogue and consultation and will gravely sabotage the strategic security interests of regional countries, including China, and [the] regional strategic balance. China strongly urges the U.S. and ROK to halt the process of deploying the system and refrain from complicating the regional situation or undermining China's strategic security interests.*<sup>66</sup>

China views THAAD as a significant security risk, as it would expand U.S. radar coverage well into Chinese territory and could be used by the United States and its allies in a contingency involving China.<sup>67</sup> Moreover, given THAAD's interoperability with other missile defense systems in Northeast Asia, Beijing is concerned about the expanding U.S.-allied missile defense radar network in the region and closer intelligence sharing and broader strategic cooperation between the United States, South Korea, and Japan.<sup>68</sup> Beijing has dismissed repeated U.S. reassurances that THAAD would only be used to defend against the North Korean threat and would not be directed in any way at China.<sup>69</sup> U.S. Army Chief of Staff Mark Milley visited Beijing in August 2016 to provide a technical briefing on the system to People's Liberation Army (PLA) Army General Li Zuocheng, in an effort to reassure Beijing that its planned deployment will not threaten China.<sup>70</sup>

### Technical Details of THAAD

The exact configuration of the THAAD battery that will be deployed in South Korea is not known,<sup>71</sup> but a single battery usually consists of six to nine truck-mounted launchers, 48 to 72 interceptors, a fire control and communications unit, and an AN/TPY-2 X-band radar.<sup>72</sup> It takes an average of 30 troops to operate and is road-mobile, allowing for quick mobilization in a conflict.<sup>73</sup> THAAD is designed to intercept short- and medium-range ballistic missiles up to 200 kilometers (125 miles) away and up to 150 kilometers (93 miles) in altitude—far superior to other missile defense systems deployed in South Korea.<sup>74</sup> According to most estimates, THAAD's X-band radar has a range up to approximately 2,000 kilometers (1,243 miles) in “forward-based mode,” which covers most of the eastern half of China.<sup>75</sup> However, using this mode would disable THAAD's missile intercept capability. U.S. defense officials have stated that the system will operate in “terminal mode,” limiting the radar's range to 600 kilometers (373 miles), which would cover minimal Chinese territory near the China-North Korea border and part of Shandong Province.<sup>76</sup>

On the day of North Korea's February 2016 satellite launch and the THAAD announcement, China separately summoned both the North Korean and South Korean ambassadors to China,<sup>77</sup> seeming to suggest that Beijing views THAAD as a security threat at least on par with that of Pyongyang's ballistic missile and nuclear programs, although China views THAAD through a different security lens than it does North Korea. Beijing sees THAAD as a direct threat to its national security, whereas it perceives North Korea as a more manageable and limited threat.<sup>78</sup>

U.S. government officials and analysts argue Beijing's concerns are overblown, particularly those related to THAAD's X-band radar. Troy University professor Daniel Pinkston notes, “The U.S. does not need a radar in South Korea to acquire and track Chinese [intercontinental ballistic missiles] early in flight. There are two X-Band radars deployed in Japan, and sea-based tracking radars on Aegis ships are in the region as well. Furthermore, U.S. space-based early warning systems would detect a Chinese [intercontinental ballistic missile] almost immediately after it was launched.”<sup>79</sup>

It is unclear how the THAAD deployment will impact China's strategy toward the Korean Peninsula in the long term. U.S. and foreign observers suggest a number of potential outcomes: (1) China could align more strongly with Pyongyang in an attempt to counterbalance what it views to be an increasing regional security threat from the U.S.-South Korea alliance; (2) it could decide to expand enforcement of UN sanctions in an effort to reassure the United States and South Korea in hopes of demonstrating that the planned missile defense system in South Korea is unnecessary; or (3) it could seek to maintain the status quo and instead focus on the other flashpoints along its periphery, including the South China Sea, East China Sea, and Taiwan.<sup>80</sup>

Regardless of whether or how China adjusts its policy in response to THAAD, the deployment has already led to an interruption in the recent warming of China-South Korea relations<sup>81</sup> and to greater Chinese obstructions to international and regional cooperation on North Korea. For example, in August, some events and concerts featuring South Korean pop stars and television personalities were canceled, and several joint Chinese-South Korean television projects were postponed. Industry observers in both countries assessed that pressure from Beijing and Chinese firms' anticipation of Beijing's directives quashed these activities.<sup>82</sup> According to Lee Jong-seok, a senior research fellow at South Korean think tank the Sejong Institute and former unification minister of South Korea in 2006, who visited the China-North Korea border area in August 2016, "Local sources [at the border] have said passage through Chinese customs have become much easier since the [South Korean] government announced its decision to deploy THAAD. ... [The] deployment decision appears to have relieved some of the psychological burden from the UN's sanctions against North Korea among Chinese people involved in economic relations with the North."<sup>83</sup> As mentioned earlier, China also reportedly blocked a UN Security Council resolution condemning North Korea's launch of a ballistic missile that landed for the first time in waters within Japan's exclusive economic zone,\* insisting that the resolution include language denouncing the THAAD deployment.<sup>84</sup> Beijing's opposition to and suspicion of the THAAD deployment likely will impede cooperation with the United States and the region on issues related to North Korea. However, some U.S. experts assert the interruption of recent positive ties between China and South Korea probably will only be a short-term development due to robust bilateral economic relations.<sup>85</sup>

## **Evolution in China's Policies and Perceptions Regarding North Korea**

### ***Debate in China on North Korea Policy***

Chinese analysts occupy a wide spectrum of views on North Korea, and generally include "traditionalists" who favor Beijing's current policy supporting the Kim regime, "strategists" who support increased Chinese pressure on North Korea, and the "abandonment" school that calls for Beijing to withdraw support for Pyongyang.†<sup>86</sup> This division among foreign policy experts on North Korea demonstrates the complexity of the China-North Korea rela-

\*In response to North Korea's increasing threat, Japan has renewed its pursuit of improved missile defense systems, which includes exploring the possibility of THAAD. As early as 2009, Japan considered THAAD as a possible solution. Julian Ryall, Gabriel Dominguez, and Neil Gibson, "Japan Considers Adding THAAD to its Air Defense Capabilities," *IHS Jane's*, August 12, 2016; Andy Sharp, "Japan Mulls THAAD Missile Defense System amid North Korea Threat," *Bloomberg*, November 24, 2015; and Reuters, "Japan Mulls New Missile Defense System—Media," July 5, 2009.

†During the Xi Administration, the public debate on North Korea among Chinese foreign policy experts has expanded. In addition, President Xi has allowed a diverse public debate among Chinese citizens. One Chinese scholar asserts, "[The] more that nuclear and missile provocations are committed by the DPRK, the more that the Chinese people cannot accept [North Korea's behavior]. ... Talking about North Korea openly and negatively used to be taboo in China, but that is no longer the case." Yu Tiejun, "The Significance of the Korean Peninsula in Xi Jinping's Global Strategy," in *Chinese Perspectives toward the Korean Peninsula: In the Aftermath of North Korea's Fourth Nuclear Test*, Stimson Center, June 2016, 18.

tionship and probably reflects a similar diversity of opinions among the Chinese leadership.<sup>87</sup>

After the January 2016 nuclear test, the public debate among these experts appears to have been less active than after Pyongyang's previous nuclear test in 2013, during which the "abandonment" view gained some traction,<sup>88</sup> and concentrated among the strategist and traditionalist camps. Some in the strategist camp supported China's full implementation of UN Security Council resolutions.<sup>89</sup> Others in the traditionalist camp advocated for friendlier ties with North Korea and for the United States to avoid overly critical rhetoric and punitive actions toward North Korea.<sup>90</sup> Following the September 2016 nuclear test, a more active public debate emerged with the strategist and traditionalist camps again more vocal among Chinese experts. In alignment with the Chinese government's response to U.S. Secretary of Defense Ashton Carter that the United States—and not China—bears responsibility for North Korea's fifth nuclear test, many downplayed the leverage China has on North Korea and blamed the United States and South Korea (and its decision to deploy THAAD) for causing the test.<sup>91</sup> On the other hand, a group of Chinese commentators supported continued pressure on North Korea through a combination of sanctions and dialogue.<sup>92</sup>

### ***China's Increased Emphasis on Denuclearization***

Beijing's North Korea policy has always included advocating for denuclearization, but historically it has been least important among its three longstanding policy priorities of "no war, no instability, no nukes."\*<sup>93</sup> Beijing has increasingly emphasized denuclearization as North Korean provocations have become more frequent in recent years, possibly signaling that China seeks a larger role in realizing a nuclear-free Korean Peninsula. High-level Chinese officials in meetings with their U.S. counterparts and Chinese Ministry of Foreign Affairs statements increasingly stress denuclearization over stability.<sup>94</sup> According to one Chinese analyst, China's prioritization of denuclearization was one of the main drivers compelling it to agree to a more stringent UN resolution in the aftermath of the January 2016 nuclear test.<sup>95</sup> Nonetheless, as Renmin University professor Shi Yinhong asserts, "Beijing ... [believes] that China must prevent the denuclearization process and its own role within it from seriously and lastingly damaging China-North Korea relations by becoming too alienated from the Pyongyang regime."<sup>96</sup>

China's preferred method to accomplish this goal is through restarting the Six-Party Talks.† In the aftermath of North Korea's January 2016 nuclear test, a spokesperson for China's Ministry of Foreign Affairs said, "All relevant parties should return to the

\*North Korea has repeatedly stated it will not give up its nuclear weapons program. In April 2016, North Korea's diplomat to the UN said, "Denuclearization should not be an objective of any future talks with us. We will never give up nuclear weapons before the U.S. and the world are denuclearized." Baik Sungwon, "N. Korean Envoy: Nuclear Weapons Not Negotiable," *Voice of America*, April 1, 2016.

†The Six Party Talks involving China, Japan, North Korea, Russia, South Korea, and the United States were established in 2003 to negotiate the termination of North Korea's nuclear program. After six rounds of negotiations, North Korea left the Six-Party Talks in 2009, and the negotiations have not resumed since. Jayshree Bajoria and Beina Xu, "The Six Party Talks on North Korea's Nuclear Program," *Council on Foreign Relations*, September 30, 2013.

right track of resolving the Korean nuclear issue through the Six-Party Talks as soon as possible with the larger picture of regional peace and stability in mind.”<sup>97</sup> President Xi himself has made numerous calls for resuming the Six-Party Talks, the most recent of which was on the sidelines of the September 2016 G20 summit in Hangzhou, China.<sup>98</sup> Pursuing this dialogue is beneficial to Beijing for many reasons: (1) it portrays China as a responsible stakeholder in the international community, and, if the talks can actually be revived, China will be able to take credit for it; (2) dialogue is preferable to instability and conflict (even in the event the Six-Party Talks are unsuccessful); and (3) it absorbs U.S. pressure for change in North Korea.<sup>99</sup>

In addition to renewed diplomatic efforts to return to the Six-Party Talks, China has also proposed a dual-track strategy to bring North Korea to the negotiating table by seeking a peace treaty to replace the 1953 armistice agreement that marked a ceasefire in the Korean War\*—a treaty North Korea has long sought†—alongside denuclearization.<sup>100</sup> In March 2016, Chinese Foreign Minister Wang Yi said these two goals “can be negotiated in parallel, implemented in steps, and resolved with reference to each other.”<sup>101</sup> However, such an agreement appears highly unlikely to be realized anytime soon, given North Korea’s refusal to dismantle its nuclear program.<sup>102</sup> While Beijing would like to see the peace treaty signed as a symbol of good faith to North Korea, Washington and Seoul insist that talks regarding a treaty would only happen if North Korea agrees to abandon its nuclear program first.<sup>103</sup>

In August 2016, weeks before North Korea’s fifth nuclear test, in a trilateral meeting with the Japanese and South Korean foreign ministers, Minister Wang laid out a new formulation for China’s priorities on the Korean Peninsula of “three objections” and “three persistence[s]”: China opposes (1) North Korea’s nuclear weapon development, (2) any actions that cause tension on the Korean Peninsula, and (3) measures in violation of UNSCR 2270, and it continues to pursue (1) denuclearization of the peninsula, (2) dialogue and negotiation, and (3) the maintenance of peace and stability.<sup>104</sup> It is unclear how, if at all, these priorities and their dual approach of pursuing a peace agreement alongside denuclearization will change in the aftermath of the September test, but Beijing’s response thus far does not suggest a change in policy.

### ***Gaps in China’s Enforcement of UNSCR 2270***

As stated earlier in this section, it is too early to fully assess China’s enforcement of UNSCR 2270. Skeptics contend that Beijing

\*The armistice agreement, which the United States, South Korea, China, and North Korea signed in 1953, was designed to act as a temporary ceasefire until all parties could agree on a peace treaty. It established the Korean Demilitarized Zone between the two Koreas that is still intact today. BBC, “The Korean War Armistice,” March 5, 2015; Council on Foreign Relations, “Korean War Armistice Agreement,” July 27, 1953.

†North Korea has offered to conclude a peace treaty in exchange for an end to U.S.-South Korea military exercises. According to Bruce Bennett, a senior defense analyst at RAND, Pyongyang probably views the peace treaty as a means to unify the Korean Peninsula under the North Korean regime because such a treaty would plausibly remove the necessity of U.S. forces to remain in South Korea. In this scenario, the United States would find it more difficult to redeploy forces to the region in a contingency. Bruce W. Bennett, “Kim Jong-un Is Trolling America Again,” *National Interest*, May 17, 2016; Reuters, “North Korea Says Peace Treaty, Halt to Exercises, Would End Nuclear Tests,” January 16, 2016.

will not completely enforce the sanctions and will take advantage of loopholes in UNSCR 2270, as its track record on previous UN resolutions on North Korea suggests.\*<sup>105</sup> China has a history of strictly enforcing sanctions in the months immediately following new rounds of sanctions and then loosening enforcement.<sup>106</sup> Moreover, Beijing has used its seat in the UN Security Council to weaken past UN sanctions on North Korea, particularly in the years prior to North Korea's 2013 nuclear test,<sup>107</sup> although there is no public documentation that China used its position to dilute UNSCR 2270. However, sources assert that Beijing insisted on including language allowing for the vague exception to the sanctions' bans on exports of North Korean coal, iron, and iron ore for "livelihood purposes."†<sup>108</sup> This exception provides China (and other countries) an opportunity to flexibly enforce sanctions.

Still, early signs show that Beijing has made some progress in working to fulfill its commitments under the resolution. These signs include the following:

- *Chinese government agencies issue new regulations:* Just days after UNSCR 2270 passed in March 2016, China's Ministry of Transport ordered maritime agencies to bar from Chinese ports 31 North Korean boats operated by North Korean firm Ocean Maritime Management, which is sanctioned under the resolution. In addition, authorities in Dandong, a northeast Chinese city that borders North Korea, reportedly issued a restriction on the number of vehicles crossing each day via a bridge into North Korea from 300–400 to 100.‡<sup>109</sup> One month later, China's Ministry of Commerce, in compliance with UNSCR 2270, issued an embargo on coal and some other mineral exports to North Korea.<sup>110</sup> Shortly thereafter, Chinese authorities reportedly increased customs inspections on all cargo crossing the border.<sup>111</sup> Following reports of a reopened plutonium processing facility in North Korea in June 2016, China's Ministry of Commerce, the Ministry of Industry and Information Technology, the China Atomic Energy Authority, and the General Administration of Customs issued new bans on dual-use items and technologies being exported to North Korea, in compliance with the sanctions.<sup>112</sup>

\*For more information on China's enforcement of the UN sanctions enacted following the DPRK's 2013 nuclear test, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 456–457.

†Several days after the resolution passed, a spokesperson at China's Ministry of Foreign Affairs was the first to reference the exception. The spokesperson said, "The resolution prohibits the DPRK's export of coal, iron ore and iron, but those that are deemed essential for people's livelihood and have no connection with the funding of the DPRK's nuclear and missile programs will not be affected." In addition, China's Ministry of Commerce disseminated forms for Chinese firms to use when importing resources listed under this provision, allowing traders to continue buying embargoed minerals from North Korea. Russia also appeared to support UNSCR 2270's livelihood exception, among other exceptions. China's Ministry of Commerce, *Ministry of Commerce, General Administration of Customs Announcement No. 11 of 2016 Regarding the Embargoed Mineral Export List to North Korea Announcement*, April 5, 2016. Staff translation. <http://www.mofcom.gov.cn/article/b/c/201604/20160401289770.shtml>; China's Ministry of Foreign Affairs, *Foreign Ministry Spokesperson Hong Lei's Regular Press Conference on March 4, 2016*, March 4, 2016; and Radio Free Europe and Radio Liberty, "Russia Carved out Exceptions to North Korean Sanctions," March 3, 2016.

‡According to an expert on the North Korean economy, about 70 percent of economic activity between China and North Korea runs through Dandong and the surrounding region in northeast China. U.S. expert on North Korea's economy, meeting with Commission, May 26, 2016.

- *China bans North Korean remittances in Dandong*: Just hours before UNSCR 2270 passed, Chinese state-owned banks in Dandong froze all transfers of renminbi currency to North Korean banks in compliance with the sanctions. Since North Korea's 2013 nuclear test, Dandong banks have halted all U.S. dollar transfers.\*<sup>113</sup>
- *China works with the United States to improve sanctions regime*: Several weeks after UNSCR 2270 passed, Beijing found that four North Korean ships were mistakenly included in the resolution's list of vessels banned from calling at international ports, thinking they were affiliated with sanctioned North Korean entity Ocean Maritime Management. China obtained written commitments that the ships would not use North Korean crews associated with the barred firm, and then worked with the United States to remove the four ships from the resolution's blacklist.<sup>114</sup>

These encouraging signs notwithstanding, it remains difficult to measure China's enforcement of UNSCR 2270 due to lack of Chinese transparency and detailed reporting mechanisms. For example, some level of cross-border trade (both legal and illicit) is known to persist without being counted in official Chinese trade figures.<sup>115</sup> Moreover, coal trade—one of the most significant components of China-North Korea trade and a major source of hard currency for North Korea (the U.S. government estimates North Korean revenue from coal exceeds \$1 billion per year and accounts for about one-third of its total export income)<sup>†</sup><sup>116</sup>—is problematic to measure. Regarding Chinese coal imports from North Korea, it is nearly impossible to tell whether the initial decline in shipments in the months after the implementation of UNSCR 2270 was driven by the sanctions or a result of unrelated factors, such as lower Chinese demand.<sup>117</sup> According to Andrea Berger, deputy director of the Proliferation and Nuclear Policy Program at the Royal United Services Institute, a London-based think tank, “Financial flows from general commodity sales to prohibited programs are extremely difficult to prove in practice, meaning that China will be able to continue to buy large quantities of North Korean coal and argue that it is adhering to the resolution.”<sup>118</sup>

As of the publication of this Report, evidence suggests Beijing has not stopped the trade of all banned items and goods with North Korea and has not fully maintained its commitments under UNSCR 2270. As of July 2016, North Korean entities were using e-commerce website Alibaba to sell coal to the Chinese market.<sup>119</sup> One month later, several South Korean analysts cited Chinese sources that observed eased cross-border inspections since the July THAAD deployment announcement, and noted increased economic

\*Nonetheless, UNSCR 2270 and China's ban on North Korean remittances in Dandong appear to have resulted in the increased use of cash and local banks for transactions, according to an expert on the Korean Peninsula who spoke with the Commission. The expert assesses these smaller banks are less transparent and transactions at these institutions are more difficult to track. U.S. expert on the Korean Peninsula, meeting with Commission, May 26, 2016.

†As the world's largest coal consumer and producer, China is a major importer and exporter of coal. In its trade relationship with North Korea, China's demand for coal has dropped in recent years due to environmental regulations, and China has placed quality restrictions on North Korean coal it imports to meet certain environmental requirements. Laura Dattaro, “Here's How China Is Screwing North Korea's Economy,” *Vice News*, March 10, 2015.

activity at the China-North Korea border, including an increase in North Korean trucks entering China and signs of heightened smuggling operations.<sup>120</sup> In August, China imported a record amount of coal in a single month, amounting to a 74 percent jump compared to the same month in 2015, according to Chinese customs data.<sup>121</sup> In addition, some barred vessels listed in UNSCR 2270 have been seen entering and leaving Chinese ports, while others have been observed operating close to Chinese ports and then disappearing from radar following the implementation of sanctions, which raises questions about whether these vessels were conducting banned trade with China.<sup>122</sup> Aside from banned trade, China in 2016 bought approximately \$74.5 million worth of North Korean fishing rights—the largest such deal involving fishing areas between the two countries—providing Pyongyang with much needed hard currency.<sup>123</sup> The purchase could violate UN resolutions if Pyongyang uses the funds for its nuclear and ballistic missile programs.<sup>124</sup>

Several recent studies illuminate how Chinese firms and individuals have colluded with North Korean entities to evade sanctions in the past. One report published in August 2016 by John Park and Jim Walsh, researchers at Harvard University and the Massachusetts Institute of Technology, respectively, who conducted interviews with a dozen defectors who worked at North Korean state-run procurement companies from 2010 to 2012, found North Korea's use of Chinese middlemen and shell companies to mask illicit trade has become increasingly efficient. In addition, the report found North Korean financial operations have become more embedded in China, and asserted that Chinese brokers working with North Korean entities may be using onshore bank accounts in China to evade sanctions targeting Pyongyang's access to foreign banks. North Korean firms have also taken advantage of Hong Kong's role as a financial hub in its business dealings with Chinese partners.<sup>125</sup> Another study published in September, by data analytics firm C4ADS and South Korean think tank the Asan Institute for Policy Studies, uncovered the aforementioned complex network of Chinese entities under a single conglomerate, Dandong Hongxiang Industrial Development Co., in the most significant case to date of a Chinese company found violating UN sanctions on North Korea:

*During the course of our investigation, we identified over \$500 million of imports and exports from the DPRK [over the last five years] associated with one specific Chinese trading conglomerate. Its subsidiaries and affiliated entities have transacted with sanctioned Burmese and North Korean entities, have been associated with North Korean cyber operators, and have traded in various goods and services that could represent serious proliferation concerns.*<sup>126</sup>

Before announcing its charges against the firm and associated individuals, U.S. Department of Justice officials alerted Chinese authorities about the case. In September 2016, Beijing launched an investigation into the firm's alleged "serious economic crimes," and froze certain assets connected to the company.<sup>127</sup> Although this action showed encouraging progress in U.S.-China cooperation on tar-

getting Chinese firms violating sanctions, some U.S. officials reportedly expressed concern that their Chinese counterparts had not shared documents related to the case and may not be genuine in their announced efforts to investigate the firm.<sup>128</sup>

### ***North Korea Remains Economically Dependent on China***

North Korea's economy is among the world's most constrained and least productive. According to Nicholas Eberstadt, a scholar at the American Enterprise Institute, North Korea's per capita trade after adjusting for inflation was lower in 2014 than in the mid-1970s.<sup>129</sup> Dr. Eberstadt asserts there are many reasons for this prolonged stagnation: "The DPRK has no rule of law; no established property rights; no possibility for private foreign trade; no reliable currency; virtually no official social and economic information; and no internal constraints whatever upon [the Kim regime]." <sup>130</sup> Moreover, North Korea's business environment is one of the most restricted globally. This is reflected in the 2016 Index of Economic Freedom published by the Heritage Foundation and *Wall Street Journal*, which gave North Korea the worst score in the world among ranked countries.<sup>131</sup> Such constraints severely limit countries' economic cooperation with North Korea, leaving China to fill the gap.

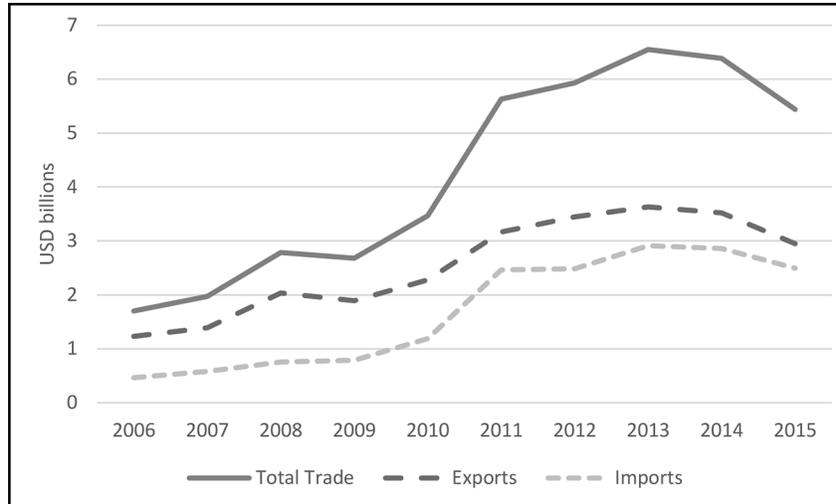
China's close economic ties with North Korea are unlikely to diminish significantly in the near term, despite the UN and international community monitoring Beijing's enforcement of UNSCR 2270. Total trade between the two countries has been falling since 2013 with much of the decline related to reductions in the value of mineral shipments, according to Chinese customs figures.<sup>132</sup> With UNSCR 2270 covering much of the mineral trade (most importantly coal), total trade would be expected to decline further if China fully enforces the sanctions. According to Chinese trade data through August 2016 (the most recent as of the publication of this Report), total trade increased by 3.4 percent year-on-year since March when sanctions were implemented.<sup>133</sup>

In 2015, China comprised approximately 91 percent of North Korea's legitimate foreign trade of \$6.25 billion (excluding trade with South Korea).<sup>134</sup> The February 2016 closure of the inter-Korean Kaesong Industrial Complex, where essentially all trade between North Korea and South Korea was transacted,<sup>135</sup> sustains China's dominant position. Official Chinese trade figures show China-North Korea trade in 2015 fell 14.7 percent from 2014 to \$5.4 billion, largely resulting from a decline in commodities prices, especially coal and iron ore.<sup>136</sup> Chinese exports to North Korea in 2015 were approximately \$2.9 billion, a decline of 16.4 percent from the previous year, while Chinese imports from North Korea were \$2.5 billion, a 12.9 percent decline from 2014 (see Figure 2).<sup>137</sup> North

\*According to the South Korean government's trade promotion agency, Chinese exports to North Korea in 2015 were \$3.2 billion, a 20 percent decline from 2014, and Chinese imports from North Korea were \$2.4 billion, down 13 percent from 2014. These data account for an additional 500,000 tons of Chinese oil exports not included in China's customs data since China stopped counting oil in its trade data in 2014. To calculate the amount of extra Chinese exports to North Korea, the South Korean government statistics multiply the estimated 500,000 tons by the international price for oil in 2015. Korea Trade-Investment Promotion Agency, *2015*

Korea runs perpetual merchandise trade deficits primarily with China (and also Russia);<sup>138</sup> possible financing sources for these deficits include overseas business activities, illicit activities, foreign aid, and remittances.<sup>139</sup>

**Figure 2: China-North Korea Trade, 2006–2015**



Source: China General Administration of Customs via CEIC database.

To help facilitate bilateral trade and tourism, North Korea has established 11 special economic zones (SEZs) near the North Korea-China border, which have been heavily promoted under Kim Jong-un, though most are not operational due to North Korea's business environment, bureaucratic constraints, and tensions in bilateral relations.<sup>140</sup> According to Curtis Melvin, a researcher at the U.S.-Korea Institute at the Johns Hopkins University School of Advanced International Studies, "North Korea's business environment is not a welcoming destination for Chinese capital even when relations are relatively good because with no credible commitment to policies, there is ultimately nothing preventing the DPRK from shaking down or seizing assets of Chinese investors at some point in the future when the bilateral environment changes."<sup>141</sup> Beijing seeks to build improved infrastructure connecting some of these SEZs to China, but these projects have largely stalled in recent years.<sup>142</sup> Lu Chao, director of the North and South Korea Research Center at the Liaoning Academy of Social Sciences in China, notes that cross-border economic development projects between Dandong and North Korea, including a \$338 million bridge linking Dandong (China) and Sinuiju (North Korea), have been delayed indefinitely by Pyongyang since December 2013 when Kim Jong-un purged and executed his uncle and high-level official Jang Song-taek, who was important in facilitating bilateral economic ties.<sup>143</sup>

<sup>140</sup> *North Korea Foreign Trade Trends*, July 2016, 12; Analyst, Korea Trade-Investment Promotion Agency, interview with Commission staff, September 5, 2016.

Total Chinese investment in North Korea is unclear due to the lack of reliable data, but several analysts assess official Chinese investment accounts for approximately 95 percent of foreign direct investment in North Korea.<sup>144</sup> Chinese companies largely view the North Korean investment climate as difficult, opaque, and risky because of inadequate legal protections for foreign investors in North Korea and its poor infrastructure.<sup>145</sup> In addition to North Korea's SEZs, China operates a free trade zone in Dandong and two others are set to operate in the border region,\* providing North Korea with another source of hard currency. According to public reports, Chinese citizens can buy a limited amount of North Korean goods duty-free within 20 kilometers of these areas.<sup>146</sup> An expert on the North Korean economy told the Commission that China has ambitious goals for expanding trade and investment through the Korean Peninsula by eventually expanding high-speed rail from China through North Korea and South Korea to further open the Chinese market and access North Korean ports.<sup>147</sup>

Chinese firms are able to circumvent barriers to investment in North Korea by importing North Korean labor, which is not prohibited under UNSCR 2270, providing a major source of hard currency for the Kim regime. According to North Korean defectors, Pyongyang has steadily increased the number of workers it sends to China in recent years.<sup>148</sup> There are arrangements in Dandong and in Tumen—another Chinese city that borders North Korea—to allow North Korean laborers to cross the border for work.<sup>149</sup> According to Mr. Lee, at least 70,000–80,000 North Korean workers are employed in China as of August 2016, and “in a few years this [number] is likely to reach a few hundred thousand;” of the total workers in China, he assesses 30,000 North Koreans work in Dandong and 4,000 work in Tumen.<sup>150</sup> These workers are reportedly only allowed to keep one-third of their monthly wages; the rest must be sent to the Kim regime.<sup>151</sup> The U.S. Department of State estimates North Korea receives compensation in the low hundreds of millions of dollars from work abroad, mostly in China and Russia.<sup>152</sup>

Another critical area of support for the Kim regime is Chinese energy assistance to Pyongyang (aside from coal, mentioned earlier), and includes fuel, hydropower, solar panels, and power lines from China connecting into North Korea.<sup>153</sup> Among these, certain types of fuel are now sanctioned under UNSCR 2270, namely aviation fuel, including rocket fuel.<sup>154</sup> A North Korea economy expert told the Commission that electricity access in North Korea is now probably better than at any time since the famine in the 1990s, due in part to Chinese solar panel exports.<sup>155</sup> While the actual amount of Chinese fuel provided to North Korea is unknown (since China stopped reporting crude oil exports in 2014), evidence suggests it is rising, as more cars and trucks appear on the roads in Pyongyang and Chinese exports of automobiles and related components to North Korea over January–August 2016 have increased 29 per-

\*The Guomenwan trade zone in Dandong opened in October 2015. The Ji'an Joint Border Economic Zone has been built but is not open, and the Helung Joint Border Economic Zone has yet to be constructed. Xinhua, “Largest City on China-North Korean Border Dandong Opens Border Trade Zone,” October 15, 2016. Staff translation. [http://news.xinhuanet.com/world/2015-10/15/c\\_1116838250.htm](http://news.xinhuanet.com/world/2015-10/15/c_1116838250.htm); Lee Je-hun, “Report: N. Korea-China Relations Maybe Not So ‘Strained’ after All,” *Hankyoreh* (South Korea), November 13, 2015.

cent year-on-year.<sup>156</sup> An oil pipeline from Dandong to Sinuiju in North Korea has operated since 1976, and China has insisted that these exports support the “livelihood” of North Koreans under UNSCR 2270.<sup>157</sup> According to Yukihiro Hotta, a researcher at the Aichi University in Japan, the pipeline must maintain a minimum flow of 500,000 tons per year in order to avoid clogs that damage the pipeline.<sup>158</sup> China also has provided free oil to North Korea in the form of aid, which historically has not been included in its official exports.<sup>159</sup>

### ***China Continues to Prioritize Stability and the Status Quo***

Despite Beijing’s frustration with North Korea’s belligerence and the increased threat its nuclear weapons and ballistic missile programs pose for China’s security interests, it still prioritizes stability and the status quo in North Korea to maintain a buffer between itself and U.S.-allied South Korea. According to a North Korea expert who spoke with the Commission, a major concern for China is that the collapse of the North Korean regime could inspire Chinese citizens to seek political reform or regime change in China as well.<sup>160</sup> Beijing is also worried a collapse scenario could cause an influx of North Korean refugees in northeast China.\*<sup>161</sup> A collapse could give rise to other problems for China, including unsecured nuclear weapons, the movement of U.S. forces closer to the Chinese border, or the outbreak of a major conflict that could drag China into war.<sup>162</sup> As a result, Beijing holds stability in North Korea as a higher priority than denuclearization, though China has made efforts to prioritize denuclearization more recently, as noted earlier in this section.

### **Differences between China and the United States on North Korea Policy**

As the North Korean threat to U.S. security interests grows, U.S. engagement with China on North Korea is of increased importance. However, China’s views of the U.S. role in the region pose obstacles to the productive engagement necessary to achieve the goal of denuclearization of the Korean Peninsula. Such views include the following:

- China perceives U.S. policy on North Korea is designed to strengthen U.S. alliances with South Korea and Japan, which it views are being leveraged to contain China.<sup>163</sup> Most recently, Beijing sees U.S. efforts to deploy THAAD in South Korea not only as a defensive measure taken to protect against potential North Korean missile strikes, but also as targeted at China. This, in China’s view, limits its own strategic offensive capabilities in a contingency.<sup>164</sup> As mentioned earlier, China sees the THAAD deployment in South Korea as complicating its strategic environment by expanding the U.S.-allied missile defense radar network in the region and facilitating closer intelligence sharing and broader strategic cooperation between the United States, South Korea, and Japan.

\* Though instability in North Korea is often cited as a major concern for Beijing, some Chinese observers who met with the Commission in Beijing assert the resilience of the North Korean regime is understated and that no rebellion is on the horizon. Commission meeting with Chinese observers, Beijing, China, June 24, 2016.

- China advances the narrative that the United States incites Pyongyang to engage in provocations. In particular, Chinese officials and commentators refer to unilateral U.S. sanctions, high-profile U.S. military exercises with South Korea, and other actions as damaging to regional stability.\*<sup>165</sup> In response to Secretary Carter’s remarks following the September 2016 nuclear test that China take more responsibility for North Korea, China’s Foreign Ministry spokesperson said, “Mr. Carter was being unnecessarily modest. The cause and crux of the Korean nuclear issue rest with the U.S. rather than China. The core of the issue is the conflict between the DPRK and the U.S. It is the U.S. who should reflect upon how the situation has become what it is today, and search for an effective solution. It is better for the doer to undo what he has done. The U.S. should shoulder its due responsibilities.”<sup>166</sup>

These views speak to fundamental differences in how China and the United States perceive developments in North Korea, necessarily limiting bilateral cooperation. At the heart of this mismatch in priorities is the debate about China’s “leverage” over North Korea. U.S. officials and experts often refer to the leverage Beijing holds over Pyongyang by virtue of China’s role as North Korea’s primary source of economic and political support. They argue the North Korean “problem” can be solved if China uses its leverage to apply pressure on Pyongyang such that the regime will be forced to change its ways.<sup>167</sup> Though this may be true, to do so would undermine Beijing’s ultimate goal: the maintenance of regime stability and the buffer state it perceives it needs between itself and the U.S.-allied South. Seoul-based scholar and long-time North Korea watcher Andrei Lankov explains China’s perceived quandary:

*From decades of experience China has learned that ... when the North Korean economy runs into trouble, it is the common people, not the small hereditary elite, who pay the price. And since commoners have no way to influence the government, the North Korean elite is always willing to pursue those policies most conducive to their interests, even if such policies mean economic hardships and starvation of the population at large. ... Hence, subtle pressures are not efficient in dealing with Pyongyang—and the Chinese know this very well. The only way to make a difference is to strike North Korea really hard, by dramatically reducing or halting nearly all economic exchanges, expelling North Korean workers, and taking other measures which will provoke a grave economic crisis in North Korea. Such a crisis might create a revolutionary situation, thus making the North Korean elite consider serious concessions on the nuclear and missile issues. However, such a hard blow is unlikely to ever be delivered by China. This is because extreme*

\*The Center for Strategic and International Studies’ Beyond Parallel project studied North Korean provocations and U.S.-South Korea exercises from 2005 to 2016 and found that the exercises had a “null effect” on belligerent DPRK activity. Victor Cha, Na Young Lee, and Andy Lim, “Understanding the Relationship between DPRK Provocations and U.S.-ROK Military Exercises,” *CSIS Beyond Parallel*. <http://beyondparallel.csis.org/dprk-provocations/>.

*pressure is more likely to bring about regime collapse than denuclearization, and regime collapse is not what Chinese leaders want to see.*<sup>168</sup>

### **Implications for the United States**

Unwilling to apply the full force of its leverage on Pyongyang, but unable to ignore U.S. and international appeals for cooperation on North Korea, Beijing pursues the status quo, doling out occasional punishments to the Kim regime. This necessarily leaves the United States and the international community hamstrung in encouraging change in North Korea. In addition, China's continued economic assistance to North Korea creates greater instability in Northeast Asia by facilitating the Kim regime's missile and nuclear weapons development. Beijing states that its goal is to realize a nuclear-free Korean Peninsula, but its actions suggest otherwise.

Indeed, Beijing's enabling of the Kim regime as a bulwark against U.S. and allied influence and power on the Korean Peninsula appears to be backfiring, as the United States, South Korea, and Japan pursue greater defense and intelligence cooperation and enhance their military capabilities against North Korea.<sup>169</sup> Following North Korea's September 2016 nuclear test, President Obama reiterated to Seoul and Tokyo "the unshakable U.S. commitment to take necessary steps to defend our allies in the region, including through the deployment of a [THAAD] battery to [South Korea], and the commitment to provide extended deterrence, guaranteed by the full spectrum of U.S. defense capabilities."<sup>170</sup> South Korea and Japan are increasingly concerned with North Korea's escalating threat. Tokyo has been exploring expanded missile defense capabilities for some time now, and North Korea's recent provocations appear to be lending these discussions more urgency.<sup>171</sup>

China's mistrust of the U.S.-South Korea alliance and its unique security priorities vis-à-vis North Korea restrict its level of engagement with South Korea and the United States in discussions about North Korea collapse scenarios and contingency planning.<sup>172</sup> As a result, the countries most likely to intervene in North Korea in the event of regime collapse—the United States, China, and South Korea—are not fully informed of each other's intentions, which could lead to accidents, miscalculation, and conflict in the event of a contingency.

China's enforcement of UNSCR 2270 and its reaction to the THAAD deployment are still unfolding, while as of the publication of this Report, Beijing has stated that the next UN resolution following the September nuclear test should include tightened sanctions.<sup>173</sup> If the past is any indication, China can be expected to unevenly enforce UNSCR 2270 and the forthcoming round of sanctions in a way that will not seriously destabilize the Kim regime. The impact of THAAD is less clear, though in the near term it likely will encourage greater cooperation between Beijing and Pyongyang and cause increased tensions between China and the United States and South Korea.

## Conclusions

- Following a series of missile and weapons systems tests demonstrating alarming advances in capabilities, in September 2016 North Korea conducted its fifth nuclear test, which was the most powerful to date. Beijing's diplomatic response to the test was its strongest yet, condemning the test and emphasizing that Pyongyang abide by UN resolutions. As of the publication of this Report, Beijing has said it will cooperate in a forthcoming UN resolution tightening sanctions on North Korea, but given its track record China can be expected to unevenly enforce sanctions in a way that will not seriously destabilize the Kim regime.
- Since 2012, when President Xi Jinping took office and Kim Jong-un became leader of North Korea, persistent North Korean belligerence has contributed to a noticeable downturn in China's relations with North Korea. This trend continued in 2016 when, after North Korea's fourth nuclear test, China supported the most stringent UN Security Council resolution to date on North Korea. Beijing appears to be attempting to maintain some stability in the relationship, but notably high-level exchanges (at the vice ministerial-level and above) between China and North Korea have decreased since the beginning of 2015 compared to the previous two-year period, continuing a negative trend from years prior.
- As North Korea increases the frequency of its missile tests, especially those using ballistic missile technology, and the UN Security Council and countries in Northeast Asia call for increased pressure on Pyongyang, Beijing continues to emphasize stability and the status quo above denuclearization as its guiding strategy regarding North Korea policy. Given its fear of instability in North Korea making its way into China and its desire to retain a strategic buffer between itself and U.S.-allied South Korea, Beijing will almost certainly not cut off trade of critical resources with Pyongyang, including coal and oil, or other sources of hard currency for North Korea.
- Although it is still too early to judge the full extent of China's enforcement of UN Security Council Resolution 2270, thus far Beijing has unevenly enforced sanctions and used to its advantage a significant loophole that allows China an exception to continue importing North Korean coal, iron, and iron ore for "livelihood purposes." While certain areas of progress and gaps are evident in Chinese enforcement thus far, China's lack of accountability and transparency in enforcing sanctions increases the difficulty for international observers to determine its level of enforcement.
- In accordance with the North Korea Sanctions and Policy Enhancement Act of 2016 (which became law in February 2016), the U.S. Department of the Treasury in September for the first time sanctioned Chinese entities with economic ties to North Korea, designating Dandong Hongxiang Industrial Development Co. and four Chinese nationals who directed and managed the firm for sanctions evasion activities and froze their assets. In addition, the U.S. Department of Justice indicted the individuals and enti-

ty for sanctions violations, conspiracy, and money laundering. It also confiscated funds in 25 Chinese bank accounts allegedly belonging to the firm and its front companies. These actions could compel Beijing to increase regulatory measures on Chinese firms doing business with North Korea, but such measures will probably be constrained by China's desire to support the Kim regime.

- China claims the decision by South Korea and the United States to deploy the U.S. Terminal High Altitude Area Defense (THAAD) ballistic missile defense system to South Korea to defend against North Korea's increased nuclear and missile capabilities is a direct threat complicating its own security environment. Beijing has used the announced deployment to obstruct international and regional cooperation on North Korea and to reduce certain areas of economic cooperation with South Korea. Over the near term, THAAD is likely to encourage China to move closer to North Korea, while increasing frictions between China, the United States, and South Korea.
- China's close economic ties with North Korea are unlikely to diminish significantly in the near term. In 2015, China accounted for approximately 91 percent of North Korea's legitimate foreign trade of \$6.25 billion (excluding trade with South Korea). One of North Korea's main sources of hard currency (which is not covered by sanctions) is from foreign labor, which generates revenue in the low hundreds of millions of dollars annually, mainly in China and Russia. According to an estimate in August 2016, approximately 70,000–80,000 North Korean workers are employed in China, and around 34,000 North Koreans work in two Chinese border cities, with this number set to rise in the coming years.
- As the North Korean threat increases, placing U.S. alliances and security interests at risk, China's skepticism about the U.S. role in the region poses obstacles to the productive engagement necessary to achieve the goal of denuclearization of the Korean Peninsula. Chief among these obstacles is Beijing's view that U.S. policy on North Korea is designed to strengthen U.S. alliances to contain China, and that U.S. military exercises with South Korea incite Pyongyang to conduct further provocations.

## **RECOMMENDATIONS**

### ***China and North Korea***

The Commission recommends:

- Congress require the U.S. Department of State to produce an unclassified report assessing China's compliance with UN resolutions on North Korea.

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