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Restricting North Korea's Access to Finance

Elizabeth Rosenberg, Senior Fellow and Director, Energy, Economics, and Security Program
Center for a New American Security

Chairman Barr, Ranking Member Moore, distinguished members of the committee, thank you for the opportunity to testify today on restricting North Korea's access to financial services.

The United States has in place an array of sanctions and other restrictive financial measures on North Korea to expose and constrain its increasingly dangerous missile and nuclear proliferation activities. Since 2006, North Korea has conducted five nuclear tests including, most recently, two in January and September 2016.¹ The country has also conducted a series of ballistic missile tests, including over 80 since Kim Jong Un's rise to power in 2011.² In response to this growing threat, since 2006 U.S. leaders have worked with international counterparts to bring into force an array of United Nations Security Council resolutions with sanctions on North Korea, responding to provocative and dangerous nuclear and missile tests by the rogue state, including three resolutions since 2016.³ U.S. leaders have also urged many like-minded nations to amplify the multilateral effort by imposing their own restrictive financial measures.

These various sanctions programs have focused primarily on North Korea's proliferation activities and networks, both those in support of Pyongyang's weapons capability and its activities to supply other countries with components and technology. In the more recent past, international sanctions have expanded to include broader restrictions on North Korea's economy and trade to deny the country the ability to earn hard currency to support its dangerous proliferation activities. Policy

¹ Amanda Erickson, "A timeline of North Korea's five nuclear tests and how the U.S. has responded," *The Washington Post*, April 14, 2017, https://www.washingtonpost.com/news/worldviews/wp/2017/04/14/a-timeline-of-north-koreas-five-nuclear-tests-and-how-the-u-s-has-responded/?utm_term=.4a2d32c55440.

² Joshua Berlinger, "North Korea's missile tests: By the numbers," CNN, July 5, 2017, <http://www.cnn.com/2017/05/29/asia/north-korea-missile-tests/index.html>.

³ See UN Security Council, Security Council resolution 2321 (2016), November 30, 2016, S/RES/2321 (2016), <https://www.un.org/sc/suborg/en/s/res/2321%282016%29-0>; UN Security Council, Security Council resolution 2270 (2016), March 2, 2016, S/RES/2270 (2016), <https://www.un.org/sc/suborg/en/s/res/2270%282016%29>; and UN Security Council, Security Council resolution 2345 (2017), March 23, 2017, S/RES/2345 (2017), <https://www.un.org/sc/suborg/en/s/res/2345-%282017%29>.

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leaders have also expanded their sanctions authorities to target North Korea's human rights abuses and malicious cyber activity.

U.S. Policy Leaders Must Expand Economic Pressure on North Korea

The coercive financial measures in place against North Korea constitute a tough set of tools to pressure Pyongyang toward policy change, including nuclear diplomacy. However, they have had limited utility in compelling North Korea to curb its proliferation activities. This is unsurprising given the until-recent, narrow focus of sanctions authorities on proliferation materials and actors, as well as the limited implementation of sanctions, including by China, which provides over 90 percent of North Korea's trade volume.⁴ Recent statistics even showed a ten percent increase in bilateral trade during the first half of 2017.⁵

Careful observers of sanctions note that “loopholes abound,” both in the legal restrictions and in their implementation,⁶ and that there are a variety of options to toughen the financial pressure on North Korea. By no means is the country “sanctioned out” or “sanctions proof” as some have argued. However, it will take a much more intensive and coordinated effort, and one that is multilateral, to truly disable the sophisticated network of front companies and money laundering schemes that generate foreign currency earnings to support North Korea's proliferation aims and destabilizing behavior.

U.S. policy leaders can and should use restrictive financial measures more aggressively, and at a greater pace, to address North Korea's grave and growing threat to U.S. interests and allies. Specifically, the U.S. Treasury Department should engage in a significantly expanded and energized campaign to sanction nodes in North Korean proliferation networks, and the agents and instrumentalities that raise and launder money for North Korea. A recent C4ADS study found that a few key entities play a substantial role in allowing Pyongyang to evade sanctions and that actions against one of these could significantly disrupt the country's illicit global network.⁷ For example, one entity with strong links to North Korea's global illicit trading network appeared to account for as much as 9.2 percent of its total exports to China in 2016.⁸

In their sanctions efforts, U.S. officials should focus specifically on transit hubs for North Korea, and the entities, both local and foreign, that do business through these hubs. Officials should also

⁴ Eleanor Albert, “The China-North Korea Relationship,” Backgrounder (Council on Foreign Relations, July 5, 2017), <https://www.cfr.org/backgrounder/china-north-korea-relationship>.

⁵ Anna Fifield, “Chinese figures show trade is up with North Korea, but questions abound,” *The Washington Post*, July 13, 2017, https://www.washingtonpost.com/world/chinese-imports-from-north-korea-fall-sharply-a-sign-that-beijing-is-cracking-down/2017/07/13/1ff1f49a-6787-11e7-83d7-7a628c56bde7_story.html?utm_term=.de0c949e6c36.

⁶ Jane Perlez, Yufan Huang, and Paul Mozur, “How North Korea Managed to Defy Years of Sanctions,” *The New York Times*, May 12, 2017, https://www.nytimes.com/2017/05/12/world/asia/north-korea-sanctions-loopholes-china-united-states-garment-industry.html?_r=0.

⁷ “Risky Business A System-Level Analysis of the North Korean Proliferation Financing System,” (C4ADS, June 12, 2017), <https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/59413c8bebbd1ac3194eafb1/1497447588968/Risky+Business-C4ADS.pdf>.

⁸ Ibid.

craft additional sanctions to target entities that operate in and do business with other economic sectors in North Korea, including the mining, energy, light manufacturing, transportation, and construction sectors. It may also be advisable to craft new sanctions on commercial tour operators in North Korea, with appropriate exceptions. Additionally, U.S. officials should focus sanctions on North Korean front companies and agents in China and elsewhere outside of North Korea, to sever and stymie the shippers, insurers, manufacturers, and traders that wittingly and unwittingly prop up the regime. With regard to the authorities that they use to target illicit North Korean activity, U.S. officials should maintain their focus on sanction and expand use of USA PATRIOT Act Section 311 authorities, as well as other law enforcement tools, to expose and halt North Korean money in the United States and global financial systems.

To date, U.S. administration officials have moved relatively tentatively to target Chinese banks that facilitate North Korean commerce and money laundering, largely for political, economic, and intelligence reasons. In June 2017, the U.S. Department of the Treasury took an important step in naming Bank of Dandong, a Chinese bank, as a “primary money laundering concern” under section 311, citing particular concerns about its service to North Korea as gateway to the U.S. and international financial systems.⁹ However, the severity of Pyongyang’s proliferation threat now demands an even more assertive push on sensitive targets such as Chinese banks. New sanctions should include restrictions on any bank involved in financing the manufacture, or purchase, of North Korean exports, including coal, minerals, textiles, and other products. This will, necessarily, include additional pressure on Chinese banks. Also, policy leaders should require that all payments to North Korean entities be held in escrow accounts outside North Korea, with limitations on how the money can be used.

The United States has existing authorities to embark upon a new financial pressure campaign pursuant to a series of executive orders dealing with proliferation generally, and North Korea in particular. It also has authorities in statute updated as recently as last year with expansive new North Korea targeting provisions. Finally, there are options for secondary sanctions, including in proposals considered by Congress.

To complement a ramped up campaign on financial facilitators of North Korean activity, the United States should encourage like-minded nations to join in amplifying the pressure on North Korea. The administration should fully staff its diplomatic corps to engage allies on this issue, and also ensure that key roles in the Treasury Department, intelligence agencies, law enforcement, and at the national security council, are filled to enable advanced analysis, targeting, and coordination with foreign counterparts to build designations and enforcement cases against North Korean targets. Within the State Department, for example, key roles such as the Assistant Secretary for East Asian and Pacific Affairs, the Coordinator for Sanctions Policy, and the Special Envoy on North Korean Human Rights are either vacant or under acting leadership. Additionally, administration leaders should take every appropriate opportunity in multilateral security and economic fora to strengthen international resolve on the North Korean proliferation threat, and joint action to politically and economically isolate the country. The United States missed an important opportunity to lead

⁹ “Treasury Acts to Increase Economic Pressure on North Korea and Protect the U.S. Financial System,” U.S. Department of the Treasury, press release, June 29, 2017, <https://www.treasury.gov/press-center/press-releases/Pages/sm0118.aspx>.

counterparts in highlighting the North Korean threat at the last G20 meeting, which occurred only days after the July 4 North Korean intercontinental ballistic missile test.

China is the Lynchpin for Any Successful Economic Pressure Strategy

New U.S. sanctions on North Korea will achieve some progress in limiting the country's access to critical hard currency and addressing its destabilizing, nuclear threat. However, true success in altering Pyongyang's financial means and its proliferation aims will only be delivered if its key conduit to the international financial system, China, makes the strategic decision to impose constraints on North Korea. This decision will have to include Beijing's direction to state-owned and private Chinese firms to curb their dealings with the criminal rings and front companies making and moving money for Pyongyang. Even with a commitment to cooperation from Beijing, however, progress may be slow-moving due to the challenges of coordinating all parts of the Chinese government on a North Korea financial pressure strategy, and aligning the different Chinese regional approaches and capacities to North Korea policy implementation.

China's strong preference to live with a provocative, nuclear neighbor in order to avoid what it sees as deeply problematic military, political, and human migratory implications of a North Korean regime collapse means that China will not easily be swayed to pressure North Korea. Indeed, it will only do so to achieve Chinese interests, including vis-à-vis the United States. Fundamentally, China is very unlikely to be bullied into pressuring North Korea by U.S. financial sanctions pressure. The strongest and most successful approach for U.S. policy leaders to apply economic pressure on North Korea is to find ways to cooperate with Beijing on this goal. Coming to a joint agreement to cooperate should include intensive diplomacy and creative thinking about how to advance bilateral security interests. Also, committing to agreement to cooperate should include the imposition of sanctions on North Korean front companies and facilitators in China. This will clarify the strong resolve of U.S. policy on North Korea, and an intolerance of sanctions evasion or inaction when it comes to China's facilitation of North Korean proliferation.

The current administration is placed to advance this approach with China as part of its "maximum pressure and engagement" policy on North Korea. Secretary of State Rex Tillerson acknowledged the primacy of China in resolving the crisis, suggesting that U.S. sanctions could play a role in punishing individual actors while Washington also seeks cooperation.¹⁰ However, to execute this policy the administration requires further diplomatic, sanctions, and strategic policy development resources as a complement the force posture arrangements in place.

Principles for Sanctions Implementation

U.S. policy leaders can and should act quickly, aggressively, and in step with key international counterparts to pressure North Korea with financial measures. However, they must be guided by several principles to create conditions for success in to advance U.S. interests. First, sanctions cannot be the only pressure tactic deployed to deter North Korea; they are not a strategy on their own. They will be most successful when their deployment occurs in close coordination with

¹⁰ Demetri Sevastopulo, "North Korea condemns 'reckless' US bombing exercises," *Financial Times*, July 9, 2017, <https://www.ft.com/content/67916256-637a-11e7-91a7-502f7ee26895?mhq5j=e1>.

diplomatic outreach and coordination with U.S. allies, and when they are a corollary to the threat of military action. Second, U.S. policy leaders must have a clear, shared, and public view about what policy change they aim to achieve with sanctions pressure on North Korea. The current administration must do more to publicly clarify strategy when it comes to Pyongyang, and how it views scenarios to spar or partner with Beijing to advance this strategy. Otherwise, the application of economic pressure and exposition of military force posture may involve the expenditure of hard-won and precious international credibility with no political path forward and at the expense of diplomatic options and leverage.

A third and final principle to guide the implementation of new sanctions on North Korea is that policy makers must be very careful with the use of secondary sanctions. There are many ways to pressure North Korea economically and with tremendous effect, short of this extraordinarily aggressive tool to bar foreign entities dealing with North Korea (which in this case may be primarily Chinese) from the U.S. financial system. Always, the threat of secondary sanctions must be credible and implementers should be sure that the effect will be truly severe for North Korea. The United States cannot afford to bluff with idle threats to use this powerful tool. Nor can it be cavalier about the consequences to U.S. markets, financial institutions, and trade, of potentially dropping this axe on large Chinese banks, which are the largest banks in the world.¹¹

A Renewed Policy Focus on Countering Proliferation Finance

In the broader effort to use economic means to isolate and pressure North Korea over its enrichment goals, sanctions are perhaps the best-known tool. However, they are not the only tool. Their utility should be properly situated in the broader policy and regulatory framework to combat the financing of proliferation.

When global banks and companies attempt to stop North Korea's proliferation activities by checking transactions and customers against sanctions and trade control lists there is a lot they miss. Proliferation finance is often hidden behind money laundering schemes and what might appear as the financing of industrial goods trade or retail banking of all-cash businesses. These practices are poorly understood and hard to detect. Only the largest global banks, and of those primarily the subset that are highly exposed to U.S. or EU banking regulations, have sophisticated and holistic programs to analyze their client data for proliferation finance. Even then, they may unwittingly move millions of dollars for North Korea. Earlier this month a federal judge in Washington, D.C. made public a series of "damming" seizure warrants against eight major U.S. and European banks believed to have processed \$700 million of prohibited transactions for North Korea between 2009 and this year through front companies, possibly without being of the beneficial owners.¹²

To the extent that foreign banks in high-risk jurisdictions for proliferation finance, including East Asia and Southeast Asia, look carefully for hidden North Korean proliferation-linked transactions it is more due to the requirements of their U.S. and European correspondent banking partners than

¹¹ "The World's Largest Banks," *S&P Global Market Intelligence*, <http://pages.marketintelligence.spglobal.com/Global-Bank-Rankings-Request.html>.

¹² Jonathan Stempel, "U.S. seeks funds tied to North Korea from eight big banks," Reuters, July 6, 2017, <http://www.reuters.com/article/us-usa-northkorea-banks-idUSKBN19S014>.

their own local banking regulators. These banks and their customers have a demonstrated record of vulnerability to abuse by North Korean agents. This means that there are many, many weak links in the global financial system that Pyongyang can access to move money undetected into and within the global financial system, thereby sustaining its proliferation activities.

This situation is unacceptable and dangerous. Furthermore, with the agreement of the Iran nuclear deal two years ago some global financial institutions and regulators are under the impression that proliferation finance is no longer the threat it used to be. This is an illusion and should be a call to action for U.S. policymakers to lead a new global initiative to combat proliferation finance. The United States is well placed to lead such an effort, and in so doing will lend technical sophistication, credibility, and true efficacy to its “maximum pressure” policy on North Korea.

Already, U.S. administration officials are helping to guide the Financial Action Task Force, the global standard-setting body on anti-money laundering and illicit finance policy, to give new public guidance on how to combat proliferation finance. U.S. administration officials should also raise the need to strengthen proliferation finance controls and regulatory regimes globally in diplomatic and technical outreach, and in every high-level economic engagement with counterparts in jurisdiction through which proliferation finance notoriously flows. To aid this push, Treasury Department and National Security Council staff should explore the creation of a new proliferation finance tracking program with key international allies as a mechanism in which financial data can be more easily shared and analyzed across national boundaries. With this mechanism in place it will be easier to map proliferation finance networks, gathering leads to target with sanctions, law enforcement, intelligence, or other tools in the United States and other jurisdictions. To be sure, creating such a mechanism would involve working through a myriad of national data privacy and protection laws. However, the extraordinary proliferation threat, most egregiously embodied by North Korea at present, makes this effort nothing short of essential.

There are other steps that the U.S. government can take to enhance the broad counter-proliferation finance architecture at home. U.S. policymakers should consider criminalizing the financing of proliferation. The administration, specifically the Treasury Department in coordination with intelligence community and banking regulatory partners, should give further public guidance on the typologies of proliferation finance to aid banks in finding and stopping this activity. These administration officials should also actively encourage more information between the government and banks, and among banks, pursuant to the Bank Secrecy Act, which is necessary for effective mapping and analysis of proliferation finance.

Conclusion

North Korea is an insidious threat and one of the most significant foreign policy challenges facing U.S. leaders today. Financial measures, including sanctions as well as broader work to strengthen the framework for countering proliferation transactions, are part of the tool kit for dealing with North Korea. But these financial tools must be used much more aggressively, along with other national tools, for a tough U.S. policy toward North Korea to be successful in deterring the regime from its proliferation aims. Also, these U.S. tools must be matched with a concerted effort to coordinate with international allies in the joint application of pressure on Pyongyang. If like-minded countries join U.S. sanctions, and improve their own counter-proliferation finance architecture, it may be possible

to achieve effective pressure to compel North Korean policy change or nuclear diplomacy. If this comes about it will fundamentally advance core U.S. national security, and it may have the effect of safeguarding the global financial system against other, and potential future, proliferation threats.

Biography

Elizabeth Rosenberg

Senior Fellow and Director, Energy, Economics, and Security Program, Center for a New American Security



Elizabeth Rosenberg is a Senior Fellow and Director of the Energy, Economics and Security Program at the Center for a New American Security. In this capacity, she publishes and speaks on the national security and foreign policy implications of the use of sanctions and economic statecraft as well as energy market shifts. She has testified before Congress on sanctions and energy issues and been quoted widely by leading media outlets in the United States and Europe.

From May 2009 through September 2013, Ms. Rosenberg served as a Senior Advisor at the U.S. Department of the Treasury, to the Assistant Secretary for Terrorist Financing and Financial Crimes, and then to the Under Secretary for Terrorism and Financial Intelligence. In these senior roles, she helped to develop and implement financial and energy sanctions. Key initiatives she helped to oversee include the tightening of global sanctions on Iran, the launching of new, comprehensive sanctions against Libya and Syria and modification of Burma

sanctions in step with normalization of diplomatic relations. She also helped to formulate anti-money laundering, counter-terrorist and counter-proliferation financing policy and oversee financial regulatory enforcement activities.

From 2005 to 2009 Ms. Rosenberg was an energy policy correspondent at Argus Media in Washington D.C., analyzing U.S and Middle Eastern energy policy, regulation and trading. She spoke and published extensively on OPEC, strategic reserves, energy sanctions and national security policy, oil and natural gas investment and production, and renewable fuels.

Ms. Rosenberg studied energy subsidy reform and Arabic during a 2004-2005 fellowship in Cairo, Egypt. She was an editor of the Arab Studies Journal from 2002-2005 and researched and wrote on Middle Eastern politics at the Council on Foreign Relations in 2003. She received an MA in Near Eastern Studies from New York University and a BA in Politics and Religion from Oberlin College.