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RESTRICTING NORTH KOREA'S ACCESS TO FINANCE

HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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CONTENTS

	Page
Hearing held on:	
July 19, 2017	1
Appendix:	
July 19, 2017	39

WITNESSES

WEDNESDAY, JULY 19, 2017

Newcomb, William J., Visiting Scholar, U.S.-Korea Institute, Paul H. Nitze School of Advanced International Studies, Johns Hopkins University 7
Park, John, Director, Korea Working Group, Belfer Center for Science and International Affairs, John F. Kennedy School of Government, Harvard University 10
Rosenberg, Elizabeth, Senior Fellow, Center for a New American Security 9
Ruggiero, Anthony, Senior Fellow, Foundation for Defense of Democracies 5

APPENDIX

Prepared statements:
- Newcomb, William J. 40
- Park, John 46
- Rosenberg, Elizabeth 52
- Ruggiero, Anthony 60

RESTRICTING NORTH KOREA'S ACCESS TO FINANCE

Wednesday, July 19, 2017

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONETARY POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:32 p.m., in room 2128, Rayburn House Office Building, Hon. Andy Barr [chairman of the subcommittee] presiding.

Members present: Representatives Barr, Williams, Huizenga, Pittenger, Love, Hill, Mooney, Davidson, Hollingsworth; Moore, Foster, Sherman, Green, Heck, Kildee, Vargas, and Crist.

Ex officio present: Representative Hensarling.

Also present: Representative Royce.

Chairman BARR. The Subcommittee on Monetary Policy and Trade will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Also, without objection, the gentleman from California, Chairman Royce, is permitted to participate in today's subcommittee hearing. Chairman Royce is the Chair of the House Foreign Affairs Committee as well as a member of the full Financial Services Committee, and we appreciate his interest in this important topic.

I appreciate everyone's indulgence as we are delayed in the start of this hearing, just coming from votes. But this hearing couldn't be more timely and more important, so we appreciate your participation. This hearing is entitled, "Restricting North Korea's Access to Finance."

I now recognize myself for 4 minutes to give an opening statement.

The focus of today's hearing, "Restricting North Korea's Access to Finance," will appear timely to many observers. With the July 4th test launch of the country's first intercontinental ballistic missile, the Hwasong-14, it would now seem to be the time to cut off North Korea's resources and deprive it of the means to further develop its nuclear and missile technologies.

But in fact the time to think about genuine limitations on North Korea's capabilities is long overdue, as more than 2 decades of failed agreements punctuated by 5 nuclear tests since 2006 have made clear. As a result, hovering over this hearing is not only a sense of urgency, but disappointment in years of misguided assumptions about the North's behavior and vulnerability to pressure.

If we are to change North Korea's calculations, we must confront why economic sanctions have failed and adapt our policies accordingly. More of the same is unacceptable.

Of course, sanctions can respond to any number of North Korean outrages. One thinks immediately of Otto Warmbier, an American student who was imprisoned for more than a year in Pyongyang only to pass away last month, just days after being sent home in a coma.

Other crimes come to mind as well, from cybersecurity attacks around the world, including the alleged heist of $81 million from Bangladesh's Central Bank last year, or the continued abuse of political prisoners and their families in DPRK's labor camps.

Today, however, we will be concentrating on the Kim regime's proliferation efforts, with the aim of making our sanctions policy both more realistic and more ambitious as well: more realistic by evaluating the actual trade and finance networks exploited by Pyongyang; and more ambitious by assessing new sanctions targets that can influence North Korean behavior, even if those entities are located outside the DPRK itself.

We must also calibrate our sanctions according to how enforceable they are. The future of sanctions as a tool of foreign policy, whether in North Korea or elsewhere, hinges on getting their implementation right.

Central to North Korea's behavior is China, the DPRK's largest trading partner. It is often said that Beijing is worried more about stability in its region than a nuclear-armed North Korea.

However, a nuclear North Korea with a flourishing missile program is incompatible with regional stability, as it would allow Pyongyang to bully its neighbors and manufacture new crises on demand.

While much ink has been spilled over China's role as an emerging global leader, we should be clear that North Korea is a test of that claim. Pyongyang's behavior underlines that Beijing still has a long way to go to pass this test convincingly.

In the end, our goal should be nothing less than stopping North Korea from being able to threaten the U.S. with a nuclear device. This may mean stripping Pyongyang of the wherewithal to further develop its weapons.

It may mean sowing dissent among North Korea's elite. It may mean convincing China that the long-term costs of sanctions require it to lean on the Kim regime.

Different observers will attach different probabilities to each of these outcomes. But again, the overarching goal, the protection of the U.S. and U.S. lives on U.S. territory, must be ever present, with sanctions designed and ultimately judged with this goal foremost in mind.

The Chair now recognizes the ranking member of the subcommittee, the gentlelady from Wisconsin, Gwen Moore, for 5 minutes for an opening statement.

Ms. MOORE. Thank you so much, Mr. Chairman. And I want to thank our witnesses for joining us this afternoon. I know that more and more Americans are concerned, especially when they hear that North Korea has just launched a missile that the Pentagon believes could potentially reach our Nation.

North Korea is a belligerent nation with nuclear aspirations and an unstable leader. President Obama warned President Trump that North Korea would be the most urgent national security threat facing our country. I sure wish we had had this hearing before the House took up and passed major new North Korea sanctions legislation, H.R. 1644, the Korean Interdiction and Modernization Sanctions Act.

All options may be on the table with North Korea, but that doesn't mean that all of them are wise, effective, or even practical. The absolute best tool the U.S. has against North Korea is our global leadership and credibility to lead diplomacy and sanctions efforts.

And yet, U.S. ambassadorships to Japan and South Korea remain vacant. And the President has yet to nominate a permanent Assistant Secretary of State for East Asia and Pacific Affairs.

Needless to say, in a tense and volatile region, unpredictable or absent policy or actions run the risk of unimaginable consequences for our country and our allies. Sanctions, as the Chair said, have a limit. They have a role to play, but so does robust diplomacy.

North Korea is well-versed in sanctions evasion. So we need effective, globally enforced measures. These efforts take years of hard work and cannot be turned off or on in an instance. We need the continuity, serious diplomatic work, rather than unpredictability, or saber-rattling as the right way to press North Korea.

It is just ridiculous to think that we could engage on North Korea absent enduring, persistent, and tireless effort and the proper resourcing of the State Department, another area where our President is lacking in responding to the situation.

I want to yield the balance of my time to the gentleman from New York, Mr. Sherman—I mean, California. Oh God, I will never be forgiven.

Mr. SHERMAN. I am so thrilled the gentlelady would yield, that I will be from whatever State she suggests.

After 20 years on the House Foreign Affairs Committee, I am now the ranking member on the Asia Subcommittee. I am glad we are having these hearings about closing off North Korea's access to the financial system. But unless we pressure China, we will only be able to annoy or punish the North Koreans but not force them to change their behavior.

The idea has been put forward for 20 years that if we just have someone brilliant and eloquent go to Beijing, they will realize that their policy toward North Korea is wrong and they will adopt our policy.

That will not happen. As long as China can have a strong North Korea on the one hand and have easy access to American markets on the other hand, they will continue their present policy.

So we are not in a position where more rhetoric or eloquence will solve the problem. We have to change the facts. We have to choose between two approaches. One is putting pressure on China by saying access to U.S. markets will not be available to them as long as they support the North Korean regime in its present configuration and policies.

Or second, we need to build fallout shelters starting on the West Coast because the idea of just saying, "We are going to close this

or that banking relationship, therefore we have done something" is a way to—ignore—to fail to build those fallout shelters, which are more necessary now than they were 20 years ago.

We also have to have reasonable goals. China will not allow the overthrow of this regime. The regime will cling to power and cling to at least some nuclear weapons.

If we have a reasonable policy, a big stick toward China, and a willingness to accept a very limited, highly-monitored non-missile's cache of nuclear weapons, we may be successful.

But if we think that just restricting North Korea without China changing its policy will work, it won't. It may cause North Korea to free this or that prisoner of conscience, but it won't cause them to give up their missile and nuclear program. And if we think China is going to put pressure on North Korea that endangers the regime when they can have access to our markets anyway, that is not going to happen.

Chairman BARR. The gentlelady's time has expired.

The Chair now recognizes the chairman of the House Foreign Affairs Committee, the gentleman from California, Mr. Royce, for 1 minute for an opening statement.

Mr. ROYCE. Thank you, Mr. Chairman. Mr. Sherman and I did raise this issue with the premier in Beijing. He is right. We have to leverage this with China.

We have only one example where this has been effective, and that was with North Korea with Banco Delta Asia when we froze the accounts in a dozen of those banks. And at that point in time, they could not get the hard currency to continue with their program.

Recently, I had passed legislation with Mr. Engel that was signed into law. The U.N. Security Council has put that into force. That was H.R. 757.

Mr. Sherman also raises the point that there are some loopholes that the North Koreans have developed. One of those loopholes is the use of forced labor overseas where the check actually goes to the regime, rather than the money going to the workers. And we have a long list of countries that are only too willing to feed these workers without paying them.

And that loophole we closed by the bill that we passed 419—1, another bill that I passed into the Senate. We are having trouble getting that bill out of the Senate. It also closes a loophole used by some of the Chinese financial institutions.

And so I am hoping this hearing today—and I think the chairmen will put enough pressure on the Senate for them to move that legislation. And then yes, enforcement is key to this—leverage on Beijing is key to this. Thank you.

Chairman BARR. The gentleman's time has expired.

Today, we first welcome the testimony of Anthony Ruggiero, a senior fellow at the Foundation for Defense of Democracies, who has spent more than 17 years in the U.S. Government as an expert in the use of targeted financial measures.

Most recently, he was a foreign policy fellow in the office of Senator Marco Rubio and was Senator Rubio's senior advisor on issues related to the Senate Foreign Relations Committee.

Mr. Ruggiero has also served in the Treasury Department as Deputy Director and then Director of the Office of Global Affairs and the Office of Terrorist Financing and Financial Crimes. In this capacity, he developed and implemented policy options to combat illicit finance, including terrorist financing and proliferation finance, kidnapping for ransom, money laundering, narcotrafficking, and transnational organized crime.

Prior to joining Treasury, Mr. Ruggiero spent over 13 years in various capacities at the State Department, including as chief of the Defensive Measures and WMD Finance Team.

William Newcomb is a visiting scholar with the U.S.-Korea Institute at the Johns Hopkins School of Advanced International Studies. From 2011 to 2014, he served as a member of the United Nations Security Council Panel of Experts on North Korea. And from 2002 to 2005 he was Deputy Coordinator of the U.S. State Department's North Korea working group.

Mr. Newcomb has served in senior economist positions, both at State and Treasury. While at Treasury, he conducted investigations into Banco Delta Asia, which in 2005 was designated an institution of primary money laundering concern for its role in illicit North Korean financial activities.

Elizabeth Rosenberg is a senior fellow and director of the Energy Economics and Security Program at the Center for a New American Security. Under the Obama Administration, she 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.

Dr. John Park is director of the Korea Working Group and is an adjunct lecturer at Harvard University's John F. Kennedy School of Government. He is also a faculty affiliate with the project on Managing the Atom at the Kennedy School's Belfer Center for Science and International Affairs. From 2012 to 2013, Dr. Park was a Stanton Nuclear Security junior faculty fellow at MIT's Security Studies program.

He previously directed Northeast Asia projects at the U.S. Institute of Peace in Washington, and has served as the project leader of the North Korea Analysis Group at the Kennedy School's Belfer Center.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Mr. Ruggiero, you are now recognized for 5 minutes.

STATEMENT OF ANTHONY RUGGIERO, SENIOR FELLOW, FOUNDATION FOR DEFENSE OF DEMOCRACIES

Mr. RUGGIERO. Thank you. Chairman Barr, Ranking Member Moore, and distinguished members of the subcommittee, thank you for the opportunity to address you today on this important issue. Kim Jong-un is a despot who murdered an American citizen, tortures, starves and kills his own people, and will spare no expense to achieve an intercontinental ballistic missile that can deliver a nuclear weapon to the United States.

Furthermore, one should not assume Kim will hold back from using his nuclear weapons on America and our allies. Sanctions remain the best policy option to protect the United States and its allies from North Korea's expanding programs.

Both critics and supporters of the 2015 Iran Nuclear deal agree that sanctions brought Iran to the negotiating table. The Trump Administration should use the Iran sanctions playbook for its North Korea policy.

It is common for scholars and journalists to note that years of strong sanctions against North Korea have failed. It is true that thus far sanctions have not achieved the U.S. objective of disarming North Korea, but it is not true that sanctions have been either strong or well-enforced or that they cannot work.

An effective North Korea sanctions regime would target Pyongyang's international business and non-North Koreans facilitating sanctions evasion

On Slide 1, a quantitative review of U.S. sanctions programs reveals that North Korea currently sits fifth behind Ukraine, Russia, Syria, Iran, and Iraq.

North Korea sanctions have more than doubled since the North Korea Sanctions and Policy Enhancement Act came into effect on February 18, 2016. Prior to that date, North Korea ranked eighth behind Ukraine, Russia, Iran, Iraq, the Balkans, Syria, Sudan, and Zimbabwe.

Slide 2, please. A U.N. Panel of Experts reported in February of this year that North Korea uses, "non-nationals of North Korea as facilitators and relies on numerous front companies."

Slide 3, please. At present, only 2 percent of U.N. sanctions and 12 percent of U.S. sanctions target non-North Koreans facilitating Pyongyang sanctions evasion, while only 27 percent of U.N. sanctions and 47 percent of U.S. sanctions target North Korea's international business.

Thus, while the number of U.S. and U.N. North Korea sanctions may be increasing, they focus on the wrong areas. The goal of sanctions on North Korea is different than it was with Iran since the regime will not negotiate away its nuclear program.

Kim Jong-un views negotiations merely as one step toward his goal of recognition of North Korea as a state with nuclear weapons.

The U.S. goal should be to protect the U.S. and its allies at all costs by strangling the sources of revenue and its materiel on which North Korea relies for its nuclear weapons program.

The key aspect of the Iran sanctions model that worked? It forced companies, individuals, banks, and governments wherever located to make a choice: continue doing business with Iran; or join the U.S. efforts.

The approach worked around the world as banks and companies and eventually governments curtailed or eliminated business with Iran. To be as tough on North Korea as it was on Iran, the U.S. should move aggressively against Chinese banks that are integral to North Korea's sanctions evasion efforts.

Information on North Korea's use of Chinese banks to access the American banking system is incomplete. The available estimates generally encompass only transactions with designated North Korean entities and individuals or those who work on their behalf.

One pattern that emerges is the disturbing extent to which Chinese banks helped North Korea leverage the U.S. financial system to evade sanctions. Recent disclosures show that from 2009 to 2017, North Korea used Chinese banks to process at least $2.2 billion in transactions through the U.S. financial system.

Pyongyang's provocations, including its test of an ICBM, deserve increasingly harsh responses from Washington. A new North Korea sanctions approach is needed to secure the United States and its allies against the dangerous and growing threat from this rogue regime.

Iran-style sanctions are the only peaceful way to coerce the Kim regime, and for that reason are indispensable. Thank you again for inviting me to testify, and I look forward to your questions.

[The prepared statement of Mr. Ruggiero can be found on page 60 of the appendix.]

Chairman BARR. Mr. Newcomb, you are recognized for 5 minutes.

STATEMENT OF WILLIAM J. NEWCOMB, VISITING SCHOLAR, U.S.-KOREA INSTITUTE, PAUL H. NITZE SCHOOL OF ADVANCED INTERNATIONAL STUDIES, JOHNS HOPKINS UNIVERSITY

Mr. NEWCOMB. Thank you, Chairman Barr, Ranking Member Moore, and members of the subcommittee. I appreciate the opportunity to speak before you today. And I want to discuss the effectiveness of international sanctions. Now as we meet, our representative to the U.N. is seeking agreement on yet another sanctions resolution as a response to the DPRK's test of an ICBM earlier this month.

If one were adopted soon, it would be the second in as many months and the eighth overall beginning with UNSCR 1718 back in 2006, upon which subsequent resolutions have been built. To date, all but one of the sanctions resolutions have been adopted under Chapter 7, Article 41, of the U.N. charter. That is crucially important so that they are legally binding upon all member states.

All the resolutions were announced with rhetorical flourishes about how the latest measures adopted were even more comprehensive and tougher. The trajectory of successive sanctions measures does show resolutions adopting a broadened set of targets and becoming more comprehensive, especially in restrictions on trade, transport, and finance. I would expect proposed measures now being discussed to continue in that direction.

Despite delays in adoption while being negotiated, which gives the DPRK time to take immediate defensive measures and move assets of entities likely to be designated, and built-in loopholes insisted upon by China and Russia, these measures are of immense value, potentially.

Regrettably, the success the U.S. and like-minded countries have achieved in getting tougher sanctions adopted has been blunted by inadequate action by most member states, squandering the political capital Washington has spent to obtain agreement from Beijing and Moscow.

Over the past decade, the record of implementation is poor. There were some years when even members of the security council had not implemented the measures.

Typically, it took several years following adoption for the rate of implementation to reach the 50 percent mark. This appears true for all U.N. sanctions program. It also held true for Iran, for example.

More recently, efforts by the 1718 Committee and the Panel of Experts to address this problem through outreach appeared to be having some success.

As of July 10th, 92 of 192 member states have reported implementation of Resolution 2270, which was passed in 2016, and 70 had reported implementation of 2321, which passed later last year.

These numbers include states reporting on the implementation for the first time, thus prospects are improved for attaining a higher rate of adoption.

But unfortunately, reports on implementation don't tell the whole story. Many nations failed to disclose details about how sanctions were implemented. Even those that do upon an inspection have fallen short of what was required.

Mexico, for example, didn't implement the assets freeze provision, which gave it a big headache when it tried to seize the Mu Du Bong, which was a ship owned by Office of Maritime Management.

Singapore prosecuted Chinpo Shipping for violation of proliferation finance. It was overturned by the high court in Singapore because that part of the resolution hadn't been implemented correctly.

If Mexico and Singapore, countries that have adequate resources and good regulatory capacity, have difficulty in implementing sanctions, think about the problem faced by many countries that don't have adequate capacity.

Then, we get to the problem of enforcement. When it comes to the U.N., violations are not treated as a judicial matter, but as a political one. Following the 2013 nuclear test, 43 candidates were proposed for designation. China accepted only three. One of the ones on that list of 43 that was not accepted was a company known as Pan Systems Pyongyang.

It was revealed earlier this year to be a front for Reconnaissance, General Bureau, involved in the sale of battlefield technical radios via a Malaysian listed company named Glocom.

Now, the U.S. and like-minded countries are uniquely able to leverage the effect of international sanctions by adopting positive and negative incentive to encourage states to implement and rigorously enforce them.

You need to give assistance to capacity-challenged states. You need to encourage one way or another those that lack political will. And states that tolerate or help in evading sanctions need to face consequences. Thank you very much. I look forward to your questions.

[The prepared statement of Mr. Newcomb can be found on page 40 of the appendix.

Chairman BARR. The gentleman yields back.

Ms. Rosenberg, you are now recognized for 5 minutes.

STATEMENT OF ELIZABETH ROSENBERG, SENIOR FELLOW, CENTER FOR A NEW AMERICAN SECURITY

Ms. ROSENBERG. Thank you, Chairman Barr, Ranking Member Moore, and distinguished members of this subcommittee for the opportunity to testify today on restricting North Korea's access to financial services. There are an array of international sanctions and other restrictive financial measures on North Korea to expose and constrain its increasingly dangerous missile and nuclear proliferation activities.

However, these measures have had limited utility in compelling North Korea to curb its proliferation activities. This is unsurprising, given the until-recent narrow focus of sanctions only on proliferation materials and actors, significantly within North Korea, as well as the limited implementation of sanctions including by China, which provides over 90 percent of North Korea's trade volume.

U.S. policy leaders can and should use restrictive financial measures more aggressively as part of the holistic U.S. strategy to pressure North Korea.

The country is not sanctioned-out and many loopholes can be closed with new measures and stronger enforcement, as has already been mentioned. An invigorated U.S. effort should involve sanctioning more of the agents that procure and proliferate missile and nuclear components and that raise and launder money for North Korea.

Sanctions officials should target transit hubs for North Korea and the entities that do business through these hubs. They should also target additional economic sectors in North Korea including mining, energy, light manufacturing, transportation, and construction. They can also consider sanctioning commercial tour operators in North Korea with appropriate exceptions.

Additionally, though it will be politically sensitive and economically significant, U.S. officials should focus sanctions on companies in China and elsewhere to stymie the shippers, insurers, manufacturers, and traders that wittingly and unwittingly prop up Pyongyang.

Moreover, U.S. officials should restrict banks from financing any manufacturer of or facilitator for the purchase of North Korean exports including coal, minerals, textiles, and other products. Also, U.S. 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.

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.

China will not easily be swayed to this end and will only do so to achieve its own interest. This means that the United States will have to find ways to cooperate with Beijing and this will necessitate intensive diplomacy and creative thinking about how to advance mutual interests.

It should also involve imposition of U.S. sanctions on North Korean companies and facilitators in China to clarify strong U.S. re-

solve when it comes to North Korea and intolerance of sanctions evasions and nonenforcement in China.

Tough new sanctions carefully implemented with multilateral partners are an important part of the financial strategy to address the North Korean threat. However, they must be grounded in a broad policy effort to protect the financial system and institutions generally against abuse by proliferators.

This is notoriously difficult even for the most sophisticated banks as proliferation finance is often hidden behind money laundering schemes or what appears to resemble the financing of industrial goods trade or retail banking of all cash businesses.

The United States is well-placed to lead a much needed global initiative to combat proliferation finance and Administration officials should explore the creation of a new proliferation finance tracking program with key international allies to more easily share and analyze financial data across national boundaries.

This will make it easier to map proliferation networks, gathering leads to target with sanctions and with law enforcement tools, intelligence tools, and others.

U.S. policymakers should also give further public guidance on typologies of proliferation finance to aid banks in stopping this activity and contemplate additional legal protections or risk management guidance to promote more financial information-sharing between the government and banks and among banks.

Sanctions and counter-proliferation finance policy must be used more intensively along with other national tools to achieve meaningful progress in deterring North Korea from its proliferation aims.

I applaud this committee's attention to this important issue and thank you for the opportunity to discuss it with you today. I look forward to answering any questions that you may have.

[The prepared statement of Ms. Rosenberg can be found on page 52 of the appendix.]

Chairman BARR. Thank you.

And Dr. Park, you are recognized for 5 minutes.

STATEMENT OF JOHN PARK, DIRECTOR, KOREA WORKING GROUP, BELFER CENTER FOR SCIENCE AND INTERNATIONAL AFFAIRS, JOHN F. KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY

Mr. PARK. Thank you very much. Chairman Barr, Ranking Member Moore, and members of the subcommittee, it is an honor to appear before you today. I am particularly honored to be on the same panel with Mr. Bill Newcomb, who has mentored me and many others in researching the North Korean regime's illicit activities.

As requested by the subcommittee, I will be summarizing my research into the North Korean regime's accumulative learning in evading sanctions.

The key takeaway is not that the North Korean regime has been evading sanctions. They have been engaged in this activity for decades. Rather, it is the story of how North Korea sanction evasion techniques have improved significantly because of North Korean's incorporated migration to the Chinese marketplace.

As a result, U.S. policymakers need to factor in these growing gaps and consider underutilized measures, like Chinese domestic policy tools, to disrupt Chinese-North Korean business partnerships and restrict North Korea's access to finance.

My MIT colleague, Dr. Jim Walsh and I, recently conducted research on, "North Korea Incorporated," a term we use to describe the web of state trading companies, or STCs, that the regime operates. We found that STC managers were able to significantly improve their procurement operations by engaging in the following four main activities.

Number one, hiring more capable Chinese middlemen. Instead of impeding procurement activities, we found that additional sanctions in some key instances have actually attracted more capable Chinese middlemen incentivized by a bigger payday through elevated commission fees.

The North Korean regime has financed these larger paydays by drawing on sizable slush funds on the mainland that had amassed during the lucrative North Korea-China coal trade in the late 2000s.

Number two, embedding in commercial hubs in China. What was striking about interviewing former STC managers was the normalcy of their business practices. Like American or European expatriate businessmen, they explained the challenges and opportunities of operating in a particular local market in Asia.

By embedding in commercial hubs in China, STC managers gained tacit business knowledge that was critical to increasing their procurement effectiveness.

Number three, leveraging commercial and banking hubs in Hong Kong and Southeast Asia. As global trends in trading and banking shifted to this part of Asia, these managers have benefited from increased access to business partners with an international reach.

In the case of Hong Kong, we documented how a former STC manager based there was able to procure high-tech medical equipment from Japan through a local business partner. This partner filled out all the required documentation using the details of its own registrations and licenses.

In the case of Singapore, it has been particularly useful for STC managers to pay local firms to arrange wire transfers for payments to foreign counterparties. As Singapore has rapidly risen to be a global center of money management, opportunities abound for the North Korean regime to benefit from illicit financial service offerings.

Number four, extensive use of embassies as vehicles for procurement. North Korean embassies serve two key functions with respect to North Korea Incorporated illicit activities. The first is serving as a vehicle for procuring controlled items in a foreign country.

Former STC managers note that the regime co-locates shell companies with its embassies in countries that offer unique access to sought after items ordered by the regime.

The second function is the ability to credential an STC manager as a North Korean diplomat. In addition to gaining valuable tacit business knowledge by embedding in a country for a longer duration, STC managers are able to use diplomatic pouches for illicit

purposes relating to transporting a banned item or couriering unreported cash.

The net effective sanctions was that they in practice ended up increasing the regime's procurement capabilities, what we call the sanctions conundrum.

Because of the elevated risk of doing business, an STC had to pay higher commission fees to private Chinese companies that played a middleman role. The elevation of risks and rewards attracted more capable professional middlemen into illicit activities on behalf of North Korean clients.

In sum, targeted sanctions unintentionally and counterintuitively helped to more efficiently enable these North Korea Incorporated actors to operate in the Chinese marketplace.

With an improved understanding of how North Korea Incorporated evades sanctions, we can better disrupt its business partnerships in China. In this endeavor, we need to develop ways to bolster the impact of sanctions, but we also need to explore other policy tools.

Diversifying the set of policy tools and coordinating with different policy actors will significantly constrain the remarkably open space within which North Korea Incorporated currently operates. A top priority is to disrupt these partnerships upstream before the procured item becomes a part of globalized trade flows.

In addition to the recommendations offered by my distinguished colleagues on the panel, I would like to bring to the subcommittee's attention another policy option, what I call the the "three antis." These are a set of China's domestic policy tools—namely anticorruption apparatus, antinarcotics campaign, and anticounterfeiting activities—that can be used to impede North Korea's illicit procurement. I would be glad to discuss them in greater detail during the Q&A.

In conclusion, stopping North Korea Incorporated's illicit procurement and blocking its access to finance constitutes a top priority in slowing down the regime's rapid advances in its nuclear and ballistic missile programs.

The work of the subcommittee, the panel members, as well as sanctions-focused officials is critical in finding new, adaptive, and effective ways to counter the North Korean regime's WMD threats to the United States, its Northeast Asian allies, and the international community. Thank you.

[The prepared statement of Dr. Park can be found on page 46 of the appendix.]

Chairman BARR. The gentleman's time has expired.

And the Chair now recognizes himself for 5 minutes for questions.

Dr. Park, your writings have documented how illicit procurement by the North Koreans is embedded in these legal trade networks. The final report of the U.N. Panel of Experts has also found that the DPRK continues to access the international financial system.

How can we better identify—and you have spoken about these brokers and middleman in China—these middlemen and these transactions that violate our sanctions against North Korea?

Mr. PARK. Thank you, Mr. Chairman. I think one aspect of this is to view these as business transactions. One of the incredible

stores of knowledge about doing business in China resides in American Chamber of Commerce members and others who have experience in these marketplaces.

I think using that lens gives us another angle to observe these type of partnerships and activities that, frankly, are bewildering in terms of their normalcy.

So I think from that angle it has to adopt a business lens that goes away from the security aspects, but in understanding the causality within the business community, bring those insights to enhancing these type of policy tools.

Chairman BARR. And is there anything else besides that recommendation that we can do to adapt kind of a holistic approach that would deter Chinese middlemen from working with the North Koreans so that we don't have this kind of "whack-a-mole" scenario where the North Koreans simply change out middlemen?

Mr. PARK. Absolutely. And this is a bit counterintuitive on the face of it, but to look at these activities in the context of Chinese-North Korean business partnerships, and that being the target.

If you focus it along those lines, there are a number of ways in which the Chinese authorities are concerned about North Korean illegal activities that I think would unleash the potential for cooperation on using Chinese domestic policy tools.

But it is that angle of framing these as threats and concerns from the Chinese authorities' perspective and then looking at the common ground that we can work towards this type of cooperation.

Chairman BARR. Mr. Newcomb, the Associated Press reported this month that Chinese trade with North Korea increased 15 percent in the first 5 months of 2017 compared to last year. This includes an 18 percent rise in oil exports to the North, while iron ore purchases from the DPRK were up 34 percent. What pressure points can we place on China to target this trade?

Mr. NEWCOMB. Clearly, when we have tried to put the pressure points on China, the renegotiation of the ban on coal exports was recently successful, although, photography and ship tracking information shows that North Korea ships containing coal continue occasionally to call at Chinese ports. China has not done anything to dent the trade in iron ore because they are classifying it all as for in effect humanitarian purposes.

So the only way you can really go after the China-North Korea business link is by changing the risk profile. And you change the risk profile by making sure that the companies that are engaged in illicit trade have consequences.

Chairman BARR. You talk about the lesser developed countries and the North Korean's ability to evade sanctions and you argued that certain countries that help North Korea evade sanctions should face consequences. Is it reasonable for the United States to impose multilateral assistance to developing countries that knowingly evade U.N. sanctions?

Mr. NEWCOMB. I think the answer to that depends on whether or not we can deconflict our national security priorities. In the case of some countries it might be pretty easy to apply a fairly broad-based sanction. But what will you do in the case of Egypt, where the Ministry of Defense there imported North Korean missile parts?

So it adds a complication. Perhaps it is a matter of going in and targeting certain aspects of that country's operation or making it face consequences in other ways. This is where robust action by the Department of State could perhaps stop these in advance. The U.S. capabilities of knowing some of these things before they take place is pretty good.

Chairman BARR. Mr. Ruggiero, a final question, what counts as success when it comes to sanctions in countering North Korea? And kind of a follow-up question, some observers have criticized the Trump Administration's tough rhetoric and threat of military action in response to North Korea's and the Kim regime's belligerence. Does dovish American foreign policy in contrast embolden North Korea, or is this strong language a deterrent?

Mr. RUGGIERO. In terms of the strong language, the Trump Administration is the first one, really in the last 10 years, to go after a Chinese bank. I think that, to the question of, how do we convince China to go after the—China is not going to do this.

They are not going to go after these companies. They are not going to go after these individuals. And the reason why these Chinese companies and individuals are engaged in these activities is because they know there is no punishment.

In terms of success, when you have a regime that is not interested in negotiating its nuclear program, then success will look like protecting ourselves, trying to reduce the capabilities of the nuclear and missile programs as best as we can and really squeezing the revenue. That is unfortunately where we are at 10 years—or excuse me, 11 years after the first nuclear test.

Chairman BARR. My time has expired.

And the Chair recognizes the distinguished ranking member, Congresswoman Moore, for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman, and I agree with you. We are both on the same page here. We really do want to figure this out. But just listening to the witnesses here, it sounds like this is really like getting the camel through the eye of a needle here.

On one hand, Mr. Ruggiero, you have shared with us that you think that there is a lot more sanctions capacity out there. But then again, Ms. Rosenberg, and maybe Dr. Park, and maybe you, too, Mr. Ruggiero, all of you have said that China is just not going to do—we are not going to pressure them into greater sanctions.

But we ought to sanction other people who do business with—maybe not with North Korea, but with China. I just want a little clarification about where these pressure points other than China could be and an example of what those could be?

Ms. ROSENBERG. If I may take a—

Ms. MOORE. Yes ma'am.

Ms. ROSENBERG. —stab at the question? China is a critical player in putting pressure, financial pressure, on North Korea. And while I believe it is true that China of its own accord and in the current set of political circumstances is not motivated to put financial pressure on North Korea, it will not do it until it sees it in its interest to do so. I think it is possible for the United States to create the conditions such that China sees it in its interest to do so.

As I suggested in my testimony, I think there is a combination of both coordination and pressure on Chinese facilitators and front companies that can and should be applied when it comes to the U.S. bilateral relationship with China to motivate Chinese pressure on North Korea and create those conditions.

So certainly that could and should be a first, primary, most significant press in U.S. sanctions, law enforcement activities and broader proliferation finance policy frameworks, but there are other targets and other vulnerabilities in the global financial system.

I have heard mentioned here Malaysia and Singapore. These are clear examples. There are a number of others, vulnerable nodes in the global financial system where the United States can focus its attention on North Korean evasion.

Mr. PARK. Thank you, Ranking Member Moore. If I could take another angle to this. In terms of pressure points, there are opportunities to cooperate with the Chinese authorities. I know that this may sound unconventional in the sense that there is a primary focus right now to pressure the Chinese government and the Chinese authorities, but just to give a little bit of background, in 2013, the Chinese authorities, a group of Chinese ministries came together and issued something called Technical Bulletin 59. This was a 236-page report that listed the items and the descriptions.

The title of it, essentially being Chinese nationals, are banned from selling these activities, these items, to North Korean clients, and that this was deemed to be a criminal activity. This is broadly a Chinese effort to sanitize its trade with North Korea. But we know that hasn't worked.

After 2013, North Korea has done more effective tests in both ballistic and nuclear fields. What we are finding in the market activity is that these type of efforts are creating more efficient markets unintentionally in the sense that it becomes easier for Chinese middlemen to approach a North Korean client, get the 236-page report and say what do you need, and basically list the terms and the higher commission fees and so forth.

So the area of cooperation with this node and this segment of the Chinese authority apparatus and law enforcement, I think, is another area that we can further explore.

That could be a combination of pressure points in other areas, like secondary sanctions, but under the heading of capabilities enhancement and going after these business partnerships, this could prove to be effective.

Ms. MOORE. I just wonder, Mr. Ruggiero, or any of you, do you have any thoughts on whether or not shoring up the State Department and getting those assets in there would be a helpful strategy for us?

Mr. RUGGIERO. I wonder if I could answer the China question, if that is okay?

Ms. MOORE. Oh, yes, go on. Go on.

Mr. RUGGIERO. Yes. I hate to be the pessimist here, but we have been trying to work with China for 10 years now, and it hasn't worked. I think we have to be very clear. For those of us who—we are in government delivering a lot of these messages to the Chinese, they were very specific messages for them to act and so I think we have to be clear about that.

I think the example in the Iran sanctions is also important here, where the U.S. fined European banks over $12 billion from 2012 to 2015. So we were willing to fine our own allies, but we are not willing to go after China. I think that is the problem with our sanctions here.

Ms. MOORE. Got it. Thank you. My time has expired.

Thank you Mr. Chairman.

Chairman BARR. The Chair recognizes the vice chairman of the subcommittee, Mr. Williams from Texas.

Mr. WILLIAMS. Thank you, Chairman Barr, and I thank all of you for being witnesses today. We appreciate it. Obviously, given the recent actions by the North Korean government, this topic is of course very timely. And although the most recent missile test did not have the capability to carry a nuclear device the potential is there, and we must not take these actions lightly.

So Mr. Ruggiero, if I might address you, in an analysis from earlier this year the nonprofit group c4ads reported that from 2013 to 2016 there were only 5,233 companies in China that imported goods from a net from or exported goods to North Korea. By comparison, over 67,000 Chinese companies exported to South Korea.

So I have two questions. First, should we target all banks that deal with this limited set of companies given that the line between North Korea's legal and illegal procurement is so unclear?

Mr. RUGGIERO. Yes, I think there is a way to target Chinese banks. I think the examples that I provided in my written testimony about some areas where banks are either complicit or they are not asking the right questions of whether North Koreans are involved.

Mr. WILLIAMS. Okay. And second, how confident could we be that a designated firm wouldn't simply pop up under a new name or be replaced by a Chinese competitor?

Mr. RUGGIERO. This is not easy. It was not easy with regard to Iran. I remember working the aspect of IRISL, which was Iran's shipping line. We had one person working full-time on that because of the number of times that those vessels change flags, change owners, change everything about them. So this is not an easy process.

But in terms of the question that the ranking member asked about resources, the question I would ask is, how many people are actually dedicated to North Korea in OFAC, in Treasury, and at the State Department?

And I know, at least in my time there, that there were never enough people dedicated to this. And that is the real question of how many people are working these designation packages to get us to that point? And it is not going to be easy and it is going to take some time, but it is still worth it.

Mr. WILLIAMS. Okay.

Mr. Park, in a July 13th Washington Post article, a high-level North Korean defector who routinely evaded sanctions noted how, even when North Korean firms are blacklisted, "North Korea is 100 percent state enterprise so these companies just change their names the day after they have been sanctioned. That way the company continues but with a different name than the one on the sanctions list."

So without objection, I would ask that this article be entered into the record.

Chairman BARR. Without objection, it is so ordered.

Mr. WILLIAMS. Okay. In addition, North Korea reportedly confiscates from 30 to 90 percent of what its nationals made abroad, which may not derive from illicit activity at all.

My question is this: No one wants to harm ordinary North Koreans, but how meaningful is the distinction between legal and illegal activity when all of it helps secure foreign exchange from the Kim regime? And when it is so difficult to determine if a company is simply a sanctioned entity that has been rebranded?

Mr. PARK. Thank you very much, Congressman. One thing I would like to start off with is moving away from the characterization of North Korea as a country when we look at these business activities. It is really the story of the 99 percent and the one percent.

When we are talking about North Korea, Incorporated, that is the one percent. So to your question about looking at some of these activities that Mr. Reid, the former senior manager in Office 39, a very elite state trading company for the North Korean regime, as he is talking about his evasion techniques, you are looking at the operation of this one percent of North Korea, Incorporated.

When it comes to looking at how to disrupt their activities, I think it is the focus on their partners. The local middlemen are crucial as enablers. So while we do continue to go after the North Korean entities and as they have masked themselves and take on other forms, another parallel effort, I think,is to target these Chinese entities in using a different number of measures.

But the domestic policy measures that I mentioned on the Chinese side could be effective if they are labeled in terms of threats to Chinese interests.

So the three that I briefly mentioned, the corruption drive, these local businessmen are tied to local corrupt party officials, so targeting them could be one area of further disruption.

The second is looking at their narcotics. There is a narcotics problem in the China-North Korea border region. That could be another means to unleashing more law enforcement on that effort.

And then the third is related to the counterfeiting activities. Something not well-known in the West but certainly a strong concern among the Chinese is increasing evidence of North Korea counterfeiting Chinese currency. So these are areas where I think you can create common ground in targeting these Chinese middlemen.

Ms. ROSENBERG. Congressman, may I answer your question as well?

Mr. WILLIAMS. Yes, ma'am. Sure.

Ms. ROSENBERG. With regard to the difference between what is illicit trade for the North Korean regime and its proliferation aims, and what is legal trade, which may then subsequently be used for illicit proliferation aims, it is difficult to distinguish these often commingled revenue streams. Recent U.N. Security Council resolutions, as well as U.S. sanctions, have gone after entire sections, sectoral sanctions of the North Korean economy under the assumption that this threat is so grave. Because it is so difficult to distinguish

between these two different kinds of revenue streams, we must put financial pressure on the regime by going after both.

Mr. WILLIAMS. Thank you. I yield back.

Chairman BARR. The gentleman's time has expired.

The Chair recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Okay. First, I support virtually every piece of legislation to tighten the screws on North Korea. And I commend the Chair of the Foreign Affairs Committee for shepherding so many of those last year and this year, and I hope the U.S. Senate passes them.

That being said, we have to determine whether we are willing to just put enough pressure on North Korea to win a small victory, perhaps one or two people released from prison, perhaps they would stop counterfeiting U.S. currency and devote their efforts to counterfeiting Chinese currency instead, versus the big thing, which is ICBMs that could hit my Congressional district.

I will ask the panelists not for a prescription but for a prediction. Do any of you predict that North Korea would not have at least one ICBM able to hit Los Angeles with a nuclear weapon 10 years from now?

Is there anyone, please raise your hand if you believe that you would predict that North Korea would not have that capacity? I see no hands going up. That sounds like civil defense for Los Angeles.

The issue before us is company sanctions versus country sanctions. As Mr. Park points out, if we just have the objective, as he says, to sanitize China's trade with North Korea, not cut if off, then we would aim at particular companies. But some companies aren't doing business with the United States.

Other companies can be created that would focus just on making profits, perhaps a few extra percentage points at the expense of the North Korean government, in doing business with North Korea.

Some will rebrand, hide behind other entities, some will shift to other companies, and sometimes the Chinese government will just wink and let it happen because the Chinese government is determined that they don't want to pressure this regime too much.

The other approach is country sanctions, 10, 15 percent tariff on everything coming into the United States from China. That would get Beijing's attention.

Is there anybody on the panel who, and I realize that describing the effectiveness of sanctions this way you have to come up with some metric, but I will take the metric 10 percent decline of GDP.

Let's say we had sanctions, just company sanctions, this and that, and continue of passing all of the bills that are before Congress, they cut North Korea's GDP by 10 percent. Do any of you think that Kim Jong-un would give up his nuclear program in order to get that 10 percent of his GDP back? Any hands? Let the record show, no hands were raised.

Do any of you believe that sanctions against individual companies caught doing business with North Korea could cut the North Korean GDP by 10 percent? I am looking for hands. I see none. This is depressing, unless you are in the business of building fallout shelters in Los Angeles.

Is there—so we can talk about country sanctions. I will ask our first witness. Would North Korea, if they faced an all-out effort from China, and the risk of losing all trade with China, be willing to accept a highly monitored, small cache of nuclear weapons and a halt to its missile program?

Mr. RUGGIERO. Well, I don't think that is our goal, right? Our goal is to—

Mr. SHERMAN. Well, it is—

Mr. RUGGIERO. —get rid of their nuclear weapons program.

Mr. SHERMAN. Did I mention I represent Los Angeles? Yes. I know what our goal is. We are the country that refused to sign a non-aggression pact with North Korea in the late 1990s. Or was it at the early part of this century?

Because our goal, the political—if you want to be a good politician, you just slam the table and say we want a democratic North Korea and we will settle for nothing less.

And then 20 years from now when we have a nuclear North Korea you, well, I will point out that has been the President's proposal, where he announces that everything goes wonderfully and he is meeting with the Chinese president. And then we see the massive increases in trade between North Korea and China just during his presidency.

So assume that the goal was more modest than our stated goal. Could we achieve it if we got China to threaten an end to trade?

Mr. RUGGIERO. There is no evidence based on the 4 times we have achieved this that a freeze or, which I think is what you are describing, a similar freeze will be effective.

I think it is important to remember that during the freeze the North Koreans developed their covert enrichment program and they built a nuclear reactor in Syria. So North Korea does not abide by their freeze.

Mr. SHERMAN. We know they are going to cheat.

I yield back.

Chairman BARR. The gentleman's time has expired.

The Chair recognizes the chairman of the House Foreign Affairs Committee, the gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman, and thank you again for holding this hearing. One of the most interesting conversations I think we have had is with the former director of propaganda, or minister of propaganda in North Korea, who laid out for us that, frankly, this was the number one priority of the regime and that the regime did not spend its hard currency on food.

That is the responsibility of the people. And so many live in the no-go areas that aren't exactly in support of the regime that they don't put their resources there.

They put their resources into: first, the ICBM program, their nuclear program; second, paying the military to keep them loyal; and third, their party-building activities around their core leadership.

So given that reality, what he indicated is that the one effective thing is figuring out how to shut down their access to hard currency since it takes them several billion dollars to run this nuclear ICBM program. It is very expensive.

And second, it costs them an enormous amount of money to pay the generals and the military.

What we know about Banco Delta Asia was that when given a choice between economic collapse or bankruptcy I guess, versus giving up and freezing the accounts with North Korea, the financial institutions decided to do that, just that. They froze the accounts.

And the consequence of that, as we know in hindsight, was that is shut down the production of the line, because we did talk to the defectors, including those who worked on the missile production program.

So there is that methodology, which would freeze the banks which are used, and I would say that the line of argument that my colleague from California, Mr. Sherman, walked us through speaks directly to the challenge we have here.

Because if their number one goal is to develop, let us say, 100 ICBMs that can hit the United States, then we have to figure out how to shut down their capability given the temperament of their leadership, their capability to do that. We know what worked in the past.

The other aspect of this that I think is important is we have done a lot of work on human trafficking. Well, here we have a situation where North Koreans are sent to countries such as, and I will just go down the list: Angola, Burma, Cambodia, China, Democratic Republic of Congo, Ethiopia, Kuwait, Malaysia, Qatar, Russia, and Senegal.

When we are talking about sanctions, this is why I think it is important we follow up with our second sanctions bill over in the Senate, because we can make it unthinkable to these governments to continue a process of exploitation where people are fed.

As one of the managers said overseas, "And they will work for nothing. We feed them. They work long hours, they get very little sleep, and they don't have any labor problems." I guess not.

I would say it is time for all of us with one voice to speak on both of these issues and to look at every means available to pressure Beijing, because 90 percent of that subsidy comes from Beijing. And we know one other thing from the South Koreans. We know that the motors and the wiring was made in China.

We also know 10 years ago, when we shut down the production line, that the defectors said the advanced gyroscopes were bought on the black market from Japan. So they do not have the indigenous capability for all aspects of this.

They put their money into obviously the centrifuge programs, enriched uranium, plutonium, and ICBM. But the parts, if we cut off the hard currency we could shut that down and, more importantly, we shut down his ability to pay his generals.

I think at that point you get the kind of negotiation that Mr. Sherman's talking about where a regime begins to think differently about just how committed it is to this particular aspects of the program.

Is there any concurrence on what I have argued here? I would just ask the members of the panel what your thoughts are on that?

Mr. NEWCOMB. I think, Chairman Royce, you have highlighted two very important things to do. I worked on BDA and it was very powerful because it sent a message to the international banking community that North Korea was not a profit center for them so they began to shun North Korean business.

I think the Section 311 action against the Bank of Dandong should serve a similar purpose for Chinese banks. I am not saying we have to go and do a Section 311 on a number of other banks. Mr. Ruggiero mentioned fines. Fines can play a big role.

Bank of China Singapore was complicit in the financing of the Chong Chon Gang, which was caught by Panama. Those payments went through correspondent accounts in New York City banks. Yet Bank of China Singapore didn't suffer any consequences for this complicity in arranging the finance. So there are things that we can do there.

Second, network disruption is key. Network disruption—

Chairman BARR. The gentleman's—

Mr. NEWCOMB. —loss of financing and—

Chairman BARR. The gentleman's time has expired.

Mr. NEWCOMB. —self—

Chairman BARR. And we will let you—

Mr. NEWCOMB. Sorry, sir.

Chairman BARR. —elaborate later on. I just have to be fair to everybody here.

The gentleman from Texas, Mr. Green, is recognized.

Mr. GREEN. Thank you, Mr. Chairman, and I thank the ranking member as well.

Mr. Royce, would you desire additional—

Mr. ROYCE. It is all right, Al.

Mr. GREEN. You are good?

Mr. ROYCE. Thank you, Congressman.

Mr. GREEN. Okay. I want to thank you and Mr. Sherman for your commentary today. It has been quite enlightening, to be very candid with you. And you and I had a conversation coming over to the hearing about the slave labor, and I am just going to follow up on that.

It really concerns me that we have this slave labor situation that is fueling the nuclear arsenal. And while I can't end every problem in the world, I am always concerned about freedom, liberty. And my concern has a lot to do with the countries that allow these workers to enter such that they will be exploited.

Tell me how we can work to end the exploitation of the workers who benefit very little from their work and find themselves in situations from which they can't extricate themselves and they need us to help them. What can we do?

Yes, sir?

Mr. RUGGIERO. I think that the conservative estimate is that North Korea gets about $500 million a year from this practice. And the U.N. Security Council noted that money is being used for its weapons programs. But there was no prohibition on that.

I think that what has been used by Administrations so far is targeting the North Korean individuals and companies that are exporting these laborers. The issue here is what Chairman Royce's bill does, which goes after the companies, the foreign companies and individuals that employ this labor. And that is the next level.

But I would also caution here in the sense that this gets us back to the China problem and Russia problem where certain estimates suggest that 10,000 in China, at least 10,000 in China and 20,000 in Russia.

So while we should be able to roll up the rest of the 50,000 or more, 20,000 total outside China and Russia, we are going to be back to, are you going to sanction Chinese and Russian companies and individuals for slave labor? That is what we are going to head toward.

Mr. GREEN. Does it always come back to China and Russia regardless as to where we start? Do we end up with China and Russia as obstacles?

Mr. RUGGIERO. I would say yes. I think that there is the China issue where you have the volume of trade and so there is value. There is always value in going after Southeast Asia, and countries and countries in Africa, and there are countries in Europe where there is a North Korean problem, and in the Middle East where we are talking about millions there, whereas with China we are talking about billions.

And then the issue with Russia is that there is some indication that they might be backfilling some of the aspects that China is increasing its own sanctions. And I am thinking here of oil and aviation fuel and jet fuel. The Treasury Department in early June sanctioned a Russian oil and gas company for its relationship with North Korea.

Mr. GREEN. Assuming that we had the will to act on Russia and China, what level of retaliation should we expect?

Mr. RUGGIERO. I would say it depends on how we do it. One of the things that I have advocated—

Mr. GREEN. Assume that we take what you consider the most efficacious action.

Mr. RUGGIERO. The examples I can give you, they are not numerous because we haven't gone after Chinese companies and banks. In 2013, we went after North Korea's foreign trade bank. Bank of China, closed that account inside China.

Last year the c4ads there was a report that forced the hand of acting against Dan Tong Hong Jiao and the Chinese government finally froze the assets and arrested people.

Bank of Dandong, frankly, they haven't really—they have talked a lot about it. They are not going to stand up and defend the fact that one of their banks was a money launderer for North Korea. So again, if it is done the right way we are not talking about impacting U.S.-China broad trade relationship.

Mr. GREEN. Anyone else?

Yes, ma'am?

Ms. ROSENBERG. Just to add further to this, there is an effect that will come when the U.S. takes specific action to engage in sanctions or use the USA PATRIOT Act 311 authorities. And there will be an amplification of this effect when global banks, specifically those based in the United States or in Europe which are in highly regulated jurisdictions, highly concerned about proliferation finance and with the capacity to do broad, Big Data analysis for this.

When they see that certain entities in China, for example, are sanctioned in this way it gives them more information and better tools to go after this and improve the way they search for proliferation finance transactions.

And in turn what they require of their correspondent banks in China and elsewhere in vulnerable jurisdictions, who then also increase the searching for and freezing of North Korean illicit finance when it moves through their jurisdictions.

Mr. GREEN. Mr. Chairman, may I say that I would like to thank Mr. Royce for that piece of legislation and the ranking member as well and you, thank you.

Chairman BARR. Thank you. The gentleman's time has expired.

The gentleman from North Carolina, Mr. Pittenger, is recognized.

Mr. PITTENGER. Thank you, Mr. Chairman.

And thanks to each of you for your expert testimony today. I think we have established once again the reality that we cannot work with North Korea in good faith. We certainly learned that through the Clinton years and through the Bush years.

We at one point had sanctions there on the Bank of Macao which were very effective and operated in good faith. And I am glad to see that FinCEN will be greater employed as a sense to impose further sanctions.

As well, it seems to me that these companies that supply material support to North Korea, I would like to get your understanding of how many companies that there are right now?

China has been very aggressive in acquisitions in the U.S. today and buying technology. They spent $50 billion last year alone, much of that targeted toward acquiring technology firms.

We passed a bill last week that I had introduced that would punish those technology firms that provided material assistance to North Korea and not allowing them to do contract work with DOD. But I would like to get some sense from you of what is the scope of the companies there?

We fined ZTE a few months ago $1 billion, something that I had spent a lot of time on, for selling technology not only to Iran but also for selling embargoed technologies to North Korea. These are the kind of I think meaningful efforts we can make.

But give me your response and what else we can be doing in terms of impacting these telecom companies? And how many there are, too? What is the scope of our mission there?

Mr. NEWCOMB. Do you want me to start? Thank you, Congressman. I don't think anyone has a good fix on the universe of total population of companies that are involved. Research by c4ads, as was mentioned earlier this afternoon, shows that there are over 5,000 companies involved in trade with China.

And that actually is a bit of an overestimate of the concentration because the time devoted to this work wasn't sufficient to enumerate some of the subsidiaries of these companies. So it is probably inflated a little bit.

What was even more impressive about this work, though, is the concentration of managers, directors, that are guiding this network. North Korea's illicit activities operate in licit space. They leave tracks, financial tracks, purchasing tracks.

You can get at them through business-to-business databases. It is researchable. Some breakthrough reports have been done over the last couple of years demonstrating this.

Investigative reporters have broken stories on Glocom and most recently on a company in Singapore named OCN that operates a complex trading relationship with North Korea. So you can go after them.

And I agree if you just designate entities, then you are playing whack-a-mole. You have to also designate the people who are operating them and get them on the compliance lists.

Mr. PITTENGER. One thing that we are seeking right now is to address CFIUS and it hasn't been reformed much since the Gerald Ford years when it was established.

And we are working on legislation right now because we believe that we need much greater review and with the enormous amount of recurring investments that are taking place by the Chinese and in acquiring these technology firms, including those in the supply chain of DOD.

But the chains appear to be very much focused on their technology advancement. And the best way to get it is to steal it or buy it. But it seems to me that should be a clear direction that we need to be about to make sure we have the best tools available to prevent those types of acquisitions. Would you concur with that?

Mr. NEWCOMB. Yes, sir, I do.

Mr. PITTENGER. Any other comments by any of the rest of you? Thank you. I yield back.

Chairman BARR. The Chair recognizes the gentleman from Arkansas, Mr. Hill.

Mr. HILL. Thanks, Mr. Chairman.

Thanks to the panel for being here. Thank you for taking a keen interest in this topic on this subcommittee. And I think we all saw today why we appreciate so much Chairman Ed Royce and Congressman Engels' engagement in our Foreign Affairs Committee and what a fine job they do together on behalf of the American people.

There has been a lot of conversation. My friend from North Carolina mentioned it. We are on our fourth President now in dealing with North Korea since we have all acknowledged the clear and present danger of North Korea's nuclear program to the West, to the region.

And so 24 years have gone by. We have had a lot of sort of Neville Chamberlain moments along the way, and we haven't seemingly accomplished our goals, the goals of the United Nations and the United States and our partners in Asia.

So I really want to explore that a minute and say maybe if each of you could respond, in your personal view, in your professional capacity, is China today in working with the Trump Administration, the most active and helpful they have been over that 24 years? And you are making a relative statement.

In other words, are they engaging and realizing that this has gone on too long and has been too inconclusive and is not in their national interest to let it proceed? So are they more engaged than they have been over 24 years?

I will just go down the row if you would start, Mr. Ruggiero?

Mr. RUGGIERO. No. I don't think they have done enough to rein in North Korea.

Mr. HILL. Okay.

Mr. RUGGIERO. I think they are interested in the freeze, which is not an option really there.

Mr. HILL. Mr. Newcomb?

Mr. NEWCOMB. There has been an increase in cooperation from China over the life of the sanctions. But it is not enough.

Mr. HILL. Yes, okay.

Ms. Rosenberg?

Ms. ROSENBERG. I would agree with that and maybe I would put the peak last year and unfortunately going the wrong direction.

Mr. HILL. All right.

Dr. Park?

Mr. PARK. I think it is a very complicated picture. There are different interest groups in China, particularly at the provincial level, that have very close economic benefits with these North Korean border provinces. So with that I think there is this conflict within the Chinese hierarchy.

One quick thing I would mention, out of the seven members of the standing committee of the politburo, two come from the provinces near the border with North Korea. Their elevation and their path to the politburo was from cranking out economic growth in their jurisdictions.

Mr. HILL. Yes.

Mr. PARK. So it gives you a sense of how the enmeshment and the entanglement, it makes it a very complicated picture within China. There are some agencies and some ministries who are keen on trying to sanitize this trade, and others that are working against it in order to work with corrupt party officials and make a lot of money.

Mr. HILL. Thank you.

And that is helpful. And so then when I look at ourselves, the United States and the leader of sanctions, both at the United Nations and then bilaterally with our allies, over that 24-year period, are we now just getting it on how we should really design and impose sanctions and enforce them?

Because you guys are really talking in the present tense and talking about the nuance about how to really do the administrative work, how to really do the enforcement. And as a Representative of the taxpayer, I would say what have we been doing the last 24 years, just sort of experimenting unsuccessfully? And now you think we have it right?

So give me a little feedback about design. Are we now prepared at the United Nations and here in the United States with our allies in the region to do a more aggressive and better job at designing and implementing sanctions? And I am trying to be constructive.

Have we learned from our mistakes? I will phrase it that way. And suddenly we can do a more effective job or we just have the willingness to do a more effective job now because we have allowed 24 years of progression?

Again, let us go down the row and hear that.

Mr. Ruggiero?

Mr. RUGGIERO. I think the fact that sanctions have doubled in a little over a year indicates—

Mr. HILL. Still modest on your chart though, compared to—

Mr. RUGGIERO. Sure. It is compared to other sanctions programs. But the fact that it has doubled suggests that we were not even really focused on North Korea. And now we are focused on whether we should act against China, and that is the outstanding question.

And other Administrations have determined that it is not a priority for the U.S.-China relationship. That is the outstanding question.

Mr. HILL. Thank you.

Mr. Newcomb?

Mr. NEWCOMB. I think the United States did too little for too long, and they are just now thinking about getting serious about it. But again, it depends on establishing this as a national security vital interest.

Mr. HILL. Thank you, sir.

Ms. Rosenberg?

Ms. ROSENBERG. I think that there has been technical capacity in the Administration to do very good, creative targeting work for decades. And there has been select dedicated leadership in Congress also on this issue.

However, there are two things that have changed more recently that I think have really brought this to the fore. One is the experience of what many believe as a success in the Iran sanctions case, where the United States led a global coalition of countries that engaged in financial pressure applied to Iran, and it worked in affecting Iran's economy and their political calculus.

And the second issue that has changed this picture and I think the political will around it is the perception of a much more imminent threat, as was discussed by Congressman Sherman and many others, who feel this way to the United States and U.S. vital interests.

Mr. HILL. Thank you. My time has expired.

I'm sorry, Mr. Chairman.

Chairman BARR. The Chair recognizes the gentleman from West Virginia, Mr. Mooney.

Mr. MOONEY. So Dr. Park mentioned in his testimony the coal trade between North Korea and China. And when the word "coal" comes up, it piques my attention, because I represent the great State of West Virginia.

Coal has been a major driver of our economy for years, our number one product. Despite the previous Administration's war on coal, we still believe in coal and we believe it is going to come back. So anyway, when coal is mentioned I pay special attention.

But my question will be for anybody on the panel who wants to address it, because in 2016 China negotiated the loophole which you referenced, Dr. Park, in its coal trade with North Korea, which permitted the purchases of the coal for "livelihood purposes."

What would be anyone on the panel's assessment of the humanitarian exemptions in North Korea sanctions? And a follow-up to that, are the sanctions too difficult to enforce, and how meaningful are they given Pyongyang's control of resource distribution to its people?

Go ahead?

Mr. PARK. If I could take a first crack at your questions there, Congressman, one of the things about the loophole that you meant and the livelihood purposes, there is actually a larger loophole.

In 2009 in October, then-Premier Wen Jiabao led a Chinese equivalent of a cabinet delegation to Pyongyang and they signed a number of trade deals. And they created essentially the openings that became the coal trade between China and North Korea. That was the enabler.

And the message from that trip to Chinese companies was that under Chinese law it is legal to do business with North Koreans. And that created something of the opening of the floodgates.

But the loophole that they had there was under the headings of economic development, tourism, and education. Those became the gateways that the Chinese justified a lot of their trade with the North Korean entities.

But to your point about the humanitarian exemptions, there are, I think, important elements that we have to be very careful of. But if we go back to these loopholes and how the Chinese have been using those as the legal justification to do the coal trade, right now with the sectoral bans I think there is an incentivization of smuggling along the border as well. And that is what we have to factor in as we try to look at other measures, to implement sectoral bans and other things.

We should not be surprised by these activities. But when you restrict quantity prices go up and you incentivize smugglers, in many instances the very officials who are tasked with implementing the sectoral bans.

Mr. NEWCOMB. If I may add to John's answer? The livelihood provision on coal was changed in the following Resolution 2321 and because China was not employing it correctly. They were misapplying the measure and granting anyone the opportunity to import coal and just going through the motions of saying it was for livelihood purposes.

So 2321 imposed a quota system. And it was a hard-won concession on the part of the Chinese. and it appears to have worked episodically but not totally. Now, the livelihood provision remained in force on iron ore, which continues to soar as a part of trade.

Mr. MOONEY. Thank you. If there are no other comments, I will yield back the balance of my time.

Chairman BARR. The gentleman yields back.

The Chair recognizes the gentleman from Ohio, Mr. Davidson.

Mr. DAVIDSON. Thank you, Mr. Chairman.

Thank you to our panel. I really appreciate your input. It has been very helpful. Prior to coming to Congress, I spent about 15, 16 years in manufacturing. And obviously, China exports a fair bit of manufactured goods to the United States.

I also serve on the Terrorism and Illicit Finance Subcommittee, and we spend a lot of time there talking about know your customer. Is there a burden to know your supplier? So when you go to China and you do business, most American companies wouldn't say, hey, I am doing business with a North Korean, because to them, they are not.

But the Chinese company may very well have a beneficial ownership interest that is North Korean or may be one of the companies

in China that has chosen to do lots of business with North Korea. Is there any burden to know your supplier in that extent?

Ms. ROSENBERG. I think the answer is it depends, and it depends a lot on your banking regulator. So taking a step back, for most global banks who handle the financing side of the manufacturing trade, there is, obviously, an importance placed on or a requirement to know your customer.

And many of the major global banks, those in the United States and Europe, also feel the need to know your customer's customer, which is another way of getting at knowing your supplier.

And there are some leading global banks, for example Standard Charter, which takes this very seriously. They also have a business footprint, if you will, that is in a lot of very high-risk jurisdictions for terrorism and proliferation financing.

They send teams of their bankers out to educate their correspondent banks so that they do not find themselves in the position of having a correspondent banking relationship with, for example, a bank in China where the trade that they are financing, the supplier may actually be supplying North Korean goods, that kind of thing.

So there, one of the ways that they are trying to know the supplier or possibly the beneficial owner is by taking that training out to their correspondent banks. There are other versions of this but I think some of the biggest global banks take it very seriously and too many banks, regional banks elsewhere in the world, are completely unaware, which is a major vulnerability.

Mr. DAVIDSON. Thank you. To follow up on that, if you are an American corporation, it could be manufacturing, it could be agriculture, it could be shipping, whatever you are going to—energy, you are going to wire some money to a Chinese corporation.

And as Chairman Royce pointed out, they really need hard currency to pull this off or they need core components. They get this through means like this.

Now, a wire transfer goes to a Chinese company but may very well benefit North Korea. Follow that back to the know your supplier, what are the burdens by the U.S. entity, not just the financial institution, in making that transfer?

Ms. ROSENBERG. I will—go ahead.

Mr. DAVIDSON. Mr. Newcomb or—

Mr. NEWCOMB. In terms of suppliers, too few, I think, actually try to manage their supply chain. There is an Australian sportswear company that accidentally found that a North Korean textile manufacturer was sewing "Made in China" labels on its clothes and then shipping it through China. This was discovered through investigative reporting, not through their own due diligence.

So it is a very difficult process, but the problem is North Korea operates banks within banks using foreign subsidiaries, fronts, and shell corporations that act as a bank that absorb the money from various North Korean-linked sources and then pass it on.

That is where banks are failing to know their customers, and that is where banks are failing in due diligence. And that is what is exactly exposing our financial system to money laundering and terrorism and proliferation risk.

Mr. DAVIDSON. Thank you.

Dr. Park, Let's say that there was a law similar to the Foreign Corrupt Practices Act or Know Your Customer Act that said you are fine to do business with the companies in China, including state-owned companies in China, however, you can't do business with any company that does business with North Korea. You must know your supplier.

Would that have a deterrent effect or a decrease in hard currency going into North Korea?

Mr. PARK. It could possibly, but in many cases the way that it is masked, even the middleman is surprised that they are getting semi-sourced products whether—the middleman directly. But the supply chain is such that I think it is so complicated to get these things aligned unless you get these rules and regulations in place.

One thing to explore though I think is the use of incentives. If there could be ways to monetize this information that can lead to the interdiction or some notion of tracking down to the source, that is something we haven't explored. I think that is a very robust area, the area of incentives.

Mr. DAVIDSON. Thanks. I would love to talk longer, but my time has expired.

Mr. Chairman, I yield back.

Chairman BARR. The gentleman yields back. And without objection, we will move to a brief second round of questions. And I will recognize myself for an additional 5 minutes.

Mr. Newcomb, I want to ask you about sanctions enforcement a little bit more. You have highlighted implementation challenges with existing sanctions. And according to the U.N. Panel of Experts' final report, following the adoption of U.N. Security Council sanctions last year 43 of 54 countries in Africa failed to submit their national implementation reports.

The U.N. report also highlights difficulties in countries' ability to coordinate their sanctions enforcement and in basic failures to freeze the assets of entities acting on behalf of designated persons.

So aside from using secondary sanctions to encourage foreign countries' compliance, what is the role of technical assistance, be it through the Treasury Department, IMF, or other international financial institutions in improving those countries' ability to enforce the U.N. Security Council resolutions?

Mr. NEWCOMB. That is ongoing. The Panel of Experts actually works with the Financial Action Task Force and with the FSRBs, in particular the East Africa, any money laundering organization. So the education on what is required by the resolutions is taking place.

The bottleneck appears to be in the political process of adopting the rules and regulations necessary to implement and enforce and of course overcoming the political will. North Korea gave material assistance to a number of African liberation movements, and it supplied arms, and so it built a lot of goodwill.

The problem is convincing a number of African countries that their future in the international area relies on cooperating to suppress the North Korean program and not facilitating its support.

Chairman BARR. Mr. Ruggiero, I think earlier you defined the objective well. If the objective is not just deterrence through mutually assured destruction, if the goal here of sanctions is to force North

Korea to abandon its nuclear and ballistic missile programs, if our goal is to stop North Korea from being able to threaten the United States with a nuclear device, if that is the objective please define success, each of you down the row in my remaining time, what does success look like with an updated sanctions regime?

Mr. RUGGIERO. I think success in terms of protecting ourselves is less successful missile tests. I think less the ability for North Korea to deploy these missiles, the inability for North Korea to make advances in its weapons programs. Those are high goals and those should be the high goals if our goal currently is not denuclearization because this regime is not interested in that.

We should have a high goal in trying to protect ourselves against North Korea's nuclear and missile programs.

Chairman BARR. And specifically in terms of success of what the sanctions should—

Mr. RUGGIERO. Oh, in terms of the success on what the sanctions, I think that there has been a lot of questions about the scale. And I think Bill did a great job of sort of describing these are really networks. If we start to take down complete networks, the Dandong-Hangzhou action last year was incomplete.

It didn't sanction any of the front companies. And through the Bank of Dandong action we learned that Dandong-Hangzhou was doing $56 million in transactions through that bank, minimum. So we need to be completely going after networks. We need to be using fines or other criteria to go after Chinese banks if we are really going to be serious about this.

Chairman BARR. Mr. Newcomb, Ms. Rosenberg, and Dr. Park on the same question?

Mr. NEWCOMB. I agree with everything that Mr. Ruggiero said. And I would add that success also means we have to be working much more closely with other like-minded countries. They have to be doing the same thing.

The E.U. has imposed sanctions on entities that do not appear on the SDN list. I mentioned that the Pyongyang company that did the radios, that is still not on the SDN list. We have to step up the pace.

Chairman BARR. Ms. Rosenberg and Dr. Park?

Ms. ROSENBERG. I would agree that success in sanctions implementation looks like taking down these networks that prop up the North Korean proliferation aims and motivate massive enforcement by other countries at the national level around the world, specifically in China.

Furthermore, that this success for sanctions will only act to empower and strengthen and coalesce U.S. alliance relationships in North East Asia and never come at the expense of them.

Chairman BARR. Dr. Park?

Mr. PARK. So very quickly, I think it is disrupting North Korea, Incoprporated's business partnerships. This in terms of the nuclear weapons and the ballistic missiles development, those are happening because of their procurement abilities and business practices.

So we have to break up these business partnerships and targeting using these different policy tools that I mentioned earlier, I

think, prime candidates for slowing it down so that North Korea doesn't build out this arsenal of ICBMs with nuclear weapons.

Chairman BARR. Thank you for your conclusions.

And now I will recognize the ranking member for an additional 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman, and thank you all for this very important discussion.

I am wondering, Ms. Rosenberg, you indicated in your written testimony that it was sort of a lost opportunity to build the sort of international coalition and the consensus on sanctioning North Korea at the recent G-20 meeting.

What kind of message does that send? How can we recover from that diplomatically? And what should we do in the absence of having not done that?

Ms. ROSENBERG. Thank you for the question. I think it is an incredibly important question. I see that as a massive opportunity missed, and it sends the wrong signal only days after.

This is still in the news cycle for anxiety and concern about that ICBM test, that the United States didn't provide leadership in that forum, particularly when, as has been stated by other representatives at that meeting, everyone shared that concern, at least in some fashion.

The way to come back from that or to address that, not just that, as I see it failing, but this issue more broadly, is for the United States to take the opportunity in meetings, at highest level meetings between the United States and China, bilateral meetings, as well as in every appropriate multilateral forum to raise this issue again and again and again. And I think the severity of it demands nothing less.

Ms. MOORE. Just a thought on the diplomatic efforts, I think. Mr. Ruggiero, you mentioned that we do need to deploy our diplomatic assets. And I am just wondering about the recent nomination of Mr. Huntsman to be our main diplomatic asset to Russia.

Do you think that his history and his background will be a lot more useful to have him switch back to being an asset and a diplomat to China?

Mr. RUGGIERO. Putting aside whether leaving it to the Senate to confirm him, his prior postings in Singapore and China, I think, provide ample background on the North Korea issue because, as Mr. Newcomb said about Singapore, that is a significant North Korea hub.

We have already talked about China. And as I mentioned in the answer to a prior question, there is this sort of suggestion that some of this activity is moving from China, some of this China-North Korea trade, to Russia. And I think that the Administration is concerned about that.

So I expect if he is confirmed that a large portion of his interactions with the Russian government will be about North Korea.

Ms. MOORE. Okay. So it might be beneficial for him to be in that spot.

Ms. Rosenberg, you talked about expanding the USA PATRIOT Act. And could you just share with us just a little bit about how you want to expand the use of the PATRIOT Act?

Ms. ROSENBERG. Thank you. I think I will highlight two things. So the PATRIOT Act 311 authorities have been used with noted success by a number of members of this committee before to target North Korean proliferation concerns.

There is an opportunity to both increase the use of the specific tool. It is a really useful one, including by comparison to sanctions, but not that one should exclude the other because when a 311 is made there is an awful lot of information that becomes available to companies, manufacturers, banks that are in the position of trying to look for and prevent North Korean trade and illicit finance from occurring. So it is a very useful kind of action for the information it gives. That is one way.

Another way is that in that same piece there—well, I would just say the opportunity for greater information sharing between the government and banks and among banks that can be facilitated by statute, not the Patriot Act in particular, but in order to facilitate more such 311 actions, so that is our Banking Secrecy Act opportunity to expand and create some safeguards around great information sharing.

That is another thing that can further the—

Ms. MOORE. Do we need a statutory expansion to do—

Ms. ROSENBERG. I think that is a great thing to consider by this committee.

Ms. MOORE. All right. Thank you.

And I will yield back.

Chairman BARR. Thank you.

The gentlelady yields back.

And the Chair recognizes Mr. Williams for an additional 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman.

Mr. Newcomb, in a 2015 report the U.N. estimated that North Korea had sent 50,000 laborers to dozens of countries, which provided them with $1.2 billion to $2.3 billion annually. And in an article from July 11th, the New York Times noted how North Korean laborers in Russia saw their wages confiscated by the North Koreans in amounts that hinged on the ruble's exchange rate with the dollar.

How do we prevent North Korea from exchanging laborers' foreign earnings into desirable currencies, be it be dollar to euros or whatever? And how do we prevent the DPRK from subsequently accessing those currencies, whether it is in the form of bank accounts or in the form of bulk cash?

Mr. NEWCOMB. Sir, the relationship supplying workers to Russia, mostly for the logging industry, has existed for a number of years. And more recently, of course, this did supply of a lot of North Korean workers to China.

I really don't think that there is a lot that can be done directly to curtail these numbers or impinge upon their ability to earn money through that. But you can go after all the other countries on the list that Chairman Royce read.

There were other countries on that list earlier. Poland has now stopped its use of North Korean workers. Malta has stopped its use of North Korean workers. Malaysia has said it is going to reduce the number and send them back.

Some of the North Korean workers are building facilities for the World Cup. Why in the world, as a member of that, is the U.S. going along with it and not raising serious objections to that?

I think every place the North Koreans are, particularly in countries in the Middle East where we have a lot of influence, such as Qatar, why are the workers still there? Why are they still in Kuwait? Right?

I don't think we are exercising the diplomatic and other kinds of pressure that we can bring quietly in these jurisdictions to get them to abandon this practice.

Otherwise, North Korean workers need to be treated, if they are going to be hired, under international labor organization standards, and they are not.

Now, the companies that provide them are receiving the money. The workers are not. They are getting a pittance. And in many cases the money is being carried back to North Korea via cash couriers. Now, that can be intercepted as North Korean cash couriers go through international checkpoints. So we have opportunities to put a dent in this.

Mr. WILLIAMS. Okay. Thank you for that answer.

Dr. Park, what behavioral change could trigger the relaxation of financial sanctions against the DPRK? Is it a complete freeze, would you say, on missile development?

Mr. PARK. The North Korean regime is the subject of a number of sanctions. So even if there were the ones that linked to North Korea's stopping the activities on ballistic missile development, there are other sanctions in place that I think you would see the North Koreans coming back expecting sanctions relief.

But frankly, yes, at this particular point in time, the North Korean regime has not expressed any interest in terms of the notion of trying to coordinate some sort of deal for the relief on these type of sanctions.

Mr. WILLIAMS. Okay. Dr. Park, Justin Hastings, of the University of Sydney, has written that Taiwan was only second to China as a focus for North Korean trading partnerships after 2006. What is your assessment of Taiwanese efforts to prosecute brokers of illicit North Korean activity? And can we do more to remove Taiwan from the DPRK's trading network?

Mr. PARK. I think there are a number of measures in terms of looking at these type of business partners. But in addition to Taiwan there are also Japanese-based entities who are largely tied to the North Korean resident community there as well.

So I think Taiwan and the Taiwanese companies in terms of their activities, documenting them, sharing that kind of information with Taiwanese authorities as well. But a number of these type of activities, especially under the private sector growth of compliance within different financial institutions as well is another means to do this.

But we have more tools, and I think with that there is an opportunity to ply the accumulative learning on our side in terms of these North Korean practices.

Mr. WILLIAMS. Okay.

Mr. Chairman, I yield my time back. Thank you.

Chairman BARR. Finally, the Chair recognizes the gentleman from Ohio for an additional 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman.

And thank you all. Thanks for sticking around for a few more questions, and I thank my colleague for the question about Taiwan or other countries.

Some of these countries we have great relationships with and we consider allies, but they are not exactly supportive of our efforts with respect to North Korea, and perhaps others, but the topic here is North Korea.

We have talked a little bit about sanctions. We have talked about how going back to the 1990s we haven't really been as serious. We have had forays into economic policy messaging maybe. When does the line cross and it is really economic warfare where we are going to use every economic means possible to stop this?

If we are declaring North Korea as a potential existential threat, that is obviously something that could be a trip line for kinetic force, not just economic.

So what escalations could be possible? Dr. Park, you mentioned one that we haven't, incentives, but I guess down the line, if you could, what are we not doing with respect to diplomacy with our allies like Taiwan and Japan but with respect to anything that is in the kit bag or potentially in it?

Mr. PARK. I think you are right. We are not serious when it comes to either diplomatic or economic input with our allies in particular. And that is why in my testimony I have referenced the Iran-style sanctions, which is, and I know it sounds bravado, but that is essentially what we did with Iran.

It was either North Korea or us, and I think that is the like-minded coalition that the Administration could build.

Mr. DAVIDSON. Warfare.

Mr. PARK. But it will still circle us back to China and Russia, so we are sort of avoiding the larger question unfortunately.

Mr. DAVIDSON. Mr. Newcomb?

Mr. NEWCOMB. I think much can be done with Taiwan. There are Taiwanese companies that do cooperate with North Korea. Royal Tea comes to mind. There are others, including one that was prosecuted in Chicago about a year-and-a-half ago.

Taiwan is a trading nation, right? And so they look for opportunities to sell. Taiwanese machine tools get copied by the North Koreans one way or another. When Japan started to prohibit trade with North Korea a lot of the activity was redirected toward Taiwan. So Taiwan needs to do a lot of its own due diligence about what its own companies are up to.

And in terms of moving to economic warfare, you could probably draw the line at a blockade. Crossing over into a blockade would definitely move us into economic warfare.

Mr. DAVIDSON. Thank you.

Ms. Rosenberg?

Ms. ROSENBERG. I will just add to this, what is the trip line for waging economic warfare? I think what we ought to be careful to encourage sanctions policymakers to remember is that when we get there, whatever that looks like, and it may be a bit of moving target that a blockade is certainly one I would endorse.

But there will be others, other kinds of threats to our allies and ourselves. That economic warfare should always come as, in my view, a counterpoint, in addition to and alongside the credible threat of military force.

And so there should be no situation where economic warfare is ever waged by itself. It has to come, at that point, at that severe point of threat to the U.S. interests. It must come along with the use of military force, posture, and potentially projection.

Mr. DAVIDSON. Thank you.

Dr. Park, if you have another one?

Mr. PARK. I would just echo what my colleagues here are saying. But also, one of my colleagues at the Kennedy School, Aaron Arnold, has also been looking at the notion of what are the implications if you double down and concentrate more along the lines that would potentially trigger something like economic warfare?

There is also the negative unintended consequence that different trading countries migrate away things that are U.S. dollar-based. So we have to anticipate that. It is not to say we shouldn't pursue some of these coercive measures, and certainly as my colleagues here have been saying it, in the context of a broader strategy.

But I think we have to look at these very complex unintended consequences because we are going to trigger both positive as well as these negative unintended consequences.

Mr. DAVIDSON. Thanks.

Everyone, last question. Lots of folks in this whole deal would like to see the United States off the Korean Peninsula. We have been there since 1950. I think that wouldn't be a bad outcome. What would it take for us to see that as a win in our departure from Korea?

Mr. RUGGIERO. I think the problem in this current circumstance is that if the United States withdrew from the peninsula, that could increase the option of North Korea becoming more aggressive. And I think that could also lead to South Korea and perhaps even Japan considering developing their own nuclear weapons.

Mr. DAVIDSON. Yes, I think short of that, it would take some sort of reconciliation path between North and South Korea similar to what happened in East Germany and West Germany, personally.

Mr. Chairman, I yield back.

Chairman BARR. The gentleman yields back. And I spoke too soon.

The chairman of our Capital Markets Subcommittee has arrived and would like to be recognized for questions. Mr. Huizenga is recognized.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate that. And I had the privilege of chairing this subcommittee last Congress and my interest is definitely there.

I would like to put for the record, not sure where my colleague was going, not everybody agrees that we ought to be withdrawing from the Korean Peninsula. Someday if we—yes.

There are a lot of aspirational things happening here in Washington right now, but I do believe we have a strategic interest there both with South Korea and Japan.

Dr. Park, in your testimony you had suggested using China's anticorruption campaign to target corrupt officials who will facili-

tate North Korean trade and also noted that the Chinese have an interest in, or at least should have an interest in stopping North Korea's trafficking of narcotics and counterfeit bills in China. And I would think that would be of strategic interest for them and practical interest.

What kind of room is there for truly meaningful cooperation in these areas? Is that really in the cards for us, and how can the U.S. impress on Beijing that a harder line with Pyongyang will service its own self-interest?

Mr. PARK. This is a very nuanced approach. On the face of it, the idea of cooperating with the Chinese authorities seemed to be something that would not work.

But there are two outstanding recent trends. One is the growing urgency among the Chinese leadership about how quickly North Korea is developing its nuclear weapons and ballistic missile capabilities. And the second I think is the possibility of coercive economic measures directed on a larger scale.

We have had the precedent of secondary sanctions against the Bank of Dandong, and potentially others as well. But in this atmosphere, the notion of using these means, the question then becomes, where can you get political buy-in? And where are you going to get the sustained coordination?

I would offer the Commerce Department's newly launched comprehensive economic dialogue, and as well as the State Department and Pentagon's approach with their Chinese counterparts within the diplomatic and security dialogue has been used where they can explore further cooperation in these areas.

Because if you do look at it from the Chinese perspective, they are not concentric circles. They may not look like much in the beginning, but certainly those can be expanded and done in a way that we are looking at it from Chinese interests and then expanding upon those towards creating this notion of slowing down the procurement on the North Korean side.

And I would conclude that the overall image that one can imagine as a basis of this type of discussion is a sanitization of China's trade with North Korea. It is actually a small sliver of the overall "legal trade" that is illicit.

And if you look at these commercial channels, they become almost like dual-use technologies. If you are moving innocent goods through you have all the intimate areas and processes in place to move illicit goods through.

Breaking that apart and using these different types of domestic policies on the Chinese side, I think, is a serious area of investigation given the urgency.

Mr. HUIZENGA. And it is my understanding that the—and I am not going to get the phrase correct, but the industrial park that was in North Korea, that was fenced going in from South Korea and had North Korean workers there and trucks coming out? My understanding is that has been shut down? Correct?

Mr. PARK. The Kaesong industrial complex, yes, that is correct.

Mr. HUIZENGA. Yes, and has that had any kind of effect in North Korea? Has that been a pressure point?

Mr. PARK. I think a lot of researchers have documented how the revenue earned from essentially rent from those facilities went to

the North Korean military. But since that has been shut down, that source of funds to the North Korean military has also ceased.

There is some discussion among this new government in South Korea, the Moon Jae-in administration to explore potentially looking at ways to reopen the Kaesong industrial complex as a broader part of their North Korea policy.

Mr. HUIZENGA. And do you think that would be a positive move?

Mr. PARK. I think if you look it from their rationale that they would try to use it as an incentive, enticement to the North Korean regime, they have to factor in the fact that the North Korea-China trade far over shadows what is happening in the potential restarting of the Kaesong industrial complex.

Mr. HUIZENGA. Okay.

Mr. PARK. It really is, I think, critical that we look at how the Chinese authorities, in particular the Communist Party of China, has been rebuilding the Worker's Party of North Korea for a stabilizing game plan for a number of years now. And that is something that has a certain type of momentum.

Mr. HUIZENGA. Yes. In my last 30 seconds, which I need 3 minutes really to do this, but Mr. Ruggiero and Mr. Newcomb and Dr. Park as well, the Banco Delta Asia had been tagged as a primary money laundering concern.

You have brought up some of the bank sanctions. Are there any lessons that case carries forward, and are there any specific high-profile designations or prosecutions that should be pursued in order to make Chinese banks a little more reticent in helping out?

Mr. RUGGIERO. I guess I would say the lesson learned, I know people see that as a silver bullet, that doesn't exist right now. I think that going after something similar to that where North Korea values it, whether it from a financial or commercial perspective.

I think some of the information coming out now clearly indicates that the Justice Department and the Treasury Department are going after Chinese banks allowing U.S. dollar transactions, which are illegal, on behalf of North Korea.

And I think that is the right approach. But again, it is going to take a lot of work on the part of the Trump Administration to reverse the tide over the last 10 years.

Mr. HUIZENGA. Thank you, Mr. Chairman.

Chairman BARR. The gentleman's time has expired.

And I would like to thank all of our witnesses today for their insightful testimony, and you all have certainly informed our oversight of U.S. sanctions policy as it pertains to North Korea and our oversight of Treasury's implementation of those sanctions.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is adjourned.

[Whereupon, at 4:26 p.m., the hearing was adjourned.]

A P P E N D I X

July 19, 2017

Proposed Testimony before the United States House of Representatives, Committee on Financial Services

Prepared by: William J. Newcomb
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The United States is uniquely capable of sharply increasing the global rate, pace and rigorous enforcement of United Nations sanctions measures on the DPRK through diplomatic encouragement, assistance to capacity-challenged nations, pressure to overcome vested interest and foot-dragging, and the demonstration effect of imposing stiff penalties in cases of willful complicity in evasion or violation. I suggest that even more could be accomplished through coordinated action with like-minded countries.

It is essential to act soon as time is critically short to force the DPRK to reconsider its strategic course by changing the stakes. Sanctions are the only tool that has a chance of compelling North Korea to enter diplomatic negotiations where removal of nuclear weapons and a stand-down in ballistic missile development is on the table. Settling for negotiating objectives short of those, such as a freeze, does nothing to reduce the threat that the DPRK poses militarily and as a WMD proliferator nor would such negotiations re-secure the Non-Proliferation Treaty or be effective in dissuading other states, which might be considering an attempt at nuclear breakout.

Even with built-in loopholes insisted upon by China and Russia, international sanctions are of immense value. UN sanctions adopted under Chapter VII, Article 41, of the Charter are legally binding on all Member States and are respected by the few non-member jurisdictions. In the case of the DPRK, the trajectory of successive sanctions measures shows broadened coverage, particularly in trade, transport and finance, and increased specificity. I have no doubt that new sanctions measures now being negotiated to respond to the recent ICBM test will continue in this direction. Nonetheless, success in securing tougher sanctions has been blunted by inadequate action by Member States, squandering the political capital the U.S. spends to fashion an agreement with China and Russia.

Over the past decade, the record of implementation by Member States is a poor one. It was not unusual to find that even several members of the Security Council had not implemented sanctions. Typically it took many years following adoption of a resolution before reports of its implementation rose to the fifty percent mark.

Recent efforts by the 1718 Committee and the Panel of Experts to address sluggishness in adoption of sanctions through increased outreach seem to be paying dividends. As of July 10th, 92 of 192 Member States had reported implementation of UNSCR 2270 (2016). A similar quickened pace appears to be occurring in implementation of UNSCR 2321 (2016), with 70 states so far reporting implementation. Should this pace be maintained, odds favor attaining a higher rate of implementation than in past. Security Council members also have become more conscious about shouldering this responsibility by setting an example through reporting their own implementation.

Yet, there is a considerable difference between reporting implementation and implementing measures completely and correctly. As drafted, sanctions measures grow more complicated. Countries generally are better at adopting more straightforward export control measures than implementing those dealing with finance. Even countries with considerable capacity fail to get them right. For example,

- Mexico had considerable difficulty when it tried to take control the North Korean vessel Mu Du Bong, an asset of the UN designated entity, Office of Maritime Management, because it had not adopted the assets freeze provision, a crucial tool of sanctions enforcement that was introduced originally in UNSCR 1718 (2006).

- Similarly, the conviction in Singapore of DPRK-linked Chinpo Shipping for violation of measures restricting the finance of proliferation, because of its involvement in helping fund the MV Chon Chong Gang's transport of Cuban-supplied military hardware, was reversed on appeal. Reviewing the courts ruling shows Singapore had failed to adopt sanctions measures completely and to keep them up to date, shortcomings not obvious from reading the country's report to the UN on implementation.

Reasons for not implementing sanctions vary from disinterest to lack of regulatory and technical capacity to lack of political will. None, however, can claim to be unaware of what is required because of extensive outreach to Member States in New York by the Committee and in the field by the Panel. While outreach will remain essential, particularly to explain the growing complexity of sanctions as new resolutions are adopted, positive and negative incentives are needed to encourage more Member States to act.

The Security Council itself and the 1718 Committee it established to oversee sanctions have demonstrated time and again over more than a decade an inability to bring about widespread enforcement of measures. Worse, they have shown an unwillingness to act against countries, firms, and individuals who violate sanctions and assist in evasion. The reason is simple and obvious; violations are not handled as a "judicial" matter but as a political one. For example, following the DPRK's 2013 nuclear test, Security Council members and the Panel were canvassed to recommend candidates for designation. A list was compiled with 43 names and associated justification for designation, but the Committee operates by consensus and China held out. After long, mostly fruitless, negotiations China only consented to three new designations.

Additions to the designation list apparently are treated as if the list were a rheostat, and the Security Council has only slowly dialed up the temperature. Many offenders thus profit without concern over consequences.

- One of the companies on the list of 43 that escaped designation was Pan Systems Pyongyang. Findings of parallel investigations by the Panel of Experts and Reuters published earlier this year show how it was linked to North Korea's Reconnaissance General Bureau. Operating under the alias of Glocom, Pan Systems Pyongyang was involved in the global sale of battlefield tactical radios. It used "bank accounts, front companies and agents mostly based in China and Malaysia to buy components and sell completed radio systems," according to the UN report submitted by the Panel.

- Pan Systems Pyongyang has yet to be designated by the UN, perhaps it is currently a candidate once again. Yet neither has it so far been placed on OFAC's SDN list, a curious lack of action.

The pace of designations at the UN has picked up over the past year. Currently 53 individuals and 46 entities are on the Consolidated List. Almost all are "internal" designations; only 3 entities are located outside the DPRK: BVI-registered DCB Finance (Dalian, China), Hong Kong Electronics (Kish Island, Iran, and Leader (Hong Kong) International (Hong Kong). This is a very short list considering the number of known shell and front companies and overseas agents operating on North Korea's behalf.

The relatively few entities and individuals designated by the United Nations also have benefited from inconsistent and lax enforcement of assets freeze and travel ban penalties, as demonstrated by the Panel's investigations of continued overseas operations and international travel. Tables documenting unenforced sanctions and prohibited travel can be found in the Panel's most recent report.

The authority to impose an assets freeze and travel ban is a powerful means to encourage compliance with sanctions measures but it is most difficult to gauge effectiveness in the case of the DPRK because there is no scorecard. Member States are encouraged but not required to report to the Committee or inform the Panel on value of assets frozen or number of cases of travel denied or even if they had taken steps to enforce a designation. This is unlikely to change but here again like-minded countries can use a combination of positive and negative incentives to encourage compliance, enforcement and voluntary reporting.

Reports by investigative reporters, think tank researchers, and the Panel of Experts show what can be done using open sources to expose North Korea's overseas networks. Recent work published by C4ADS in particular demonstrates that DPRK networks in China are concentrated and vulnerable. Similarly, NKNews earlier this week published its findings on Singapore's OCN, a complex of related, DPRK-linked companies apparently providing prohibited luxury goods to North Korea. It has taken only a few dedicated researchers with limited resources to expose these networks.

So, where are the Member States? Why hasn't Malaysia or Singapore or Thailand, to say nothing of China, conducted unprompted investigations? Where are their bank regulators? In addition to financing trade through host country banks, DPRK-linked front companies operate often as banks inside a bank. Banks obviously are failing to conduct due diligence and have deficient know-your-customer procedures. Our own financial system thus is exposed to this risk. In the case of Chinpo Shipping, payments were cleared through New York and Bank of China Singapore was complicit in hiding North Korea's role from clearing banks. What has been the consequence? As far as I know, there have been none.

This is not to fault the clearing banks that were victimized. Banks are heavily challenged to deal with financial sanctions, particularly in trying to prevent proliferation finance, where typologies are few and regulations under-developed. The Financial Action Task Force is renewing attention to proliferation finance but much more is needed. States, in particular, should find ways to provide assistance via coordinated inter-agency sharing of information with banks to help them evaluate customer and jurisdiction risk. Banks can also take steps to help themselves. One bank compliance office has found that a bank's own transactional records can be used to identify likely front companies and build an early warning system to flag suspect transactions.

The U.S. acting in coordination with like-minded countries can do so much more to improve enforcement of existing UN sanctions.

- Capacity challenged States should be given assistance since North Korea exploits weak links.

- Sanctions pressure needs to be continually ratcheted up, not used as tit-for-tat following provocations.

- DPRK support networks need to be identified and disrupted. Exposing company names and placing them on sanctions lists is insufficient. Those running them in particular need to face legal consequences. It is too easy for a company to reorganize under a new name and continue business as usual.

- The U.S. and others need to convey internationally that whether or not the 1718 Committee or Security Council impose penalties on violators, countries will face consequences for sanctions busting trade and finance dealings with the DPRK.

None of this will be easy, and it will take a willingness not demonstrated yet to deconflict priorities and sustain.

William J. Newcomb is a visiting scholar at the U.S.-Korea Institute, Johns Hopkins School of Advanced International Studies, and a Fellow at the Center for Advanced Defense Studies. He served in senior economist positions at the U.S. Treasury Department, and the U.S. State Department's Bureau of Intelligence and Research. Prior to joining the State Department, he researched Asian and East European economies for the Central Intelligence Agency's Office of Economic Analysis. Mr. Newcomb has written extensively on developments in China, Vietnam, and North Korea for American policymakers. While at the Treasury Department, he conducted investigations into Banco Delta Asia. In September 2005, the bank was designated a "primary money laundering concern" for alleged assistance to North Korea's illicit activities such as money laundering and counterfeiting. The designation led to freezing of over 50 North Korean accounts in Macau valued at $24 million, and limited Pyongyang's access to foreign financial institutions. He was a member of the United Nations Security Council Panel of Experts on Democratic People's Republic of Korea Sanctions from 2011 to 2014. Mr. Newcomb was deputy coordinator of the U.S. State Department's North Korea Working Group from 2002 and 2005. He served as an officer in the U.S. Army. Mr. Newcomb earned a B.A. in history from The Colorado College. He did graduate work in economics at St. Mary's University and at Texas A&M University.

Statement before the
House Committee on Financial Services
Subcommittee on Monetary Policy and Trade

"Restricting North Korea's Access to Finance"

Testimony by:

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19 July 2017

Rayburn House Office Building
Room 2128

Introduction

Chairman Barr, Ranking Member Moore, and Members of the Subcommittee, it is an honor to appear before you today to discuss how to restrict North Korea's access to finance to prevent the country's weapons development. I'm particularly honored to be on the panel with Mr. Bill Newcomb, who has mentored me and many others in researching the North Korean regime's illicit activities.

As requested by the Subcommittee, I'll be providing a summary of my research into the North Korean regime's accumulated learning in evading sanctions – particularly through its elite state trading companies, commercial partners in China and Southeast Asia, and the nesting of illicit procurement within licit commercial activities.

The key takeaway is not that the North Korean regime has been evading sanctions – they've been engaged in this activity for decades. Rather it's the story of how North Korea's sanctions evasion techniques have improved significantly because of North Korea, Inc.'s migration to the Chinese marketplace. As a result, U.S. policymakers need to factor in these growing gaps and consider under-utilized measures – like Chinese domestic policy tools – to disrupt Chinese-North Korean business partnerships and restrict North Korea's access to finance.

Understanding North Korea, Inc.

My MIT colleague, Dr. Jim Walsh, and I recently completed a three-year study assessing the application of targeted sanctions to halt the North Korean regime's nuclear and ballistic missile programs. Based on interviews with former managers of "North Korea, Inc." – the web of state trading companies (STCs) that the regime operates to procure licit and illicit items – we were able to map North Korea, Inc.'s practices, partners, and pathways.[1]

We found that STC managers were able to significantly increase the effectiveness of their procurement activities by 1) hiring more capable Chinese middlemen who can more effectively handle financing, logistics, and doing business with private Chinese firms and foreign firms operating in China, 2) taking up residence and embedding themselves on the mainland, which increases their effectiveness, 3) expanding the use of Hong Kong and Southeast Asian regional commercial and banking hubs, and 4) increasing the use of embassies as a vehicle for procurement.[2]

1) The Unique Role of Chinese Middlemen

By working directly with local Chinese middlemen, North Korean STC managers have been able to better evade sanctions. These middlemen charge their North Korean clients a fee to purchase

[1] John Park and Jim Walsh, "Stopping North Korea, Inc.: Sanctions Effectiveness and Unintended Consequences," MIT Security Studies Program, August 2016. Accessed at: https://drive.google.com/file/d/0B_ph0c6i87C_eGhCOGRhUVFaU28/view

[2] Park and Walsh, "Stopping North Korea, Inc.," p. 3.

dual-use technologies – items that can be used for either civilian or military purposes, such as industrial equipment and components.

Following the application of additional rounds of sanctions, these local Chinese middlemen began to charge larger fees to reflect the increased risk of doing business with North Korean STC clients. Instead of impeding procurement activities, we found that additional sanctions have actually attracted more capable middlemen, incentivized by a bigger payday. The North Korean regime has financed these larger paydays by drawing on sizeable slush funds on the mainland that it amassed during the lucrative North Korea-China coal trade in the late 2000s.[3]

2) Embedding in Commercial Hubs in China

Using diplomatic credentials, former North Korean STC managers noted that they were able to reside longer in commercial hubs on the mainland. What's new was not that STC managers had been engaged in procurement activities – they've been doing so for decades – rather it was how and where they had conducted business. Previously, STC managers would go on the equivalent of a business trip from Pyongyang to Eastern Europe to procure an item ordered by the regime. They acquired very limited information about local market dynamics on such transactional trips.

What was striking about interviewing former STC managers was the normalcy of their business practices. Like American or European expatriate businessmen, they explained the challenges and opportunities of operating in a particular local market in Asia. Gaining the tacit business knowledge that resides in these networks was critical to increasing the procurement effectiveness of North Korean managers.[4] By acting more like regular businessmen, STC managers were able to form improved business partnerships with local middlemen.

3) Leveraging Commercial and Banking Hubs in Hong Kong and Southeast Asia

North Korean STC managers have operated in Hong Kong and Southeast Asian hubs for many years. As global trends in trading and banking shifted to this part of Asia, these managers have benefited from increased access to business partners with an international reach. In the case of Hong Kong, we documented how a former STC manager based there was able to procure high tech medical equipment from Japan through a local business partner. This partner filled out all the required documentation using the details from its own registrations and licenses. It also coordinated with other companies on the logistics of delivery.[5]

In the case of Singapore, it has been a particularly useful venue for North Korean STC managers to pay local firms to arrange wire transfers for payments to foreign counterparties. As Singapore

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[3] John Park, "To Curb North Korea's Nuclear Program, Follow the Money," *The Conversation*, September 20, 2016. Accessed at: http://theconversation.com/to-curb-north-koreas-nuclear-program-follow-the-money-65462

[4] Ibid.

[5] Park and Walsh, "Stopping North Korea, Inc.," p. 25.

has rapidly risen to be a global center for money management, opportunities abound for the North Korean regime to benefit from illicit financial service offerings.[6]

4) Extensive Use of Embassies as a Vehicle for Procurement

North Korean embassies serve two key functions with respect to the operation of North Korea, Inc.'s illicit activities. The first is serving as a vehicle for procuring controlled items in a foreign country. Former North Korean STC managers note that the regime co-locates shell companies with its embassies in countries that offer unique access to sought-after items ordered by the regime. Business cards of these shell companies list the local embassy's address and fax number. The second function is the ability to credential an STC manager as a North Korean diplomat. In addition to gaining valuable tacit business knowledge by embedding in a country for a longer duration, STC managers are also able to use diplomatic pouches for illicit purposes related to transporting a banned item or couriering unreported cash.[7]

The Sanctions Conundrum

In examining U.S.-led efforts to counter these sanctions evasion techniques, we observed what we call the "sanctions conundrum" – one of the key negative unintended consequences of applying more sanctions on North Korea, Inc. The net effect of sanctions was that they, in practice, ended up increasing the regime's procurement capabilities. Because of the elevated risk of doing business, an STC had to pay higher commission fees to private Chinese companies that played a middleman role. The elevation of risks and rewards attracted more capable, professional middlemen into illicit network activities on behalf of North Korean clients.[8]

Accelerating this trend in this niche marketplace was the Chinese middlemen's monetization of political relationships. Linked to local corrupt Chinese officials, the private companies used portions of the elevated commission fees to clear a path for efficiently completing a procurement transaction on behalf of a North Korean client. In sum, targeted sanctions – unintentionally and counterintuitively – helped to create more efficient markets in China for North Korea, Inc.

If one were to view sanctions as the antibiotics in the U.S. national security toolkit, increasing the dosage on the North Korean regime has triggered, in some instances, the development of drug-resistance. This resistance is in the form of alternative, more effective commercial channels. We need to better target sanctions and strengthen law enforcement and other measures, based on an improved understanding of how North Korea, Inc. has devised innovative techniques to evade them.

Stopping North Korea, Inc. by Disrupting its Business Partnerships in China

An important starting point is setting the strategic goal of disrupting the North Korean regime's procurement networks. While we need to develop ways to bolster the impact of sanctions, we

[6] Park and Walsh, "Stopping North Korea, Inc.," p. 26.
[7] Park and Walsh, "Stopping North Korea, Inc.," p. 27.
[8] Park and Walsh, "Stopping North Korea, Inc.," p. 31.

should also explore other policy tools. Diversifying the set of policy tools and coordinating with different policy actors will significantly constrain the remarkably open space within which North Korea, Inc. currently operates.

If we widen the aperture and view the target as the business partnership between a private Chinese company linked to a local corrupt party official on one side and an elite North Korean STC on the other, we can apply tailored policy tools to disrupt this partnership. These specialized partnerships have created largely unconstrained opportunities for the North Korean regime to procure the critical components for its nuclear and ballistic missile development programs.

Using the definition of technology as the knowledge of techniques and processes, these partnerships constitute a "dual-use" technology in that they are essentially commercial channels that can be readily used to move either illicit or licit goods. A key reason behind the procurement effectiveness of these business partnerships is that they hide in the open. Given the massive quantity of business transactions that occur daily in the Chinese marketplace, filling out documents, signing contracts, and taking out insurance on freight enables illicit consignments to "blend in." A top priority is to disrupt these partnerships upstream – before the procured item moves through this dual-use technology and literally becomes a part of globalized trade flows.

In addition to the policy recommendations offered by my distinguished colleagues on the panel, I'd like to bring to the Subcommittee's attention the "Three Antis" which are a set of China's domestic policy tools – anti-corruption apparatus, anti-narcotics campaign, and anti-counterfeiting activities.[9] U.S. policymakers can coordinate closely with their Chinese counterparts on redirecting these Chinese domestic policy tools to counter North Korean procurement in China. (Contrary to common perception there are precedents of bilateral cooperation, such as the U.S.-China Joint Working Group on the Nonproliferation of WMD, which was established during the July 2014 round of the Strategic and Economic Dialogue). With respect to current policy cooperation, the U.S.-China Comprehensive Economic Dialogue (CED) and the U.S.-China Diplomatic and Security Dialogue (D&SD) could serve as effective mechanisms for building and sustaining high-level political support. Collaboration on the "Three Antis" would advance the U.S. and China's common goal of stopping North Korea, Inc.'s illicit activities in China.

1) Anti-Corruption Apparatus

Perhaps the highest impact policy tool in disrupting North Korea, Inc. is China's anti-corruption apparatus. The September 2016 case of the Dandong Hongxiang Industrial Development Company[10] serves as an important precedent for scaling up the application of the anti-corruption apparatus to target corrupt party officials involved in these Sino-North Korean business partnerships. Given the link between private Chinese middlemen and local corrupt party officials, using the anti-corruption apparatus for this specialized function would have an

[9] Park and Walsh, "Stopping North Korea, Inc.," p. 47.
[10] "In China's Shadow: Exposing North Korean Overseas Networks," Asan Institute for Policy Studies and C4ADS, August 2016. Accessed at: https://c4ads.org/reports/

immediate impact on procurement deals. Of all the policy tools, this substantial one is readily available, but dependent on the senior Chinese leadership's decision to go down this path. The United States should use policy cooperation mechanisms like the CED and D&SD to regularly provide commercial intelligence to the Chinese authorities so that they can apply their domestic policy tools on Chinese entities engaged in criminal activities. Secondary sanctions could raise the appeal of pursuing this path.

2) Anti-Narcotics Campaign

An open secret in China's northeastern provinces is that there's an expanding narcotics problem emanating from North Korea. Called "ice," this cheap and potent form of methamphetamine is produced in large quantities in North Korean pharmaceutical factories. Drawing on the precedent of Sino-U.S. cooperation in the late 2000s when China was confronting an inflow of opiates through its border with Afghanistan, there's an opportunity to adapt the previous program to China's northeastern provinces. Although aimed at the narcotics trade, the positive spillover effect of increased Chinese law enforcement activities would further constrain the areas in which North Korea, Inc. and its Chinese partners operate.

3) Anti-Counterfeiting Activities

The North Korean regime is well documented as the creator of "supernotes" – counterfeited US$100 bills. What's not so well known in the West is that there's strong concern in China that its neighbor has been counterfeiting Chinese currency. From Beijing's perspective, this criminal activity is a direct threat to China's economic security. U.S. policymakers could leverage this Chinese concern to elevate channels of bilateral cooperation drawing on U.S. experience tracking down the North Korean regime's sophisticated counterfeiting operations. Given the high threat level, the United States should encourage China to further expand the deployment of Chinese law enforcement resources trained on counterfeiting activities, with special authorization to investigate and inspect consignments and facilities.

Objectively assessing how criminal North Korean activities affect China's national interests yields a clear view of areas of common ground upon which we can build a common cause in stopping North Korea, Inc. In this endeavor, it's important to reassure the Chinese authorities that these measures are intended to "sanitize" China's growing bilateral trade with North Korea, not to cut it off. The majority of the bilateral trade is in non-sanctioned goods and services that are a significant element of the economies of Chinese provinces near the border with North Korea.

Conclusion

Stopping North Korea, Inc.'s illicit procurement and blocking its access to finance constitute a top priority in slowing down the regime's rapid advances in its nuclear and ballistic missile programs. The work of the Subcommittee, the panel members, as well as sanctions-focused officials is critical in finding new, adaptive, and effective ways to counter the North Korean regime's WMD threat to the United States, its Northeast Asian allies, and the international community.



Center for a
New American
Security

July 19, 2017

Testimony before the House Financial Services Committee Subcommittee on Monetary Policy and Trade

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

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[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.

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

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[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
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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.

CONGRESSIONAL TESTIMONY: FOUNDATION FOR DEFENSE OF DEMOCRACIES

House Committee on Financial Services
Monetary Policy and Trade Subcommittee

Restricting North Korea's Access to Finance

ANTHONY RUGGIERO

Senior Fellow
Foundation for Defense of Democracies

Washington, DC
July 19, 2017

Anthony Ruggiero July 19, 2017

Introduction

Chairman Barr, Ranking Member Moore, and distinguished members of this subcommittee, thank you for the opportunity to address you today on this important issue.

My testimony will examine why current sanctions on North Korea are insufficient to exert meaningful pressure while also explaining how the U.S. government and its foreign partners can implement sanctions that have a much better chance of restraining Pyongyang's brutal dictatorship. Above all, the U.S. and its partners must apply the lessons learned from its successful effort to force Iran to the negotiating table via comprehensive sanctions.

Despite the common misperception that tough sanctions on North Korea are already in place, my testimony will illustrate how the current restraints on Pyongyang pale in comparison to the ones that compelled Tehran to negotiate. Above all, the U.S. and its partners must target the Chinese individuals, banks, and front companies who play a crucial role in enabling North Korea to evade current sanctions. Again, there is a common perception that China is immune to pressure from abroad, yet there are already strong indications that it will bend when facing the right kind of pressure.

In the course of my testimony, I will offer nine specific recommendations for how Congress and the Trump administration can implement an effective sanctions regime.

Before proceeding, it is essential to underscore the urgency of the threat from Pyongyang. Kim Jong Un is a despot who murdered an American citizen; tortures, starves, and kills his own people; and will spare no expense to achieve an intercontinental ballistic missile (ICBM) that can deliver a nuclear weapon to the United States. The July 4 ICBM test is a wakeup call to all of us, including those who once called Kim a "Swiss educated reformer" or believe North Korea has any interest in serious negotiations with the United States.[1]

Furthermore, one should not assume Kim will hold back from using his nuclear weapons on America and our allies.

Thus, the U.S. finds itself in a rapidly deteriorating situation where counterproductive policy options like a freeze of North Korea's nuclear and missile programs or a peace treaty are treated like real options. Advocates say North Korea is ready to accept a freeze and/or peace treaty and it will lead to denuclearization. Unfortunately, we have seen this movie before.

Not only has North Korea told us it is not interested in denuclearization, its actions reinforce it. Pyongyang showed us the "Map of Death" in 2013 suggesting its nuclear targets are Washington, DC; Hawaii, home to Pacific Command; possibly San Diego, home to the Pacific Fleet; and possibly San Antonio, home to U.S. Air Force Cyber Command.[2] Just after the July 4 ICBM test, North Korea's state media said that the Kim regime would not negotiate its nuclear weapons or

[1] Michael Moynihan, "Kim Jong Un & The Myth of the Reformer Dictator," *The Daily Beast*, December 24, 2013. (http://www.thedailybeast.com/kim-jong-un-and-the-myth-of-the-reformer-dictator)
[2] Jeffrey Lewis, "The Map of Death," *Foreign Policy*, April 3, 2013. (http://foreignpolicy.com/2013/04/03/the-map-of-death/)

ballistic missiles or stop bolstering its nuclear force unless the United States ended its "hostile policy and nuclear threat" to North Korea.[3] Translation: When Washington abandons its allies in Tokyo and Seoul and removes all troops, North Korea might be willing to talk about its programs.

The Nature of North Korea Sanctions

North Korea is simultaneously known as the land of lousy policy options or the land of no policy options. It is simply not true. And the choice is not between negotiating a flawed deal or fighting a catastrophic war. Sanctions remain the best policy option to protect the United States and its allies from North Korea's expanding programs.

Understanding the utility of sanctions as part of a broader, coherent North Korea policy is often clouded by myths about the country's history. It is common for scholars and journalists to note that years of strong sanctions against North Korea have failed. It is true that, thus far, sanctions have not achieved the U.S. objective of disarming North Korea, but it is not true that sanctions have been either strong or well-enforced, or that they cannot work. In prior testimonies before the House Foreign Affairs Committee and its Subcommittee on Asia and the Pacific, I reviewed four of the most prevalent myths about sanctions, including: 1) North Korea is the world's most-sanctioned country; 2) North Korea is isolated financially; 3) the U.S. will run out of North Korea designations; and 4) China will not respond to pressure over North Korea.[4]

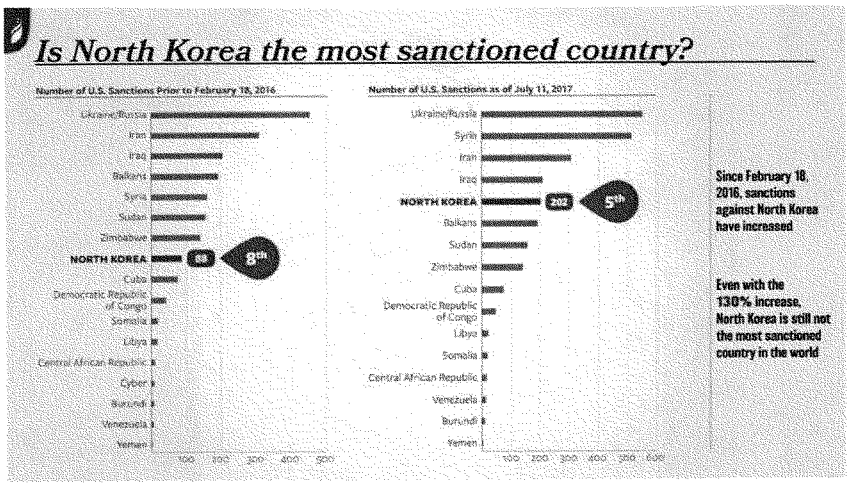
A quantitative review of U.S. sanctions programs reveals that North Korea currently sits fifth, behind Ukraine/Russia, Syria, Iran – even after the lifting of numerous sanctions on Iran to comply with the Joint Comprehensive Plan of Action (JCPOA), as the 2015 nuclear deal is formally known – and Iraq (see graphic 1).[5] North Korea sanctions have more than doubled since the North Korea Sanctions and Policy Enhancement Act came into effect on February 18, 2016. Prior to that date, North Korea ranked eighth, behind Ukraine/Russia, Iran, Iraq, the Balkans, Syria, Sudan, and Zimbabwe. A qualitative assessment of the sanctions imposed on North Korea reinforces the conclusion that it has not been targeted aggressively, since those sanctions barely touch the international business networks – especially in China – on which Pyongyang relies to evade most restrictions.

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[3] "Kim Jong Un Supervises Test-launch of Inter-continental Ballistic Rocket Hwasong-14," Korean Central News Agency, July 5, 2017. (https://kcnawatch.co/newstream/276945/kim-jong-un-supervises-test-launch-of-inter-continental-ballistic-rocket-hwasong-14/)

[4] Anthony Ruggiero, "Countering the North Korean Threat: New Steps in U.S. Policy," *Testimony Before House Foreign Affairs Committee,* February 7, 2017. (http://www.defenddemocracy.org/content/uploads/documents/20717_Ruggiero_Testimony.pdf); Anthony Ruggiero, "Pressuring North Korea: Evaluating Options," *Testimony Before House Foreign Affairs Committee, Subcommittee on Asia and the Pacific,* March 21, 2017. (http://www.defenddemocracy.org/content/uploads/documents/32117_AR_NK.pdf)

[5] The review of sanctions included those entities and individuals listed on the U.S. Department of the Treasury's Office of Foreign Assets Control Specially Designated Nationals list. The Ukraine/Russia sanctions category includes persons sanctioned under the Sergei Magnitsky Rule of Law Accountability Act and persons subject to the Ukraine-related Directives. U.S. Department of the Treasury, Specially Designated Nationals List, accessed through July 11, 2017. (https://sanctionssearch.ofac.treas.gov/)



Thus, while the number of U.S. and UN North Korea sanctions programs may be increasing, they focus on the wrong areas. To be sure, there is value in naming the North Koreans responsible for the regime's proliferation activities, missile and nuclear developments, human rights abuses, and other illicit activities. But the UN Panel of Experts reported in February that North Korea uses "non-nationals of [North Korea] as facilitators, and rel[ies] on numerous front companies" to generate "significant revenue" for North Korea.[6]

[6] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 27, 2017. (http://undocs.org/S/2017/150)

At present, 47 percent of U.S. sanctions target persons located/conducting business outside of North Korea, and only 12 percent of those persons are non-North Korean. The UN sanctions numbers are worse. Only 27 percent of all designations target persons located or conducting business outside of North Korea, and just 2 percent of those persons are non-North Korean.



The Iran Sanctions Model for North Korea

Both critics and supporters of the 2015 nuclear deal agree that sanctions were the main driver that brought Iran to the negotiating table. Thus, the Trump administration should look to the Iran sanctions playbook for its North Korea policy. If we want to change North Korea's behavior, our sanctions have to be at least as tough as they were on Iran.

The goal of sanctions on North Korea is different than it was with Iran, since the regime will not negotiate away its nuclear program. Kim Jong Un views negotiations merely as one step toward his goal of recognition of North Korea as a state with nuclear weapons.

The U.S. goal should be to protect the U.S. and her allies at all costs by strangling the sources of revenue and materiel on which North Korea relies for its nuclear weapons program.

The key aspect of the Iran sanctions model was that it forced companies, individuals, banks, and governments wherever located to make a choice: continue doing business with Iran or join the U.S. efforts. If they chose business with Iran, Washington would restrict or end their access to the U.S. dollar, freeze their assets, and label them as doing business with a state sponsor of terrorism intent on developing a nuclear weapon. The approach worked around the world as banks and companies – and eventually governments – curtailed or eliminated business with Iran.

By this standard, sanctions on North Korea have a long way to go. Former Deputy Director of the CIA and former Under Secretary of the Treasury for Terrorism and Financial Intelligence David Cohen has noted, "North Korea is not, by any stretch, 'sanctioned out.' Despite a broad set of international and U.S. sanctions, North Korea has gotten off relatively easy, especially as compared with Iran."[7]

We learned earlier this year that Belgium allowed North Korean banks sanctioned by the UN to maintain access to SWIFT, the secure financial messaging service, despite SWIFT's checkered history with Iran, whose access to SWIFT only ended when Congress began considering legislation prohibiting it.[8] This shows we are not serious about sanctions that have sufficient teeth to have the desired impact. Likewise, Austria claimed that ski equipment for Kim's chalet was not listed as a luxury good in the European regulations, taking a literal view of sanctions rather than realizing that building a ski resort in a country where its population is starving is the very definition of luxury.[9] There are other such examples of sanctions violations, in most cases aided by countries that have a lax interpretation of the UN sanctions architecture in Southeast Asia, Africa, and the Middle East.

North Korea's Chinese Banks

To be as tough on North Korea as it was on Iran, the U.S. should move aggressively against the Chinese banks that are integral to North Korea's sanctions evasion efforts. Pyongyang's activities taint every Chinese financial transaction conducted through the United States as a possible effort to finance prohibited activities.

Conventional wisdom says Beijing will shelter North Korea from international sanctions at all cost.[10] That is not necessarily true. China's response to last month's U.S. sanction against Bank of Dandong has been muted. In 2013, the U.S. Treasury sanctioned North Korea's Foreign Trade Bank because it was facilitating transactions on behalf of actors linked to Pyongyang's proliferation network.[11] Two months later, the Bank of China sent the Foreign Trade Bank a notice closing its account, cutting off its access the Chinese financial system.[12] When Washington moved against Chinese nationals aiding a designated North Korean bank in September 2016, Beijing arrested 10 people and froze the assets of those involved.[13] Clearly, when Pyongyang threatens

[7] David S. Cohen, "One powerful weapon to use against North Korea," *The Washington Post*, April 21, 2017. (https://www.washingtonpost.com/opinions/one-powerful-weapon-to-use-against-north-korea/2017/04/21/ddbb9702-26c2-11e7-bb9d-8cd6118e1409_story.html?utm_term=.f4a892212dbee)

[8] Anthony Ruggiero, "Time to act against rogue North Korean banks," *The Hill*, March 17, 2017. (http://thehill.com/blogs/pundits-blog/foreign-policy/324430-time-to-act-against-rouge-north-korean-banks)

[9] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 27, 2017. (http://undocs.org/S/2017/150)

[10] Joel Wit and Richard Sokolsky, "The Art of a Deal with North Korea," *Politico*, January 24, 2017. (http://www.politico.com/magazine/story/2017/01/the-art-of-a-deal-with-north-korea-214686)

[11] U.S. Department of the Treasury, Press Release, "Treasury Sanctions Bank and Official Linked to North Korean Weapons of Mass Destruction Programs," March 11, 2013. (https://www.treasury.gov/press-center/press-releases/Pages/jl1876.aspx)

[12] Simon Rabinovitch and Simon Mundy, "China reduces banking lifeline to N Korea," *Financial Times* (UK), May 7, 2013. (https://www.ft.com/content/a7154272-b702-11e2-a249-00144feabdc0)

[13] U.S. Department of Justice, Press Release, "Four Chinese Nationals and China-Based Company Charged with Using Front Companies to Evade U.S. Sanctions Targeting North Korea's Nuclear Weapons and Ballistic Missile

Chinese economic interests, Beijing can tighten its leash on North Korea, even moving against its own citizens who had likely been authorized to trade with the country.

Information on North Korea's use of Chinese banks to access the American banking system is incomplete and likely represents the tip of the iceberg. The available estimates generally encompass only transactions with designated North Korean entities and individuals or those who work on their behalf.

One pattern that emerges from the data is the disturbing extent to which Chinese banks help North Korea leverage the U.S. financial system to evade sanctions.

Merchants that knowingly or unknowingly sell goods to North Korea or its Chinese front companies want payment in dollars. Pyongyang has consistently turned to Chinese banks to process transactions through the U.S. financial system on its behalf. While doing so is illegal, such banks have little to fear from a government in Beijing that has made clear its lack of interest in enforcing sanctions.

Recent disclosures show that from 2009 to 2017, North Korea used Chinese banks to process at least $2.2 billion in transactions through the U.S. financial system:

- The Justice Department stated that Dandong Hongxiang and its associated front companies created by four Chinese individuals accused of evading North Korean sanctions processed over $1.3 billion in transactions through the American banking system between 2009 and 2016.[14]

- Along with four front companies, Dandong Zhicheng Metallic Material Company Ltd., which accounted in 2016 for 9.19 percent of total North Korean exports to China, used the Chinese financial system from 2009 to 2017 to process $700 million, including $52 million this year.[15]

- The Treasury Department stated that Bank of Dandong processed at least $133.62 million from May 2012 to May 2015 as an agent for companies transacting with, or on behalf of, U.S.- and UN-sanctioned North Korean entities.[16]

Programs," September 26, 2016. (https://www.justice.gov/opa/pr/four-chinese-nationals-and-china-based-company-charged-using-front-companies-evade-us); Elizabeth Shim, "China arrests more than 10 business executives for North Korea trade," *UPI*, September 21, 2016. (http://www.upi.com/Top_News/World-News/2016/09/21/China-arrests-more-than-10-business-executives-for-North-Korea-trade/1531474469593/)

[14] *United States of America v. Funds Associated with Mingzheng International Trading Limited*, No. 1:17-cv-01166-KBJ (D.D.C. June 14, 2017). (Accessed via PACER)

[15] "Risky Business," *C4ADS*, June 2017. (http://c4ads.org/reports/); *United States of America v. All Wire Transactions involving Dandong Zhicheng Metallic Material Company, LTD., et. al.* (D.D.C filed May 22, 2017). (http://www.dcd.uscourts.gov/sites/dcd/files/BAHMemoandOrder.pdf)

[16] U.S. Department of the Treasury, Financial Crimes Enforcement Network, "Proposal of Special Measure Against Bank of Dandong as a Financial Institution of Primary Money Laundering Concern," 82 Federal Register 129, July 7, 2017. (https://www.fincen.gov/sites/default/files/federal_register_notices/2017-07-07/2017-14026.pdf)

- In May 2016, Treasury stated that Leader (Hong Kong) International Trading Limited, a North Korean front company, from January 2009 to November 2012 cleared at least $13.5 million through correspondent accounts at U.S. banks.[17]

- Further afield, a Singaporean court found that a local firm, Chinpo Shipping, used its bank accounts – including in Bank of China – from April 2009 to July 2013 to process more than $40 million through the U.S. for North Korea.[18]

- From October to November 2015, Mingzheng International Trading Limited, a front company in Shenyang, China, laundered more than $1.9 million using the Chinese banking system for U.S.-sanctioned North Korean Foreign Trade Bank.[19]

The Justice Department declared in September 2016 that there were "no allegations of wrongdoing" by Chinese banks involved in the Dandong Hongxiang network.[20] We now know that was not correct, as the June 2017 action against Bank of Dandong revealed that Dandong Hongxiang owned a minority stake in the bank through December 2016. The Treasury Department also stated that Dandong Hongxiang used the bank to process $56 million through the U.S. financial system between October 2012 and December 2014. Treasury noted in June 2017 that "the close relationship between the two entities helped establish Bank of Dandong as a prime conduit for North Korean activity."[21] This case illustrates that it is crucial for the U.S. government to target entire networks, including the Chinese banks that facilitate these activities.

Recommendation 1: Sanction Additional Chinese Banks. The nonprofit research firm C4ADS has done ground-breaking work on the Dandong Hongxiang network, in which a Chinese company and Chinese individuals created front companies for a UN- and U.S.-designated North Korean bank, thereby enabling dollar transactions to be processed through the U.S. financial system.[22] The UN Panel of Experts reported that North Korea's networks generate revenue in dollars and euros, providing leverage for U.S. sanctions and regulatory actions.[23] Following its designation of Bank

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[17] U.S. Department of the Treasury, Financial Crimes Enforcement Network, "Finding that the Democratic People's Republic of Korea is a Jurisdiction of Primary Money Laundering Concern," 81 Federal Register 35441, June 2, 2016. (https://www.fincen.gov/sites/default/files/shared/2016-13038(DPRK_Finding).pdf)

[18] Andrea Berger, "Thanks to the Banks: Counter-Proliferation Finance and the Chinpo Shipping Case," *38 North*, December 16, 2015. (http://38north.org/2015/12/aberger121615/)

[19] U.S. Department of Justice, Press Release, "United States Files Complaint to Forfeit More Than $1.9 Million from China-Based Company Accused of Acting as a Front for Sanctioned North Korean Bank," June 15, 2017. (https://www.justice.gov/usao-dc/pr/united-states-files-complaint-forfeit-more-19-million-china-based-company-accused-acting)

[20] U.S. Department of Justice, Press Release, "Four Chinese Nationals and China-Based Company Charged with Using Front Companies to Evade U.S. Sanctions Targeting North Korea's Nuclear Weapons and Ballistic Missile Programs," September 26, 2016. (https://www.justice.gov/opa/pr/four-chinese-nationals-and-china-based-company-charged-using-front-companies-evade-us)

[21] U.S. Department of the Treasury, Financial Crimes Enforcement Network, "Proposal of Special Measure Against Bank of Dandong as a Financial Institution of Primary Money Laundering Concern," 82 Federal Register 129, July 7, 2017. (https://www.fincen.gov/sites/default/files/federal_register_notices/2017-07-07/2017-14026.pdf)

[22] "In China's Shadow," *The Asan Institute for Policy Studies and C4ADS*, August 2016. (https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/57dfe74acd0f68d629357306/1474291539480/In+China%27s+Shadow.pdf)

[23] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 27, 2017. (http://undocs.org/S/2017/150)

of Dandong in June, the Trump administration should move against another Chinese bank using the full suite of Treasury's tools. Treasury should issue significant fines against one or more medium-sized banks as a means of signaling there is a systemic problem inside China's financial system.[24] The purpose of such moves is not simply punitive; it is to drive a wedge between Chinese banks that covet their access to the U.S. financial system and Chinese leaders who indulge North Korea. If the banks fear they will be the next target of U.S. sanctions, they will pressure political leaders to change course.[25]

North Korea's Chinese Networks

Tracing North Korea's proliferation activities is difficult, as Pyongyang obscures the true nature of the procurements and uses non-North Korean entities and individuals to shield these activities from scrutiny.[26] A report by C4ADS found that "the system of North Korean sanctions evasion is centralized, limited, and vulnerable, and that its disruption can greatly increase the pressure on the Kim regime."[27] Many of these activities involve Chinese facilitators or have a nexus in China, suggesting that Beijing should do more to curtail these activities.[28] A sample of these proliferation activities include:

- Since 2009, North Korea has engaged in a sophisticated effort to sell military radios using front companies and banks in mainland China, Hong Kong, and Malaysia, according to *Reuters* and a UN report in February.[29] The UN stated that funds for the effort were provided by Pyongyang's main proliferation entity, which was designated by the U.S. in 2005 and by the UN in 2009.[30]

- The July 4 ICBM test was delivered to the launch site on a Chinese-made truck.[31] The same trucks were used by North Korea to parade six road-mobile intercontinental ballistic

[24] Anthony Ruggiero, "Severing China-North Korea Financial Links," *Center for Strategic & International Studies*, April 3, 2017. (https://www.csis.org/analysis/severing-china-north-korea-financial-links)
[25] Anthony Ruggiero, "Time for Trump to Get Tough on China," *Politico*, July 6, 2017. (http://www.politico.com/magazine/story/2017/07/06/donald-trump-china-north-korea-215343)
[26] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 27, 2017. (http://undocs.org/S/2017/150)
[27] "Risky Business," *C4ADS*, June 2017. (http://c4ads.org/reports/)
[28] Joshua Stanton, "UN report finds extensive evidence that China hosts N. Korea's proliferation networks," *One Free Korea*, March 15, 2017. (http://freekorea.us/2017/03/15/un-report-finds-extensive-evidence-that-china-hosts-n-koreas-proliferation-networks/#sthash.mB0tb4EF.WXqoytkT.dpbs)
[29] James Pearson and Rozanna Latiff, "North Korea spy agency runs arms operation out of Malaysia," *Reuters*, February 27, 2017. (http://www.reuters.com/article/us-northkorea-malaysia-arms-insight-idUSKBN1650YE); United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 27, 2017. (http://undocs.org/S/2017/150)
[30] The President of the United States, "Blocking the Property of Weapons of Mass Destruction Proliferators and Their Supporters," 70 Federal Register 126, June 28, 2005. (https://www.treasury.gov/resource-center/sanctions/Documents/whwmdeo.pdf); United Nations Security Council, "Narrative Summary of the Designation of the Korea Mining Development Trading Corporation," April 24, 2009. (https://www.un.org/sc/suborg/en/sanctions/1718/materials/summaries/entity/korea-mining-development-trading-corporation)
[31] James Pearson and Jack Kim, "North Korea appeared to use China truck in its first claimed ICBM test," *Reuters*, July 4, 2017. (http://www.reuters.com/article/us-northkorea-missiles-china-truck-idUSKBN19P1J3)

missiles in 2012.[32] North Korea claimed the trucks were for the forestry ministry, and the UN has prohibited since 2006 the export of items for the Kim regime's missile program.[33]

- In 2015, a Chinese company supplied sophisticated machine tools to North Korea, which could be used for its nuclear, missile, and military programs, according to a report published in April by the Institute for Science and International Security.[34] The UN has prohibited these items since 2006, and such activity probably violates China's own export-control restrictions.[35]

- In 2016, *Reuters* reported that North Korea had showcased a new mobile artillery system on Chinese trucks, despite a 2009 UN ban on exporting arms and related material to North Korea.[36]

- In 2008, China's Limac Corp and North Korea's Ryongbong General Corp established a joint venture to mine tantalum, niobium, and zirconium, which can be used for nuclear reactors and missile technology.[37] Ryongbong was sanctioned by the U.S. in 2005 and by the UN in 2009. However, the *Wall Street Journal* reported that the joint venture continued for another five years before its registration was revoked due to a failure to file inspection reports.[38]

- In June 2016, Dandong Dongyuan Industrial Co. Ltd. exported to North Korea a shipment worth $790,000 of radio navigational aid apparatus.[39] Experts at the James Martin Center for Nonproliferation Studies stated that this equipment can be used in navigation systems in vehicles and can serve as guidance devices for ballistic missiles.

- According to the UN Panel of Experts, North Korean universities that train the regime's nuclear scientists have exchange agreements with Chinese universities, even though UN

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[32] Larry Shaughnessy, "Truck raises questions about China's role in North Korea's missile program," *CNN*, April 20, 2012. (http://www.cnn.com/2012/04/20/world/asia/north-korea-chinese-truck/)
[33] United Nations Security Council, Resolution 1718, October 14, 2006. (http://www.un.org/ga/search/view_doc.asp?symbol=S/RES/1718%20%282006%29)
[34] David Albright, "Shenyang Machine Tools Company," *Institute for Science and International Security*, April 13, 2017. (http://isis-online.org/isis-reports/detail/shenyang-machine-tools-company/)
[35] United Nations Security Council, Resolution 1718, October 14, 2006. (http://www.un.org/ga/search/view_doc.asp?symbol=S/RES/1718%20%282006%29)
[36] James Pearson, "China-made truck used by North Korea in new artillery system," *Reuters*, March 8, 2016. (http://www.reuters.com/article/northkorea-nuclear-truck-corrected-updat-idUSL4N16H1CL); United Nations Security Council, Resolution 1874, June 12, 2009. (http://www.un.org/ga/search/view_doc.asp?symbol=S/RES/1874%282009%29)
[37] Jeremy Page and Jay Solomon, "Chinese-North Korean Venture Shows How Much Sanctions Can Miss," *The Wall Street Journal*, May 7, 2017. (https://www.wsj.com/articles/chinese-north-korean-venture-shows-how-much-sanctions-can-miss-1494191212?mod=djem10point&mg=prod/accounts-wsj)
[38] Jeremy Page and Jay Solomon, "Chinese-North Korean Venture Shows How Much Sanctions Can Miss," *The Wall Street Journal*, May 7, 2017. (https://www.wsj.com/articles/chinese-north-korean-venture-shows-how-much-sanctions-can-miss-1494191212?mod=djem10point&mg=prod/accounts-wsj)
[39] "Risky Business," *C4ADS*, June 2017. (http://c4ads.org/reports/)

resolutions ban the training of North Koreans in sensitive technology that can be used for nuclear proliferation.[40]

- Debris from the February 7, 2016 Kwangmyongsong rocket contained several foreign-sourced items. The UN Panel of Experts traced the parts, through the serial number and the manufacturer of the camera, to Beijing East Exhibition High-Tech Technology Co. Ltd.[41] The UN prohibited the export of missile technology and parts to North Korea in 2006.[42]

- The UN 2016 report noted that the shipment of Scud missile parts from North Korea to Egypt was run out of the North Korean embassy in Beijing.[43]

- The UN 2016 report traced the manufacturer of the North Korean UAV drone recovered by South Korean authorities to Chinese companies including Morrowind Aerial Imaging Technology and Microfly Engineering & Technology.[44]

Recommendation 2: Sanction Chinese Facilitators of Pyongyang's Sanctions Evasion. A bipartisan group of experts has recommended that targeting China's role in Pyongyang's sanctions evasion is essential to change the Kim regime's calculus.[45] The Trump administration should sanction elements of the network, preferably with near simultaneity for maximum effect. Chinese entities and individuals are at the heart of this network and Beijing will object to the sanctions, but the time for accepting China's excuses is over.

Overseas Laborers

To be as tough on North Korea as it was on Iran, the U.S. must work to disrupt the stream of revenue generated by Pyongyang's provision of *de facto* slave labor to foreign countries in exchange for hard currency. The regime sends citizens overseas – estimates range from 50,000 to 120,000 – into terrible work conditions while requiring foreign countries and companies to pay

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[40] Joshua Stanton, "UN report finds extensive evidence that China hosts N. Korea's proliferation networks," *One Free Korea*, March 15, 2017. (http://freekorea.us/2017/03/15/un-report-finds-extensive-evidence-that-china-hosts-n-koreas-proliferation-networks/#sthash.mB0tb4EF.NGxNL3Pq.dpbs)

[41] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 27, 2017. (http://undocs.org/S/2017/150)

[42] United Nations Security Council, Resolution 1718, October 14, 2006. (http://www.un.org/ga/search/view_doc.asp?symbol=S/RES/1718%20%282006%29)

[43] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 24, 2016. (http://undocs.org/S/2016/157)

[44] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 24, 2016. (http://undocs.org/S/2016/157)

[45] Anthony Ruggiero, "Severing China-North Korea Financial Links," *Center for Strategic & International Studies*, April 3, 2017. (https://www.csis.org/analysis/severing-china-north-korea-financial-links); Joshua Stanton, Sung-Yoon Lee, and Bruce Klingner, "Getting Tough on North Korea," *Foreign Affairs*, May/June 2017. (https://www.foreignaffairs.com/articles/north-korea/2017-04-17/getting-tough-north-korea); David S. Cohen, "One powerful weapon to use against North Korea," *The Washington Post*, April 21, 2016. (https://www.washingtonpost.com/opinions/one-powerful-weapon-to-use-against-north-korea/2017/04/21/ddbb9702-26c2-11e7-bb9d-8cd6118e1409_story.html?utm_term=.cf5c7aef261b); Elizabeth Rosenberg, "The Maximum Financial-Pressure Strategy for North Korea," *Foreign Policy*, May 9, 2017. (http://foreignpolicy.com/2017/05/09/the-maximum-financial-pressure-strategy-for-north-korea-secondary-sanctions-china/)

the workers' salaries directly to the regime, which passes on just a small percentage to the workers.[46] These slave laborers likely participated in the construction of venues for the upcoming soccer World Cups in Russia in 2018 and Qatar in 2022.[47] UN Security Council Resolution 2321 states that Pyongyang uses earnings from overseas labor for its nuclear and ballistic missile programs, which would be a violation of previous Security Council resolutions.[48] One expert puts North Korea's earnings from the practice at some $500 million annually.[49]

Recommendation 3: Block the Revenue North Korea Receives from Overseas Laborers. The U.S. should lead an effort to end North Korean slave labor by using Executive Order 13722 and the North Korea Sanctions and Policy Enhancement Act of 2016 to sanction foreign companies and individuals who pay the Kim regime for such labor. The U.S. should then build a coalition of like-minded countries that commit to not accept North Korean overseas laborers. China and Russia would block a UN ban on payments to North Korea, but exposing the terrible work conditions and links between the revenue and the prohibited programs could pressure Beijing and Moscow to alter the payment mechanism while continuing to import North Korean laborers.

Additional Sanctions Recommendations

Recommendation 4: Pursue an Offensive and Defensive Cyber Strategy. North Korea is honing its cyber skills to use both as an asymmetric weapon against the United States and South Korea, and as a means of generating revenue, such as the regime's attempt to steal $1 billion from Bangladesh's central bank.[50] Pyongyang conducts its cyber activities from inside China. Beijing and other supporters value access to the American financial system, and we should issue sanctions and criminal charges against them to send a message that enabling cyberattacks has consequences. We must harden our defenses and strengthen the castle walls, share data with the private sector – the primary target of North Korea's attacks – and think more creatively about new forms of cyber cooperation with the most technologically-advanced of our allies.[51] The *New York Times* reported

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[46] Shin Chang-Hoon and Go Myong-Hyun, "Beyond the UN COI Report on Human Rights in North Korea," *The Asan Institute for Policy Studies*, November 3, 2014. (http://en.asaninst.org/contents/asan-report-beyond-the-coi-dprk-human-rights-report/); Marcus Noland, "Organized Exports of Labor: Welcome to the Echo Chamber," *Peterson Institute for International Economics*, June 1, 2015. (https://piie.com/blogs/north-korea-witness-transformation/organized-exports-labor-welcome-echo-chamber)

[47] David Conn, "World Cup 2018: Fifa admits workers have suffered human rights abuses," *The Guardian* (UK), May 25, 2017. (https://www.theguardian.com/football/2017/may/25/fifa-world-cup-2018-workers-human-rights-abuses); Allie Conti, "North Korean Slaves Are Building Qatar's World Cup Centerpiece," *Vice*, November 7, 2014. (https://www.vice.com/en_us/article/north-korean-slaves-are-building-qatars-world-cup-centerpiece)

[48] United Nations Security Council, Resolution 2321, November 30, 2016. (http://www.un.org/en/ga/search/view_doc.asp?symbol=S/RES/2321%282016%29)

[49] Marcus Noland, "Organized Exports of Labor: Welcome to the Echo Chamber," *Peterson Institute for International Economics*, June 1, 2015. (https://piie.com/blogs/north-korea-witness-transformation/organized-exports-labor-welcome-echo-chamber)

[50] Michael Corkery and Matthew Goldstein, "North Korea Said to Be Target of Inquiry Over $81 Million Cyberheist," *The New York Times*, March 22, 2017. (https://www.nytimes.com/2017/03/22/business/dealbook/north-korea-said-to-be-target-of-inquiry-over-81-million-cyberheist.html?_r=0)

[51] Samantha Ravich and Anthony Ruggiero, "The growing North Korean cyber threat," Fifth Domain Cyber, June 12, 2017. (http://fifthdomain.com/2017/06/12/the-growing-north-korean-cyber-threat-commentary/); Samantha Ravich, "State-Sponsored Cyberspace Threats: Recent Incidents and U.S. Policy Response," *Testimony before the Senate Foreign Relations Committee*, June 13, 2017. (http://www.defenddemocracy.org/content/uploads/documents/6132017_Ravich_Testimony.pdf)

in March that Washington is engaged in a cyber effort to sabotage North Korea's missile launches, sending Pyongyang a message that cyber attacks go both ways.[52]

Recommendation 5: Impose Mandatory Inspections for all North Korean Ships. North Korea uses its shipping fleet to transfer prohibited materials, which in some cases are disguised as shipments of legitimate items. The UN reported in February that Egypt intercepted the *Jie Shun*, which was carrying rocket-propelled grenades and components concealed under iron ore.[53] All North Korean ships should be subject to inspection to ensure they are complying with the UN sanctions on transfers of prohibited goods. The U.S. and its partners should sanction all elements of the North Korean fleet to subject them to increased inspections at foreign ports, including regular updates to assist with port state compliance, and expand interdiction exercises with key partners in the region.

Recommendation 6: Address Iran-North Korea Cooperation. A February 2016 Congressional Research Service report noted the North Korea-Iran ballistic missile relationship is "significant and meaningful."[54] That missile relationship was serious enough for the Obama administration to sanction Iran a month earlier, just one day after the nuclear deal with Tehran was implemented.[55] North Korea's successful tests and stated deployment of the solid-fueled Pukguksong-2 medium-range ballistic missile could be attractive to Iran.[56] The U.S. and its partners should use their own authorities and North Korea-related UN sanctions to prohibit the exchange of technicians, review the role of Iranian ports in North Korea's proliferation activities, and ensure the intelligence community is assessing the relationship for signs of increased missile cooperation or incipient nuclear cooperation.

Recommendation 7: Use U.S. and Partner States' Authorities to Enforce UN Sanctions. UN Security Council Resolutions are not self-enforcing, and the United States has a special responsibility to lead a UN sanctions implementation effort given the preeminent role of the U.S. dollar in the international financial system. China and Russia successfully blocked UN condemnation of the July 4 ICBM test and they will not allow the UN Security Council to address the implementation challenges identified by the UN Panel of Experts. The United States should coordinate an implementation effort with other like-minded countries (South Korea, Japan, Australia, the United Kingdom, France, and Germany). In some cases, countries may need

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[52] William J. Broad and David E. Sanger, "U.S. Strategy to Hobble North Korea Was Hidden in Plain Sight," *The New York Times*, March 4, 2017. (https://www.nytimes.com/2017/03/04/world/asia/left-of-launch-missile-defense.html)

[53] United Nations Security Council, "Report of the Panel of Experts established pursuant to resolution 1874 (2009)," February 27, 2017. (http://undocs.org/S/2017/150)

[54] Paul K. Kerr, Steven A. Hildreth, and Mary Beth D. Nikitin, "Iran-North Korea-Syria Ballistic Missile and Nuclear Cooperation," *Congressional Research Service*, February 26, 2016. (https://fas.org/sgp/crs/nuke/R43480.pdf)

[55] The White House, "Statement by the President on Iran," January 17, 2016. (https://obamawhitehouse.archives.gov/the-press-office/2016/01/17/statement-president-iran); U.S. Department of the Treasury, Press Release, "Treasury Sanctions Those Involved in Ballistic Missile Procurement for Iran," January 17, 2016. (https://www.treasury.gov/press-center/press-releases/Pages/jl0322.aspx)

[56] Anthony Ruggiero and Behnam Ben Taleblu, "The danger of North Korea and Iran – and how Trump should tackle it," *The Hill*, July 6, 2017. (http://thehill.com/blogs/pundits-blog/foreign-policy/340832-the-great-danger-of-north-korea-and-iran-and-what-trump-can)

assistance drafting implementation laws or regulations. In other cases, the U.S. should sanction those countries that violate UN sanctions and refuse implementation assistance.

U.S. Tourist Travel to North Korea

The death of American student Otto Warmbier was nothing less than a callous murder at the hands of North Korea's Stalinist dictatorship. At least three Americans are being held in North Korea. These detentions are part of a pattern for Pyongyang, which uses Americans as bargaining chips in its standoff with Washington.[57] Senior American envoys have also bought into the illusion that engagement could yield results, regardless of how clearly the regime advertised its hostility. While this issue is not directly tied to the regime's revenue, it is important to mention here.

Ultimately, the U.S. should not be surprised that Kim killed an American – the real surprise is that it took this long. The North Korean regime has perfected torture on its own people. When the UN detailed these abuses in a ground-breaking report in 2014, the world collectively shrugged.[58] Even the United States – the "city on a hill" – waited two years to act against North Korean human rights abusers, an inexcusable dereliction of leadership.[59]

The UN report noted that Kim's thugs carry out forced abortions, and any baby that survives is drowned or suffocated in front of the mother; immerse prisoners in a tank until they almost drown, hang people upside down, force needles under fingernails, and pour a water-hot chili pepper concoction down the victim's nose; and use starvation as an element of statecraft to keep innocent civilians fearful of the state.[60] At some level, it was naïve to hope that North Korea would not subject Americans to life-threatening abuses.

When dealing with North Korea, it is also essential to recall that China plays a central role in excusing the regime's behavior, just as it excuses North Korea's nuclear weapons and missile programs. In particular, Beijing allows despicable groups, such as Young Pioneer Tours, to operate on its soil, selling trips to Pyongyang to young people like Warmbier while assuring them that visits to North Korea are "extremely safe."[61] More concerning is Beijing's refusal to allow the Security Council to refer North Korea to the International Criminal Court or a new international tribunal. No one should forget that Chinese President Xi Jinping has the blood not only of Otto Warmbier, but every dead and imprisoned North Korean on his hands.

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[57] Anthony Ruggiero, "North Korea Takes another American Hostage," *Foundation for Defense of Democracies*, April 24, 2017. (http://www.defenddemocracy.org/media-hit/anthony-ruggiero-north-korea-takes-another-american-hostage/)

[58] United Nations Human Rights Council, "Report of the commission of inquiry on human rights in the Democratic People's Republic of Korea," February 7, 2014. (http://www.ohchr.org/EN/HRBodies/HRC/CoIDPRK/Pages/ReportoftheCommissionofInquiryDPRK.aspx)

[59] Anthony Ruggiero, "Don't let North Korea's nukes overshadow human rights abuses," *The Hill*, April 28, 2017. (http://thehill.com/blogs/pundits-blog/foreign-policy/331061-dont-let-north-koreas-nukes-overshadow-human-rights-abuses)

[60] United Nations Human Rights Council, "Report of the commission of inquiry on human rights in the Democratic People's Republic of Korea," February 7, 2014. (http://www.ohchr.org/EN/HRBodies/HRC/CoIDPRK/Pages/ReportoftheCommissionofInquiryDPRK.aspx)

[61] Austin Ramzy and Choe Sang-Hun, "Otto Warmbier Came Home in a Coma. Travel Company Says North Korea Is 'Extremely Safe!'" *The New York Times*, June 16, 2017. (https://www.nytimes.com/2017/06/16/world/asia/otto-warmbier-north-korea-travel.html?_r=0)

The North Korea Sanctions and Policy Enhancement Act of 2016 mandated that the State Department issue warnings for travel to North Korea given "the serious risk of arrest and long-term detention" there.[62] The travel warnings are not working.

Recommendation 8: End Tourist Travel to North Korea. Congress could prohibit citizens from traveling to the country at all (with limited exceptions including humanitarian work, government activities, and the press, for example). The time has come to deprive Pyongyang of such bargaining chips, which may limit the escalation of economic pressure.

Recommendation 9: Address North Korea's Human Rights Abuses. U.S. Ambassador to the UN Nikki Haley should press for a Security Council session on North Korea's human rights violations, including a vote on the commission of inquiry's recommendation to refer the issue to the International Criminal Court or create an international tribunal.[63] Washington should lead this effort, which would force serial human rights enablers China and Russia to veto the resolution. Congress should consider extending the North Korean Human Rights Act that expires later this year.[64] Congressional action to extend this important law will maintain focus on the issue, promote information flow into North Korea, and ensure the administration makes it a priority in discussions with Pyongyang and Beijing.[65]

Conclusion

Pyongyang's provocations, including its test of an ICBM that could reach parts of the West coast, deserve increasingly harsh responses from Washington.[66] A new North Korea sanctions approach is needed to secure the United States and its allies against the dangerous and growing threat from this rogue regime. Iran-style sanctions are the only peaceful means for coercing the Kim regime, and are for that reason indispensable.

On behalf of the Foundation for Defense of Democracies, I thank you again for inviting me to testify and I look forward to addressing your questions.

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[62] North Korea Sanctions and Policy Enhancement Act of 2016, Pub. L. No. 114-122, 130 Stat. 93, codified as amended at 114 U.S.C. §201. (https://www.congress.gov/114/bills/hr757/BILLS-114hr757enr.pdf); U.S. Department of State, "North Korea Travel Warning," May 9, 2017. (https://travel.state.gov/content/passports/en/alertswarnings/north-korea-travel-warning.html)

[63] United Nations Human Rights Council, "Report of the commission of inquiry on human rights in the Democratic People's Republic of Korea," February 7, 2014. (http://www.ohchr.org/EN/HRBodies/HRC/CoIDPRK/Pages/ReportoftheCommissionofInquiryDPRK.aspx)

[64] North Korea Human Rights Act of 2004, Pub. L. No. 108-333, 118 Stat. 1287, codified as 22 U.S.C. §7801. (https://www.congress.gov/108/plaws/publ333/PLAW-108publ333.pdf)

[65] Anthony Ruggiero, "Don't let North Korea's nukes overshadow human rights abuses," *The Hill*, April 28, 2017. (http://thehill.com/blogs/pundits-blog/foreign-policy/331061-dont-let-north-koreas-nukes-overshadow-human-rights-abuses)

[66] Ankit Panda, "Why is Russia Denying That North Korea Launched an ICBM?" *The Diplomat* (Japan), July 11, 2017. (http://thediplomat.com/2017/07/why-is-russia-denying-that-north-korea-launched-an-icbm/)

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