

**A LEGISLATIVE PROPOSAL TO  
IMPEDE NORTH KOREA'S  
ACCESS TO FINANCE**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON MONETARY  
POLICY AND TRADE  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED FIFTEENTH CONGRESS  
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## **A LEGISLATIVE PROPOSAL TO IMPEDE NORTH KOREA'S ACCESS TO FINANCE**

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**Wednesday, September 13, 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 10:06 a.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, Emmer, Mooney, Davidson, Tenney, Hollingsworth; Moore, Foster, Sherman, Green, Heck, Kildee, and Vargas.

Ex officio present: Representative Hensarling.

Also present: Representative Wagner.

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.

Today's hearing is entitled, "A Legislative Proposal to Impede North Korea's Access to Finance."

I now recognize myself for 5 minutes to give an opening statement.

Today's hearing will examine draft legislation that would impose secondary sanctions on foreign banks whose business supports the North Korean regime, whether directly or indirectly. By encompassing virtually all of North Korea's economic activity, these measures would represent the toughest financial sanctions yet directed at Pyongyang. This means going after coal, petroleum, textiles, and minerals, as well as North Korean laborers abroad.

In addition, the bill would incentivize greater compliance with U.N. sanctions by leveraging our vote at the international financial institutions where certain countries with lax enforcement go to seek assistance. This bill puts those countries on notice.

This proposed legislation has been informed by the committee's ongoing work on North Korea, as well as the U.N. panel of experts' evaluation of existing sanctions effectiveness.

Needless to say, North Korea's sixth nuclear test on September 3rd, coupled with its repeated launching of intermediate and long-range ballistic missiles, underlines that more must be done. As a result, the legislative draft we will be looking at lays out a choice:

Foreign banks can either do business that benefits North Korea or they can do business with the United States. They cannot do both.

As many of us here today are aware, this is a similar approach to the one taken in 2010 against Iran, which helped compel the ayatollahs to negotiate over their nuclear program. While there are differences of opinion over how successful those negotiations were, there is consensus, I believe, that in the absence of secondary sanctions affecting banks, Tehran would have been far less incentivized to even engage in talks.

A focus on banks is especially important given how North Korea has evaded sanctions in the past. As Dr. John Park of Harvard's Kennedy School testified before this subcommittee in July, the North Koreans have moved much of their trading activity offshore using third-country brokers and front companies.

The specter of financial sanctions may concentrate the minds of foreign banks so that the entities identified by Dr. Park and others have fewer options to carry out transactions and mask North Korean involvement.

Having said that, this bill would expand the scope of our sanctions to encompass even actors engaged in conventional trade with the North. Given North Korea's unchecked hostility, broadening our efforts in this way appears essential.

Nevertheless, China's response to stronger sanctions has been cited as a concern as the country accounts for an estimated 90 percent of North Korea's trade. Some have therefore argued that harsher sanctions now may damage cooperative efforts with Chinese leaders to curb North Korea's weapons program. But I would submit that those critics should be far more sensitive to a quarter century of failed multilateral efforts to reign in Pyongyang. There comes a time when caution or, "strategic patience," as one Administration phrased it, becomes a euphemism for self-delusion.

As this subcommittee learned from its hearing in July, if China is not part of the solution to North Korea, it is part of the problem. Chinese officials have fallen short on enforcing U.N. sanctions that Beijing itself has signed on to. And as the U.N. Security Council talks following the North's sixth nuclear test have demonstrated, it is still unclear if China is committed to meaningfully tackling the North Korean threat.

Finally, we should acknowledge that Kim Jong-un's eagerness in forcing the withdrawal of U.S. troops from the region may not be entirely inconsistent with Chinese interests. For all the breathless talk of China exerting influence around the globe as a rival to U.S. power, we are curiously asked to believe that its hands are tied when it comes to a small, economically dependent state next door.

Well, if Chinese officials' hands are tied, then we should proceed with secondary sanctions so that their banks can assist international efforts to cut off North Korea's access to finance. If, on the other hand, China could do more than it has, then secondary sanctions may finally inspire it to do so.

I want to thank our witnesses for appearing today, and I look forward to their testimony.

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 in the absence of our ranking member of the full Financial Services Committee, Ms. Waters, I would like to share some thoughts that she has committed to paper regarding today's hearing:

"I want to thank our witnesses for joining us to discuss the legislative proposal aimed at expanding United States sanctions against North Korea and pressuring the international community to enforce those restrictions as well.

"The situation in North Korea is the most urgent and dangerous threat to peace and security that we face. And it is one that grows more dangerous as North Korea aggressively pursues the capacity to extend its nuclear reach to United States cities.

"In fact, there are no good options for dealing with North Korea. Most experts agree that a preemptive strike at this point on North Korea would be reckless beyond belief.

"Of the least-bad options, I like the idea of pressing China to lean more heavily on North Korea and I like the idea of tougher sanctions. But we should not confuse either of those things with a coherent strategy, and we should be clear up front about our goals and objectives and what we expect sanctions can accomplish.

"Any ratcheting up of sanctions must be coupled with aggressive diplomatic engagement by the United States and within a framework that would entail nuanced negotiations with North Korea, U.S. allies, and China. This would require unprecedented policy-making capacity and coordination across the United States Government as well as skilled policy coordination with our allies.

"It concerns me, therefore, that just as this crisis is accelerating, our diplomatic capabilities, which open channels for crisis communication and reduce the risk of miscalculation, are diminished. Not only are U.S. ambassadorships to Japan and South Korea still vacant, the President has yet to nominate a permanent Assistant Secretary of State for East Asia and Pacific affairs.

"The legislative proposal before us today rightly recognizes the need to exert massive and immediate pressure on the North Korean regime and, importantly, enlists China and others in this effort. However, such a powerful approach towards sanctions that have the capacity to reverberate throughout the global economy and present potentially disastrous, unintended consequences must also allow for careful calibration in its implementation.

"We look forward to the witnesses' views on the proposal before us as well as your views on how the U.S. can most effectively use this leverage to contain the alarming danger North Korea presents.

"And I reserve my time."

Chairman BARR. The Chair now recognizes the gentleman from Washington, Mr. Heck, for an opening statement.

Mr. HECK. Thank you, Mr. Chairman, and Ranking Member Moore, for the time. And thank you all for convening this important hearing.

Responding effectively to North Korea's provocations will require a variety of tools: credible deterrence; adept alliance management; skillful diplomacy; and a careful design of nonmilitary sanctions.

Here in the Financial Services Committee, we have jurisdiction over only one of those tools: sanctions. But I believe it is important

that we always keep the broader picture in mind as we work to perfect the discussion draft which has been put forward today.

Even with perfect compliance, I believe it is very difficult to stop any country from pursuing a course of action which it views as vital to its survival through sanctions alone. These challenges are even greater when dealing with a regime like North Korea, a regime which relies on force to stay in power, a regime which has demonstrated indifference to the incredible suffering of its own people, a regime which can easily make sure that its elite and its nuclear program are the last to feel any pinch.

Done right, however, sanctions can make further North Korean advances slower and more costly, giving more time for other policy tools to work.

And I look forward to hearing from our distinguished witnesses about how this proposed draft fits into a larger strategy.

My constituents in the South Puget Sound, who include the servicemembers at Joint Base Lewis-McChord, are counting on us to respond to this crisis in a responsible manner. So, too, are our allies, like South Korea and Japan and an Asia Pacific region which has enjoyed decades of peace and prosperity in large part because of the credibility of U.S. security guarantees and a broader commitment to the region.

We cannot afford to fail them. We have to get this right. And I am hopeful that with steady American leadership working in a bipartisan manner, we will get this right.

I yield back, Mr. Chairman.

Chairman BARR. The gentleman yields back.

And because of the significance of the issues under consideration in this hearing and the importance of the North Korean threat to our homeland and to the interests of our country, a number of members from the full Financial Services Committee have expressed an interest in participating in today's subcommittee hearing.

And so I ask for unanimous consent that members who are on the full committee, but not on this subcommittee, may join in this hearing. Without objection, it is so ordered.

Today, we welcome the testimony of a distinguished panel of witnesses. First, David Albright, who is the founder and president of the Institute for Science and International Security. He has written numerous assessments on the secret nuclear weapons programs throughout the world. Mr. Albright has published assessments in numerous technical and policy journals, including *The Bulletin of the Atomic Scientists*, *Science*, *Scientific American*, *Science and Global Security*, *Washington Quarterly*, and *Arms Control Today*. Mr. Albright has also coauthored four books, including, "The World Inventory of Plutonium and Highly Enriched Uranium," as well as, "Peddling Peril: How the Secret Nuclear Trade Arms America's Enemies."

Prior to founding the Institute, Mr. Albright worked as a senior staff scientist at the Federation of American Scientists, and as a member of the research staff of Princeton University's Center for Energy and Environmental Studies.

Anthony Ruggiero is a senior fellow at the Foundation for Defense of Democracies. He 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 adviser on issues relating 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 in the Office of Terrorist Financing and Financial Crimes.

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. He was also nonproliferation adviser to the U.S. delegation to the 2005 rounds of the six-party talks in Beijing, and participated in U.S.-North Korea meetings following the identification of the Macao-based Banco Delta Asia as a primary money-laundering concern. He has also served as an intelligence analyst covering North Korean nuclear and missile programs and proliferation activities.

Bruce Klingner specializes in Korean and Japanese affairs as the senior research fellow for Northeast Asia at the Heritage Foundation's Asian Studies Center. He is a frequent commentator on the region in U.S. and foreign media. Mr. Klingner's analysis and writing about North Korea, South Korea, and Japan are informed by his 20 years of service at the Central Intelligence Agency and the Defense Intelligence Agency.

From 1996 to 2001, Mr. Klingner was the CIA's Deputy Division Chief for Korea, responsible for the analysis of political, military, economic, and leadership issues for the President of the United States and other senior U.S. policymakers. In 1993 and 1994, he was the Chief of the CIA's Korea branch which analyzed military developments during a nuclear crisis with North Korea.

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 energy market shifts and the use of sanctions in economic statecraft.

From May 2009 through September 2013, Ms. Rosenberg served as a Senior Adviser to the Assistant Secretary for Terrorist Financing and Financial Crimes and then to the Under Secretary for Terrorism and Financial Intelligence. In these roles, she helped to develop and implement financial and energy sanctions. She also helped to formulate anti-money-laundering and counter-terrorist financing policy and oversee financial regulatory enforcement activities.

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. Albright, you are now recognized for 5 minutes.

**STATEMENT OF DAVID ALBRIGHT, PRESIDENT, INSTITUTE  
FOR SCIENCE AND INTERNATIONAL SECURITY**

Mr. ALBRIGHT. Chairman Barr, Ranking Member Moore, and other members of the subcommittee, thank you for the opportunity to testify today.

North Korea's September 3rd nuclear test, its sixth overall and by far the largest in terms of explosive yield, demonstrates its re-

solve and commitment to developing a nuclear arsenal able to strike its enemies.

During the last few years, North Korea has embarked on an intensive nuclear weapons testing and production campaign that has included the construction and operation of many nuclear facilities, three underground nuclear tests, and tens of ballistic missile launches.

Its apparent goal is to have a variety of nuclear warheads of many varieties mated to ballistic missiles with ranges stretching to intercontinental distances. Few doubt that North Korea can now launch nuclear-tipped ballistic missiles that can strike our allies, Japan and South Korea. There is rightly more skepticism that North Korea is yet able to deliver a nuclear warhead to an American city, but it is making rapid progress toward that goal.

I continue to believe that North Korea can be peacefully denuclearized; however, substantive negotiations appear unlikely unless North Korea changes its path. Given North Korea's unwillingness to enter denuclearization talks, and its provocative behaviors, there is little choice but to assert more pressure, including harsher sanctions and additional trade cutoffs. The U.N. Security Council resolution passed on Monday is an important step in that direction.

A near-term priority is to far more effectively isolate North Korea from the regional and international financial system. A central problem is that many countries are not enforcing sanctions effectively or are, in some cases, willfully disregarding them. Punitive measures are needed to encourage compliance and deter violations. Additional U.S. legislation that supports that goal is useful.

North Korea appears to target entities and persons engaging in activities in violation of U.N. Security Council sanctions in tens of countries with weak or nonexistent trading control system, poor proliferation financing controls, or higher-than-average corruption.

Although a range of remedies are needed to fix the poor performance, in general, of many of these countries, the creation of punitive measures may be an effective means to accelerate more compliant behavior in the short term among a wide range of countries where entities and individuals see North Korea as a quick way to make money or obtain military or other goods either more cheaply or unavailable elsewhere.

Dealing with China's trade with North Korea is in a different category. North Korea has depended on illegal or questionable procurements for decades for its nuclear and other military programs. And as the chairman pointed out, they have gone offshore quite successfully to be able to acquire those goods.

And they don't just acquire them, let's say, in a country such as China. They are able to get those goods from the United States, Europe, and Japan by operating in China and exploiting China's weak export control and sanctions legislation.

Although China is improving its export control laws, Beijing has certainly not done an adequate job of enforcing its laws and sanctions against illegal exports and re-transfers to North Korea. And I have provided several examples in my testimony.

China remains North Korea's central, perhaps unwitting supply conduit for its nuclear weapons program. And one of the priorities

is to change that. The Trump Administration's efforts to sanction Chinese, and for that matter Russian-owned companies and individuals that significantly support North Korea's weapons programs, are a positive step.

But unless China and Russia show dramatic improvements in ending their nefarious trade with North Korea, the United States should go further and sanction major Chinese and Russian banks and companies for any illicit North Korea dealings.

Both countries have gotten away with for far too long, and have faced too-few consequences, for turning a blind eye to the sanction-busting business activities of their citizens and those of North Korea in using their economies for nefarious purposes.

North Korea has a diplomatic path out of its isolation and sanctions if it negotiates a full, verified denuclearization of its nuclear and long-range missile programs. Any such negotiations would need to repair past mistakes where North Korea was able to evade inspections and continue expanding its nuclear programs.

An agreement would also need to allow unprecedented inspections and access allowing for a full accounting of the program as part of a denuclearization process. Although this prospect seems unlikely in the short term, given North Korea's current trajectory, it is important to keep this goal available as a matter of U.S. policy in case increased sanctions can convince North Korea to negotiate in earnest.

Likewise, the Trump Administration should continue to make clear that regime change is not its goal. And particularly if the goal is to seek cooperation from China, that becomes even more important.

Chairman BARR. The gentleman's time has expired.

Mr. ALBRIGHT. Okay.

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

Chairman BARR. Thank you. We will look forward to the remainder of your testimony during the question-and-answer session.

And, 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.

Often, U.S. policy toward North Korea gets stuck in a cycle whereby a North Korean provocation is met with a strong American rhetoric and/or a token increase in sanctions, a pattern repeated over and over. If we don't break this cycle, the Kim regime can keep distracting the United States with its repeated provocations. We must ensure that the U.S. response to every North Korean provocation advances our goal of denuclearizing North Korea.

Some experts will call for the White House to negotiate a freeze of North Korea's nuclear program with claims that it will reduce the threat and eventually lead to denuclearization. But we have seen this movie before and its ending is not encouraging.

North Korea has made it clear that it has no interest in denuclearization. To the extent that Pyongyang is interested in negotiations, it is only for the purpose of extracting concessions in exchange for promises it will quickly violate as it did with the 1994 agreed framework.

In testimony before this subcommittee in July, I noted that U.S. sanctions did not have a serious impact because they have neither sufficiently targeted enough of Pyongyang's international business, nor have they targeted non-North Koreans facilitating sanctions evasion. Fortunately, this appears to be changing. The Trump Administration has started to sanction North Korea's international business partners.

Since March 31st, the U.S. has sanctioned 43 persons, of whom 86 percent operate outside North Korea and 54 percent are non-North Koreans. But this work is not done. As I note in my written testimony, recent U.S. actions against North Korea reveal three methods Pyongyang uses for financing prohibited activities.

In slide one, the first method starts with North Korean revenue in China following the sale of commodities brokered by Chinese firms and individuals. The payment then moves through a North Korean bank. Moving left to right, from there, the funds move to a Chinese company and then a front company that accesses U.S. banks. This only happens because the U.S. banks are tricked into processing the North Korean transactions. This is how payment is made for the original item in U.S. dollars.

This method is important to highlight with recent reports that Chinese banks have cut off North Korean accounts. The method relies on a ledger system between North Korea and China where the Chinese firms and individuals hold these bank accounts.

Slide two, please.

The second method was identified by the Justice Department based on information from an unnamed North Korean defector. On the left side of the slide, Chinese entity one owes money to North Korean entity one while North Korean entity two owes a similar amount to Chinese entity two. The entities pay each other, given the difficulties of moving money over the China-North Korea border.

Slide three, please.

The third method was used by a Russian company to receive U.S. dollars for a shipment of gas and oil to North Korea. Again, this is very important, given the new resolution that restricts energy sales.

A U.S. bank would not process this transaction between sanctioned parties. To avoid this scrutiny, the front companies were created in Singapore to obscure the nature of the transaction, allowing almost \$7 million in payments for this transfer.

All three methods show that North Korean suppliers prefer U.S. dollar payments, providing a key vulnerability that Washington can exploit. This is why it is crucial for the Trump Administration to issue fines against Chinese banks that are facilitating North Korea sanctions evasion, matching the successful U.S. policy, as the chairman said, used to pressure European financial institutions that were facilitating Iran sanctions violations. The fines likely will

prompt Chinese banks to increase scrutiny of North Korea-related transactions.

To be clear, if nongovernmental organizations here in Washington can find these transactions, I am confident the largest banks in China, with its significant manpower, can find them, too. Chinese banks need to do more or face severe consequences.

In the meantime, it is important to remember that there are other political considerations at play. Pyongyang is trying to decouple the United States from our closest allies in South Korea and Japan. The Kim regime's ultimate goal is not a suicidal nuclear attack on the U.S. homeland, but rather using that threat to bolster Pyongyang's effort to reunify the Korean peninsula and intimidate our Japanese allies.

A sanctions approach that focuses on North Korea's financial activities has the best chance of success.

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 78 of the appendix.]

Chairman BARR. Thank you, Mr. Ruggiero.

Ms. Rosenberg, you are recognized for 5 minutes.

**STATEMENT OF ELIZABETH ROSENBERG, SENIOR FELLOW  
AND DIRECTOR, ENERGY, ECONOMICS, AND SECURITY PRO-  
GRAM, CENTER FOR A NEW AMERICAN SECURITY**

Ms. ROSENBERG. Thank you, Chairman Barr, Ranking Member Moore, and distinguished members of the subcommittee. I appreciate the opportunity to testify before you today.

North Korea's alarming and dangerous recent ballistic missile launches and its sixth nuclear test highlight the need for much stronger pressure on the regime to limit its proliferation activities and cease its provocations. Financial sanctions should be a core part of a pressure strategy along with force posture and projection and complemented by a diplomatic engagement to move North Korea toward stability and denuclearization.

I applaud the work of Congress to impose new sanctions authorities this past summer to tighten financial pressure on North Korea along with complementary new sanctions from the United Nations. However, non-enforcement and evasion is gravely concerning, particularly when it comes to China, through which flows the overwhelming majority of North Korean international finance and trade.

For some observers, the lack of sanctions enforcement is an immediate indication that the current sanctions framework is inadequate and that the United States should make secondary sanctions' shock treatment mandatory to force other countries to comply with sanctions.

While current sanctions authorities are already very aggressive to apply pressure on North Korea and its international enablers, I support the efforts of this committee to consider how mandatory secondary sanctions should be deployed to enhance pressure.

We must not forget, however, that secondary sanctions require delicacy in their application. They may be counterproductive if they are so aggressive or politically incendiary that U.S. partners be-

come utterly defiant, uncooperative, and create officially backed evasion schemes and impose retaliatory sanctions or economic punishments on U.S. firms abroad or a trade war.

Ultimately, avoiding pitfalls in the use of secondary sanctions is primarily the responsibility of the U.S. Administration. The body that implements and enforces sanctions, Congress, must oversee aggressive sanctions implementation, but also give the Administration adequate flexibility, even within the framework of mandatory secondary sanctions, to impose these measures and also manage their consequences for the United States and its partners.

In addition to sanctions, U.S. policy leaders must deploy another form of economic statecraft to target North Korea, pushing for rigorous, risk-based approaches for global banks to identify and curtail proliferation finance. Currently, only large U.S. banks and some major European and Asian banks holistically pursue proliferation finance, leaving all other global banks significantly vulnerable to abuse by North Korean or other proliferators.

For these other global banks, weak supervisory frameworks and expectations, lack of knowledge and resources, and insufficient prioritization of the threat means that they often take a mechanical approach to proliferation finance in the form of checking customers or transactions against entities sanctioned by the U.N. or national governments, sometimes, but not always, including the United States. This presents obvious opportunities for proliferators to use front companies or proxies to get around limited compliance controls outside of major financial institutions. And we have just heard that described in some of the examples offered by my colleague, Mr. Ruggiero.

The global standard-setting body for countering illicit finance, the Financial Action Task Force, endorses an approach toward proliferation finance along the lines of checking customers against sanctions lists instead of a risk-based evaluation of suspected proliferation conduct or proliferation typologies.

This limited approach is inadequate and we need much stronger leadership from the United States to clarify that global banks must take a more holistic, risk-based approach to screening and investigation for proliferation finance and that there must be stronger public/private information exchange around known proliferation entities and typologies.

In my written testimony, I outline several specific points in response to your legislative discussion draft and some ideas for additional legislative measures. To briefly summarize a few items, I support your tough approach on secondary sanctions and encourage the inclusion of meaningful waiver provisions to manage unintended consequences.

Also, I urge you to consider ways to provide additional financial support for the Treasury and State Departments and the U.S. intelligence community to expand the group of experts crafting and enforcing U.S. sanctions and offering technical assistance to foreign countries related to sanctions enforcement.

Finally, Congress should mandate new bank supervision requirements for U.S. banks extending to their foreign branches, subsidiaries and correspondence related to proliferation finance and facili-



tate greater public/private information sharing on this topic to enhance global compliance and to impede the proliferation threat.

Thank you for the opportunity to testify, and I look forward to answering any questions you may have.

[The prepared statement of Ms. Rosenberg can be found on page 71 of the appendix.]

Chairman BARR. Thank you.

And, Mr. Klingner, you are now recognized for 5 minutes.

**STATEMENT OF BRUCE KLINGNER, SENIOR RESEARCH  
FELLOW, NORTHEAST ASIA, HERITAGE FOUNDATION**

Mr. KLINGNER. Chairman Barr, Ranking Member Moore, and distinguished members of the subcommittee, it is truly an honor to be asked to speak before you.

Although North Korean nuclear and missile programs are indigenous, the regime requires access to foreign technology, components, and hard currency. Pyongyang maintains covert access to the international banking system through a global array of overseas networks and shell companies. Most of North Korea's financial transactions, and those of the foreign entities that assist the regime, continue to be denominated in U.S. dollars and thus are still going through U.S. banks.

While the challenges in imposing targeted financial measures on North Korea may appear overwhelming, a closer examination reveals several encouraging characteristics. North Korea uses a limited number of trusted individuals to run its covert networks. Although the shell companies can be swiftly changed, the individuals responsible for establishing and managing them have remained unchanged, often for years. By embedding their illicit activities into the global financial network, North Korean agents leave behind a digital trail making them vulnerable to targeted sanctions.

As C4ADS, a non-government organization using only publicly available information discovered, while China accounts for almost 90 percent of total North Korean trade, the entire trading system consists of 5,000 companies. Those firms are centralized among a smaller number of large-scale trading firms so that the top 10 importers of North Korean goods in China controlled 30 percent of the market. And those trading firms themselves are controlled by a smaller number of individuals.

As such, the North Korean network in China is centralized, limited, and therefore vulnerable. Therefore, targeting a relatively small number of strategic choke points can have disproportionate, disruptive ripple effects impacting multiple networks across multiple countries.

Every law enforcement action could induce remaining components in the network to change routes, bank accounts, and procedures to less-effective means. Even legitimate businesses will become more fearful of being entangled in illicit activity and more fully implement required due-diligence measures. Cumulatively, these efforts reduce North Korea's foreign revenue sources, increase strains on the regime and generate internal pressure on the regime.

Sanctions enforcement must be flexible, innovative, and adaptive to the changing tactics of the target. But as North Korea altered

its modus operandi, international law enforcement agents didn't keep pace. When North Korea shifted to Chinese brokers, the U.S. and U.N. agencies should have begun including them on sanctions lists that lagged.

To raise the cost of North Korean defiance, the U.S. must go beyond sanctions and diplomacy to include a full-court press to diplomatically and economically isolate North Korea from the international community and introduce tremors into regime stability.

For too long, successive U.S. Administrations have used sanctions as a calibrated and incremental diplomatic response to North Korean provocations rather than a law enforcement measure defending the U.S. financial system.

The U.S. should target any entity suspected of aiding or abetting North Korean nuclear missile and conventional arms development, criminal activities, money-laundering, or the import of luxury goods. The U.S. should also end de facto Chinese immunity from U.S. law. Beijing has not paid a price for turning a blind eye to North Korean proliferation and illicit activity occurring on Chinese soil. Washington has long cowered from targeting Chinese violators of U.S. laws out of fear of undermining perceived assistance and pressuring North Korea or economic retribution against U.S. economic interests.

The North Korea Sanctions and Policy Enhancement Act mandates secondary sanctions on third-country banks and companies that violate U.S. sanctions and U.S. law. The U.S. should penalize all entities, including Chinese financial institutions and businesses that trade with those on the sanctions list, export-prohibited items, or maintain correspondent accounts for North Korean entities.

Washington should impose significant fines on China's 4 largest banks at a commensurate level to the \$12 billion in fines the U.S. levied on European banks for money-laundering for Iran. And the U.S. should designate as a money-laundering concern any medium or small Chinese banks or businesses complicit in prohibited North Korean activities.

In conclusion, the most pragmatic U.S. policy is a comprehensive, integrated strategy using all of the instruments of national power to increase pressure in response to Pyongyang's repeated defiance of the international community, to expand information operations against the regime, to highlight and condemn Pyongyang's crimes against humanity, and to ensure the U.S. has sufficient defenses for itself and its allies, while leaving the door open for diplomatic efforts.

Sanctions require time and the political will to maintain them in order to work. It is a policy of a slow python constriction rather than a rapid cobra strike.

Thank you again for the privilege of appearing before you.

[The prepared statement of Mr. Klingner can be found on page 53 of the appendix.]

Chairman BARR. Thank you for your testimony.

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

Earlier this month, Russian President Vladimir Putin argued that the potential for North Korea sanctions to be effective remains

limited. He claimed that the North Koreans would, “prefer to eat grass,” rather than give up their nuclear weapons.

How would you respond to those who claim that North Korea can always weather sanctions, that sanctions are not an effective means of providing substance and meaning to our diplomacy, and that the Kim regime will never care if its economy will suffer in order for him to advance his weapons?

And I will ask all of you to briefly respond to that question.

Mr. ALBRIGHT. I think sanctions can have a very big impact in North Korea, partly for what you have been focusing on, they are not implemented, so there is a lot of room to really press North Korea to change its behavior. So I think it is an extremely valuable tool.

I think part of the purpose of sanctions—I would like to see North Korea eat its nuclear weapons. If that is what they choose, that the sanctions should start to have a cost, and I think that can actually be done. And particularly in North Korea, I think it is more vulnerable because it is surrounded by very big powers. This isn’t like India and Pakistan or even Iran. North Korea is a relatively weak state that is surrounded by very powerful neighbors who increasingly, even in the case of Russia, do not like its behavior.

Chairman BARR. Mr. Ruggiero, when you answer this question, could you also address the issue that, of course, North Koreans have been very creative in using third-country brokers, as you testified, and front companies to mask their illicit transactions? And as you answer the question, could you address our draft bill and whether you think that banks and third countries, above all China, actually possess the capacity to identify these brokers, middle men, and front companies?

Mr. RUGGIERO. On Russia, I would start with perhaps President Putin should focus on his Russian companies that are facilitating North Korea sanctions evasion, the ones that are working with a North Korean proliferation entity called Tanguin that was designated by the U.N. in 2009, that the U.S. sanctioned twice in the last couple of months. So perhaps if he had his own companies implementing sanctions, they would do a little bit better.

I would also go back to 2005 and my experience at that time, that Banco Delta Asia was very effective in targeting North Korea’s financial activities. Now, there is a difference here because North Korea is, frankly, not stupid enough to concentrate all their financial activities in one bank.

In terms of being creative, certainly people criticized sanctions because it is a game of whack-a-mole. And certainly, it takes a lot of resources, it did with Iran, but they are not invisible. As Mr. Klingner said, if C4ADS can find them, the largest banks in the world can find them. And that is the part I would highlight, amongst other things in the legislation, is the due diligence.

If we are not having in particular Chinese banks and U.S. banks looking for these activities, that is the problem, that is the serious problem here.

Chairman BARR. Ms. Rosenberg?

Ms. ROSENBERG. I would just add that China has a variety of strong interests in ensuring that there is no money-laundering oc-

curing in their own economy, not just related to their support or relationship with North Korea. So yes, I agree that China has the capability to go after, investigate, and take action on North Korean money laundering or the use of front companies in the Chinese economy.

And if China, a country with extensive and sophisticated capital controls and that has taken measures, including installing facial recognition cameras at ATMs in order to manage the flow of currency outside of China, then they can certainly do a lot more to recognize some of these trusted agents of the North Korean government that change their names and change their legal entities in order to launder money through China.

Chairman BARR. And Mr. Klingner, in the remaining time, if you could answer the question. And given how North Korea has evaded sanctions in the past, I wanted you to specifically address your quote that every U.N. Security Council resolution is an incremental step forward. Because of Chinese resistance, what we have is incremental law enforcement because we get what China allows us to have.

If the Security Council resolutions are incremental, can we afford to just rely only on those, or do we need to do more in Congress?

Mr. KLINGNER. Yes. I would tell Mr. Putin that sanctions have several objectives. They are enforcing U.S. law, they are imposing a penalty or a pain on those that violate our laws. They put in place measures to make it harder for North Korea to import items for their prohibited programs. It puts in place tougher proliferation or counter-proliferation measures. And we hope, with all the other instruments of national power, that gets North Korea to abide by resolutions and laws. So I believe in doing the right thing, even if it is difficult. Rather than throwing up our hands in despair, I believe in rolling up our sleeves and getting to work.

On implementation—

Chairman BARR. My time has expired. I will have to yield to the gentleman from Illinois at this point, Mr. Foster.

Maybe you can follow up during the remainder of the time.

Mr. FOSTER. Thank you, Mr. Chairman.

And thank you to our witnesses.

The financial sanctions we are talking about seem to be having two strategic goals. The first is to cut off access to the technical components necessary for the development of what looks to be many dozens of deliverable nuclear weapons in the next several years.

What is the rough estimate? It has been widely reported that there is a lot of indigenous capability to make components inside North Korea at this point. So what is the rough amount, what is the dollar figure, a decent ballpark estimate for the dollar figure for how much they have to purchase outside their country to execute that program that everyone is worried about?

Mr. ALBRIGHT. I must confess, when we watch their business of acquiring equipment, and we focus mostly on the nuclear weapons program, they are buying things in orders of millions of dollars and they are buying a lot. What they paid—

Mr. FOSTER. For example, is it a small fraction of a billion dollars?

Mr. ALBRIGHT. Yes. I would say for what—because they also have an infrastructure that has been in place for 40 or 50 years that they have been paying for incrementally. So while I see they seem to have no shortage of cash to buy things for the nuclear program, it is not huge amounts of money that they are using.

Mr. FOSTER. Yes. But in terms of trying to understand what sort of leaks we could tolerate in a sanctions regime designed to shut down their nuclear program, the answer is it would have to be really prohibitively tight.

Mr. ALBRIGHT. But these objects aren't, we have found anyway—and even in the case of Iran where they put in place more deceptive practices in their procurements, companies, governments are pretty good at detecting these things. We get a pretty good readout on a lot of what North Korea has acquired over the years. And we use that both strategically to understand their program and where it is going, but also tactically you get a lot of information about the networks that you can then act on.

The problem has been China is not cooperating. So a company, let us say a German company in China is getting help from its own government to try to defeat the North Korean efforts, but the Chinese government isn't doing very much and they are the ones who should be doing the most.

Mr. FOSTER. So the goal, rather than to actually cut off money, which is a tough thing, is to actually increase information and increase our shaming ability towards—

Mr. ALBRIGHT. But once you identify the goods, you can then move to cut off the financing because they have to pay for it, as my colleagues have talked about. And so I think these things build upon each other. And I think I would agree that going after the money is the way to hurt them the most.

Mr. FOSTER. The Chinese are well-known to be sort of past masters at shuffling around money in black markets. The cryptocurrencies alone are just enormous compared to the amount of fund transfers that we are talking about having to detect, so that is my read.

The second part of the question, the second strategic goal is actually to put pressure on the general economy. You mentioned fuel, luxury goods, things like that. And the strategic goal there seems to be to put the fear in the leadership in North Korea of some sort of general unrest.

And my big worry on that is that if that actually comes to fruition that it will be interpreted as a decapitating strike or something like that may trigger even a preexisting plan to retaliate certainly against our allies, which, as you mentioned, are very hard to defend against given their current nuclear capability.

And so I was wondering if you have any thoughts on that, on the sort of risks that we are heading for?

Mr. ALBRIGHT. I think, again, if the question was directed at me, and maybe someone else can answer.

Mr. FOSTER. Ms. Rosenberg?

Ms. ROSENBERG. In addition to those two goals that you outlined, I would add a third, which has become what I see as a primary goal for Congress in contemplating mandatory, secondary sanctions now. That third goal is, putting pressure specifically on the foreign

or third-country enablers of North Korea's either specific proliferation programs or their economy more broadly.

So going after China in particular, Chinese government entities, or private institutions, banks, and companies, to encourage or compel their greater activity to advance your, as you outlined, goals one and two.

Mr. FOSTER. Yes, Mr. Klingner?

Mr. KLINGNER. One of the functions of the pressure tactics, along with increased information operations and ensuring sufficient defenses, is to put greater pressure on the regime's stability. We want to make Kim Jong-un fearful of regime stability if he continues down the path of defying the international community.

That said, I disagree with those who advocate a regime change through a decapitation strike, either special forces or limited military strikes or a more general invasion. I think we are in a long-term game. It is like the long Cold War strategy against the Soviet Union. We are deterring, defending, pressuring, and seeking to undermine.

Mr. FOSTER. Thank you.

Chairman BARR. The gentleman's time has expired.

The Chair now recognizes the Vice Chair of the subcommittee, the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

And thanks to all of you witnesses for your testimony this morning.

North Korea continues to destabilize Southeast Asia and threaten the safety of the United States and our allies in the region. The aggression shown by Kim Jong-un is equally as concerning as the methods he uses to finance his hostile activity. As the United States develops its strategy to further curb the threat posed by the DPRK, we must consider the profound effect that other nations have in enabling their actions.

Because Kim has proven unresponsive to sanctions imposed by the West, we must consider actions to target and cut off the governments that prop him up. Nations that are unwilling to cut ties with the rogue regimes that encourage mass destruction, suppress their people, and threaten global security should not be in business with the United States of America.

So with that, Mr. Klingner, can you explain the decision that China is faced with when determining whether to do business with the United States or continue financial and technological support with North Korea? And furthermore, is this a geopolitical issue for China, or is their investment in North Korea so substantial that there are severe financial implications to cutting them off?

Mr. KLINGNER. What I would focus on is those entities that are acting against the U.N. resolutions as well as international and U.S. law, so entities that are violating our laws by misusing the U.S. financial system, the money laundering and other criminal acts, or that are engaging in facilitating the North Korean nuclear and missile programs.

So I would focus on more of a law enforcement basis of going after those entities, banks, businesses, individuals, that are violating laws and resolutions.

Mr. WILLIAMS. Okay. Another question, let me follow up. If the DPRK eventually falls, what do you believe will be the fate of the North Korean people who have been exposed to decades of propaganda and oppression? And do you believe that they can adapt to a new way of life or a new form of governance?

Mr. KLINGNER. I think the answer really, sir, is we don't know. They have been isolated for decades. They have been fed a daily diet of propaganda. That said, increasingly, information from the outside world is getting in. So whether they believe the propaganda is a question we debate amongst ourselves. I think it varies by individual and by certainly the access they have to outside information.

So that is one of the reasons, like with East Europe and the Soviet Union, we are trying to get information into the regime as much as we can have the citizens question the propaganda that their government gives them.

Mr. WILLIAMS. Thank you.

Mr. Albright, can you discuss the level of nuclear cooperation that North Korea has with other countries? And who, outside of China, do you believe to be of the greatest concern?

Mr. ALBRIGHT. North Korea had considerable nuclear cooperation with Syria, including essentially building a nuclear reactor which was bombed by Israel in 2007 prior to its operation. After that, it has been much harder to track any nuclear cooperation.

There are suspicions that something could happen between North Korea and Iran and that is a very active area. But as far as I know, nothing substantial has been found.

During the six-party talks, North Korea committed in a Singapore minute not to engage in proliferation. Obviously, we don't believe that is true. But I think it is on notice that if it does engage in significant nuclear cooperation it will be incredibly significant and can trigger or cross a red line that would be very hard for the United States not to take very draconian action, including even military action, if it involved plutonium, weapon-grade uranium, or a nuclear weapon.

Mr. WILLIAMS. Okay, thank you.

And, Mr. Ruggiero, can you discuss the ways in which the U.S. Government exposes and then targets money-laundering activity related to DPRK? And if we impose secondary sanctions, are you confident that we can identify illicit transactions and stop them?

Mr. RUGGIERO. I think what we are seeing now, in particular with China, is that the Trump Administration is using a combination of the Justice Department tools and the Treasury Department tools. On six occasions since late May, they have used those tools to target money launderers in particular, those who are trying to do financial transactions through the United States, whether it is designations, requests for asset forfeiture, or the new one was what are called damming warrants which we are setting that up in U.S. banks, understanding that Chinese banks were going to do the transactions through U.S. banks.

We need more of that. We need nongovernmental organizations exposing these networks and we need the U.S. Government in particular putting the right amount of resources, like we had on Iran,

on this problem. And I am not sure that latter part is happening yet.

Mr. WILLIAMS. Thank you.

Thank you, Mr. Chairman.

Chairman BARR. The gentleman's time has expired.

The Chair recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Mr. Chairman, I want to commend you on this bill draft. I look forward to working with you on it, and I look forward to cosponsoring it.

Chairman BARR. Thank you.

Mr. SHERMAN. But I have been doing this for 20 years. And for 20 years—I want to applaud you for getting these witnesses here, I have heard them often, and they have enlightened me—I have sat on the Foreign Affairs Committee, and Administration after Administration, expert after expert has come forward and we have gone from no nuclear weapons in North Korea to hydrogen bombs and near-ICBMs in North Korea.

What is less well-known is that we have seen a 50 percent increase in the real GDP of North Korea, even while this regime is subject to sanctions, and then we are told we are going to change this with, “unprecedented sanctions,” which just means a little bit more than what we have been doing before.

Now, hydrogen weapons, ICBMs, 50 percent GDP growth, some would say our policy has been a failure. But viewed another way, our policy has been a tremendous success, a success for the political class in Washington. We have been able to tell Americans we are doing all we can to protect them and don't blame us, and at the same time we have avoided doing anything that is difficult for the political class in Washington.

What would those too difficult things be? The first would be to move beyond company sanctions to country sanctions. Because these witnesses are experts in how we can tell China goes after this bank instead of that bank, but as long as China wants North Korea to be relatively stable, they will find a bank that will do business with them or they will set one up.

And yet, country sanctions would be very difficult for the political class here in Washington because that would really concern big companies who would wonder whether there is some risk to their supply chain.

The other thing we haven't done because it is politically difficult is to set realistic objectives. We keep banging the table and saying we are going to get this regime to give up all its nuclear weapons. Saddam's dead, Gadhafi's dead and Kim Jong-un does not want to join them and he is not going to give up all his nuclear weapons. And if he thought his regime was falling, he would use them.

So I want to commend you, Mr. Chairman, for the more realistic objective you have in this bill, because you sunset it upon verifiable limits on the nuclear weapons program. We might achieve those. So you have done something that those who spend their time on foreign affairs have been unwilling to do, and you have taken a very constructive step. But I have seen this go on.



Let me ask Mr. Albright, if Kim Jong-un really thought his regime was going down, would he shrug his shoulders and go to The Hague for trial or would he use his nuclear weapons?

Mr. ALBRIGHT. I think if there was a conflict going on, I would imagine that he would use them. But if he is knocked off by some of his military generals, then he very well may not use them. So I think it depends on how this unravels.

Mr. SHERMAN. So we can hope that they are saner and more peaceful than he is.

Mr. ALBRIGHT. I think they would be moving to survive, and I think they would want to accommodate the neighbors.

Mr. SHERMAN. I will point out, Saddam's people didn't do that to him, Gadhafi's people didn't do that to him, and many of the people around Saddam and Gadhafi would have been worse than their leader.

How has the North Korean economy grown by 50 percent—I am trying to achieve 50 percent economic growth for my country—in spite of all these sanctions, Ms. Rosenberg or anybody else?

Ms. ROSENBERG. The first best answer to that is because they have been allowed to do that by a broad culture of noncompliance and nonenforcement with sanctions.

Mr. SHERMAN. Yes. Even if there were no sanctions, 50 percent economic growth, but I would also want to put this in context. Their economy is only \$15 billion today. They use as much oil in the whole country as 150 gas stations. I have 150 gas stations on Ventura Boulevard. They grew from a very small base and they are still very small, which makes the whack-a-mole a little bit more difficult because we are dealing with relatively small moles.

I yield back.

Chairman BARR. The gentleman yields back.

The Chair recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman.

And I thank each of you for your expert witness today and for the very important role that you play in these areas.

As you may know, I authored an amendment to NDAA that was adopted. It would prohibit the Defense Department from doing business with Chinese entities that provide material support to North Korea's cyber attacks.

Earlier this year, I also led efforts to punish the Chinese government-affiliated firm ZTE, located in the USA, for violating export controls and selling embargoed technologies to the North Korean government, which resulted in a billion-dollar fine.

Mr. Ruggiero, in your opinion, should my amendment capture ZTE? Is this an appropriate response? And would selling embargoed technologies to North Korea to be presumably used for cyber capabilities qualify as material support for North Korean cyber attacks?

Mr. RUGGIERO. On the amendment in terms of anything that suggests that firms need to do better at identifying North Korea transactions and North Korea companies, and I think an amendment like that and the bill that is proposed by the committee, the main goal is diligence and making sure that DOD and others do not do transactions with companies in China.

On cyber, I would just point out that there has been some focus on North Korea's cyber. There have been some reports recently, I believe this month or this week, that North Korea is looking at Bitcoin and other cyber-enabled technologies to avoid sanctions, including trying to steal Bitcoin I believe from South Korea. So that is certainly a different turn on their illicit activities.

Mr. PITTENGER. Do you believe these fines are an effective deterrent?

Mr. RUGGIERO. I think ZTE is a very interesting case. I think that everybody would equate ZTE with a large Chinese bank or large or medium-size Chinese bank. And I think, as you well know, but others might forget, that ZTE actually agreed to that fine and it was because ZTE was caught doing the transactions.

And I would also point out that there are some North Korean front companies that are caught up in the ZTE—

Mr. PITTENGER. Do you think, though, that it will be a deterrent?

Mr. RUGGIERO. I think, again, ZTE is—and I think for the Chinese leadership, look, if you are a senior official in the C suite of a Chinese bank, you have to be worried right now.

Mr. PITTENGER. Sure.

Mr. Klingner, what other entities like ZTE provide the most material support to any North Korean cyber attacks?

Mr. KLINGNER. I think a lot of the North Korean programs, as I said before, are indigenous, but they do need technology and components and knowledge.

Mr. PITTENGER. Any specific ones you have in mind?

Mr. KLINGNER. I don't know specific companies right now, sir.

Mr. PITTENGER. Would you support blocking those firms from doing business with the U.S. or with the Department of Defense?

Mr. KLINGNER. I think we should have a provision where you can do business with North Korea or you can have access to the U.S. financial system. So I think that is a choice that companies should have to make.

Mr. PITTENGER. Yes, sir.

Mr. Klingner, from a strategic standpoint, whenever we discuss responses to North Korea, as you said earlier, we are really talking about U.S.-China policy. And how can we better compel the Chinese government to work with us on this issue?

Mr. KLINGNER. I think we need to separate law enforcement from diplomacy. We can continue on the U.N. path and cajoling and imploring and pressuring China to do more to implement required U.N. sanctions, but we don't need Chinese permission to enforce U.S. law. So we made clear to them that we are not going to negotiate away our law enforcement. We have had incrementally better U.N. resolutions, but we should not incrementally enforce U.S. law.

Mr. PITTENGER. Thank you.

Ms. Rosenberg, could you elaborate on data sharing between the private and public sector that you mentioned in your testimony and what we could do, what type of enhancement and capabilities that could provide us and assist our efforts?

Ms. ROSENBERG. Sure, thank you for the question. In my written testimony, I outlined a couple of ideas that I think would be a good opportunity for Congress to take action on increasing data sharing among financial institutions. So pursuant to Section 314(b) of the

USA PATRIOT Act, instructing the Administration to offer some new guidance and adaptation in order to facilitate more information sharing between financial institutions within U.S. jurisdiction. That will also transfer to their—

Mr. PITTENGER. Could this be done, protecting our privacies while enhancing our capabilities?

Ms. ROSENBERG. I believe that is absolutely feasible. To be sure, it is not a walk in the park. There are a lot of serious civil liberties and privacy considerations here. But if we can pioneer this, as has been successfully done for the sharing of terrorism financing information, then it can and should be done for proliferation finance information as well.

Mr. PITTENGER. Thank you. My time has expired. I appreciate your comments.

Chairman BARR. The gentleman's time has expired.

The Chair now recognizes the gentleman from Arkansas, Mr. Hill.

Mr. HILL. I thank the chairman for this hearing.

And I particularly appreciate the expertise of our witnesses. And I share Mr. Sherman's compliments of their longstanding work on this issue, and appreciate your service for our government in office and out.

Bill Newcomb from Johns Hopkins was here a few weeks ago to talk on this topic and he basically, in response to my question—I asked him, I said, we have been dealing with this, as you have, for 3 decades now, 4 Presidencies, and I asked him, are we ever going to get serious about sanctions on North Korea? And why weren't these great sanctions proposed to President Clinton or President Bush or President Obama?

And he said, "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—meaning North Korea—as a national security vital interest."

Boy, that confused me because I watched TV in 2002 when President Bush declared North Korea a part of the axis of evil.

So I am confused about why North Korea is so low on your chart, Mr. Ruggiero. You have been in government. Why is it that we are just now getting serious about North Korea? Tell me your top three reasons why for 20 years we have not sanctioned North Korea in an effective way?

Mr. RUGGIERO. It has not been the foreign policy priority. That is the bottom line. Whether you look at getting rid of the sanctions against or giving the money back on Banco Delta Asia in 2005, whether it is, and this is going to be bipartisan, whether it is removing North Korea from the state sponsor of terrorism, as Dr. Albright said, right after we discovered that they built a reactor in Syria, or whether it is looking at this Congress approving, insisting that North Korea be evaluated as a primary money laundering concern. And when you look at that detailed information provided last year, you see that financial transactions went back all the way to 2009, you start to ask the question, what have we been doing over the last 10 years?

And the answer unfortunately is that it has not been the foreign policy priority. And when I hear people suggest that this new Ad-

ministration policy is the same as the prior one, that is just frankly not true. As I have said, they have gone after China six times, they have gone after Russia, they have moved North Korea up the chart, but there is a lot more to do.

And to the question of how are we going to get from this point to denuclearization, the point I would make on this Administration is, Secretary Tillerson said it is a dial and it is at five or six, it is the United States that is determining that it is not at 20 right now, and that is what we really need and it should be moved to an extreme level so that North Korea will start to feel that impact.

Mr. HILL. I appreciate that. And I appreciate the work Ambassador Haley is doing in the United Nations, but I don't think it is a substitute for increased pressure by the United States. And I thank the chairman for bringing this draft bill before us.

You said, Mr. Ruggiero, in your testimony that another suggestion was mandated inspection for North Korean vessels. Is that a United Nations sanction? Is that an American sanction? How does one do that and be lawful, how does one do that in a legal manner?

Mr. RUGGIERO. Right. I think the U.N. sanctions use the phrase, and even the new resolution uses the phrase, "reasonable grounds," that some kind of sanctions violation or prohibited material are being transferred.

I believe, just as we did with Iran, you can create a group of like-minded countries, probably South Korea, Japan, Australia, the U.K., France, and Germany, that say we interpret that clause to now say there are reasonable grounds that every shipment that North Korea puts back and forth from North Korea is a violation and that it is subject to inspection.

Of course, there are international laws with regard to flag-state consent and master consent and all of that, that would have to be worked out, but that would be a key element, just like the proliferation security initiative in the 2000s.

Mr. HILL. Thank you, Mr. Chairman. I have other questions, but I yield back.

Chairman BARR. The gentleman yields back.

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

Mr. DAVIDSON. Thank you, Mr. Chairman.

And thank you to our guests. I really appreciate your testimony, written and verbal, here. I have enjoyed your dialogue on the questions.

And I just want to say that perhaps we are shooting for too low of a goal. It seems that our goal there is a non-nuclear peninsula in Korea except that most of the parties don't really want that outcome, and so it makes it a pretty hard outcome to attain.

We seem to desire it, but we may be one of the few. South Korea doesn't want the North to have it, and as long as we have their back, I guess they are okay that they don't have it themselves. Japan doesn't want it, but the list might stop there, frankly.

And so I think it might make sense to set a higher goal, which should have been our goal since 1950, which is an end state that does not have the United States defending the North Korean Peninsula or the Korean Peninsula altogether.

What would it take to do that? Well, it would take peace. It would take the same sorts of conditions that led to the United States minimizing our presence in Germany where the East and the West have reconciled. And so we haven't really moved down a path that pursues that. We have moved down a path that continues to escalate and continues to make seeking nuclear weapons somewhat rational for a really irrational guy, generation after generation.

So I think that begin with the end in mind, maybe perhaps why we have failed. Along with lots of other things that my colleague Mr. Hill highlighted, failure to act in the past.

I do feel that we have a good track record in Iran to build on. And we have had good track records in other situations to use economic action to hopefully pursue a peaceful outcome to our desired end states.

And I get that there are some concerns about trade with China. They are certainly a key part of our supply chains, but they are also a vital part of North Korea's supply chain. And at some level, when you look at the risk on supply chain management, I think we need to get to the point where we use all of the levers of U.S. power to force, just like banks are forced to know your customer, the rest of the world needs to be forced to know your supplier. And part of that will be hard in China. But to enforce these good sanctions that I think are highlighted in the North Korea Sanctions and Policy Enhancement Act, it may take that.

And, Mr. Klingner, I think you highlighted a number of those things in your testimony. And I would just like to say, or ask, how is it that we can take action down to the small manufacturing company in China that has allied themselves with someone from North Korea and they are moving products, services, and cash back and forth? What tangible steps can we take to close off that pipeline?

Mr. KLINGNER. I think there are a number of things and, first of all, it is really having the political will to do it. I have been surprised over the years that the U.S. has hesitated to enforce its own laws to the same degree to North Korea as we have done to a greater degree on other countries for far less egregious violations.

So I think that the three reasons, I might say, are naivete, wishful thinking, and lack of political will. We have gone down the diplomatic path a number of times. We have tried freezes before and they didn't work. I think we need to give greater resources to the intelligence community and the State Department and the Treasury Department and sort of unleash the law enforcement.

If you talk to officials in the government, they will say, yes, for years I have had a list of Chinese and North Korean violators in my drawer, and I am sort of allowed to take out 10 or so every time there is a provocation and then I have to put the rest back in the drawer. I think it is time to empty the drawer, as it were, of going against all those entities that we have evidence for.

Mr. DAVIDSON. Yes, Mr. Albright?

Mr. ALBRIGHT. I think many of these companies are becoming multinational and some of them come to the United States for their subcomponents. And I think what U.S. companies should be doing and they haven't been doing it is gaining assurance from those Chi-

nese companies in writing that they will control the end use of their product that contains U.S. goods.

I think that it is in U.S. law, but it should be applied much broader to start to push these Chinese companies. If they want to do business with the U.S., they have to meet our ethical and legal standards that you are not arming, in essence, our adversaries.

Mr. DAVIDSON. Thank you.

My time has expired, but I get that my conclusion is that we have an existing law in place, we don't really need more laws, we need to enforce our existing laws.

I look forward to any other feedback with our office to help bridge that gap. So thank you for your testimony.

Mr. Chairman, I yield back.

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

The gentlelady from Utah, Mrs. Love, is recognized.

Mrs. LOVE. Thank you.

Thank you all for being here.

In the wake of North Korea's sixth nuclear test, the proposal was circulated among U.N. Security Council members that would have frozen North Korea's leaders' assets. Could our witnesses just very quickly comment on the desirability of expanding the prohibition in our draft legislation to include the members of the North Korean government and the DPRK Workers' Party?

We can start with you, Mr. Albright.

Mr. ALBRIGHT. Yes, I think it is useful to do.

Mrs. LOVE. Okay.

Mr. RUGGIERO. I think there is already an Executive Order on that. I would go in a different direction. I would say the issue on leadership assets is identification of those assets. So anything that can be done to incentivize those folks in banks in Europe in particular that might have information on leadership assets, I think that would be more beneficial.

Mrs. LOVE. Ms. Rosenberg?

Ms. ROSENBERG. I would certainly agree. And not just gathering that information and reporting back to the United States as a law enforcement matter, but also being able to share that among other banks because there is never an instance where money laundering exists only in one financial institution. That will allow the variety of banks where these different assets are located to understand them as a network and to stop it.

Mrs. LOVE. Okay.

Mr. KLINGNER. I would absolutely go after leadership assets. Last year, the U.S. finally designated Kim Jong-un, and I believe nine others, for human rights violations, so we have identified Kim Jong-un in the past. There is an Executive Order issued in January, 2015, that gives us the authority to sanction any member of the North Korean government simply for being a member of the North Korean government. So I think we can and should go after not only Kim Jong-un, but the other senior leaders.

Mrs. LOVE. Okay. Along those same lines, Mr. Klingner, could you discuss the potential for North Korea to assist countries such as Iran in developing nuclear weapons and advanced ballistic missiles?

Mr. KLINGNER. As Mr. Albright was saying before, I think there has clearly been a missile relationship between North Korea and Iran. The first Shahab-3 missiles that Iran paraded were actually a hundred percent made in North Korea, they were No Dongs and given a local paint job.

The information on nuclear cooperation is much more difficult to get. We know North Korea was engaged in nuclear cooperation with Pakistan through the A.Q. Khan network and Libya and others, but the information with cooperation with Iran is much more difficult to get, particularly outside of government.

I think there clearly is a relationship on the nuclear side between the two countries, but I think it is very hard to get particularly unclassified information on it.

Mrs. LOVE. Mr. Albright, here is my connection between the two. I am concerned that if we continue to just try and be as—and we want to be as diplomatic as possible, we want to be able to work with people who are willing to work with us. However, we have seen North Korea be incredibly defiant. We have seen them do test after test after test.

To me, and I don't know if you have these same concerns, but it seems as if they are not a threat by itself, that the proliferation of these activities can support nuclear ambitions for other foreign regimes. Are you concerned about that at all?

Mr. ALBRIGHT. Certainly. I think you have to be concerned with North Korea, because they like to go and sell things of value, and their nuclear assets are of increasing value. So you have to worry about that a great deal and that has to be part of what is watched for and in the messages delivered to North Korea.

I don't think it was a coincidence that the Director of the CIA was on FOX News the other day raising this issue. And so I think it is important to send the signal that if North Korea crosses that line and is willing to sell weapons-grade uranium, plutonium, or nuclear weapons, that we will probably respond militarily to take out that regime.

It may be a bluff, but I think it is important that that line be maintained and I would say enforced. And North Korea will get the message. They don't want to commit suicide.

Mrs. LOVE. I just have one more question. Given Beijing's reluctance to take a harder line with North Korea, what arguments should be brought to bear in order to convince the Chinese that pressuring the dictators of North Korea is in their self-interest?

Mr. ALBRIGHT. One, China wants to be a responsible member of the international community. So a lot of these arguments on applying sanctions on Chinese companies are the same arguments we used in the 1980s against Germany. It was at that point, arming Pakistan, Iraq, Libya, Iran and probably several others with the wherewithal to make nuclear weapons. So I think these are not new arguments. And China wants to be responsible and so it should start to act that way.

Mrs. LOVE. Thank you very much.

My time has expired. Thank you, Mr. Chairman.

Chairman BARR. The gentlelady's time has expired.

The Chair now recognizes the gentleman from Indiana, Mr. Hollingsworth.

Mr. HOLLINGSWORTH. Good morning. I really appreciate everybody being here.

And as everyone has reiterated already, this is an important and timely topic and something we need to take with grave earnestness. And so I appreciate the consistent testimony that everybody here has provided.

One of the things that I really wanted to talk about was making sure that we have partners that are engaged in this as well. And Russia comes to mind, and my concern has continued to be that they don't have an interest in enforcing sanctions at the same level that we do and a willingness to combat this issue. The more the United States continues to be, I will use the word, "distracted," and I don't mean that lightly, but distracted by North Korea, the better off they may see themselves.

And so, can you talk a little bit about what we can do to engender some cooperation and willingness on behalf of Russia to be able to participate in whatever solution this looks like? And that is for any of the panelists.

Ms. ROSENBERG. Thank you for the question for us. I think a good strategy is one that we have discussed here primarily with regard to China, but in this case applying it to Russia, which is, using sanctions or other law enforcement actions to go after specific Russian entities that are acting in violation of sanctions or specifically in violation of the U.N. sanctions so—

Mr. HOLLINGSWORTH. To what extent do you think the Russian government would be able to shield those companies from the ill effects of those?

Ms. ROSENBERG. It is possible that they would try and do that, certainly rhetorically, such as the dismissive rhetorical gestures that we were discussing from President Putin. Nevertheless, if those companies want to use U.S. dollars, then they won't be able to if U.S. sanctions enforcement or law enforcement measures prevent them from doing that.

And any Russian company or bank that wants to stay in the good graces of the United States will be very reluctant to facilitate such sanctions evasion activity going forward, notwithstanding what their political top cover may offer them at home.

Mr. HOLLINGSWORTH. So you really believe that these can be efficacious, even without participation from the political sector in Russia?

Ms. ROSENBERG. I do. And we have seen that in other instances not related to North Korea. For instance, in Iran, in the era before there was broad international consensus about the need for strong sanctions, going after companies and speaking directly to them was a way to have them get out far in front of their own governments on their willingness to abide by sanctions.

Mr. HOLLINGSWORTH. Great. So the second question I have, and really, I am just a business guy at heart, so one of the things I think about is, what does success look like? When will we know that this has been successful? What does that look like? And what is the next step after that?

Obviously, we want, to the greatest extent possible, to either slow down or stop the technical progress both with ICBMs and nuclear/hydrogen weapons. But what does it look like after that?



What is the next step? We put in place these very, very tight sanctions and we just continue them forever? Or kind of tell us a little bit about what phase two would look like beyond putting in sanctions that theoretically would work?

Mr. ALBRIGHT. I think one is—I should emphasize we haven't talked about this that much. The point of this is to have meaningful negotiations. That would be a sign of success. If North Korea, without accepting benefits, that is one new change in this Administration compared to others. The benefits come after the concrete actions, not a reward for negotiating.

But if there are meaningful negotiations that are toward denuclearization, creating limits on their nuclear program, you see intrusive inspections. Inspectors have never gone outside of Yongbyon in North Korea, and yet we know there are other sites.

And if there is movement toward a peace treaty, that is also something that is actually important to work into this whole process.

So I think on that side, we know it when we see it. And with the new criteria that are being used that are really built on avoiding the mistakes of the past, I think that we will know it when we see it.

Mr. RUGGIERO. I would just—I agree with most of that. I would caution that we want to make sure we get out of the trap of negotiations' sake. I think from my perspective, a freeze is not as valuable as some people think it is. I think the next step, if we are talking about negotiations, is a demonstratable step by North Korea of its commitment to denuclearization, which would flip the negotiations on its head.

And it used to be we freeze then we drag them to denuclearization. We need to flip that on its head. But we also have to recognize that this might not be the regime that is willing to do that. And if sanctions can't get them there, then perhaps we need to start having that conversation.

Mr. HOLLINGSWORTH. Your second point notwithstanding, I very much agree with the first as well. I just want to comment on the second in that making sure we don't just freeze here at the precipice of ICBM, at the precipice of being able to launch a nuclear attack, but instead move them back, because we have seen their willingness to renege on promises before. I don't want us to be a month, a year, a year-and-a-half away from an ICBM and find them reneging in the future.

And with that, Mr. Chairman, I will yield back.

Chairman BARR. I thank the gentleman. The gentleman's time has expired.

The Chair now recognizes the Chair of our Oversight and Investigations Subcommittee, and also a member of the House Foreign Affairs Committee, the gentlelady from Missouri, Mrs. Wagner. She is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman, for hosting this very timely hearing.

In August, I traveled to Korea and Japan and China to dialogue with our allies in the peninsula. And I had the opportunity to visit not only the DMZ, but also to visit Dandong where I watched Chi-

nese trucks loaded with goods drive across the China-Korea Friendship Bridge into North Korea.

Seventy percent of North Korea's trade passes over that bridge. And it was a stark reminder that the United States should prioritize secondary sanctions against the Chinese companies and banks that sustain the regime.

Mr. Ruggiero, I have had the pleasure of hearing your testimony in the Foreign Affairs Committee before. You wrote that North Korea is the fourth-most-sanctioned country in the world. And given the recent September U.N. Security Council resolution, how would you rank North Korea today, given that certain Chinese investments and trade efforts are grandfathered in or exempted from the August and September U.N. sanctions? How effective do you think the resolutions will be?

Mr. RUGGIERO. I would just point out that February 2016 was number eight. And when I testified before this subcommittee in mid-July, it was number five, so it is moving up the ranks. But it has a long way to go, unfortunately.

The way I like to look at it is very similar to Iran. In 2010, we had Resolution 1929. That was really the foundation, and sanctions passed by this U.S. Congress and implemented by the prior Administration were what put Iran over the edge and led it back to the negotiating table. We need that here. We have the U.N. foundation, but what we need is the U.S. sanctions.

And I would just say, it is concerning to hear the Treasury Secretary say, well, we are going to wait and see if the Chinese implement the U.N. resolution. I think that is the wrong approach. I think what we should be moving forward with right now is U.S. sanctions against Chinese banks. We should not give China a veto over U.S. sanctions. They might have a veto in the U.N., but they should not have a veto over U.S. sanctions.

Mrs. WAGNER. I agree.

Mr. Klingner, barring a threat to the Kim regime's very survival, Kim will never come to the negotiating table in good faith, I believe. We must change Kim's financial calculus, as we have discussed here, which is why comprehensive secondary sanctions are so critical, I believe.

I appreciated your statement on increasing inspection and interdiction of North Korean shipping. Would you support mandatory secondary sanctions on ports that don't implement required inspections?

I agree we must pay much more attention to this.

Mr. KLINGNER. I agree. And that is something that the Congress has been looking at, particularly if a port doesn't implement required sanctions, then measures such as any ship cannot transit that port and enter the United States waters for 6 months or so. So it is an area that has been looked at.

One thing we have been hampered by in the U.N. resolutions is that all of them have been passed with what is called Chapter 7, Article 41 authority where we are not allowed to board a ship on the high seas, even if it is suspected of carrying nuclear missile contraband. So we have been advocating Chapter 42 which would give us the authority to have Coast Guard or law enforcement agencies intercept and board ships.

Mrs. WAGNER. Doesn't the recent package allow us to board now and others on the high seas in terms of member states? I think they have some new tools, don't they, to stop high-seas smuggling of these prohibited products?

Mr. KLINGNER. I believe that was included in the original U.S. draft, but it was something that I think was tossed overboard, as it were, that did not make it in the final resolution.

Mrs. WAGNER. Yes, Mr. Ruggiero?

Mr. RUGGIERO. I think that it is the "reasonable grounds" standard, but it still goes back to what Mr. Klingner is saying. You need flag-state consent or masters consent in order to board the ship.

Mrs. WAGNER. Okay, quickly here.

Mr. Albright, in my view, North Korea already has nuclear weapons. For my constituents without access to classified information, it would be helpful if you can explain from public sources how many nuclear weapons the Kim regime may have and where they may be.

Mr. ALBRIGHT. Yes. We estimate they have 13 to 30 as of the end of 2016. It is a rough estimate. We have no idea where they are.

Mrs. WAGNER. Thirteen to—

Mr. ALBRIGHT. Thirty. And I think the U.S. Government estimates are higher than that. But I have worked on this problem since 1985 and I have visited North Korea a couple of times, met their nuclear people, and I think they are not giants technologically and they encounter problems. So that estimate tends to be lower than the U.S. Government one, but it is still a significant number and it is growing.

Chairman BARR. The gentlelady's time has expired.

Mrs. WAGNER. Thank you, Mr. Chairman, for your indulgence.

And thank you, Mr. Albright.

Chairman BARR. Thank you.

And because of the interest in the witnesses' testimony, Members here I think are interested in a second round of questioning. If we can seek the indulgence of the witnesses for a brief round, we would appreciate that.

And with that, I will recognize myself for an additional 5 minutes of questioning.

Just to revisit this issue of effectiveness of sanctions, and you all heard the comments and questions of my colleague from California, Mr. Sherman, on that point. That over the last several decades, there has been maybe a lower priority, but there have been sanctions nonetheless on North Korea. And yet, we have seen a continuous belligerence, a continuous development and an acceleration of the development of the nuclear program and the capabilities of the Kim regime, particularly in recent years.

So my question to anyone who wants to answer is, what is different, if anything, about the foreign policy, the sanctions efforts of the current Administration, particularly the efforts of Ambassador Haley and the U.N. sanctions packages that she has been able to secure at the United Nations?

We will start with that question and start with Mr. Albright.

Mr. ALBRIGHT. Yes. I think one is I would like to go back. U.S. policy has been to try to stop North Korea from acquiring goods. And in the 1980s and 1990s, a lot of effort was made to kick them

out of Europe because their missions would go to companies and buy the goods for their nuclear program. And they were kicked out.

What was not anticipated was that they would move to China and set up shop there and buy the same goods from European companies, get them to China and then send them by truck up to the nuclear program.

And so the problem has been, and this is, I would say, the most important change to me, this Administration, is they are willing to risk trade conflict with China to solve this problem. And since China has set up shop in North Korea, the Administrations have not been willing to do that until this one. And I think that is critical.

Mr. Ruggiero, as you answer that question, you have read the draft proposal, the draft bill that we have presented to you. Could you comment on that bill and the extent to which it would ratchet up this pressure through secondary sanctions on the regime?

Mr. RUGGIERO. From my approach, we tend to get ourselves in this provocation response cycle and we have done that over the last 10 years. But I agree with Dr. Albright that this Administration has gone after China and Russia to an extent that we haven't seen before. It needs to be sustained.

I think in the past, we have convinced ourselves—I personally have written, I have delivered, I have been in the same room when these have been delivered, we give China a list and we convince ourselves we have done a tough way forward and the Chinese just sort of hand wave and we are okay with that.

In terms of the legislation, I noted earlier the due diligence component. But I would also, beyond the various legislations that are out there, it is oversight, because I think that the key aspect here is ensuring that these bills that eventually become law are actually implemented.

There are many companies that are still not sanctioned and should be subject to sanctions, even from the sanctions law last year.

Chairman BARR. And could I just ask, Mr. Klingner, on the heels of that answer, again, revisiting your comment, that the importance of the distinction between the U.N. incremental enforcement and the U.N. sanctions, the two rounds of U.N. sanctions, and Congress and the Administration and the United States acting independently. How much more pressure would the legislation being proposed or U.S. independent additional action on secondary sanctions, how much of a difference would that make above and beyond the most recent round of U.N. sanctions?

Mr. KLINGNER. Right. As I have said, the U.N. sanctions, each one is incrementally better than the last. We can be cynical or positive about moving the ball a few yards down the field. But the U.S. actions, I think, are critical. They are measures that we can do ourselves. We don't need permission by China.

And to be honest, I don't see why we are having a debate about whether we should be implementing secondary sanctions. They are enforcing U.S. law, why should anyone be against enforcing our law to the fullest degree?

So the legislation as well as the oversight through which Congress can hold the Executive Branch's feet to the fire to try to push

them to fully enforce the laws that are either on the books or could be on the books. The three main actions the Obama Administration did last year were really because they were pressured through the North Korea Sanctions and Policy Enhancement Act.

Chairman BARR. I think the difference here is, it is the things that you mention, but it is also an issue of lax enforcement. So enforcement is very, very critical. The U.N. panel of experts points to continued lax enforcement of U.N. sanctions by foreign countries, so these secondary sanctions, I think, are absolutely critical in applying the additional peaceful pressure.

And I will let Ms. Rosenberg conclude on that point. Do you think these secondary sanctions would make a difference from previous efforts?

Ms. ROSENBERG. I do. I think we have seen that happen in the last year and this year as well. And I think it would do more.

One of the challenges about the new U.N. security measures passed this week are that, of course, they are not self-reinforcing and where they rely on a reduction or a cap on, for example, petroleum, that is something that the U.N. will have to do accounting on. We have problems with inaccurate or unavailable data with countries, member states not feeding the data to the United Nations. So I think there is a very high likelihood that we are not going to see compliance with this, even just as a matter of arithmetic and slow and poor reporting.

What that means is that when the United States can impose its secondary sanctions to call out and highlight where foreign countries are not undertaking their requirements as U.N. member states, it will have a major and significant effect in bringing them where they are willing to cooperate to do so.

Chairman BARR. My time has expired.

And I will now recognize the gentleman from Arkansas, Mr. Hill, for a second round of questioning.

Mr. HILL. Thank you, Mr. Chairman.

We also learned in our previous testimony on this subject that in the Standing Committee in the Politburo in China, two of the seven members are from provinces that abut North Korea, and that the presumption is that one gets on the Standing Committee of the Politburo by hitting goals established on economic development, et cetera.

So I am interested in your view on China's seriousness here. And do you think that they can recognize what Secretary Tillerson has laid out quite clearly, that we don't have aims for U.S. presence or Western presence at their border?

And so given that, comment on that Politburo political view from your point of view. And also, do you anticipate that China would be more helpful after they have their significant party congress that I believe is to be held in October? In other words, let's talk about the politics in China, about them understanding the United States' sincerity in ending this issue once and for all.

Mr. Klingner, do you want to start?

Mr. KLINGNER. I think China is as helpful as it needs to be to prevent the U.S. from taking further action on our own. The message that has been given to China, but I think needs to be given and more forcefully is, you don't want a crisis on your border, but your

lack of pressure on North Korea is only encouraging Pyongyang to continue going down that path that you don't like. It is also inducing the U.S. and its allies to take defensive measures, missile defense, et cetera, that China doesn't like, but we are being pushed into it by your ally.

So you can pay me now or you can pay me later. You need to increase pressure or we are going to head toward that crisis you don't want, China.

Mr. HILL. Your assessment of, will their diplomatic or public position be any different after they complete their party congress?

Mr. KLINGNER. I have become pretty cynical about North Korea and China. And I think it is just that they talk well, they implement sanctions for about 1 to 4 months after each U.N. resolution, and then they back off.

Mr. HILL. Mr. Ruggiero, any comment on that?

Mr. RUGGIERO. I agree 100 percent. I think that anyone who believes that China will be more cooperative after the party congress is falling into Beijing's trap again. Everybody said they had a good summit at Mar-a-Lago, and the Chinese were onboard. And it turned out that they were not onboard. Unfortunately, I can do that over the last 10 years. That has happened time and time again.

And to your question on how do we measure seriousness, I think that is a good question. How I measure it is the Chinese should not be closing North Korean accounts, they should be closing their own nationals' accounts. And they should be in Dandong stopping those trucks from going over the bridge. They should be in those companies and saying here are the sanctions, how are you implementing them? They should be in those banks doing the same thing.

Until they do that, they are not serious.

Mr. HILL. I appreciate it.

Dr. Albright?

Mr. ALBRIGHT. I agree. I don't know Chinese politics, so I can't really say. But I would agree with Mr. Ruggiero that we do need signs of seriousness. And I can give an example: If a country wanted to inspect the customs areas at the border with China and North Korea, a country with vital trade arrangements with China, and they weren't allowed in. They were literally blocked by the private company running the customs storage area.

So I think it is these signs that we are looking for. And I would love to see some Chinese busted. I have been involved in Federal prosecutions of at least one Chinese national prosecuted successfully here. He was never or his colleagues were never prosecuted in China. And so I think these signs are critical.

Mr. HILL. So, Ms. Rosenberg, enforcement we know, and upping the ante, but talk about, who is a bigger trading partner of China, the United States or North Korea? And can we use that stick?

Ms. ROSENBERG. There is certainly no question there. And to refer back to the question posed by the Chair at the beginning, what has changed, one thing I will say and apropos of what you have just said is the willingness of the current U.S. President to offer tough rhetoric on North Korea, including raising the possibility of whether trade can and should occur between the United States and China, even if that is just meant to send a really strong

signal, that is different and that has clearly been a huge wake-up call.

So obviously now the devil is in the details. How do you do implementation? And to be frank, when we have seen China comply with other international sanctions frameworks for Iran and Russia, even others, when they have gotten with the program, it has never looked like them saying to U.S. diplomats, who go sit there and pass some intelligence, we got this, we are with you. It comes under a different guise.

And so I would welcome seeing China come forward with its own domestic law enforcement or regulatory action against certain companies as a matter of going after money laundering or prosecuting corruption, which they clearly have an interest to do. And if it happens to have an effect on their relationship with North Korea, all the better.

I don't need them to get out in front. And they will have a problem politically looking like they are capitulating to U.S. sanctions, but if they do it as a measure of domestic financial sector integrity, all the better.

Mr. HILL. I agree with that.

Thank you, Mr. Chairman.

Chairman BARR. The gentleman's time has expired.

The Chair now recognizes the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the witnesses for appearing as well.

And I would indicate that we have had many duties related to some adverse circumstances that we have encountered related to bad weather, and that is putting it mildly, and these things have attracted my attention, so my apologies for not being here for the entirety of the hearing.

I am concerned about the sanctions. I do have some questions that probably have already been posed, so please forgive me for being redundant or superfluous.

My initial question is, if we can perfect the sanctions as codified, what would be the impact on China, first? And then I would like to move to a secondary portion of the question, which relates to the impact on North Korea.

So on China, what would be the impact if we perfect these sanctions as codified?

And I will leave this question to whomever would like to respond initially.

Ms. ROSENBERG. Thank you for the question. I think that a way to perfect or improve upon the sanctions that exist, and they are extensive and they are powerful, is to go after them prosecuting an aggressive strategy of implementation and enforcement.

And that may or may not include secondary sanctions measures, but by making an example of these sanctions and calling out the companies in China, certainly in North Korea, entities and persons, but also in China and other international facilitators of North Korean proliferation entities or its economic activity, that is a strong and important way to improve upon these sanctions and make them more efficacious.

Mr. GREEN. Thank you.

The efficacy of the sanctions, please, would you care to respond, sir?

Mr. RUGGIERO. I would just take a step back. There is obviously going to be an impact on Chinese companies and North Korean companies. But I think as Dr. Albright noted, China has been a problem for a long time in terms of proliferation, whether it is with Iran or North Korea.

A successful goal could be that China finally realizes that just issuing a notice from their commerce department with a list of goods that are prohibited is not enough, that they need to do more, engaging their own companies, engaging their banks, and law enforcement actions, inspections at the border, authorizing other countries to do those inspections.

The Chinese are, in a lot of ways, the center of a market and it is the market for proliferators and that is a problem. And until they realize that they have to change their ways, we are unfortunately not going to be successful.

Mr. GREEN. Let me follow up with this question. If we perfect the sanctions proposed in their entirety, what will be the impact on North Korea?

Mr. ALBRIGHT. One impact would be probably their gas centrifuge program that makes weapon-grade uranium would probably stop at some point. It may take a year or two. But they do depend on what we would consider perishable goods in order to operate that plant and they don't make those goods.

So I think if we had a perfect set of sanctions, I think you could cause serious damage to the progress of their nuclear program. You couldn't stop what they already have, but you could stop more.

Mr. GREEN. Please do not assume that I have a position based upon the questions I am posing. I think that these are some things that I just need to hear answers to.

The next question has to do with China's position that if the sanctions create turmoil to the extent that North Korea becomes a government that no longer exists for all practical purposes and people start to flood into China, they have always raised that as a possibility. Is it possible that these sanctions could create such a circumstance if completely implemented against North Korea? Because China is a means by which we get to North Korea, so would that create the breakdown in governments?

Mr. ALBRIGHT. That is China's fear. There has been some newer talk in China that, in anticipation of that, the people's army would occupy part of North Korea in order to block refugees coming into China and also to build housing for—

Mr. GREEN. So the expectation is that China would somehow seal North Korea such that people in North Korea could not migrate into China?

Mr. ALBRIGHT. There is discussion of that. It has been on the table a long time, but the discussion is recurring. But China fears that and that is part of the problem. China fears that the instability of North Korea could create problems for itself, and it worries about that more than it worries about North Korea's nuclear weapons. So it is at the crux of the matter and U.S. has to solve that problem for China.

Mr. GREEN. Thank you, Mr. Chairman.



Chairman BARR. Thank you. The gentleman's time has expired. The Chair now recognizes the gentleman from Ohio, Mr. Davidson.

Mr. DAVIDSON. Thank you, Mr. Chairman.

I yield 1 minute to the chairman.

Chairman BARR. Thank you.

And very briefly, Mr. Ruggiero, just to follow up on this hearing and the legislative proposal to impede North Korea's access to finance that has been discussed here today, would the passage of this legislation that is being proposed or the mere introduction of a bill that directed Treasury to impose these additional secondary sanctions, would that, in your judgment, give Secretary Tillerson and Ambassador Haley additional leverage in their negotiations with China and with Russia with respect to North Korea?

Mr. RUGGIERO. I think that is right. When you look at the Comprehensive Iran Sanctions and Divestment Act of 2010 (CISADA), only two banks were designated: China's Kunlun Bank; and Iraq's Elaf Bank. Elaf Bank was relieved of those sanctions. There were many threats associated with that and banks changed their compliance procedures because of that bill.

Chairman BARR. Thank you.

I yield back to my friend from Ohio.

Mr. DAVIDSON. Thank you, Mr. Chairman.

South Korea has announced that they plan to participate in some decapitation exercises. This is kinetic, not financial, presumptively. And I guess I am just curious from the panel what is your assessment of North Korea's reaction to the rhetoric, if not in fact the deeds.

Mr. KLINGNER. Actually a year ago, the South Korean minister of defense of the previous administration had announced that they have a special forces unit whose mission is decapitation. He also emphasized they have surface-to-surface missiles. And then just a week or two ago, they demonstrated a practice attack using their F-15Ks. And they had announced that they would conduct such an attack if they detected signs that North Korea was about to attack.

Pyongyang responded, well, we will preempt your preemption if they detect indications that South Korea is going to attack.

So one of my concerns is the risk of miscalculation by either Korea or the U.S., and that we sort of stumble across the red line in some kind of kinetic military action based on very difficult-to-discern intelligence.

Mr. DAVIDSON. Thank you. I think that is accurate, personally.

I think I am also curious, at some point, doesn't this make having a nuclear deterrent, given their massively weaker military stature, a rational choice for North Korea to pursue?

Mr. ALBRIGHT. Not really. No one is planning to invade North Korea. The decapitation idea is a reaction to North Korea strikes, some of which happened against South Korea, the sinking of their ship by the North Korean submarine, the artillery attack where they did not respond, and they have said next time we will.

So I think these kind of actions, I think, have to be put in context, but the background is no one is planning. Saddam had enemies, Libya had enemies.

Mr. DAVIDSON. Yes, I understand that—

Mr. ALBRIGHT. North Korea doesn't have anybody who wants to invade them so they don't need nuclear weapons.

Mr. DAVIDSON. Yes, I understand what our perspective is and I understand our probability of invading North Korea is really low. I think that on the other side of the border, they don't understand that, frankly. I think when we do our rotational efforts and they see division after division after division getting experience in Korea, if I am a North Korean, that looks a lot like people are preparing to do that. I respect the ability to draw different conclusions.

I guess the next piece I want to talk about is our naval power, there is obviously massive, differential naval power there. Of the \$15 billion mighty North Korean economy, how much of it is dependent upon access to the sea? Does anybody know?

Mr. KLINGNER. The North Korean naval forces and air forces are small and antiquated. So they have given their focus in the past on ground forces, and then as those conditions deteriorated, even in the 1990s when I was at the CIA, they compensated for declining conventional capabilities by focusing on asymmetric capabilities, like nuclear weapons, missiles, and special forces.

Mr. DAVIDSON. Right. Are they dependent upon the sea for their oil?

Ms. ROSENBERG. Not exclusively. They have the capacity to take tanker or delivery as well as pipeline from China.

Mr. DAVIDSON. So pipeline, but they do get a fair bit by ocean?

Ms. ROSENBERG. Or tanker over that bridge, for example. Those are all—

Mr. DAVIDSON. Oh, tanker trucks, not ocean tankers.

Okay. Thank you.

I guess the last thing is, in the ability to use naval power, what portion of—if you took this up to the next thing and a blockade, short of force, this is control the ocean, is there an ability to have a discernible impact on North Korea's economy?

Mr. ALBRIGHT. I would imagine. We have to consider the possibility of a submarine-launched ballistic missile.

Mr. DAVIDSON. Of course.

Mr. ALBRIGHT. They are far from that, but you have to worry about their submarine force. But in answer to your question, I think certainly an embargo would affect their economy.

Mr. DAVIDSON. Yes, that is the question. So is the next step sort of kinetic force—Mr. Chairman, my time has expired. I yield back.

Chairman BARR. Thank you.

The gentleman's time has expired.

And I would like to thank our witnesses for their testimony today.

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 12:01 p.m., the hearing was adjourned.]

# **A P P E N D I X**

September 13, 2017

TRANSCRIPT

September 13, 2017

MONETARY POLICY AND TRADE SUBCOMMITTEE HEARING ON  
LEGISLATIVE PROPOSAL TO IMPEDE NORTH KOREA'S ACCESS TO  
FINANCE

MOORE: And thank you so much, Mr. Chairman.

And I want to, in the absence of our ranking member of the full committee, I'd like to share some thoughts that she has committed to paper regarding today's hearing.

I want to thank our witnesses for joining us to discuss the legislative proposal aimed at expanding United States sanctions against North Korea and pressuring the international community to enforce those restrictions as well.

The situation in North Korea is the most urgent and dangerous threat to peace and security that we face. And it's one that grows more dangerous as North Korea aggressively pursues the capacity to extend its nuclear reach to United States cities.

In fact, there are no good options for dealing with North Korea. Most experts agree that a preemptive strike at this point on North Korea would be reckless beyond belief.

Of the least-bad options, I like the idea of pressing China to lean more heavily on North Korea and I like the idea of tougher sanctions. But we should not confuse either of those things with a coherent strategy, and we should be clear up front about our goals and objectives and what we expect sanctions can accomplish. Any ratcheting up of sanctions must be coupled with aggressive diplomatic engagement by the United States and within a framework that would entail nuanced negotiations with North Korea, U.S. allies and China. This would require unprecedented policymaking capacity and coordination across the United States government as well as skilled policy coordination with our allies.

It concerns me, therefore, that just as this crisis is accelerating, our diplomatic capabilities, which opens channels for crisis communication and reduces the risk of miscalculation, are diminished. ~~Not only are U.S. ambassadorships to Japan and South Korea still vacant, the president has yet to nominate a permanent assistant secretary of state for East Asia and Pacific affairs.~~

The legislative proposal before us today rightly recognizes the need to exert massive and immediate pressure on the North Korean regime and, importantly, enlists China and others in this effort. Such a powerful approach towards sanctions, however, ~~that~~ which have the capacity to reverberate throughout the global economy and present potentially disastrous, unintended consequences must also allow for careful calibration in its implementation.

We look forward to the witnesses' views on the proposal before us as well as your views on how the U.S. can most effectively use this leverage to contain the alarming danger North Korea presents.

And I reserve my time.

**Testimony of David Albright,  
President of the  
Institute for Science and International Security,  
before the Monetary and Trade Subcommittee of the Committee on Financial  
Services**

**Hearing Title: “A Legislative Proposal to Impede North Korea’s Access to  
Finance”**

September 13, 2017

North Korea’s September 3, 2016 nuclear test, its sixth overall and by far its largest in terms of explosive yield, demonstrates its resolve and commitment to developing a nuclear arsenal able to strike its enemies. During the last few years, North Korea has embarked on an intensive nuclear weapons testing campaign that has included three underground nuclear tests and tens of ballistic missile launches. Its apparent goal is to have a variety of nuclear warheads mated to ballistic missiles with ranges stretching to intercontinental distances. Few doubt that North Korea can now launch nuclear tipped ballistic missiles that can strike our allies Japan and South Korea. There is rightly more skepticism that North Korea is yet able to deliver a nuclear warhead to an American city.

I remain skeptical that North Korea can build a miniaturized two-stage thermonuclear weapon that it can deliver on an intercontinental ballistic missile (ICBM) to the continental United States. Nonetheless, this test appears to have achieved an explosive yield of over 100 kilotons, far larger than the yield of any of its previous tests. This yield is large enough to destroy substantial parts of modern cities. Whatever the specific design for this high yield weapon, this test is significant and requires extraordinary responses.

I still believe North Korea can be peacefully denuclearized. Accomplishing that goal will likely require exerting enormous pressure, starting with much harsher sanctions and trade cutoffs. The UN Security Council resolution passed on Monday is an important step in that direction. A priority is to far more effectively isolate North Korea from the regional and international financial system. Because many countries are not enforcing sanctions effectively, or are in some cases willfully disregarding them, punitive measures are needed to encourage compliance and deter violations. Additional U.S. legislation that supports that goal would be useful.

If pressure does not lead to successful negotiations, then it is better to have a further weakened North Korea and to make it more difficult for Pyongyang to create a functioning nuclear arsenal. In parallel, the United States needs to work with its allies in the region to build up defensive capabilities and increase deterrent postures. Today, the alliance among the United States, Japan, and South Korea is more critical and should be further strengthened. It remains imperative that those allies do not feel inclined to develop their own nuclear deterrent, further exacerbating regional security concerns and increasing the chance for nuclear war or miscalculation.

Substantive negotiations appear unlikely if North Korea continues its nuclear and missile testing efforts. Moreover, the United States should not grant additional concessions to North Korea. However, it should state to North Korea that it has a diplomatic path out of its isolation and sanctions if it commits to negotiate a full, verified denuclearization of its nuclear and long-range missile programs. Any such negotiation would need to repair past mistakes where North Korea was able to evade inspections and continue expanding its nuclear programs. An agreement would also need to allow unprecedented inspections and access, allowing for a full accounting of the program as part of a denuclearization pathway. Again, this prospect seems unlikely in the short term given the current trajectory, but it is important to keep available as a matter of U.S. policy in case increased sanctions convince North Korea to negotiate in earnest. Likewise, the Trump administration should continue to make clear that regime change is not its goal. The verified denuclearization of North Korea should remain the guiding U.S. policy, rather than piecemeal freezes with limited access in return for economic or other concessions.

### **Recent Test**

The September 3<sup>rd</sup> nuclear test had the largest seismic signal of any of North Korea's six confirmed tests. The estimated yield of this explosion was about 100-150 kilotons, far larger than its earlier tests, which topped out at roughly 15 kilotons. This much larger yield, combined with North Korea's efforts to acquire capabilities to produce key thermonuclear materials, would suggest that this test was some type of thermonuclear device to increase the yield of a fission design. How it may have used the thermonuclear materials remains unclear.

We should view skeptically North Korean claims that this test was a two-stage thermonuclear device. Likewise, the picture of an elongated device distributed by North Korea purporting to show a miniaturized two stage H bomb is likely more aimed at spreading propaganda than something to be taken literally. North Korea understands our fears and is well practiced in the art of disinformation. I believe the object in the picture was a model meant to play on our fears of H bombs, sow division, and bolster their deterrent. In reality, the picture and North Korea's statements provide no evidence that the object or test used a two-stage thermonuclear design. Moreover, the shape of the device in the picture and information in its statement do not appear to go beyond in content that which is available in the open literature. Absent other information, I believe it would be premature to assess that North Korea, which has had real struggles mastering technological targets, has reached such a difficult goal. I hope we can learn more about this test and North Korea's capabilities to build such devices. Perhaps, data and insights will come from defectors or from radioactive emissions from the test site, which are far likelier to have occurred in this test than earlier ones.

The test could have involved a boosted or a one-stage thermonuclear design, which are both easier to develop and build than a two-stage thermonuclear design. In this case, its miniaturization and weaponization for a missile is easier but also challenging. While I am skeptical that North Korea is able to successfully build such a design for delivery by an ICBM, achieving a weaponized one-stage or boosted weapon may not require more underground tests. It will likely require more above ground non-nuclear tests, but these can be done in military/nuclear research facilities that are very hard to detect or monitor remotely.

When can North Korea reach its goal of a miniaturized, high explosive yield warhead able to be successfully delivered to a target on an ICBM? This is difficult to precisely estimate but it will likely be within a few years, if testing continues unabated.

#### **More tests?**

More underground tests could refine North Korea's skills in designing more efficient fission weapons and fission boosted weapons (that use less plutonium or weapon-grade uranium per kiloton of explosion), and achieve designs with greater total explosive yields. North Korea could explore more optimized one-stage thermonuclear weapons and develop more tailored electromagnetic pulse (EMP) weapons. The bottom line is that if they test more, they will be able to develop more advanced weapons that can use less plutonium and weapon grade uranium (WGU), are more miniaturized for missiles, and can be more destructive if detonated.

With more tests, North Korea could succeed in building two-stage nuclear weapons. There are sound reasons to do so. Two stage weapons have advantages over boosted and one stage thermonuclear devices, namely (1) their explosive yield can be much higher (into megatons) than boosted or one stage designs which tend to be limited to several hundred kilotons, (2) their requirements for fissile material are less than one stage designs, and (3) their elongated shape (with a smaller fission explosive) can potentially fit more easily into missile reentry vehicles than one stage designs which tend to increase in diameter as the explosive yield increases. A two-stage design is simply more threatening than a boosted or one-stage design. But they are more complicated to develop than one-stage weapons. I believe that North Korea needs more tests and time to develop a miniaturized two stage thermonuclear weapon but it is motivated to do so.

#### **North Korea's Nuclear Weapons Capabilities**

The last several years have witnessed a dramatic and overt build-up in North Korea's nuclear weapons capabilities. The main activities that are known publicly include:

- Six underground nuclear tests in 2006, 2009, 2013, 2016, and 2017;
- Restart and refurbishment of the small 5 megawatt-electric (MWe) reactor at Yongbyon after a several-year halt;
- Revelation of a centrifuge plant at Yongbyon in 2010 and subsequent doubling of its floor size a few years later;
- Separation of several kg of plutonium in 2009 and again in 2016 from the 5 MWe reactor at the Radiochemical Laboratory at Yongbyon;
- On-going construction of an experimental light water reactor (ELWR) at Yongbyon (type of reactor is uncertain);
- Construction by a nuclear organization of a new graphite production facility. Graphite is a moderator in a type of reactor that is an excellent plutonium producer;
- Construction of facilities to make thermonuclear materials, including a lithium 6 enrichment plant and likely an Isotope Production Facility able to separate tritium;



- Modernization and construction of many buildings at Yongbyon, including likely one able to manufacture fuel for the ELWR and others to support reactor and centrifuge operations;
- Refurbishing of uranium mines and mills; and
- A robust program to develop, manufacture, and test ballistic missiles of various ranges.

In addition to known sites, North Korea has likely developed an array of secret facilities and activities. This unknown part of North Korea's nuclear weapons complex includes:

- The strong possibility of an older gas centrifuge plant that has made weapon-grade uranium for up to a decade
- Unknown sites to research, develop, and manufacture nuclear weapons and their components;
- Sites associated with nuclear weapon component testing, including full-scale cold-testing that complement underground nuclear testing at its Punggye-ri underground test site;
- Possible integration facilities that could mate a nuclear warhead to a ballistic missile; and
- Nuclear warhead storage capabilities.

All of these activities have been supported by extensive, often illegal, overseas procurements of equipment, material, and technology.

#### **Estimated Number of Nuclear Weapons**

North Korea has developed successfully the means to produce both plutonium and weapon-grade uranium for nuclear weapons. The size of its stocks of these materials provides a rough guide to the number of nuclear weapons North Korea has built.

Its stock of plutonium appears limited and all of it appears to have been produced in the small aging 5 MWe reactor at Yongbyon. It has a gas centrifuge plant at Yongbyon able to produce weapon-grade uranium. A substantial amount of weapon-grade uranium could also have been produced at unknown sites. Many assess that North Korea has another gas centrifuge plant at an unknown location that may have been producing weapon-grade uranium since about 2005 or 2006.

My Institute's median estimates of the size of North Korea's plutonium and weapon-grade uranium stocks through 2016 are:<sup>1</sup>

- 33 kilograms of separated plutonium; and
- 175-645 kilograms of weapon-grade uranium, where 175 kilograms corresponds to a median estimate for the case of one centrifuge plant and 645 kilograms corresponds to the median estimate for the case of two centrifuge plants.

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<sup>1</sup> David Albright, *North Korea's Nuclear Capabilities: A Fresh Look*, Institute for Science and International Security, August 9, 2017, <http://isis-online.org/isis-reports/detail/north-koreas-nuclear-capabilities-a-fresh-look-power-point-slides/>

Through 2016 (before the latest underground test), my Institute estimated that North Korea had about 13 to 30 nuclear weapons.<sup>2</sup> These values reflect the utilization of 70 percent of the available, estimated stocks of plutonium and weapon-grade uranium. This assumption means that thirty percent of North Korea's total stocks of plutonium and weapon-grade uranium are assessed as in production pipelines, lost during processing, or held in a reserve. The limits of 13 and 30 correspond to the median values for the cases of one or two centrifuge plants and each weapon contains either plutonium or weapon-grade uranium.

These estimates suggest that North Korea has a substantial number of nuclear weapons and add weight to assessments that North Korea is competent at using plutonium and/or weapon-grade uranium in nuclear weapons.

North Korea is currently expanding its nuclear weapons at an estimated rate of about 3-5 weapons per year. Again, the lower bound corresponds to one centrifuge plant and the upper bound corresponds to two centrifuge plants.

Through 2020, North Korea is assessed as having enough plutonium and weapon-grade uranium for about 25-50 (rounded) nuclear weapons. A worst case, involving the operation of the Experimental Light Water Reactor, is that it would have enough plutonium and weapon-grade uranium for up to 60 nuclear weapons by the end of 2020.

#### **A Closer Look at the Upper bound: Two Centrifuge Plants**

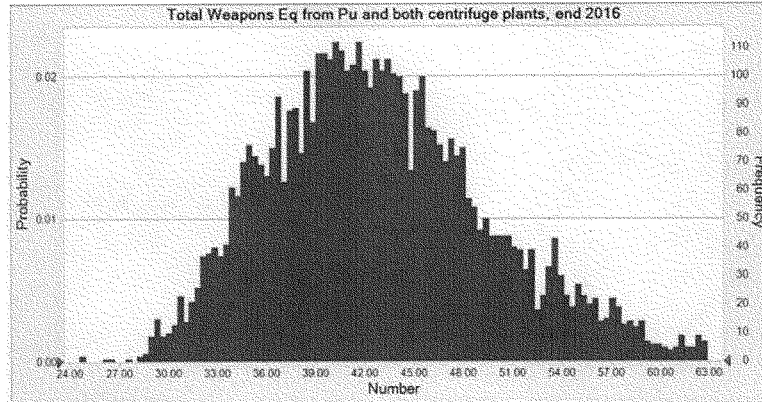
The upper bound of the estimate of the number of nuclear weapons through 2016 includes the production of weapon-grade uranium at a second, unknown enrichment plant. Based on discussions with U.S. officials, their estimates of nuclear weapons capabilities assume that this second enrichment plant exists and has contributed significantly to North Korea's stock of weapon-grade uranium. Although I am less sure, it is useful to focus on the case of two centrifuge plants producing weapon-grade uranium.

The lower and upper bound of the Institute's range above represent the medians of frequency distributions of estimates of the number of nuclear weapons, which differ mainly on whether North Korea has one or two centrifuge plants. Each frequency distribution is calculated by considering several variables, each of which is a range of values. These variables include the total number of centrifuges, the efficiency of the centrifuges, the length of operation, and the amount of plutonium or weapon grade uranium per weapon. All of these variables are uncertain, because of North Korea's efforts to keep its nuclear programs secret.

The following frequency distribution translates the total amount of plutonium and weapon-grade uranium into an equivalent number of nuclear weapons. In the chart, this value is abbreviated as the total number of nuclear weapons equivalent by "Eq."

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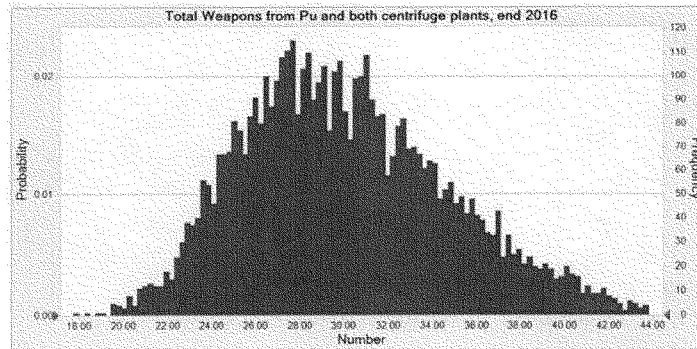
<sup>2</sup> Ibid.



The median of this slightly skewed distribution is about 42 weapons equivalent, with a standard deviation of 7 weapons equivalent. The full range is 25 to 75 weapons' equivalent.

However, as discussed above, the actual number of nuclear weapons would be expected to be fewer in number than given by the above nuclear weapons equivalent values. A fraction of the plutonium or WGU would be tied up in the manufacturing complex that makes nuclear weapons components or would be lost during such processing. Some of this material would be expected to be held in a reserve for underground nuclear testing or new types of weapons. In these estimates, it is assumed that only 70 percent of the total amount of plutonium or WGU is used in nuclear weapons.

Accounting for this reduction, the distribution of the estimated number of weapons made from plutonium or weapon grade uranium from two centrifuge plants at the end of 2016 is:



The median of this slightly skewed distribution is 30 nuclear weapons, with a standard deviation of 5 weapons. The full range is 18-53 weapons. The range defined from the 5<sup>th</sup> and 95<sup>th</sup> percentiles of this distribution is 23 to 39 nuclear weapons. The latter range of the number of weapons North Korea may possess is a more reasonable representation in the case of two centrifuge plants making weapon-grade uranium. However, I would stress that in our analysis this range represents a worst case.

One implication of this analysis is that a recent report that North Korea has up to 60 nuclear weapons represents a worst case. Alternatively, it is unlikely that North Korea has such a large number of weapons.

### **Thermonuclear Materials**

For several years, evidence has accumulated that North Korea has been producing or procuring materials needed to make thermonuclear weapons, which has added credibility to North Korea's claims that it has been pursuing boosted or thermonuclear nuclear weapons. We assess that North Korea has established a domestic capability to make lithium 6, which is a key material for thermonuclear weapons whether in one or two stage thermonuclear designs (see also below). It is also the material irradiated in a reactor to produce tritium, which can be used in boosted or one stage thermonuclear designs. North Korea has expressed interest in deuterium, another key thermonuclear material. It has also constructed a new Isotope Separation plant at Yongbyon that could separate tritium produced in the 5 MWe reactor or in a small research reactor at Yongbyon, called the IRT reactor.

### **Types of Nuclear Weapons (warhead and delivery system)**

North Korea is likely developing a range of nuclear warheads or bombs that can be fitted to delivery systems. However, there is little public information about the warheads or bombs North Korea has built or is developing. Based on delivery systems, North Korea may have:

- **Aircraft dropped bombs:** unknown if bomb designs exist but likely able to design
- **Nodong missile:** miniaturized, plutonium-based warhead likely; unknown if could build miniaturized fission-only composite core design (with both plutonium and WGU) but increasingly possible
- **Medium range missile,** land-based, warhead unknown
- **Intermediate range missile,** land-based, warhead unknown
- **ICBM,** land based, warhead unknown
- **Sea-launched missile,** medium range, warhead unknown
- **Tactical nuclear weapons,** such as backpack bombs and land mines; speculative if exist or planned

These delivery systems would likely entail different nuclear weapons designs and combinations of plutonium and weapon-grade uranium. A thermonuclear warhead is probably being developed for some of these systems.

### **Observations and Findings about North Korea's Nuclear Weapons Capabilities**

- North Korea appears able to produce considerably more weapon-grade uranium than plutonium, providing a pathway to a much greater number of nuclear weapons.
- North Korea appears to have a family of relatively reliable, miniaturized fission weapons with the destructive force rivaling the size of the Hiroshima blast that can use plutonium or weapon-grade uranium and fit on a number of ballistic missiles.
- Miniaturization is assessed as being done for the Nodong missile for a plutonium-only warhead. North Korea could use similar warheads on its longer-range missiles, although it would need to ensure that they can withstand the harsher environment experienced by these longer range missiles, particularly an ICBM. Moreover, it may experience problems in miniaturization and achieving sufficient warhead ruggedness as it seeks to use composite cores of plutonium and weapon grade uranium or thermonuclear materials. As a result, nuclear warhead miniaturization efforts likely continue.
- Other weaponization issues probably continue to be under development, i.e. reliability, safety, and security of nuclear weapons.
- North Korea can achieve explosive yields, likely using crude thermonuclear or boosted designs, that can destroy modern cities. With time, likely within a few years, it will have a reliable capability to deliver and explode such weapons over targets.
- North Korea will continue to depend on importing key goods for its nuclear programs from suppliers.
- North Korea could proliferate its capabilities to other nations. Although this aspect of the problem is not discussed here, North Korea's nuclear proliferation to other countries remains a fundamental concern.

### **Foreign Procurements by North Korea's Nuclear Programs**

The North Korean government directs highly organized and centralized illicit trade efforts to outfit its nuclear, missile, and military programs. The government also uses North Korean government officials stationed at embassies to conduct illicit procurement related business and it recruits private companies to obtain goods. North Korea has established entities abroad under its control that seek goods. It also uses North Korean expatriates who own private companies located abroad. In the past, North Korean government entities cooperated closely with Pakistan, obtaining critical sensitive gas centrifuge assistance.

North Korea has depended on illegal or questionable procurements for decades for its nuclear programs. In particular, it has sought European, Japanese, and U.S. goods for its nuclear programs. When it could no longer base its operations in Europe in the early 2000s, it shifted its operations to China where many procurement operations for its nuclear program have been centered since then. Operating in China and Hong Kong, it has acquired a wide range of goods from Chinese companies and middlemen, as well as from U.S., Japanese, and European subsidiaries, which have been deceived into thinking they were selling to Chinese end users. North Korean entities often contract with private Chinese and Hong Kong trading companies and sometimes manufacturing companies to acquire these goods, either from Chinese suppliers or subsidiaries of Western or Japanese suppliers in China. Although China is improving its export

control laws, Beijing has not done an adequate job of enforcing its laws and sanctions against illegal exports and retransfers to North Korea.

The following illustrates the range and types of goods North Korea seeks abroad and the important role these goods play in the development and success of a range of North Korean nuclear programs. Many of these procurements were detectable and could have been stopped. One example also focuses on North Korean schemes to bypass financial controls and sanctions that led to a U.S. asset freeze.

#### **Procurements for North Korea's Centrifuge Program**

The operation and expansion of North Korea's gas centrifuge program has depended on importing many goods and technologies from abroad. The annex contains a list of goods North Korea has imported for its centrifuge program during the last fifteen years. This list does not include the substantial centrifuge assistance North Korea received from Pakistan in the late 1990s and early 2000s.

Evidence supports that North Korea is still importing a variety of goods and technologies for its gas centrifuge program, while benefiting from earlier procurements obtained from abroad. North Korea can make key centrifuge components domestically and would be expected to be seeking independence from foreign supply. However, there is a wide range of materials and equipment that North Korea must import in order to produce these components and then make and operate its centrifuge plants.

#### **Procurements for North Korea's 5-Megawatt Electric Reactor at Yongbyon**

During the last several years, North Korea procured goods for its 5 MWe reactor and spent considerable funds on this endeavor. The intention appears to be the restoration and upgrading of the aged reactor. Many of these goods are neither high-tech nor certified for nuclear use. North Korea seeks them from abroad for various reasons, including finding them more affordable than producing them domestically or unable to manufacture them with sufficient reliability. In China, it procured carbon dioxide blowers for the primary cooling system, a Japanese emergency generator, and Sulzers water pumps for the secondary cooling system. North Korea also procured a relatively rare aluminum-magnesium powder for making cladding of fuel for this reactor. The supplier was in Britain but was apparently unaware of the diversion from China to North Korea.

#### **Procurements for a Lithium-6 Enrichment Plant<sup>3</sup>**

As discussed above, a critical thermonuclear material is lithium 6. Utilizing foreign procurements from China, North Korea is assessed as having built a lithium 6 enrichment plant at the Hungnam Fertilizer Complex, near Hamhung on North Korea's east coast. This site is involved in ammonia processing, fertilizer production, and other chemical processing. Key

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<sup>3</sup> David Albright, Sarah Burkhard, Mark Gorwitz, and Allison Lach, "North Korea's Lithium 6 Production for Nuclear Weapons," Institute for Science and International Security, March 17, 2017, <http://isis-online.org/isis-reports/detail/north-koreas-lithium-6-production-for-nuclear-weapons/10>

procured items included metric ton quantities of mercury and tens of kilograms of lithium hydroxide which are strong indicators of a lithium-6 enrichment plant. The order of mercury and lithium hydroxide was from a 2012 North Korean contract to arrange the purchase of a wide range of industrial and lab-scale equipment and materials abroad in China. Although the purpose of the contract was not included, the list of goods implies they are for a lithium 6 enrichment plant using mercury-based lithium exchange. The contract had handwritten notes stating that the goods were needed urgently and the procurements involved the Hamhung complex. Most of the procurements were for industrial-scale equipment.

#### **Shenyang Machine Tools Company<sup>4</sup>**

North Korea seeks advanced machine tools abroad, including from European suppliers. These machine tools are important in nuclear and ballistic missile programs. Headquartered in northeast China, Shenyang Machine Tools Company allegedly supplied sophisticated 6-axis machine tools to North Korea containing controlled subcomponents. The subcomponents were provided by a European company under the condition that they would not be re-exported. The company imports a range of subcomponents from major Western supplier nations. It sells its machine tools in China and globally, including in Europe and the United States. European government officials gathered evidence that at least two 6-axis machine tools, containing controlled, imported subcomponents, were exported to North Korea in about 2015 without authorization from the supplier country, a requirement of the original supply of the goods. Although Shenyang company officials have stated that the exports were inadvertent, other evidence suggests that the company did know about the end destination of the controlled goods being North Korea. The Chinese government refused to cooperate with a foreign criminal investigation to determine the actual situation, backing the company's claim that the exports were inadvertent or uncontrolled re-exports. As a result, legal options to investigate the company's exports are limited. However, my Institute recommends that this company should be considered a candidate for U.S. sanctions. In addition, the United States should take other measures to ensure that U.S. companies' and other suppliers' goods are not re-exported to North Korea, in part by obtaining verified assurances from Chinese companies. Moreover, China should require its companies to have internal control systems and hold top company officials liable for illegal exports originating within their companies.

#### **Dandong Chengtai of China and Velmur Management and Transatlantic Partners (both Russian-owned) of Singapore**

North Korea has used a range of methods to bypass financial sanctions and regulations on its nuclear, missile, and arms programs. On August 22, 2017, the Department of Justice announced two law suits against financial and nonproliferation sanctions busting rings in China and Singapore (the latter involving Russian-owned entities and individuals).<sup>5</sup> The Trump

<sup>4</sup> 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>

<sup>5</sup> See: Andrea Stricker, "Case Study: United States Levies Civil Suits Against Chinese and Russian Entities for Helping North Korea Bust Financial and Nonproliferation Sanctions," Institute for Science and International Security, September 7, 2017, <http://isis-online.org/isis-reports/detail/case-study-united-states-levies-civil-suits-against-chinese-and-russian-ent>

administration also sanctioned the entities and individuals involved in the case. The law suits froze North Korean assets that touched U.S. correspondent banking accounts. The suits alleged that the rings are working to help North Korea buy or sell goods internationally and then launder the money for its nuclear, missile, and military programs. The first law suit against Dandong Chengtai, which was conducting prohibited coal trade and illicit financial transactions with North Korea, shows that enforcing the new UN resolution 2371 to prohibit coal trade with North Korea may temporarily restrict its ability to acquire needed dual-use goods for its nuclear, missile, and military programs. The Velmur/Transatlantic case involved Russians setting up front companies in Singapore in order to make prohibited financial transactions for North Korea for purchases of Russian gasoil. This case shows that North Korea's imports of gasoil (as well as oil) are vulnerable commodities that deserve UN sanctions.

### **Countries Violating UNSC resolutions on North Korea**

As part of preparing this testimony, we decided to use a new tool we have developed to evaluate preliminarily 33 countries that the United Nations Security Council Panel of Experts on North Korea identified as violating UNSC resolutions on North Korea.<sup>6</sup> Although this list is not complete, it appears to be fairly representative of the type of countries implicated in nefarious activities with North Korea. These countries show a tendency of cooperation with North Korea in its illicit procurement of goods for its nuclear or missile programs, as well as cooperation with North Korea in its attempts to evade sanctions. Common offenses include facilitating or initiating the re-flagging of ships, and the setting up of front companies and bank accounts. Some of the countries are involved in the import of banned North Korean goods, such as iron and ore. Others cooperated with North Korea militarily in areas of training, arms, and equipment. This includes North Korea's alleged export of surface-to-air missiles or related equipment to at least two African countries.<sup>7</sup>

Using what we have developed and titled the Peddling Peril Index (PPI), which measures the extent and effectiveness of a country's strategic export control systems, we considered the ranking of these 33 countries in terms of trade control legislation, proliferation financing, and overall ranking in the index.

The group of countries that deal with North Korea on illicit or sanctioned goods or services tend to have a relatively poor overall ranking on the PPI. The ones that have a higher ranking tend to have adequate export control legislation but poor enforcement or anti-proliferation financing practices.

On the issue of proliferation financing, half of all countries on the list rank in the bottom 30 percent of the 200 countries evaluated under this criterion. This means that many of these 33 countries do poorly on preventing proliferation financing.

Almost all of the countries that deal with North Korea on conventional arms or are involved in reflagging their vessels have no or poor export control legislation.

<sup>6</sup> All reports can be found on the website of the United Nations Security Council Subsidiary Organs: [https://www.un.org/sc/suborg/en/sanctions/1718/panel\\_experts/reports](https://www.un.org/sc/suborg/en/sanctions/1718/panel_experts/reports)

<sup>7</sup> Mozambique and Tanzania, see [http://www.un.org/ga/search/view\\_doc.asp?symbol=S/2017/742](http://www.un.org/ga/search/view_doc.asp?symbol=S/2017/742)



Many of the countries identified in this list experience a high degree of corruption. Notably, countries on the list with adequate export control legislation, which typically translates into less corruption, performed more poorly than their peers.

These results suggest that North Korea targets those countries with weak or nonexistent export and proliferation financing controls and suffer from on average more corruption than other countries. Although a range of remedies are needed to fix the poor performance of many of these countries on this list, the creation of punitive measures may be an effective means to accelerate more compliant behavior in the short term.

Thank you for inviting me to submit testimony.

**Annex: North Korean Illicit, Foreign Procurements for Centrifuges  
(non-Pakistani supply)**

North Korea has sought the following advanced goods from Western countries and via China for its gas centrifuge programs:

- **Materials:** Aluminum tubes (low strength for outer casings), ring magnets for use in a centrifuge upper bearing, epoxy resins used in assembling centrifuge parts (sold commercially as Araldite), raw materials and additive alloys;
- **Vacuum Equipment:** A range of equipment important to operating centrifuges individually or in cascades, such as vacuum pumps, valves, specialized uranium hexafluoride resistant oils. Also pressure transducers, which are used to measure the vacuum pressure in individual centrifuges and cascades;
- **Other Equipment:** Uranium hexafluoride cylinders, uranium hexafluoride flow meter, He leak detectors, and frequency converters or their subcomponents. Also computerized control equipment, including software and updates, used to run a plant composed of centrifuge cascades. (The equipment is the same as that acquired by Iran to control its centrifuges.)
- **Manufacturing Equipment:** Flow-forming machine usable to make centrifuge rotors. an electron beam welder for centrifuge assembly, equipment to make ring magnets. State-of-the-art computer numerically controlled (CNC) machines for making centrifuge parts, and measuring equipment;
- **Spare parts** for centrifuge-related equipment.



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## CONGRESSIONAL TESTIMONY

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**Time for Shock and Awe Sanctions  
On North Korea**

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

**September 13, 2017 – A Legislative Proposal to Impede  
North Korea's Access to Finance**

**Bruce Klingner**

Senior Research Fellow, Northeast Asia

The Heritage Foundation

My name is Bruce Klingner. I am the Senior Research Fellow for Northeast Asia at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

#### **Time for Shock and Awe Sanctions on North Korea**

North Korea's successful test of a hydrogen bomb, test launches of an ICBM that could eventually threaten the American homeland, and threats to launch missiles at Guam have energized debate over U.S. policy toward Pyongyang.

Secretary of State Rex Tillerson declared that if North Korea reached a technological level deemed threatening, then military options "were on the table."<sup>1</sup> National Security Advisor H.R. McMaster commented that President Trump insisted that North Korea being able to target the United States with a nuclear warhead was "intolerable" and had directed the U.S. to prepare a preventive war option that would thwart North Korea from completing development of an ICBM.<sup>2</sup>

But shooting down missile test flights that do not clearly pose a security threat to the United States or conducting military attacks on North Korea could trigger a war with a nuclear-armed nation that has a large conventional military force poised along the border with South Korea. Such a war risks catastrophic consequences for the United States and its allies. While the U.S. should be steadfast in its defense of its territory and its allies, it should not be overeager to "cry havoc and let slip the dogs of war."<sup>3</sup>

Conversely, other experts continue to push for a rushed return to the failed approach of negotiations, insisting it is the only way to constrain Pyongyang's growing nuclear arsenal. But there is little utility to such negotiations as long as Pyongyang rejects their core premise, which is the abandonment of its nuclear weapons and programs.<sup>4</sup>

Moreover, dialogue requires a willing partner. By word and deed, North Korea has demonstrated it has no intention to abandon its nuclear weapons. Pyongyang has made emphatically clear in both public statements and private meetings that denuclearization is off the table and there is nothing that Washington or Seoul could offer to induce the regime to abandon its nuclear arsenal.<sup>5</sup>

The most effective way to engage in negotiations would be after a comprehensive, rigorous, and sustained international pressure campaign. Such a policy also upholds U.S. laws and UN resolutions,

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<sup>1</sup> James Griffiths, Paula Hancocks and Alexandra Field, "Tillerson on North Korea: Military action is 'an option,'" CNN, March 17, 2017, <http://www.cnn.com/2017/03/17/politics/tillerson-south-korea-dmz/index.html>.

<sup>2</sup> Jason Le Miere, "U.S. Prepared to Launch 'Preventive War' Against North Korea, Says H.R. McMaster," Newsweek, August 5, 2017, <http://www.newsweek.com/us-north-korea-war-mcmaster-646942>.

<sup>3</sup> Bruce Klingner, "Save Preemption for Imminent North Korean Attack," The Heritage Foundation, March 1, 2017, <http://www.heritage.org/missile-defense/report/save-preemption-imminent-north-korean-attack>.

<sup>4</sup> Bruce Klingner, "The Trump Administration Must Recognize the Dangers of Premature Negotiations with North Korea," The Heritage Foundation, May 11, 2017, <http://www.heritage.org/global-politics/report/the-trump-administration-must-recognize-the-dangers-premature-negotiations>.

<sup>5</sup> Bruce Klingner and Sue Mi Terry, "We participated in talks with North Korean representatives. This is what we learned," The Washington Post, June 22, 2017, [https://www.washingtonpost.com/opinions/we-participated-in-talks-with-north-korean-representatives-this-is-what-we-learned/2017/06/22/8c838284-577b-11e7-ba90-f5875b7d1876\\_story.html](https://www.washingtonpost.com/opinions/we-participated-in-talks-with-north-korean-representatives-this-is-what-we-learned/2017/06/22/8c838284-577b-11e7-ba90-f5875b7d1876_story.html).

imposes a penalty on those that violate them, makes it more difficult for North Korea to import components – including money from illicit activities – for its prohibited nuclear and missile programs, and constrains proliferation. While leaving the door open for eventual negotiations, the U.S. must also ensure it has sufficient defenses for itself and its allies.

#### **Greater International Response to North Korean Violations**

North Korea's two nuclear tests and numerous missile launches in 2016 produced a new international consensus that stronger measures must be imposed on North Korea for its serial violations of UN resolutions and international law. Efforts to date have moved forward on three tracks.

##### **Track 1: UN Security Council Resolutions**

In March 2016, the UN Security Council approved Resolution 2270 which increased financial sanctions, expanded required inspections of North Korean cargo, and targeted key exports. The resolution banned all financial institutions from initiating or maintaining a correspondent account with North Korea unless specifically approved by the UN 1718 Committee.

Given international financial institutions' extreme sensitivity to reputational risk, the clause should lead to increasing scrutiny of all North Korean financial transactions and greater due diligence efforts to prevent being even unwittingly complicit in North Korean illicit activities.

The UN resolution was the first targeting North Korean commercial trade, including mineral exports. The resolution also prohibited financial support for trade with North Korea if the financial support could contribute to North Korea's nuclear or ballistic missile programs.<sup>6</sup> It was notable for requiring mandatory inspections of *all* North Korean cargo transiting a country rather than only those suspected of carrying prohibited items.

In November 2016, the UN passed Resolution 2321 in response to North Korea's fifth nuclear test. The resolution expanded on its predecessors by banning export of some North Korean resources while capping coal exports at \$400 million annually, limiting the number of bank accounts held by North Korean diplomatic posts, requiring closure of foreign bank accounts in North Korea, and adding more North Korean entities to the UN sanctions list, including state-owned Air Koryo.

In August 2017, the UN passed Resolution 2371 to further augment pressure on the regime. Most notably, the latest resolution completely banned the export of coal, one of North Korea's largest exports. If fully implemented, the resolution could eliminate one-third of North Korea's total export revenue.

##### **Track 2: U.S. actions**

For years, successive U.S. administrations have pulled their punches on fully enforcing U.S. laws against North Korean, Chinese, and other violators. Contrary to the mischaracterization that North Korea is the most heavily-sanctioned country in the world, the U.S. has sanctioned other countries to a greater degree than North Korea. Prior to 2016, North Korea ranked eighth of U.S.-sanctioned

<sup>6</sup> "Security Council Imposes Fresh Sanctions on Democratic People's Republic of Korea, Unanimously Adopting Resolution 2270 (2016)," United Nations, March 2, 2016, <http://www.un.org/press/en/2016/sc12267.doc.htm>.

nations, after Ukraine/Russia, Iran, Iraq, the Balkans, Syria, Sudan, and Zimbabwe. Currently, North Korea is the fifth-most sanctioned entity by the U.S.<sup>7</sup>

In February 2016, the U.S. Congress sought to induce greater executive branch action by passing the North Korea Sanctions and Policy Enhancement Act.<sup>8</sup> The legislation closed loopholes, toughened measures, and provided new authorities. That Congress made enforcing some U.S. laws *mandatory* rather than discretionary was a strong, bipartisan rebuke to Obama's minimalist approach.

The legislation pressed the Obama Administration to take stronger measures against North Korea. The three major actions of the Obama Administration against Pyongyang in 2016<sup>9</sup> were all *required* by provisions in the NKSPEA. Since passage of the law, the number of U.S. sanctioned entities on North Korea has doubled.<sup>10</sup>

***North Korea as a Money Laundering Concern.*** In June 2016, in accordance with Section 201 of the North Korea Sanctions and Policy Enforcement Act, the U.S. designated North Korea as a primary money laundering concern.<sup>11</sup> Washington concluded that the regime "uses state-controlled financial institutions and front companies to conduct international financial transactions that support the proliferation and development of WMD and ballistic missiles [and] relies on illicit and corrupt activity of high-level officials to support its government."<sup>12</sup>

The U.S. ruling constrained North Korea's ability to gain hard currency by cutting off the regime's access to the U.S. financial system. Washington banned any U.S. financial institution, as well as all foreign banks' correspondent accounts in the U.S., from processing any transactions on behalf of North Korean financial institutions.

Since the majority of all international financial transactions are denominated in dollars, the U.S. action will force financial entities to choose between doing business with North Korea or maintaining access to the U.S. financial system. Any institution maintaining a correspondent account for a North Korean entity could face fines, seizure of funds, or preclusion from the U.S. financial institution. Foreign banks and businesses will be more reluctant to engage with North Korea even on legitimate business dealings due to risks to increased potential for themselves facing U.S. sanctions.

***North Korea as a Human Rights Violator.*** In accordance with Section 304 of the NKSPEA, in July 2016 the Obama administration imposed sanctions on North Korean leader Kim Jong Un and 15

<sup>7</sup> Anthony Ruggiero, "Restricting North Korea's Access to Finance," Foundation for Defense of Democracies, July 19, 2017, <https://www.belfercenter.org/publication/restricting-north-koreas-access-finance>.

<sup>8</sup> H.R.757 - North Korea Sanctions and Policy Enhancement Act of 2016, U.S. Congress, February 18, 2016, <https://www.congress.gov/bills/114/congress/house-bill/757>.

<sup>9</sup> Human rights-related sanctions, designating North Korea as a money laundering concern, and sanctioning Chinese entities.

<sup>10</sup> Anthony Ruggiero, "Restricting North Korea's Access to Finance," Foundation for Defense of Democracies, July 19, 2017, <https://www.belfercenter.org/publication/restricting-north-koreas-access-finance>.

<sup>11</sup> 31 U.S.C. United States Code, 2013 Edition, Title 31 – Money and Finance Subtitle IV – Money, Chapter 53 – Monetary Transactions, Subchapter II – Records and Reports on Monetary Instruments Transactions, Section 5318A - Special measures for jurisdictions, financial institutions, international transactions, or types of accounts of primary money laundering concern, U.S. Government Printing Office <https://www.gpo.gov/fdsys/pkg/USCODE-2013-title31/html/USCODE-2013-title31-subtitleIV-chap53-subchapII-sec5318A.htm>.

<sup>12</sup> "Treasury Takes Actions to Further Rescind North Korea's Access to the U.S. Financial System," U.S. Department of Treasury Press Center, June 1, 2016, <https://www.treasury.gov/press-center/press-releases/Pages/j10471.aspx>.

other entities “for their ties to North Korea’s notorious abuses of human rights.” Adam J. Szubin, acting Under Secretary for Terrorism and Financial Intelligence, explained the sanctions were imposed since, “Under Kim Jong-un, North Korea continues to inflict intolerable cruelty and hardship on millions of its own people, including extrajudicial killings, forced labor, and torture.” North Korea’s political prison camp system was cited for “torture, execution, sexual assault, starvation, slave labor, and other cruel extrajudicial punishment.”<sup>13</sup>

This was the first time that the U.S. had designated North Korean entities for human rights abuses. The United States had previously sanctioned for human rights violations the leaders of Belarus, Burma, Iraq, Liberia, Libya, Syria, and Zimbabwe.<sup>14</sup> Pyongyang’s atrocities were been well-known, particularly since a February 2014 U.N. Commission of Inquiry report, which concluded that North Korea’s human rights violations were so widespread and systemic as to constitute “crimes against humanity.”<sup>15</sup>

**Sanctioning Chinese Violators.** In September 2016, the Treasury and Justice Departments sanctioned five Chinese entities for laundering money for North Korea through 12 Chinese banks into U.S. banks. The Dandong Hongxiang Industrial Development Corporation had conducted \$532 million worth of trade with North Korea during 2011 to 2015. The action, required by the NKSPEA, was the first time the Obama Administration sanctioned a Chinese entity for providing assistance to North Korea’s nuclear weapons program.

In March 2017, the Trump Administration imposed a \$1.2 billion fine on ZTE, China’s largest telecommunications equipment company, for illegally exporting U.S. telecommunications equipment to Iran and North Korea.<sup>16</sup>

In June 2017, the United States identified the Bank of Dandong in China as a primary money laundering concern and severed its ability to access the U.S. financial system. The bank served as a conduit for North Korea to access the U.S. and international financial systems. The U.S. assessed that during 2012-2015, the bank processed \$786 million in dollar-denominated financial transactions through the US financial system, including activity for US and UN sanctioned North Korean entities linked to the regime’s nuclear and missile programs.<sup>17</sup>

In July 2017, the U.S. District Court for the District of Columbia unsealed a seizure warrant for funds of Dandong Zhicheng Metallic Materials Company that entered eight U.S.-based

<sup>13</sup> Elise Labott and Ryan Browne, “U.S. sanctions North Korean leader for first time over human rights abuses,” CNN, July 6, 2016, <http://www.cnn.com/2016/07/06/politics/north-korea-kim-jong-un-human-rights/index.html>.

<sup>14</sup> “Background Briefing on DPRK the Human Rights Abuser Report and Sanctions,” Special Briefing with Senior Administration Officials, U.S. Department of State, July 6, 2016, <https://2009-2017.state.gov/r/pa/prs/ps/2016/07/259394.htm>.

<sup>15</sup> Commission of Inquiry on Human Rights in the Democratic People’s Republic of Korea, United Nations, February 2014, <http://www.ohchr.org/EN/HRBodies/HRC/CoIDPRK/Pages/CommissionInquiryonHRinDPRK.aspx>.

<sup>16</sup> “Trump administration carrying out North Korea sanctions enacted under Obama administration,” Hankyoreh, March 9, 2017, [http://english.hani.co.kr/arti/english\\_edition/e\\_northkorea/785773.html](http://english.hani.co.kr/arti/english_edition/e_northkorea/785773.html).

<sup>17</sup> US Department of Treasury, “Treasury Acts to Increase Economic Pressure on North Korea and Protect the U.S. Financial System,” June 29, 2017, <https://www.treasury.gov/press-center/press-releases/Pages/sm0118.aspx> and Anthony Ruggiero, “Trump Acts against Chinese Bank for North Korean Money Laundering,” FDD Policy Brief, June 30, 2017, <http://www.defenddemocracy.org/media-hit/anthony-ruggiero-trump-acts-against-chinese-bank-for-north-korean-money-laundering/>.

correspondent banks.<sup>18</sup> The Chinese company had processed \$700 million in prohibited North Korea-linked transactions through those U.S. banks since 2009.<sup>19</sup>

### Track 3: Targeting North Korea's Business Practices

Diplomatic pressure, increased financial sanctions, and growing concern of reputational risk from being linked to a heinous regime has led nations, banks, and businesses to reduce business activity with even legitimate North Korean enterprises.

Numerous foreign entities are severing their business relationships with North Korea by suspending economic deals, curtailing North Korean worker visas, and ejecting North Korean diplomats.

Actions taken against North Korean business include:

#### Compendium of international actions taken against North Korea during the past two years

- **South Korea** terminated its involvement in the inter-Korean economic venture at Kaesong. South Korea's action severed a critical source of foreign currency for North Korea. Kaesong generated 23 percent of North Korea's foreign trade (\$2.3 billion of North Korea's annual overall trade of \$9.9 billion) and \$120 million in annual profits.<sup>20</sup>
- **Russian** state-run gas company Gazprom ended plans for energy-related projects with North Korea due to concerns arising from UN sanctions.<sup>21</sup>
- **Taiwan** implemented a complete ban on imports of North Korean coal, iron ore, and some other minerals.<sup>22</sup>
- **Uganda** directed that all North Korean military and police personnel should depart the country and that it was severing military and security ties with Pyongyang, which had been a source of revenue for the regime. There were approximately 50 North Korean military and police training officials. UN resolutions preclude North Korea from engaging in weapons trades or military training with other countries.<sup>23</sup>
- **Sudan** severed military ties with North Korea. In November 2016, Sudanese Foreign Minister Ibrahim Ghandour declared there was no longer any military or diplomatic cooperation with North Korea and that all diplomats had been removed.<sup>24</sup>

<sup>18</sup> Bank of America, Deutsche Bank Trust Company Americas, Citibank, Bank of New York Mellon, HSBC, JP Morgan Chase, Standard Chartered Bank, and Wells Fargo.

<sup>19</sup> Joshua Stanton, "Maximum pressure watch: The Dandong Zhicheng warrants foreshadow N. Korea-related indictments," OneFreeKorea, July 12, 2017, <http://freekorea.us/2017/07/12/maximum-pressure-watch-the-dandong-zhicheng-warrants-foreshadow-n-korea-related-indictments/#sthash.a0ZB1vF6.dpbs>.

<sup>20</sup> Kim Tong-hyung, "How Impoverished but Nuclear-armed North Korea Earns Money," *The Morning Journal*, February 12, 2016, <http://www.morningjournal.com/article/MJ/20160212/NEWS/160219852> and "S. Korea starts withdrawing nationals from Kaesong complex," Yonhap, February 11, 2016.

<http://english.yonhapnews.co.kr/northkorea/2016/02/11/64/0401000000AEN20160211002800315F.html>.

<sup>21</sup> "N.Korean Arms Dealers Run Out of Safe Havens," *The Chosun Ilbo*, April 29, 2016,

[http://english.chosun.com/site/data/html\\_dir/2016/04/29/2016042901075.html](http://english.chosun.com/site/data/html_dir/2016/04/29/2016042901075.html).

<sup>22</sup> Park Boram, "Tightening global sanctions hurting N. Korea's diplomatic ties, overseas commerce," Yonhap news, September 29, 2016,

<http://english.yonhapnews.co.kr/northkorea/2016/09/29/0401000000AEN20160929012800315.html>.

<sup>23</sup> Kang Jin-kyu and Jeong Yong-soo, "Uganda tells North Koreans to go back home," *Korea JoongAng Daily*, June 9, 2016, <http://koreajoongangdaily.joins.com/news/article/Article.aspx?aid=3019773>.

<sup>24</sup> Leo Byrne, "Sudan cuts military ties with North Korea," NK News, November 2, 2016, <https://www.nknews.org/2016/11/sudan-cuts-military-ties-with-north-korea/>.



- **Namibia** halted economic ties with two North Korean state-run companies which had built a munitions factory, a violation of UN resolutions. The North Korean entities were Korea Mining Development Trading Corporation (KOMID), which is on the UN list of sanctioned entities for earning foreign cash via illicit arms deals, and its affiliate Mansudae Overseas Projects.<sup>25</sup> Africa has been an important arms market for North Korea.
- **Angola** suspended all commercial trade with North Korea,<sup>26</sup> **South Africa** stopped military cooperation and weapons deals,<sup>27</sup> and **Uzbekistan** demanded the departure of all North Korean diplomats and the closure of the North Korean embassy.<sup>28</sup>
- **Bangladesh, South Africa, Burma,** and other countries have expelled North Korean diplomats for illicit activities.<sup>29</sup>
- **India** announced it would halt all trade, except for food and medicine, as of April 2017. India had been North Korea's third largest trading partner after China and Saudi Arabia. India will also freeze all North Korean funds and financial assets on its territory.<sup>30</sup>
- **Kuwait** plans to end its commercial and financial transactions with North Korea and discontinue visas for North Korean workers.<sup>31</sup>

#### North Korean Overseas Financial Operations Suffering

- **Conventional Arms Sales.** North Korea officials tied to illegal sales of conventional arms were deported from **Burma, Egypt, and Vietnam**. Pyongyang reportedly earned \$300 million in hard currency from arms sales in 2015.<sup>32</sup> **China** arrested dozens of smugglers involved in illegal arms trafficking with North Korea. The arms smuggling was reportedly coordinated by North Korea's Second Economic Committee, which is the central coordinating body of North Korea's military and defense industry and a UN-sanctioned entity.<sup>33</sup>
- **Overseas Restaurants.** Kim Jong-un expanded North Korean restaurants overseas to generate additional money for the regime. A high-ranking North Korean military defector estimated the regime's restaurants in **China** contributed \$200 million annually to the regime.<sup>34</sup> At least 30 of North Korea's overseas restaurants have closed due to dwindling

<sup>25</sup> "Namibia cuts ties with North Korea state firms: South Korea government, media," Reuters, July 1, 2016, <http://www.reuters.com/article/us-northkorea-namibia-idUSKCN0ZH3PW>.

<sup>26</sup> "Squeezing North Korea: Old Friends Take Steps to Isolate Regime," Reuters, September 26, 2016, <http://www.reuters.com/article/us-northkorea-nuclear-squeeze-idUSKCN11V0WE>.

<sup>27</sup> "12 Countries Downgrade Ties with N.Korea," Chosun Ilbo, October 4, 2016, [http://english.chosun.com/site/data/html\\_dir/2016/10/04/2016100401346.html](http://english.chosun.com/site/data/html_dir/2016/10/04/2016100401346.html).

<sup>28</sup> Lee Yong-soo, "N.Korean Embassy in Uzbekistan Shut Down," Chosun Ilbo, August 22, 2016, [http://english.chosun.com/site/data/html\\_dir/2016/08/22/2016082201134.html](http://english.chosun.com/site/data/html_dir/2016/08/22/2016082201134.html).

<sup>29</sup> Daniel Russel, "Statement Before the Senate Foreign Relations Committee, Subcommittee on East Asia, the Pacific, and International Cybersecurity Policy," September 28, 2016, <https://2009-2017.state.gov/p/eap/rls/rm/2016/09/262528.htm>.

<sup>30</sup> Ivana Kottasova and Sugam Pokharel, "North Korea cut off by 3<sup>rd</sup> biggest trading partner," CNN Money, May 1, 2017, <http://www.looppng.com/global-news/north-korea-cut-3rd-biggest-trading-partner-57983>.

<sup>31</sup> "Kuwait to end commercial ties, with N. Korea, visa issuance for its workers: envoy," Yonhap, August 14, 2017, <http://english.yonhapnews.co.kr/northkorea/2017/08/14/0401000000AEN20170814008400315.html>.

<sup>32</sup> "N.Korean Arms Dealers Run Out of Safe Havens," *The Chosun Ilbo*, April 29, 2016, [http://english.chosun.com/site/data/html\\_dir/2016/04/29/2016042901075.html](http://english.chosun.com/site/data/html_dir/2016/04/29/2016042901075.html).

<sup>33</sup> "China arrests dozens of smugglers trading weapons with N. Korea," Yonhap, June 16, 2016, <http://english.yonhapnews.co.kr/news/2016/06/16/0200000000AEN20160616008700315.html>.

<sup>34</sup> Choi Song Min, "From cash cow to moribund in a matter of months," Daily NK, June 8, 2016, <http://www.dailynk.com/english/read.php?catId=nk00300&num=13932>.

business brought on by sanctions, China's anti-hedonism rules, and the South Korean government calling on its citizens to avoid the restaurants.<sup>35</sup>

- **Trading Companies.** North Korean trading companies sent to China to earn hard currency have begun defaulting on payments to Chinese creditors and finding it harder to get lines of credit. A North Korean source reported, "Companies under the Ministry of External Economic Affairs and other trade agencies have begun experiencing a severe foreign currency crisis." Even Prime Minister Pak Pong-ju and Office 39, the North Korean leadership's money laundering organization, suffered foreign currency shortages.<sup>36</sup>
- **Transportation Organizations.** Cambodia, Mongolia and Singapore have revoked their permission for North Korean ships to sail under their national flag, which Pyongyang had used to evade sanctions.<sup>37</sup> North Korea's Ocean Maritime Management Company, sanctioned by the UN, has been essentially shut down and its ships denied access to ports.<sup>38</sup> Kuwait, Thailand, and Pakistan no longer allow Air Koryo to land in their countries, leaving only Russia and China as allowing flights.<sup>39</sup>
- **Overseas Workers.** Malta, Poland, and Qatar have stopped issuing work visas to North Korean workers in response to human rights abuses.<sup>40</sup> Oman repatriated 300 North Korean workers who had been involved in construction projects in response to greater international scrutiny.<sup>41</sup> Singapore will tighten control on North Korea immigrants by revoking North Korea's visa waiver status. Singapore was one of the few countries that allowed North Korean citizens to enter without a visa.<sup>42</sup> In March 2017, Malaysia cancelled its visa waiver program with North Korea after the assassination of Kim Jong-nam at the airport in Kuala Lumpur. The South Korean foreign ministry indicated that other countries in Africa, the

<sup>35</sup> Choi Song Min, "From cash cow to moribund in a matter of months," June 8, 2016, Daily NK, <http://www.dailynk.com/english/read.php?catald=nk00300&num=13932> and Jiang Jie, "NK restaurants in China falter as staff defect, profits decline," Global Times, May 25, 2016, <http://www.dailynk.com/english/read.php?catald=nk00300&num=13932>.

<sup>36</sup> Joshua Stanton, "North Korean trading companies can't pay their Chinese creditors because of sanctions," One Free Korea, June 22, 2016, <http://freekorea.us/2016/06/22/north-korean-trading-companies-cant-pay-chinese-creditors-because-of-sanctions/> and Choi Song Min, "Sanctions drive trading companies to default on payments," Daily NK, June 21, 2016, <http://www.dailynk.com/english/read.php?num=13953&catald=nk01500>.

<sup>37</sup> Park Boram, "Tightening global sanctions hurting N. Korea's diplomatic ties, overseas commerce," Yonhap news, September 29, 2016, <http://english.yonhapnews.co.kr/northkorea/2016/09/29/0401000000AEN20160929012800315.html> and <sup>37</sup> Daniel Russel, "Statement Before the Senate Foreign Relations Committee, Subcommittee on East Asia, the Pacific, and International Cybersecurity Policy," September 28, 2016, <https://2009-2017.state.gov/p/eap/rls/rm/2016/09/262528.htm>.

<sup>38</sup> Daniel Russel, "Statement Before the Senate Foreign Relations Committee, Subcommittee on East Asia, the Pacific, and International Cybersecurity Policy," September 28, 2016, <https://2009-2017.state.gov/p/eap/rls/rm/2016/09/262528.htm>.

<sup>39</sup> "N. Korea's Air Koryo operates flights to only China, Russia," Korea Times, October 25, 2016, <http://english.yonhapnews.co.kr/northkorea/2016/10/25/90/0401000000AEN20161025003000315F.html>.

<sup>40</sup> Hyun Yun-kyung and Lee Joon-seung, "Malta has stopped issuing work visas for N.Koreas: foreign minister," Yonhap, July 31, 2016, <http://english.yonhapnews.co.kr/northkorea/2016/07/31/0401000000AEN20160731000200315.html>.

<sup>41</sup> Elizabeth Shim, "Hundreds of North Korea workers in Oman sent home, report says," UPI, December 29, 2016, [http://www.upi.com/Top\\_News/World-News/2016/12/29/Hundreds-of-North-Korea-workers-in-Oman-sent-home-report-says/2551483031058/](http://www.upi.com/Top_News/World-News/2016/12/29/Hundreds-of-North-Korea-workers-in-Oman-sent-home-report-says/2551483031058/).

<sup>42</sup> Countries that continue to provide visa waiver to North Korea are Dominican Republic, Ecuador, Haiti, Malaysia, Gambia, and few other small countries. "Singapore to exclude N.Korea from visa waiver countries list in October," Yonhap, July 31, 2016, <http://english.yonhapnews.co.kr/news/2016/07/31/0200000000AEN20160731002100315.html?input=sns>.

Middle East and Europe have also taken steps to reduce the number of North Korean laborers.<sup>43</sup>

#### How North Korea Evades Sanctions

Although the North Korean nuclear and missile programs are indigenous, the regime requires access to foreign technology, components, hard currency, and the international financial system. In 2017, the UN Panel of Experts concluded that, far from being isolated, North Korea continued to circumvent sanctions through “evasion techniques that are increasing in scale, scope and sophistication.”

Pyongyang maintains covert access to the international banking system through a “global array of overseas networks [that] make up a complex overseas financing and procurement system designed to raise the funds and materials North Korea needs for its regime security and weapons programs.”<sup>44</sup> The UN panel assessed that most of North Korea’s financial transactions continue to be denominated in U.S. dollars and thus go through the U.S. banks.<sup>45</sup> The U.S. Treasury Department also found that designated North Korean banks still conduct financial transactions through the American banking system.<sup>46</sup>

North Korean networks in China are a critical component of the regime’s strategy for evading sanctions.

- In September 2016, the Justice Department found that from 2009 to 2015, Chinese nationals had used 22 front companies to open accounts in Chinese banks to conduct dollar transactions through the U.S. financial system for sales to Pyongyang on behalf of a sanctioned North Korean entity.<sup>47</sup>
- The UN identified dozens of Chinese firms linked to sanctioned North Korean entities and cited Bank of China for helping a North Korean entity move \$40 million through U.S. banks. The UN panel showed how North Korea acquired missile components via Chinese firms.<sup>48</sup>
- For years, Korea Kwangsong Bank accessed the financial system illegally through a Chinese conglomerate, Dandong Hongxiang Industrial Development. The U.S. eventually indicted DHID, froze its assets, and filed a complaint to forfeit its accounts in a dozen Chinese banks.<sup>49</sup>

<sup>43</sup> “Poland stops receiving N. Korean workers amid sanctions,” Yonhap, June 7, 2016, <http://english.yonhapnews.co.kr/northkorea/2016/06/07/0401000000AEN20160607009900315.html>.

<sup>44</sup> “Risky Business: A System-Level Analysis of the North Korean Proliferation Financing System,” C4ADS, June 2017, <https://c4ads.org/risky-business>.

<sup>45</sup> “Letter dated 17 February 2017 from the Panel of Experts established pursuant to resolution 1874 (2009) addressed to the President of the Security Council, United Nations Security Council, February 27, 2017, <https://assets.documentcloud.org/documents/3482392/NORTH-KOREA-REPORT.pdf>.

<sup>46</sup> Joshua Stanton and Anthony Ruggiero, “North Korea’s nuclear blackmail: Trump, make sanctions work again,” The Hill, April 3, 2017, <http://thehill.com/blogs/pundits-blog/foreign-policy/326974-trump-make-north-korea-sanctions-work-again>.

<sup>47</sup> Anthony Ruggiero, Severing China-North Korea Financial Links, CSIS, April 3, 2017, <https://www.csis.org/analysis/severing-china-north-korea-financial-links>.

<sup>48</sup> David Feith, “The North Korean Sanctions Myth,” Wall Street Journal, March 27, 2017, <https://www.wsj.com/articles/the-north-korea-sanctions-myth-1490642563>.

<sup>49</sup> Joshua Stanton, “For North Korean banks, 2016 has been like that Corleone baptism montage,” One Free Korea, December 7, 2016, <http://freekorea.us/2016/12/07/for-north-korean-banks-2016-has-been-like-the-corleone-baptism-scene/#sthash.wiO353uC.dpbs>.

- The UN Panel of Experts suspects that at least four U.N.-designated North Korean banks continue to operate from Chinese territory.

The UN Panel of Experts identified a characteristic that makes enforcing sanctions against North Korea easier than against Iran, “*A limited number of trusted individuals appear to serve as the networks’ key nodes.*” (emphasis added). ...Although shell companies can be swiftly changed, the individuals responsible for establishing and managing them have remained, often for years.”<sup>50</sup> While identifying the covert networks is difficult, “by hiding their illicit activities within the global financial network, the North Korean agents leave behind a digital trail within public records, and other data sources, and are acutely vulnerable to targeted sanctions.”<sup>51</sup>

A groundbreaking report by C4ADS, a small non-government organization using publicly available unclassified data, discovered that China “represents about 85% of total North Korean trade. Yet, this entire trading system has consisted of only 5,233 companies from 2013 to 2016 [that] play a disproportionately large role.” Of those firms, a “disproportionate share of that trade is centralized among an even smaller number of large-scale trading firms [so that] the top ten importers of North Korean goods in China in 2016 controlled just shy of 30% of the market.” In turn, those trading firms are controlled by a very small number of key executives.<sup>52</sup>

C4ADS concluded that North Korea has become increasingly reliant on a small number of “gateway firms” operating across multiple covert networks that could become strategic chokepoints for targeted sanctions. As such, the North Korean network in China is “centralized, limited, and therefore vulnerable.”

***Tighten the economic noose.*** The very limited and centralized nature of the North Korean network means that targeting a relatively small number of key nodes can have disproportionate disruptive ripple effects impacting multiple networks across multiple countries. Every law enforcement action could induce remaining components of the network to change routes, bank accounts, and procedures to less effective means to acquire and transfer components and currency. Even legitimate businesses will become more fearful of being entangled in illicit activity and more fully implement required due diligence measures.

Each individual action to constrict North Korea’s trade may not be decisive, but cumulatively these efforts reduce North Korea’s foreign revenue sources, increase strains on the regime, and generate internal pressure.

North Korea adapted to increasing international pressure by altering its modus operandi, including using shell companies and shifting to sophisticated Chinese networks more integrated into the global economy. But international law enforcement efforts didn’t keep pace. The UN Panel of Experts blamed the lack of success of strengthened international sanctions on a lack of “requisite political will, prioritization and resource allocation to ensure effective implementation.” Numerous countries

<sup>50</sup> “Note by the President of the Security Council, United Nations Security Council, February 23, 2015, [http://www.ncnk.org/resources/publications/DPRK\\_Panel\\_of\\_Experts\\_2015.pdf](http://www.ncnk.org/resources/publications/DPRK_Panel_of_Experts_2015.pdf)

<sup>51</sup> “In China’s Shadow: Exposing North Korean Overseas Networks,” The Asan Institute for Policy Studies and C4ADS, August 2016, <http://en.asaninst.org/contents/in-chinas-shadow/>.

<sup>52</sup> “Risky Business: A System-Level Analysis of the North Korean Proliferation Financing System,” C4ADS, June 2017, <https://c4ads.org/risky-business>.

are not implementing and enforcing legislation as well as not performing necessary due diligence, which enables North Korea to continue prohibited activities.<sup>53</sup>

Sanctions enforcement must be flexible, innovative, and adaptive to the changing tactics of the target, rather than abandoning efforts to uphold law and order as having become too difficult. As North Korea shifted to Chinese brokers, the UN and U.S. agencies should have begun including them on sanctions lists.

A Stockholm International Peace Research Institute study from 2014 found that 91% of US and 84% of UN targeted entities were North Korean, but that 74% of sanctions evading networks identified in the report were third country (non-North Korea) entities.<sup>54</sup>

Presently, only 12% of U.S. sanctions to curtail North Korea's nuclear and missile programs are targeted against non-North Korean entities whereas only 2% of UN sanctions are focused on non-North Korean entities.<sup>55</sup>

#### **Raising the Cost of North Korean Defiance**

North Korea must be held accountable for its actions. To refrain from doing so is to condone illegal activity and give *de facto* immunity from U.S. and international law and to undermine UN resolutions. The UN, the U.S. and the European Union have not yet imposed as stringent economic restrictions on North Korea as it did on Iran.

There is much more that can be done to more vigorously implement UN sanctions as well as what the U.S. can do unilaterally to uphold and defend its own laws. North Korea is more vulnerable than Iran to a concerted sanctions program since it has a smaller, less functioning economy that is dependent on fewer nodes of access to the international financial network.

It is possible to influence foreign entities' actions both through direct legal action as well as changing their cost/benefit analysis of economically engaging with Pyongyang. In 2005, the U.S. declared Macau-based Banco Delta a "money laundering concern," which, accompanied by U.S. officials' *sub rosa* meetings throughout Asia, led 24 financial institutions, including nations and the Bank of China to sever relations with Pyongyang.

The U.S. must go beyond sanctions and diplomacy to include a full-court press to diplomatically and economically isolate North Korea from the international community and introduce tremors into regime stability.

Washington should lead a world-wide effort to inspect and interdict North Korean shipping, aggressively target all illicit activity, sanction entities including Chinese banks and businesses that are facilitating Pyongyang's prohibited nuclear and missile programs, expand information operations against the regime, highlight and condemn Pyongyang's crimes against humanity, and wean away even North Korea's legitimate business partners.

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<sup>53</sup> "Letter dated 17 February 2017 from the Panel of Experts established pursuant to resolution 1874 (2009) addressed to the President of the Security Council, United Nations Security Council, February 27, 2017, <https://assets.documentcloud.org/documents/3482392/NORTH-KOREA-REPORT.pdf>.

<sup>54</sup> "In China's Shadow: Exposing North Korean Overseas Networks," The Asan Institute for Policy Studies and C4ADS, August 2016, <http://en.asaninst.org/contents/in-chinas-shadow/>.

<sup>55</sup> Anthony Ruggiero, "Restricting North Korea's Access to Finance," Foundation for Defense of Democracies, July 19, 2017, <https://www.belfercenter.org/publication/restricting-north-koreas-access-finance>.

Only such a long-term principled and pragmatic policy provides the potential for curtailing and reversing North Korea's deadly programs. Returning to over-eager attempts at diplomacy without any North Korean commitment to eventual denuclearization is but a fool's errand. Everything that is being advocated by engagement proponents has been tried, often repeatedly, and failed.

#### **What the US Should Do**

##### **Isolate North Korea economically and diplomatically.**

Prior to 2016, the UN and U.S. sanctions were narrowly target-based which was different from the broader sector-based sanctions imposed on Iran. The differences between the North Korean and Iran approaches were the difference between law enforcement and economic warfare. The latter approach should now be applied to North Korea.

- Cut off the flow of foreign currency into North Korea. The Financial Action Task Force, an international organization that sets anti-money laundering standards, has called on its members to sever ties with North Korean banks and terminate correspondent accounts. The organization is comprised of 35 nations and two regional organizations, including the U.S., South Korea, China, and Japan.<sup>56</sup>
- Target any entity suspected of aiding or abetting North Korean nuclear, missile, and conventional arms development; criminal activities; money laundering; or import of luxury goods. Such targeted financial measures should include seize and freeze assets, impose significant fines, and preclude their access to the U.S. financial system as well as targeting overseas assets, business ventures, and bank accounts associated with any prohibited or illegal activity.
- Ban any entity that trades with North Korea from being allowed to access the U.S. financial system, regardless of whether that trade activity violates UN resolutions.
- Encourage North Korea's business partners to sever their relationships by underscoring the reputation risk of being associated with a regime that exploits its overseas workers and conducts crimes against humanity and terrorist acts against civilians.
- Advocate additional UN measures and assess unilateral U.S. steps to more broadly target North Korea's national economy, including a global embargo to cut off North Korea access to oil, trade, currency, and financial markets. There is precedent for such a move. In November 1963, the UN General Assembly, in Resolution 1899 (XVIII), urged all UN member states to refrain from providing petroleum to South Africa for its policy of apartheid.
- Ban North Korea from international cultural, educational, sporting, and other exchanges, including the Olympics, as the UN requested in December 1968 that all states and organizations do so with the apartheid regime of South Africa. Pretoria was banned from participating in the Olympic Games.

##### **Fully enforce U.S. laws**

For too long, successive administrations have used sanctions as a calibrated and incremental diplomatic response to North Korean provocations rather than a law enforcement measure defending the U.S. financial system.

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<sup>56</sup> "Anti-money laundering body calls for cutting ties with N. Korean banks," Yonhap, October 24, 2016, <http://english.yonhapnews.co.kr/national/2016/10/24/0301000000AEN20161024008800320.html>.

Washington should sanction all entities violating U.S. laws, executive orders, and regulations rather than, as in the past, doling out a few entities to be designated after each North Korean violation. Sanctions do not enforce themselves, they require active continuous implementation.

Doing so, however, requires resolve and political will to sustain a comprehensive long-term campaign against a growing threat to the United States and the international community. It also entails devoting requisite resources, personnel, and funding at the Departments of State and Treasury and other agencies for the extensive and time-consuming detective work required to assemble evidence and designate entities violating U.S. law.

**End de facto Chinese immunity from U.S. law.**

Beijing has not paid a price for its lackadaisical enforcement of UN sanctions and turning a blind eye to North Korean proliferation and illicit activity occurring on Chinese soil. For whatever misguided reasons, Washington has long cowered from targeting Chinese violators of U.S. laws out of fear of undermining perceived assistance in pressuring North Korea or economic retribution against U.S. economic interests.<sup>57</sup>

Dennis Wilder, former Senior Director for Asia at the NSC commented, “Every time we got close to putting in secondary sanctions, the Chinese agree to do a little more [to apply pressure on North Korea]. They’ve been very good at playing the game of ratcheting up pressure on North Korea at times when it helps them avoid us imposing sanctions.”<sup>58</sup>

U.S. officials privately comment that they have lists of North Korean and Chinese entities for which they have sufficient evidence to enforce U.S. law and impose sanctions but were prevented from doing so. The U.S. government knew about Dandong Hongxiang’s activities for six years before taking any action, according to former U.S. Treasury official Anthony Ruggiero.<sup>59</sup>

The North Korean Sanctions and Policy Enhancement Act mandates secondary sanctions on third-country (including Chinese) banks and companies that violate U.N. sanctions and U.S. law. The U.S. should penalize all entities, particularly Chinese financial institutions and businesses that trade with those on the sanctions list, export prohibited items, or maintain correspondent accounts for North Korean entities.

Washington should impose significant fines on China’s largest four banks at a commensurate level to the \$12 billion in fines the U.S. levied on European banks for money laundering for Iran. The U.S. should designate as a money-laundering concerns any medium and small Chinese banks or business complicit in prohibited North Korean activities. The U.S. has not imposed any fines on a single Chinese bank and only recently designed the Bank of Dandong -- the first action against a Chinese bank in 12 years -- as a welcome first step.

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<sup>57</sup> Bruce Klingner, “Chinese Foot-dragging on North Korea Thwarts U.S. Security Interests, The Heritage Foundation, August 11, 2016, <http://www.heritage.org/defense/report/chinese-foot-dragging-north-korea-thwarts-us-security-interests>.

<sup>58</sup> Josh Meyer, “Failure to sanction China helped North Korea, former officials say,” Politico, April 16, 2017, <http://www.politico.com/story/2017/04/north-korea-china-sanctions-237238>.

<sup>59</sup> Josh Meyer, “Failure to sanction China helped North Korea, former officials say,” Politico, April 16, 2017, <http://www.politico.com/story/2017/04/north-korea-china-sanctions-237238>.

The U.S. must separate law enforcement measures to protect America's financial system from diplomatic attempts to encourage Beijing to more fully implement required UN sanctions. Any entity that enters the U.S. financial system is subject to its rules and regulations, regardless of country of origin. The U.S. is not only allowed but required to take action.

Imposing secondary sanctions, or even having the Damocles Sword of their future imposition, can push foreign banks and businesses to abandon dealing with North Korea, even on legitimate business ventures, lest they face U.S. fines, asset seizure, and preclusion from accessing the all-important U.S. financial system.

The U.S. should make clear to Beijing that actions are against entities violating laws, not the Chinese government. That said, Chinese government reluctance to uphold laws raises suspicions of Chinese complicity.

**Ban North Korea overseas workers exploited in highly abusive conditions.** Workers often operate in violation of international labor laws. The North Koreans are stripped of their passports, forced to perform labor in unsafe or exploitative conditions often without compensation, and have their wages paid directly to the regime which dispenses only a fraction to the workers.<sup>60</sup>

North Korea has an estimated 60,000 to 100,000 overseas workers in 50 countries but mainly China and Russia, earning the regime between \$1.2 billion and \$2.3 billion annually in foreign currency.<sup>61</sup> Other experts estimate the figure is lower, approximately \$300 million to \$400 million annually.<sup>62</sup>

The U.S. should push for a UN ban on North Korean overseas laborers which would end exploitative labor practices and eliminate a source of regime revenue. U.S. Executive Order 13722, promulgated to implement the North Korea Sanctions and Policy Enhancement Act, blocks the property of any person found to "have engaged in, facilitated, or been responsible for the exportation of workers from North Korea, including exportation to generate revenue for the Government of North Korea or the Workers' Party of Korea."<sup>63</sup>

#### **Target North Korean human rights violations**

Advocacy for human rights must be a part of a comprehensive U.S. policy on North Korea. Stigmatizing the regime for its barbaric treatment of its people is consistent with American values and principles, provides an additional means to sanction the regime, and provides greater traction in gaining international condemnation and punitive action against Pyongyang.

<sup>60</sup> Greg Scarlatoiu, "Congressional Testimony: North Korea's Forced Labor Enterprise: A State-Sponsored Marketplace in Human Trafficking," The Committee for Human Rights in North Korea, April 29, 2015, <http://www.hnkc.org/events/congressional-hearings-view.php?id=11>.

<sup>61</sup> Kim Tong-hyung, "How Impoverished but Nuclear-armed North Korea Earns Money," Associated Press, February 12, 2016, [http://host.madison.com/travel/national/how-impoverished-but-nuclear-armed-north-korea-earns-money/article\\_2d640cfa-377b-597d-b358-1dcdb1ecbf09.html](http://host.madison.com/travel/national/how-impoverished-but-nuclear-armed-north-korea-earns-money/article_2d640cfa-377b-597d-b358-1dcdb1ecbf09.html).

<sup>62</sup> "N. Korea's Treatment of Its Laborers Abroad Is Scandalous Abuse," *The Chosun Ilbo*, February 22, 2016, [http://english.chosun.com/site/data/html\\_dir/2016/02/22/2016022201738.html](http://english.chosun.com/site/data/html_dir/2016/02/22/2016022201738.html).

<sup>63</sup> "Blocking Property of the Government of North Korea and the Workers' Party of Korea, and Prohibiting Certain Transactions With Respect to North Korea," Executive Office of the President, March 18, 2016, <https://www.federalregister.gov/documents/2016/03/18/2016-06355/blocking-property-of-the-government-of-north-korea-and-the-workers-party-of-korea-and-prohibiting>.



Executive Order 13687, issued in 2015, declared that North Korea's "serious human rights abuses constitute a continuing threat to the national security, foreign policy, and economy of the United States." Since the July 2016 designation of Kim Jong-un and other North Korean entities, the United States has not taken any additional measures against North Korean human rights abusers. Washington should exponentially expand the list of North Korean entities sanctioned for human rights violations and lead an energetic public diplomacy effort to shame foreign businesses away from dealing with North Korea.

**Return North Korea to the state sponsors of terrorism list.**

Since the U.S. removed North Korea from the State Sponsors of Terrorism List in 2008 in a failed attempt to stimulate progress in the Six-Party Talks nuclear negotiations, the regime has conducted a number of violent acts which justify its re-designation. Under various statutes of U.S. law (the most relevant being 18 U.S. Code § 2331), international terrorism is defined as acts that:

- (A) involve violent acts or acts dangerous to human life that are a violation of the criminal laws of the United States or of any State, or that would be a criminal violation if committed within the jurisdiction of the United States or of any State;
- (B) appear to be intended—
  - (i) to intimidate or coerce a civilian population;
  - (ii) to influence the policy of a government by intimidation or coercion; or
  - (iii) to affect the conduct of a government by mass destruction, assassination, or kidnapping; and would be a criminal violation if committed within the jurisdiction of the United States and are intended to intimidate or coerce a civilian population.<sup>64</sup>

After its cyber attack on Sony Pictures, North Korea threatened "9/11-type attacks" against U.S. theaters to intimidate patrons from viewing the movie *The Interview* which ridiculed Kim Jong-un. North Korea has also been involved in cyber attacks South Korean government agencies, businesses, banks, and media organizations; attempted assassinations against North Korean defectors and South Korean intelligence agents; and shipments of conventional weapons to Hamas, Hezbollah, Iran, and Syria.<sup>65</sup>

**Increase information operations** to promote greater North Korean exposure to the outside world. Promoting democracy and access to information in North Korea is in both the strategic and humanitarian interests of the United States. Improving access to information will help the people of North Korea and provide a means of influencing North Korea from the inside out. As demonstrated by U.S. and West German efforts during the Cold War, technology and media can play a crucial role in undermining totalitarian regimes.<sup>66</sup>

The United States and South Korea should expand broadcasting services, such as by Radio Free Asia, and distribution of leaflets, DVDs, computer flash drives, documentaries, and movies into North Korea through both overt and covert means. South Korea should look into the potential for

<sup>64</sup> 18 U.S. Code § 2331 – Definitions, Cornell University Law School, <http://www.law.cornell.edu/uscode/text/18/2331> (accessed January 11, 2016).

<sup>65</sup> For a more complete listing of North Korean terrorist-related actions, see Bruce Klingner, "Moving Beyond Timid Incrementalism: Time to Fully Implement U.S. Laws on North Korea: Congressional Testimony before the House Foreign Affairs Committee," January 13, 2016, <http://www.heritage.org/testimony/moving-beyond-timid-incrementalism-time-fully-implement-us-laws-north-korea>.

<sup>66</sup> Olivia Enos, "Improving Information Access in North Korea," December 7, 2016, <http://www.heritage.org/research/reports/2016/12/improving-information-access-in-north-korea>.

generating cell phone transmissions, potentially using the frequency of the network created by Egyptian firm Orascom, to enable North Korean citizen communication with the outside world. Subversive coercive information operations exposing the true nature of the regime could sow domestic dissent against the regime.

**Impose Travel Ban on US citizens to North Korea.** Banning tourist travel to North Korea would protect additional Americans from being arrested on trumped up charges and sentenced to excessively lengthy and arduous imprisonment. While the U.S. government rightfully hesitates in curtailing Americans' right to travel, there are occasions where public safety considerations require such action.

A ban would also reduce, albeit on a small scale, funds to the regime. The State Department recently announced a restriction on the use of American passports to travel to North Korea.<sup>67</sup> There will be exemptions to enable humanitarian, journalist, and government travel.

The U.S. should augment the passport restriction with legislation banning "transactions incident to travel to, from, and within North Korea." Such a provision would ban dollar-denominated travel to North Korea regardless of the nationality of the traveller. The U.S. could also impose a "secondary immigration sanction on North Korea, one that would make any recent non-U.S.-citizen travelers to North Korea ineligible for admission into the United States."<sup>68</sup>

The U.S. should encourage China to also implement a travel ban on its citizens traveling to North Korea. Beijing demonstrated it can and would do so over its disagreement with Seoul over the THAAD deployment. Beijing pressured Chinese tourists away from South Korea, even to the point where thousands aboard a cruise ship all refused to disembark on Jeju Island.

**Increase Inspection and Interdiction of North Korean shipping** - UN resolutions against North Korea have all been passed with UN Charter Chapter 7, Article 41 authority. The UN should instead provide for Article 42 authority to enable military, coast guard, and law enforcement vessels to carry out the required inspections. This would authorize naval, coast guard, and law enforcement personnel to intercept, board, and inspect North Korean ships suspected of transporting precluded nuclear, missile, and conventional arms, components, or technology.

As required under UN Resolution 2270, all UN member nations should be proactively monitoring *all* North Korean cargo entering and leaving the country. The North Korea Sanctions and Policy Enhancement Act Section 205 enables the U.S. to impose secondary shipping sanctions on ports failing to implement required inspections. Washington could intensify inspections or ban shipments into the U.S. from non-compliant ports.<sup>69</sup>

<sup>67</sup> "United States Passports Invalid for Travel to, in, or Through the Democratic People's Republic of Korea," U.S. Federal Register, August 2, 2017, <https://www.federalregister.gov/documents/2017/08/02/2017-16287/united-states-passports-invalid-for-travel-to-in-or-through-the-democratic-peoples-republic-of-korea>.

<sup>68</sup> Joshua Stanton, "The North Korea travel ban, PUST, and the failure of people-to-people engagement," OneFreeKorea, July 25, 2017, <http://freekorea.us/2017/07/25/the-north-korea-travel-ban-pust-just-the-beginning/#sthash.sWImhMrK.dpbs>.

<sup>69</sup> Joshua Stanton, "China is waging economic war against S. Korea. We must stand by our ally," OneFreeKorea, March 8, 2017, <http://freekorea.us/2017/03/08/china-is-waging-economic-war-against-south-korea-we-must-stand-with-our-ally/#sthash.PqcUCFTp.dpbs>.

There should also be a concerted international effort, as required under UN Resolution 2270, to target North Korean attempts at reflagging its ships under other nation's flags of convenience.

**Conclusion**

If the U.S. is serious about going after North Korea's nuclear and missile programs and those that assist it, then Washington will have to engage in a more expansive, sustained, and committed campaign. This must include a willingness to sanction Chinese entities.

Targeted financial measures, including secondary sanctions, are a component of U.S. laws and executive orders to defend the U.S. financial system against those who would use it for illicit activities. Those who argue against imposing stronger sanctions should be called on to explain how giving entities immunity from U.S. law furthers the cause of North Korean denuclearization. That all of these measures could have been implemented years ago is testament to a collective lethargy, a multi-national reluctance to confront North Korean belligerence. Even today, some counsel caution for fear of how North Korea could respond to being held accountable for its transgressions. But just as sheepishness is contagious, so is fortitude to do the right thing. The United States and other nations should not shirk from their responsibility to stand up to those who would do us harm.

Sanctions require time and the political will to maintain them in order to work. While there are additional measures that could be included in additional legislation, more important is to vigorously and assiduously implement existing UN measures and U.S. laws. We must approach sanctions, pressure, and isolation in a sustained and comprehensive way. It is a policy of a slow python constriction rather than a rapid cobra strike.

What are America's other options? Abandon enforcing U.S. laws and give blanket immunity to North Korean and Chinese entities? Rush back to another round of negotiations that Pyongyang declares it is not interested in? Accept North Korea as a nuclear state and undermine global non-proliferation efforts. Or initiate military action to impede North Korea's imminent completion of its ICBM, in essence stating a war to prevent a war. Sanctions, working in conjunction with other instruments of national power, have a better chance than any tool being used in isolation.

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Center for a  
New American  
Security

September 13, 2017

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

A Legislative Proposal to Impede 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 before you today on U.S. policy options to pressure North Korea through constraints on its access to finance.

North Korea's alarming and dangerous recent expansion of provocations, including more ballistic missile launches and a sixth, powerful nuclear test, highlight the need for much stronger pressure on the regime. This pressure may serve to curb North Korea's threatening activity and facilitate a diplomatic process to advance denuclearization. Financial sanctions should be a core part of such a pressure strategy, along with force posture and projection, and other coercive tools of statecraft, and complemented by serious diplomatic engagement. The United States is placed to lead this effort and must closely coordinate with international partners even as it urges them to do more with secondary sanctions and other gestures.

The Sanctions Framework for North Korea, Compliance, and Circumvention

The United States has in place a framework of sanctions to apply financial pressure on North Korea to limit its proliferation activities and the broader revenue streams available to regime leaders. These complement and expand on sanctions put in place by the United Nations Security Council, which instruct member states to cease dealings with North Korean proliferation entities and stop engaging in proscribed economic activities that enrich the regime.

I applaud the recent work of Congress this past summer to impose new sanctions authorities to tighten the financial pressure framework on North Korea, along with new sanctions from the United Nations. Collectively, these new authorities expanded pressure on North Korea with restrictions on economic sectors including energy, metals and mining, transportation, financial services, and seafood, as well as limitations on North Koreans working abroad.

However, as your legislative discussion draft, the focus of today's hearing, aptly points out, circumvention of sanctions and non-enforcement is a major problem and a key reason for North Korea's continued proliferation activities. Tough sanctions authorities cannot, of themselves, create

*Bold.*

*Innovative.*

*Bipartisan.*

meaningful pressure on North Korea to change its policies. Rather, their enforcement, particularly by North Korea's key financial partners, will determine the measures' strength, which may contribute to an effective pressure strategy to facilitate North Korean policy change. In practical terms, effective sanctions enforcement comes down to China, which is responsible for over 90% of North Korea's trade, adopting a strict enforcement posture.<sup>1</sup>

#### Application of Secondary Sanctions on North Korea

The regime of current international sanctions may actually be adequate to constrain the ability of North Korea to procure proliferation materials, and to influence its cost/benefit calculation on instigating international threats, if fully enforced. Unfortunately, it is not. Also, these outcomes are not the only goals of most U.S. leaders who now aim to use pressure to change the cost/benefit calculation of China to coerce North Korea into halting its provocations and proliferation.

The United States, at present, does have sweeping, powerful authorities to impose sanctions and conduct law enforcement activities to identify and impede North Korea's international agents and affiliates propping up the regime's proliferation activities and its economic activity. The U.S. administration can go after major international companies, banks, and officials and has announced some important, recent actions to highlight and impede North Korea's international facilitation networks. There is much more that the administration can, and no doubt will, do to continue this work. The primary priority in congressional oversight of U.S. sanctions on North Korea should be to urge and support aggressive implementation of existing sanctions authorities, which will do a great deal to deepen the financial pressure on North Korea and its enablers.

Nevertheless, many legislators and other observers frustrated with non-enforcement and evasion of sanctions, and anxious that sanctions, when they are enforced, are not working rapidly enough, are gravely concerned that time is running out. For some, this translates into the belief that the current U.S. sanctions framework is inadequate, and that the United States should make secondary sanctions "shock treatment" mandatory to force other countries to comply with U.N. sanctions on North Korea. I believe it is time to contemplate where mandatory secondary sanctions would be appropriate to accelerate or deepen the pain of sanctions targeting North Korea. I support the efforts of this committee to consider how such measures should be deployed to send a very clear message to North Korea and those who prop up its regime.

We must not forget, however, that secondary sanctions require great delicacy in their application. Often, just the threat of use or a few carefully-chosen example cases can have the desired deterrent effect to motivate compliance among the global financial community. They may be counterproductive if application of secondary sanctions is so aggressive or politically incendiary so as to make U.S. partners utterly defiant, uncooperative, and move rapidly to create officially-backed evasion schemes and impose retaliatory sanctions and economic punishment on U.S. firms operating abroad. Secondary sanctions can also backfire if their implementation does not allow the targets of these measures to change their policies and effectively comply with sanctions in a manner that is politically acceptable to their domestic constituency. China, for example, is highly unlikely to sever

<sup>1</sup> Eleanor Albert, "The China-North Korea Relationship," Backgrounder (Council on Foreign Relations, July 5, 2017), <https://www.cfr.org/backgrounder/china-north-korea-relationship>.

its economic activity with North Korea if the only way to do it appears to its population and the global community to be capitulation to U.S. sanctions.

Another risk of secondary sanctions is that their application could have significant unintended consequences for U.S. businesses and individuals, particularly those within China, for rapidly expanding bilateral trade with China, or for the U.S. economy more broadly. If the United States imposes sanctions on major Chinese banks, for example, there could be significant implications for currency devaluation in China, and spillover currency valuation effects elsewhere, making U.S. goods and services less competitive for export. Sanctions on Chinese banks could also negatively impact the U.S. correspondent institutions of sanctioned Chinese banks, or bilateral and international trade, to the detriment of the economic interests of the United States and allies. The largest Chinese banks are the largest global banks, and the United States must move carefully to address any North Korean financing moving through these institutions.<sup>2</sup> We must bear in mind that the highly interconnected nature of our global economy and supply chains means that a disruption or crisis in China will inevitably affect the United States.

Targeted secondary sanctions on the largest Chinese banks could ultimately be the right answer to create pressure on North Korea, but other law enforcement actions or regulatory penalties could be more appropriate to send a strong signal and manage the consequences for the U.S. economy. Ultimately, avoiding pitfalls in the use of secondary sanctions is primarily the responsibility of the U.S. administration, the body that implements and enforces sanctions. Congress must give the administration adequate flexibility, even within a framework of broad mandatory sanctions, to be able to impose aggressive sanctions to pressure North Korea but also manage the consequences and pursue an effective diplomatic and alliance strategy with international partners.

#### A Rigorous, Risk-Based Approach to Countering Proliferation Finance

In the realm of financial statecraft to apply pressure on North Korea, sanctions are only one set of instruments available to the United States. An overwhelming focus on sanctions as the only or the primary instrument of financial pressure elides the significance of another powerful framework to limit North Korea's proliferation activities. This other framework is a rigorous, risk-based approach by global financial institutions to identify and curtail proliferation finance within their institutions.

Currently, only large U.S. banks, and some major European and Asian financial institutions, holistically pursue proliferation finance, leaving all other global banks significantly vulnerable to abuse by North Korean, or other, proliferators. For these other global banks, weak supervisory frameworks and expectations, lack of knowledge and resources, and insufficient prioritization of the threat means that they often take a mechanical approach to proliferation finance in the form of checking customers or transactions against entities sanctioned by the U.N. or national governments (sometimes, but not always, including the United States). This presents obvious, and documented, opportunities for proliferators to use front companies or proxies to get around limited compliance controls outside of major financial institutions. Very often, banks in high-risk jurisdictions are not asking the right questions to discern when money laundering, cash transactions, or other suspect

<sup>2</sup> "The World's Largest Banks," *SC&P Global Market Intelligence*, <http://pages.marketintelligence.spglobal.com/Global-Bank-Rankings-Request.html>.

activity may be disguising proliferation finance. Information from U.N. reports,<sup>3</sup> investigative journalists,<sup>4</sup> law enforcement cases,<sup>5</sup> and independent experts<sup>6</sup> illustrates how financial institutions offer services to North Korean proliferators and their money laundering fronts, often unwittingly, without rigorous investigation into proliferation finance ties.

The global standard setting body for countering illicit finance, the Financial Action Task Force (FATF), endorses an approach toward proliferation finance along the lines of checking customers against sanctions lists, instead of a broader risk-based evaluation of suspect proliferation conduct or proliferation typologies.<sup>7</sup> FATF is now in the process of updating guidance on proliferation finance. However, it has many more opportunities to provide strong leadership to activate the global banking community to identify and counter proliferation finance in a manner that is commensurate with the current proliferation risk and that is in line with the standards currently applied to other forms of serious illicit activity, such as terrorist financing.

There must be much stronger leadership from best-in-class financial sector leaders as well as from national leaders on the subject of proliferation finance to clarify that global banks must take a more holistic, risk-based approach to screening and investigating for proliferation finance, and there must be strong public-private information exchange around known proliferation entities and typologies. Without such leadership, and indeed without the creation of tough expectations and requirements for global financial institutions, most international banks and their regulators will not change the alarmingly inadequate status quo on countering proliferation finance. They may become better list-checkers if there are more primary and secondary sanctions, but that will not change the culture of compliance enough to truly mitigate the proliferation finance threat. Moreover, without strong signaling for change from FATF, the mandate of multilateral development institutions and multilateral financial service sector technical bodies will not include the provision of technical assistance around a rigorous, risk-based approach to proliferation finance.

Working to change the compliance practices of global banks around proliferation finance concerns will not immediately halt the North Korean threat. It can, however, have a profound, ultimate impact, and is an appropriate and effective complement to additional sanctions on the North Korean regime. Both of these forms of financial statecraft are needed as part of a broad strategy to apply pressure on North Korea and check its ability to engage in proliferation activities.

<sup>3</sup> See for example UN Security Council, "Report of the Panel of Experts Established Pursuant to Resolution 1874 (2009)", S/2017/150, February 27, 2017, 72.

<sup>4</sup> See for example James Pearson, Tom Allard, and Rozanna Latiff, "Exclusive - 'Dollars and euros': How a Malaysian firm helped fund North Korea's leadership," Reuters, April 10, 2017, <http://uk.reuters.com/article/uk-northkorea-malaysia-business-exclusiv/exclusive-dollars-and-euros-how-a-malaysian-firm-helped-fund-north-koreas-leadership-idUKKBN17C0AI?il=0>.

<sup>5</sup> See for example *Chinpo Shipping Co (Pte) Ltd vs. Public Prosecutor*, 'Judgment', High Court of the Republic of Singapore, Magistrate's Appeal No. 9016 of 2016, 2017 SGHC 108, May 12, 2017.

<sup>6</sup> See for example Andrea Berger, "A House Without Foundations: The North Korea Sanctions Regime and its Implementation," Whitehall Report 3-17 (Royal United Services Institute, June 2017), 16-17.

<sup>7</sup> Emil Dall, Andrea Berger, and Tom Keatinge, "Out of Sight, Out of Mind? A Review of Efforts to Counter Proliferation Finance," Whitehall Report 3-16 (Royal United Services Institute, June 2016), 9, [https://rusi.org/sites/default/files/201606\\_whr\\_3\\_16\\_countering\\_proliferation\\_finance\\_v2\\_0.pdf](https://rusi.org/sites/default/files/201606_whr_3_16_countering_proliferation_finance_v2_0.pdf). See the relevant recommendations in FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations", (FATF, February 2012), [http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf).



### Comments on Pending Legislation and Ideas for Additional Measures

I will offer a few points in response to your legislative discussion draft. I will also offer some ideas for inclusion as you continue to evaluate policy options and craft a strategy for oversight of new sanctions, following their presumed enactment into law.

- A tough approach to focusing on North Korean proliferation networks and facilitators and cutting off North Korea's ability to earn and use foreign currency is appropriate and proportionate to the risk we face today. Now is the time to embrace secondary sanctions authorities and a calculated, targeted strategy for their implementation, to contribute to a broader pressure strategy applied by the United States and international partners on the North Korean regime and its facilitators.
- Within a framework of mandatory secondary sanctions, I strongly encourage the inclusion of meaningful and unconditional waiver provisions to allow the U.S. administration to manage unintended consequences of mandatory secondary sanctions, including avoiding accidentally undermining a broader U.S.-led coalition strategy toward North Korea, a situation where sanctions create a true diplomatic breakdown or look likely to provoke a trade war between the United States and China, for example, or the creation of untenable economic costs for the United States. Waiver provisions should not excuse any proliferation activities but should provide the U.S. administration implementation discretion with regard to partner countries conducting economic activity with North Korea if they make rapid, significant, and repeated progress in reducing trade or financial transactions with North Korea, or if they could otherwise be deemed to be a closely cooperating partner of the United States. This kind of waiver framework could also prescribe escrowing of limited North Korean funds, if permitted under a significant reduction waiver, in monitored accounts from which money may not be transferred to a third country.
- Congress should require the administration to prepare a study on the impacts of different forms of sanctions on large Chinese banks that have dealt either directly or indirectly with North Korea, including its proliferation entities. As the full implications of potential U.S. sanctions or other law enforcement actions on large Chinese banks are not well understood, a rigorous and empirical approach to this matter will guide careful application of sanctions authorities, or the use of other law enforcement actions, and provide useful information to Congress as legislators oversee the U.S. financial pressure strategy on North Korea and consider possible policy options in the future.
- The threat of cutting off International Monetary Fund (IMF) support to countries in which evasion of North Korea sanctions occurs, notably China and Singapore, misses the reality that the countries of greatest proliferation concern are not necessarily aid recipients or the countries with the least capacity and funds for sound sanctions compliance. Also, cutting off IMF support for poorer countries in Africa or elsewhere in Asia that have conducted some business with North Korea, and where limited but concerning evasion may be ongoing, may be less effective than authorizing more funds for technical assistance to support rigorous compliance. Congress should consider ways to direct more money to technical assistance on

proliferation finance and sanctions compliance issues, including through the U.S. Department of the Treasury's Office of Technical Assistance, using funds from illicit finance asset forfeiture or bank fines for violation of sanctions, among other possible sources.

- I caution against new sanctions that specifically go after political leaders of countries in which sanctions evasion occurs. This will be provocative and unconstructive in the diplomatic process of working multilaterally to constrain North Korea's threat. It may create real logistical impediments for the United States in communicating and coordinating with partners on North Korea policy, and it may make it needlessly politically infeasible for these partners to find ways to comply domestically with sanctions on North Korea. The array of U.S. secondary sanctions authorities designed to go after sanctions violators and evaders outside of North Korea, including financial institutions, companies, traders, shippers, insurers, and many others, will certainly be adequate to compel the serious attention of political leaders in countries where evasion is occurring.
- To accelerate the adoption of a rigorous, risk-based approach to proliferation finance at global banks, particularly those in high-risk jurisdictions, Congress can instruct the Financial Crimes Enforcement Network (FinCEN) and the U.S. federal banking regulators to expand supervision of U.S. financial institutions with regard to proliferation finance in risk-based anti-money laundering programs. Banking supervisors should evaluate the adequacy of requirements for covered institutions' foreign subsidiaries, branches, and correspondents to appropriately and similarly apply a rigorous, risk-based approach to identify, freeze, investigate, and report proliferation transactions. FinCEN and the banking agencies should provide proliferation finance typologies, with special emphasis on those used by North Korean proliferation networks, in the new update of the Federal Financial Institutions Examination Council (FFIEC) manual, currently under revision to account for the new Customer Due Diligence rule.
- To complement and support new supervision requirements for U.S. banks, extending to their foreign branches, subsidiaries, and correspondents, on proliferation finance, Congress should facilitate greater information sharing among banks and between the public and private sectors on proliferation finance. Three ways to accomplish this include the following requirements:
  - Instruct FinCEN to regularly report to Congress on the intelligence products it generates from Bank Secrecy Act filings on proliferation finance transactions moving through the U.S. financial system and on its collaboration with law enforcement agencies, the intelligence community, and foreign financial intelligence units to make maximum use of Bank Secrecy Act data. FinCEN should also report on the advisories it issues to financial institutions on proliferation finance activity.
  - Amend Section 314(b) of the USA PATRIOT Act to more explicitly allow banks and other financial institutions authorized under that provision to share information for the purpose of detecting proliferation finance-related activity. Also, amend Section 314(b) to provide safe harbor for certain non-financial institutions, e.g. company formation service providers, to share with banks information about their customers relevant to the detection of terrorism finance, proliferation finance, and money laundering.

- Direct the Treasury Department to consider whether and how current regulations for information sharing, particularly for the purpose of identifying and impeding proliferation finance, may be expanded within the scope of Section 314(b), and to convene external experts and stakeholders in the process, conducting related rulemaking to accomplish any such expansion through a formal regulatory notice and comment process.
- Perhaps the most effective thing that Congress can do to accelerate and enhance the administration's work to analyze North Korean economic and proliferation activity and impose sanctions on those facilitating and enabling it is to give the Treasury and State Departments, and the Intelligence Community, more financial support to expand their work in this area. Such funds could come from law enforcement asset forfeiture or penalties paid by violators of sanctions. More administration experts to do the technical analytical and designations work will rapidly translate into a more muscular ability to use sanctions pressure. More diplomats to explain to foreign banks and regulators the requirements of U.S. sanctions, and the risks of violating them, will also have a direct and meaningful effect on sanctions implementation internationally. Reporting requirements for the administration to explain publicly to Congress its North Korea sanctions strategy are appropriate, and they may play a role in mitigating unintended escalation or miscalculation. However, it would be a detriment to U.S. national security if reporting requirements draw significant time and attention away from the already-stretched experts working in the government to impose and enforce sanctions.

Congress has an important role to play in authorizing and overseeing a strong pressure campaign on North Korea, including financial sanctions and other economic measures, to address the regime's dangerous proliferation activity and defiant provocations. With the direction of responsible U.S. policy leaders, this pressure campaign will maintain the multilateral framework necessary for success and a holistic approach balancing the various tools of economic statecraft with military force and diplomacy. It would be folly to think that sanctions or financial pressure alone, or even primarily, can engineer North Korean willingness to enter diplomatic talks or consider a proliferation moratorium or denuclearization. But, as such economic coercion has the potential to help move North Korea toward a more stable and peaceful path, tough financial sanctions and rigorous bank scrutiny for proliferation finance must now be key policymaker priorities.

CONGRESSIONAL TESTIMONY: FOUNDATION FOR DEFENSE OF DEMOCRACIES

House Financial Services Committee  
*Monetary Policy and Trade Subcommittee*

# A Legislative Proposal to Impede North Korea's Access to Finance

ANTHONY RUGGIERO

Senior Fellow  
*Foundation for Defense of Democracies*

Washington, DC  
September 13, 2017



[www.defenddemocracy.org](http://www.defenddemocracy.org)

## 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 begin with an update on the nature of North Korea sanctions, provide examples of North Korea's illicit financial activities, and propose ideas to combat those activities.

Often, U.S. policy toward North Korea gets stuck in the provocation-response cycle whereby a North Korean provocation is met with strong rhetoric and/or a token increase in sanctions, which is repeated over and over. These scattershot responses have not, to date, added up to a serious and effective sanctions policy because they are driven by the momentary need to look tough, rather than by a clear strategy for denuclearizing the Korean peninsula. In practice, the Kim regime can keep distracting the United States with its repeated provocation. We should break this cycle and ensure that the U.S. response to every North Korean provocation advances our ultimate goal.

Regrettably, many experts call for the acceptance of North Korea as a nuclear weapons state and insist that the U.S. can protect itself with a policy of deterrence. To evaluate the effectiveness of deterrence, one must be clear about such a policy's goals. Some suggest the United States has successfully deterred Pyongyang over the last 25 years, since there has been no second Korean war. But the goal should be deterring North Korea from actions that threaten the U.S. or its allies. On that score, deterrence has had a mixed record at best. For example, Pyongyang killed over 40 South Korean sailors when it sunk the *Cheonan*, maintains a robust relationship with Iran, built a nuclear reactor in Syria that Israel destroyed in 2007, and launched a ballistic missile directly over Japan. Unfortunately, this is a short list of the failures of deterrence.

At some point, Washington will need to consider the Kim regime as the obstacle to achieving denuclearization of the Korean peninsula, and sanctions can decrease the threat from the regime in a way that negotiations cannot.

## The Nature of North Korea Sanctions

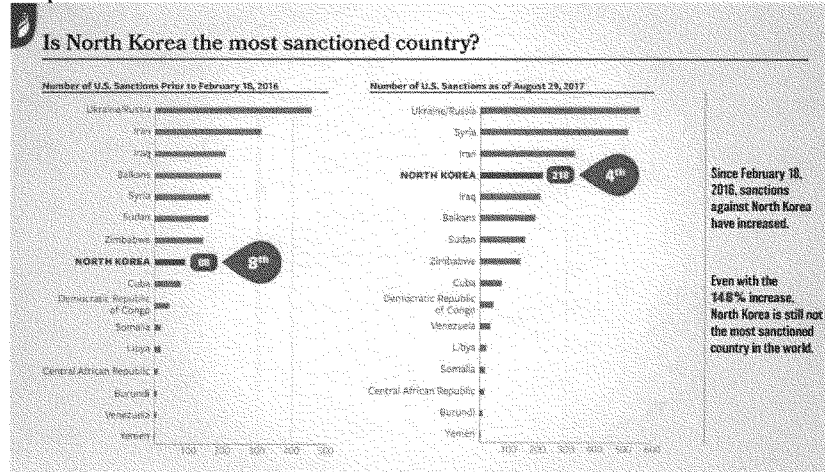
In testimony before this subcommittee in July, I provided conclusions from a quantitative and qualitative review of North Korea sanctions.<sup>1</sup> This year, the Trump administration started to sanction North Korean international business partners. Since March 31, the U.S. has sanctioned 43 persons, of whom 86 percent operate outside North Korea and 54 percent are non-North Koreans who facilitate North Korea's sanctions evasion.

A quantitative review of U.S. sanctions reveals that North Korea currently sits fourth on the list of countries with the most sanctioned entities. North Korea has moved up one position since my July testimony, placing it behind Ukraine/Russia, Syria, and Iran – even after the lifting of numerous sanctions on Iran to comply with the Joint Comprehensive Plan of Action (JCPOA), as the 2015

<sup>1</sup> Anthony Ruggiero, "Restricting North Korea's Access to Finance," *Testimony before House Committee on Financial Services, Subcommittee on Monetary Policy and Trade*, July 19, 2017. ([http://www.defenddemocracy.org/content/uploads/documents/Anthony\\_Ruggiero\\_Testimony\\_HFSC.pdf](http://www.defenddemocracy.org/content/uploads/documents/Anthony_Ruggiero_Testimony_HFSC.pdf))

nuclear deal is formally known – and ahead of Iraq (see graphic 1).<sup>2</sup> 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.

Graphic 1

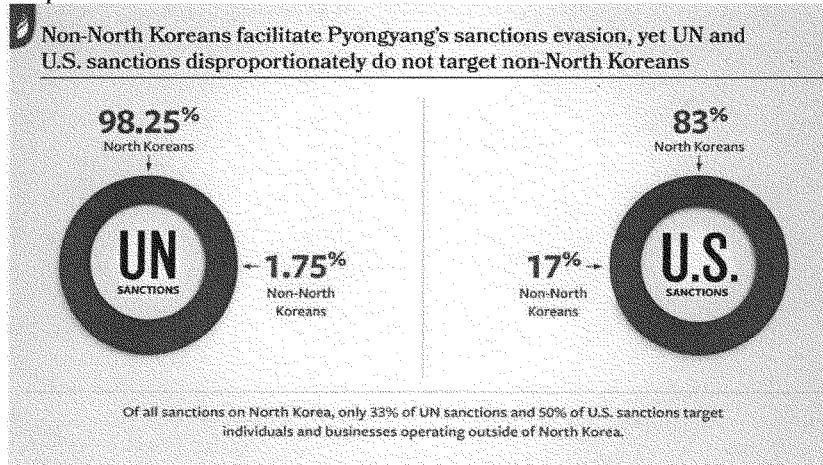


<sup>2</sup> The review of sanctions included those entities and individuals listed on the U.S. Department of the Treasury's Office of Foreign Assets Control Specially Designated Nationals list. The Ukraine/Russia sanctions category includes persons sanctioned under the Sergei Magnitsky Rule of Law Accountability Act and persons subject to the Ukraine-related Directives. U.S. Department of the Treasury, Specially Designated Nationals List, accessed through August 29, 2017. (<https://sanctionssearch.ofac.treas.gov/>)

A qualitative assessment of the sanctions imposed on North Korea reinforces the conclusion that it has not been targeted aggressively, since U.S. sanctions barely touch the international business networks – especially in China – on which Pyongyang relies to evade most restrictions. The Trump administration’s recent efforts have focused on Pyongyang’s international business and non-North Koreans, but there is still more to do.

Even the UN acknowledges 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.<sup>3</sup> In testimony before this subcommittee, I noted that 47 percent of U.S. sanctions targeted persons located/conducting business outside of North Korea. That number has now increased to 50 percent. In July, only 12 percent of those persons were non-North Korean; that number has increased to more than 17 percent (see graphic 2). The UN sanctions numbers are worse. In July, only 27 percent of all designated persons were located or conducting business outside of North Korea, a number that has improved to 33 percent. In July, only 2 percent of those persons were non-North Korean, yet that number has dropped to 1.75 percent.

**Graphic 2**



<sup>3</sup> 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>)

### North Korea's Financial Activities

A review of the Treasury and Justice Departments' actions against North Korea's financial activities reveals three main methods Pyongyang uses to finance its sanctions evasion. The first method was used by Dandong Hongxiang Industrial Development, which was sanctioned by Treasury and indicted by Justice in September 2016 (see graphic 3).<sup>4</sup> The method was also used by Dandong Zhicheng Metallic Materials, which was sanctioned by Treasury and subject to an asset forfeiture request for more than \$4 million filed by Justice in August.<sup>5</sup> Both companies' illicit activities were initially exposed by the innovative data-mining organization C4ADS.<sup>6</sup>

The scheme begins with North Korea shipping a commodity to a Chinese company – in these examples, coal is used. The Chinese company sells the item and pockets a significant profit. The money owed to the North Korean exporter remains in China, which allows North Korea to use it to purchase goods. Each side keeps a ledger that tracks debits and revenue, which allows North Korea to purchase goods from its Chinese trade partner's accounts; the Chinese partner receives additional profit from facilitating these sales. Most sellers want payment in U.S. dollars, which requires hiding Pyongyang's role to continue the transaction. This is the point at which Chinese firms and individuals use accounts in Chinese banks to transfer money to front companies in China and other jurisdictions to create the illusion of a transaction between the seller and China, when North Korea is the real destination. This fraudulent scheme tricks U.S. banks into processing the transactions, and Chinese banks are either complicit or fail to ask about Chinese companies' business with North Korea.

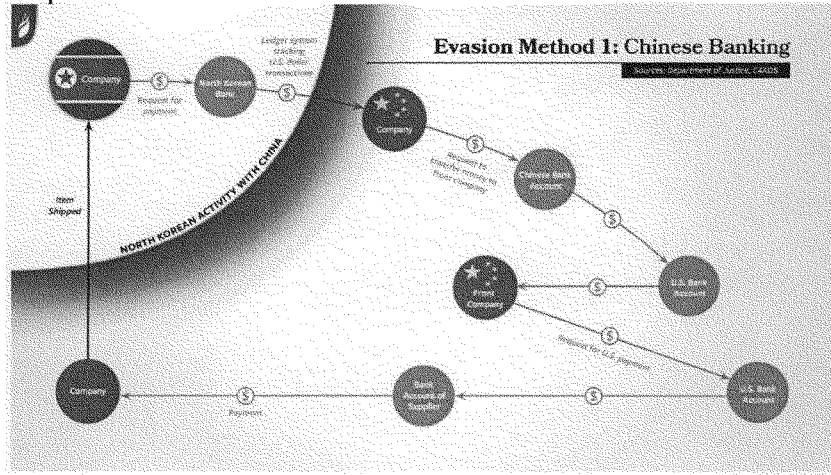
<sup>4</sup> U.S. Department of the Treasury, Press Release, "Treasury Imposes Sanctions on Supporters of North Korea's Weapons of Mass Destruction Proliferation," September 26, 2016. (<https://www.treasury.gov/press-center/press-releases/Pages/j15059.aspx>); U.S. Department of Justice, Press Release, "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>)

<sup>5</sup> U.S. Department of the Treasury, Press Release, "Treasury Targets Chinese and Russian Entities and Individuals Supporting the North Korean Regime," August 22, 2017. (<https://www.treasury.gov/press-center/press-releases/Pages/sm0148.aspx>); *United States of America v. Funds Associated with Dandong Chengtai Trading Limited*, No. 1:17-cv-01706 (D.D.C. August 22, 2017). (Accessed via PACER)

<sup>6</sup> "In China's Shadow: Exposing North Korean Overseas Networks," *The Asan Institute for Policy Studies and C4ADS*, August 2016. (<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/57dfe74acd0f68d629357306/1474291539480/In+China%27s+Shadow.pdf>); "Risky Business: A System-Level Analysis of the North Korean Proliferation Financing System," *C4ADS*, June 2017. (<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/59413c8bebbd1ac3194eafb1/1497447588968/Risky+Business-C4ADS.pdf>)

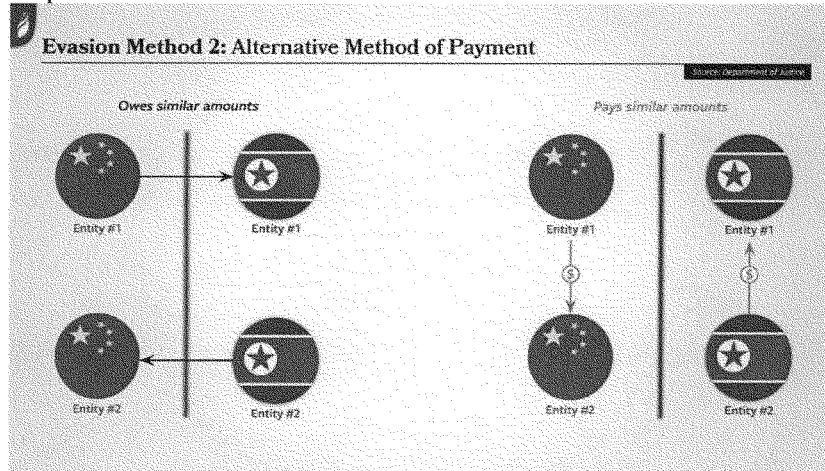


Graphic 3



The second method was identified by the Justice Department following an interaction with an unnamed North Korean defector (see graphic 4).<sup>7</sup> The scheme is simple: Chinese companies pay each other using the credits of one North Korean company to pay the debt of another North Korean company. It is unclear if these transactions involve U.S. dollars, but they have the benefit of avoiding money transfers between China and North Korea that could be subject to increased scrutiny. Chinese banks likely facilitate these payments between Chinese companies, and asking additional questions about the nature of the business relationship between these companies and North Korea could identify that these are problematic transactions prompting additional scrutiny.

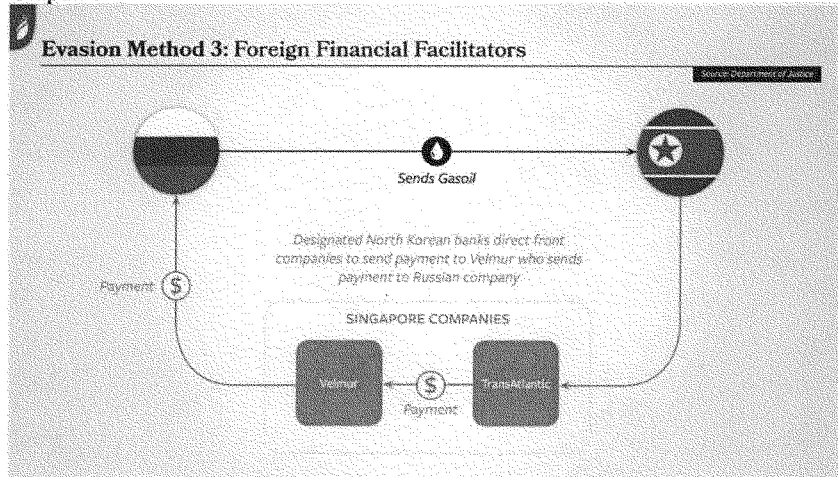
Graphic 4



<sup>7</sup> *United States of America v. Funds Associated with Dandong Chengtai Trading Limited*, No. 1:17-cv-01706 (D.D.C. August 22, 2017). (Accessed via PACER)

The third method was used by a Russian company to receive payments from North Korea for the shipment of oil (see graphic 5). Independent Petroleum Company (IPC) was sanctioned by the Treasury Department in early June for signing a contract to provide oil to North Korea and reportedly shipped over \$1 million worth of petroleum products to North Korea.<sup>8</sup> IPC shipped gasoil to North Korea and IPC requested payment from North Korea in U.S. dollars, but a direct transaction between Russia and North Korea using U.S. dollars is nearly impossible. IPC and North Korea devised a scheme to create two companies in Singapore to create the illusion of transactions between Singapore and Russia. The scheme obscured North Korea's involvement and furthered Pyongyang's ability, with assistance from a Russian company and Russian individuals, to violate U.S. law. The Justice Department requested forfeiture of almost \$7 million and fines for these alleged violations of U.S. laws.<sup>9</sup>

Graphic 5



<sup>8</sup> U.S. Department of the Treasury, Press Release, "Treasury Sanctions Suppliers of North Korea's Nuclear and Weapons Proliferation Programs," June 1, 2017. (<https://www.treasury.gov/press-center/press-releases/Pages/sm0099.aspx>)

<sup>9</sup> *United States of America v. Funds Associated with Velmur Management PTE, Ltd.*, No. 1:17-cv-01705 (D.D.C. August 22, 2017). (Accessed via PACER)

### Addressing North Korea's Financial Activities

The U.S. approach toward North Korea's financial activities should take a page out of the Iran sanctions playbook where banks were forced to make a choice: stop doing business with Iran, or lose access to the U.S. dollar and risk the U.S. freezing their assets and labeling them as doing business with a state sponsor of terrorism intent on developing a nuclear weapon. The banks' business with North Korea is a small percentage of their overall business and they will not risk working with Pyongyang over Washington.

The Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) provides a good model for North Korea financial sanctions, provided there are modifications to fit the current situation.<sup>10</sup> CISADA required the Secretary of the Treasury to cut foreign financial institutions off from the U.S. financial system if they knowingly processed transactions for Iran's Islamic Revolutionary Guard Corps or the Government of Iran's proliferation activities, money laundering, and other activities. Only two banks were sanctioned under CISADA, China's Kunlun Bank and Iraq's Elaf Bank, but the law was used by Treasury to achieve compliance from other foreign financial institutions.<sup>11</sup> The Treasury Department lifted sanctions against Elaf Bank nine months after designating it, after Treasury verified a "significant and demonstrated change in behavior." This illustrates the important lesson that financial sanctions are not simply punitive, but can lead to rehabilitation.<sup>12</sup>

The North Korea-Iran comparison is useful, but North Korea's financial activities are different than those Washington faced with Iran. The primary difference is the role of China in North Korea's known illicit financial transactions. Given the size of the Chinese economy and the U.S.-China relationship, sanctions against Chinese financial institutions should be carefully calibrated. But that does not mean Washington should shy away from protecting its own financial system.

A successful financial sanctions approach will focus on increasing the efforts of U.S. and foreign financial institutions to search for North Korea's illicit financial activities. While Pyongyang is experienced in hiding its activities behind front companies, the linkage can be found. C4ADS used data analysis tools to find multiple China-North Korea trade relationships, an effort that could certainly be duplicated by the largest Chinese banks.<sup>13</sup> In many cases, Chinese companies are not even hiding their relationships with North Korea. For example, Dandong Zhicheng Metallic

<sup>10</sup> Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. 111-195, 124 Stat. 1312, codified as amended at 22 U.S.C. §8501. (<https://www.treasury.gov/resource-center/sanctions/Documents/hr2194.pdf>)

<sup>11</sup> U.S. Department of the Treasury, Press Release, "Treasury Sanctions Kunlun Bank in China and Elaf Bank in Iraq for Business with Designated Iranian Banks," July 31, 2012. (<https://www.treasury.gov/press-center/press-releases/Pages/tg1661.aspx>)

<sup>12</sup> U.S. Department of the Treasury, Press Release, "Treasury Removes Sanctions on Iraqi Bank," May 17, 2013, (<https://www.treasury.gov/press-center/press-releases/Pages/jl1949.aspx>)

<sup>13</sup> "In China's Shadow: Exposing North Korean Overseas Networks," *The Asan Institute for Policy Studies and C4ADS*, August 2016.

(<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/57dfe74acd0f68d629357306/1474291539480/In+China%27s+Shadow.pdf>); "Risky Business: A System-Level Analysis of the North Korean Proliferation Financing System," *C4ADS*, June 2017. (<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/59413c8bebbd1ac3194eafb1/1497447588968/Risky+Business-C4ADS.pdf>)

Material Co. Ltd., which was sanctioned by Treasury and is subject to an asset forfeiture request by Justice from late August, advertised on its Alibaba site: “We are a professional company of trading the North Korea Briquettes, choose us, trust us” and highlighted the sale of North Korean coal in U.S. dollars.<sup>14</sup> Chinese financial institutions certainly could have found that same information if they wanted to ask the right questions. Facing significant fines or losing access to the U.S. dollar should heighten Chinese banks’ desire to start asking those questions.

### **Additional Recommendations**

In testimony before this subcommittee in July, I provided nine recommendations for U.S. policy on North Korea.<sup>15</sup>

#### Recommendation 1: Sanction Additional Chinese Banks.<sup>16</sup>

Recommendation 2: Sanction Chinese and Russian Facilitators of Pyongyang’s Sanctions Evasion. Russia has emerged as a key node in North Korea’s sanctions evasion, and any effort to combat Pyongyang’s activities should include sanctions against Russian entities and individuals.<sup>17</sup>

Recommendation 3: Block the Revenue North Korea Receives from Overseas Laborers. In early August, Kuwait stated that it employs over 6,000 North Korean workers and said it has no plans to reduce that number, contradicting the State Department’s 2017 Trafficking in Persons report.<sup>18</sup> The Russian government admitted in late August that it employs 40,000 North Korean workers in timber processing and construction.<sup>19</sup> UN Security Council Resolution 2371 unfortunately only caps the number of overseas North Korean workers, despite stating the revenue is used in

<sup>14</sup> The Justice Department noted that “Alibaba is one of the largest e-commerce websites in the world. It is headquartered in China.” *United States of America v. Funds Associated with Dandong Chengtai Trading Limited*, No. 1:17-cv-01706 (D.D.C. August 22, 2017). (Accessed via PACER); U.S. Department of the Treasury, Press Release, “Treasury Targets Chinese and Russian Entities and Individuals Supporting the North Korean Regime,” August 22, 2017. (<https://www.treasury.gov/press-center/press-releases/Pages/sm0148.aspx>)

<sup>15</sup> Anthony Ruggiero, “Restricting North Korea’s Access to Finance,” *Testimony before House Committee on Financial Services, Subcommittee on Monetary Policy and Trade*, July 19, 2017. ([http://www.defenddemocracy.org/content/uploads/documents/Anthony\\_Ruggiero\\_Testimony\\_HFSC.pdf](http://www.defenddemocracy.org/content/uploads/documents/Anthony_Ruggiero_Testimony_HFSC.pdf))

<sup>16</sup> 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>); 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>)

<sup>17</sup> Anthony Ruggiero, “North Korea sanctions are finally getting serious,” *Fox News*, August 25, 2017. (<http://www.foxnews.com/opinion/2017/08/25/north-korea-sanctions-are-finally-getting-serious.html>)

<sup>18</sup> Jon Gambrell, “Kuwait Says North Korean Workers Welcome Then Refutes Itself,” *Associated Press*, August 11, 2017. ([https://www.bloomberg.com/news/articles/2017-08-11/kuwait-says-north-korean-workers-welcome-then-refutes-itself?utm\\_content=politics&utm\\_campaign=socialflow-organic&utm\\_source=twitter&utm\\_medium=social&cmpid%3D=socialflow-twitter-politics](https://www.bloomberg.com/news/articles/2017-08-11/kuwait-says-north-korean-workers-welcome-then-refutes-itself?utm_content=politics&utm_campaign=socialflow-organic&utm_source=twitter&utm_medium=social&cmpid%3D=socialflow-twitter-politics)); U.S. Department of State, “Trafficking in Persons Report 2017,” June 2017. (<https://www.state.gov/documents/organization/271339.pdf>)

<sup>19</sup> Polina Nikolskaya and Katya Golubkova, “Russian-North Korea projects foundering because of missile tests: minister,” *Reuters*, August 28, 2017. ([http://www.reuters.com/article/us-russia-northkorea-trade-idUSKCN1B81BO?utm\\_campaign=trueAnthem:+Trending+Content&utm\\_content=59a4451504d3010ce4152a6b&utm\\_medium=trueAnthem&utm\\_source=twitter](http://www.reuters.com/article/us-russia-northkorea-trade-idUSKCN1B81BO?utm_campaign=trueAnthem:+Trending+Content&utm_content=59a4451504d3010ce4152a6b&utm_medium=trueAnthem&utm_source=twitter))

Pyongyang's nuclear weapons and missile programs.<sup>20</sup> The Countering America's Adversaries Through Sanctions Act mandates the president to impose sanctions on persons that employ North Korean workers, and Washington should lead an effort to end North Korean slave labor.<sup>21</sup> 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 and provide the money directly to the laborers, while continuing to import North Korean laborers.

Recommendation 4: Pursue an Offensive and Defensive Cyber Strategy.<sup>22</sup>

Recommendation 5: Impose Mandatory Inspections for all North Korean Ships.

Recommendation 6: Use U.S. and Partner States' Authorities to Enforce UN Sanctions.

Recommendation 7: Address Iran-North Korea Cooperation.

Recommendation 8: Implement Restrictions on Tourist Travel to North Korea.<sup>23</sup> The State Department has restricted the use of U.S. passports for travel to North Korea starting September 1, except under limited conditions.<sup>24</sup> This is a good step forward, but Congress must ensure it is being implemented and that it is not adversely affecting the operations of humanitarian organizations who care more about the North Korean people than the Kim regime.

Recommendation 9: Address North Korea's Human Rights Abuses.<sup>25</sup>

## Conclusion

Pyongyang's provocations, including its ICBM tests and sixth nuclear test, deserve increasingly harsh responses from Washington. A sanctions approach that focuses on North Korea's financial

<sup>20</sup> United Nations Security Council, Resolution 2371, August 5, 2017.

([http://www.un.org/en/ga/search/view\\_doc.asp?symbol=S/RES/2371\(2017\)](http://www.un.org/en/ga/search/view_doc.asp?symbol=S/RES/2371(2017)))

<sup>21</sup> Countering America's Adversaries Through Sanctions Act, 115 U.S.C.

(<https://www.whitehouse.gov/legislation/hr-3364-countering-americas-adversaries-through-sanctions-act>)

<sup>22</sup> Samantha Ravich and Anthony Ruggiero, "The growing North Korean cyber threat," *Fifth Domain Cyber*, June 12, 2017. (<http://www.defenddemocracy.org/media-hit/samantha-ravich-the-growing-north-korean-cyber-threat/>); 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](http://www.defenddemocracy.org/content/uploads/documents/6132017_Ravich_Testimony.pdf))

<sup>23</sup> 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/>)

<sup>24</sup> U.S. Department of State, "United States Passports Invalid for Travel to, in, or Through the Democratic People's Republic of Korea," 82 Federal Register 36067, August 2, 2017. (<https://www.gpo.gov/fdsys/pkg/FR-2017-08-02/pdf/2017-16287.pdf>); U.S. Department of State, "Notice of Information Collection Under OMB Emergency Review: Request for Approval To Travel to a Restricted Country or Area," 82 Federal Register 36065, August 2, 2017. (<https://www.gpo.gov/fdsys/pkg/FR-2017-08-02/pdf/2017-16286.pdf>)

<sup>25</sup> 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>)

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activities has the best chance of success, and combined with Washington's efforts to build a coalition of likeminded countries to increase other sanctions will protect the U.S. and its allies from the Kim regime's dangerous nuclear weapons and missile programs.

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.

