

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

Prepared by: William J. Newcomb
Visiting Scholar, U.S.-Korea Institute
Paul H. Nitze School of Advanced International Studies
Johns Hopkins University, and
Fellow, Center for Advanced Defense Studies (C4ADS)

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

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

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

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

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

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

- Mexico had considerable difficulty when it tried to take control the North Korean vessel Mu Du Bong, an asset of the UN designated entity, Office of Maritime Management, because it had not adopted the assets freeze provision, a crucial tool of sanctions enforcement that was introduced originally in UNSCR 1718 (2006).
- Similarly, the conviction in Singapore of DPRK-linked Chinpo Shipping for violation of measures restricting the finance of proliferation, because of its involvement in helping fund the MV Chon Chong Gang's transport of Cuban-supplied military hardware, was reversed on appeal. Reviewing the courts ruling shows Singapore had failed to adopt sanctions measures completely and to keep them up to date, shortcomings not obvious from reading the country's report to the UN on implementation.

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

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

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

- One of the companies on the list of 43 that escaped designation was Pan Systems Pyongyang. Findings of parallel investigations by the Panel of Experts and Reuters published earlier this year show how it was linked to North Korea's Reconnaissance General Bureau. Operating under the alias of Glocom, Pan Systems Pyongyang was involved in the global sale of battlefield tactical radios. It used "bank accounts, front companies and agents mostly based in China and Malaysia to buy components and sell completed radio systems," according to the UN report submitted by the Panel.
- Pan Systems Pyongyang has yet to be designated by the UN, perhaps it is currently a candidate once again. Yet neither has it so far been placed on OFAC's SDN list, a curious lack of action.

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

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

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

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

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

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

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

- Capacity challenged States should be given assistance since North Korea exploits weak links.
- Sanctions pressure needs to be continually ratcheted up, not used as tit-for-tat following provocations.
- DPRK support networks need to be identified and disrupted. Exposing company names and placing them on sanctions lists is insufficient. Those running them in particular need to face legal consequences. It is too easy for a company to reorganize under a new name and continue business as usual.
- The U.S. and others need to convey internationally that whether or not the 1718 Committee or Security Council impose penalties on violators, countries will face consequences for sanctions busting trade and finance dealings with the DPRK.

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

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