

Using the Patriot Act to Turn North Korea's Dirty Money into a Bargaining Chip

Richard S. Tracey

IN THE tumultuous aftermath of al-Qaeda's 11 September 2001 attacks on the United States, the Congress passed, by overwhelming margins, the Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act). This wide-ranging legislation contained provisions designed to enhance the US government's statutory authorities in five areas: domestic security, surveillance, money laundering, border security, and intelligence. Although the controversial surveillance and intelligence provisions generated the most intense debate and media coverage, the money laundering provisions in Title III of the Patriot Act are no less important and represent the culmination of over a decade of experience, analysis, and ideas.

A key component of Title III is section 311, "Special Measures for Jurisdictions, Financial Institutions or International Transactions of Primary Money Laundering Concern." These provisions provided the Treasury Department flexible and powerful new authorities to protect the US financial system and authorized it, after consultations with other government agencies, to designate a jurisdiction or financial institution outside of the United States as "of primary money laundering concern." Treasury can also require US financial institutions to implement one or more "special measures" to protect themselves and the US financial system. The "special measures" include enhanced transaction recordkeeping, detailed customer identification procedures, information on payable and correspondent accounts, and prohibiting business relationships with designated financial jurisdictions or institutions.¹

The Treasury Department, through the Financial Crimes Enforcement Network (FinCEN), quickly made full use of this new authority and, between 2002 and 2005, initiated section 311 actions against eight financial

Lt Col Richard S. Tracey, USA, retired, teaches in the Department of Joint, Interagency, and Multi-national Operations at the US Army Command and General Staff College. His active duty assignments included professor of military science, University of Nebraska, and deputy chief, Strategy and Policy Division, J-5, US Forces Korea. His article "Trapped by a Mindset: The Iraq WMD Intelligence Failure" appeared in the *Air & Space Power Journal's* online journal *Chronicles* in January 2007. He holds master's degrees in history from the University of Massachusetts and security studies from Georgetown University.

Report Documentation Page

Form Approved
OMB No. 0704-0188

Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.

1. REPORT DATE 2009		2. REPORT TYPE		3. DATES COVERED 00-00-2009 to 00-00-2009	
4. TITLE AND SUBTITLE Using the Patriot Act to Turn North Korea's Dirty Money into a Bargaining Chip				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Air University, Strategic Studies Quarterly, 155 N. Twining St BG 693, Maxwell AFB, AL, 36112-6026				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT	18. NUMBER OF PAGES	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

institutions and three jurisdictions.² Treasury's section 311 action against a bank located in China's Macau Special Administrative Region, Banco Delta Asia (BDA), is the best known and perhaps the most misunderstood. In September 2005, the FinCEN announced that BDA had a long-standing "special relationship" with North Korea that "specifically facilitated the criminal activity of North Korean government agencies and front companies."³ To be sure, North Korea often behaves more like a criminal gang than a responsible state, and according to a recent Congressional Research Service report, "the aggregate scale" of their criminal "activity is significant."⁴ For 20 years, BDA facilitated this illicit behavior—which included distributing counterfeit US currency, smuggling black market tobacco products, and drug trafficking—by handling North Korean financial transactions with little oversight, control, or due diligence.

The designation sparked a financial chain reaction. Spooked customers withdrew \$133 million, almost one-third of the bank's deposits. The Monetary Authority of Macau, fearing that the section 311 designation would jeopardize its access to international financial markets and systems, promptly replaced the management of the bank and froze \$25 million of tainted North Korean assets. More importantly, this action highlighted the risk of handling North Korean money, causing global financial institutions to spurn North Korean financial transactions. This situation created an informal financial embargo of North Korea.⁵ The FinCEN's section 311 designation of BDA cut off an already largely isolated North Korea further from the international financial system, and thus, as some argue, provided a strong incentive for North Korea to return to the six-party multilateral talks with China, South Korea, Japan, Russia, and the United States.⁶ Undeniably, there appears to be a causal link between the designation of BDA as a "financial institution of primary money laundering concern" and North Korea's agreement in February 2007 to freeze, disable, and declare all its nuclear weapons programs. Indeed, North Korea shut down its nuclear reactor at Yongbyon, readmitted International Atomic Energy Administration (IAEA) inspectors, and initially complied with the terms of the agreement. Thus, casual observers could easily conclude that the BDA saga offers a new policy model for dealing with recalcitrant proliferators with targeted financial sanctions.

We need to be cautious, however, about drawing hasty conclusions. While it is true that the BDA saga highlights the emerging power of coercive financial instruments to shape the behavior of miscreant states, I argue in this article that it does not offer a new policy model and put forward

three interrelated reasons to support this proposition. First, using section 311 simultaneously as a protective anti-money-laundering/counter terrorist financing (AML/CTF) tool and an active instrument of coercive diplomacy to “persuade an opponent to stop and/or undo any action he is already embarked upon”⁷ presents significant practical challenges. Congress crafted the provision primarily to protect the US financial system and increase the pressure on foreign jurisdictions to bring their AML/CTF laws into line with evolving international financial standards. Next, North Korea is a uniquely vulnerable target because of the nature of its regime, its profound isolation, and its economic destitution. Finally, section 311’s role in coercing North Korea to modify its behavior may be more a case of strategic serendipity than the purposeful use of a new AML/CTF tool to achieve nonproliferation objectives. In short, it appears that US policy makers may have taken advantage of the unintended consequences of the initial BDA designation to achieve their nonproliferation goals vis-à-vis North Korea. To develop this argument I will examine the origins, purpose, and application of section 311, with an eye cocked toward understanding what policy lessons we can draw from the BDA section 311 designation.

The Origins of Section 311

We can trace the Patriot Act’s section 311 provisions to two clusters of experiences, analyses, and ideas: (1) the Senate Foreign Relations Subcommittee on Terrorism, Narcotics, and International Operations (now the Subcommittee on International Operations) investigation into the Bank of Credit and Commerce International (BCCI) scandal in the early 1990s and (2) the Clinton administration’s elevation of international money laundering to a national security issue. Together they contributed to an emerging recognition that international flows of illicit money not only fueled crime, terrorism, and weapons proliferation but also threatened the integrity of the financial system.

The Subcommittee on Terrorism, Narcotics, and International Operations—spurred by Senator John Kerry’s (D-MA) leadership, first as chair and then as ranking member—provided the first sustained analysis and coherent policy recommendations regarding the symbiotic relations between global crime, terrorism, corruption, and the flows of illicit money through legitimate financial institutions. At the center of this work was the committee’s investigation of BCCI, an investigation that led them to uncover what

Senator Kerry later described as a “clandestine world of money launderers, drug traffickers, arms merchants, terrorists and covert nuclear programs.”⁸ This notorious scandal merited a 1991 cover story in *Time* magazine, “The Dirtiest Bank of All.”⁹ Indeed, the subcommittee found that BCCI’s Pakistani founder, Agha Hasan Abedi, had created a putrid petri dish of “multiplying layers of entities related to one another through an impenetrable series of holding companies, affiliates, subsidiaries, banks-within-banks, insider dealings and nominee relationships.”¹⁰ This elaborate structure, which spanned 73 countries, represented a political-criminal nexus that linked the underworld of criminals to the upper world of politicians.¹¹ The illicit money that flowed through BCCI’s structure corrupted not only the international financial system but also local and national political systems.

The subcommittee’s conclusions and recommendations foreshadowed the Patriot Act’s Title III provisions. At the core of the committee’s report was an understanding that the BCCI scandal was not an isolated example of a rogue bank but a case study in the expanding vulnerabilities of governments and financial institutions to the corruption of illicit global money flows. From this conclusion, the report recommended developing “a more aggressive and coordinated approach to international financial crime,” improving intelligence and information sharing and cooperation across the government, imposing new requirements on foreign auditors, establishing the identities of foreign investors in US businesses, and requiring that foreign governments improve their financial regulations. In sum, this investigation contributed to the recognition that the prevention and detection of money laundering was a national security issue, requiring not only stronger US domestic laws but also intensified international cooperation to reduce the number of financial institutions willing to handle dirty money.

Despite the committee’s fine investigative work and the notoriety of the BCCI scandal, it took the Clinton administration to elevate money laundering to a national and international security concern. In October 1995, the United Nations’ 50th anniversary, President Clinton challenged the General Assembly to cooperate against emerging transnational threats and “the increasingly interconnected groups that traffic in terror, organized crime, drug smuggling, and the spread of weapons of mass destruction.”¹² Establishing US leadership on this issue, President Clinton announced the following:

Yesterday, I directed our government to identify and put on notice nations that tolerate money laundering. Criminal enterprises are moving vast sums of ill-gotten

gains through the international financial system with absolute impunity. We must not allow them to wash the blood off profits from the sale of drugs from terror or organized crimes. Nations should bring their banks and financial systems into conformity with the international antimoney-laundering standards. We will work to help them to do so. And if they refuse, we will consider appropriate sanctions.¹³

President Clinton's direction to the government, Presidential Decision Directive 42 (PDD-42), formally acknowledged, for the first time, that international crime and money laundering were national security threats. PDD-42 directed specific actions under the International Emergency Economic Powers Act (IEEPA) to block the assets associated with the Columbian drug trade in the United States, directed various government agencies to integrate their efforts against international crime syndicates and money laundering, and established interagency working groups to address aspects of international crime. Underlining the Clinton administration's emerging approach were three operating assumptions. First, it recognized the need to stem the proliferation of unregulated jurisdictions as well as attacking existing jurisdictions facilitating money laundering. Next, the administration posed that traditional domestic regulatory and law enforcement mechanisms could not cope with the transnational nature of international crime, terrorism, and money laundering. Finally, it concluded that international and multinational cooperation was essential.¹⁴

Consistent with the goals of the strategy and the Clinton administration's underlying operating assumptions, the Treasury Department pursued a "name and (shame)" strategy to establish an international financial standard through three consensual multilateral organizations: the G-7's Financial Stability Forum (FSF), the Financial Action Task Force (FATF), and the Organization for Economic Cooperation and Development (OECD).¹⁵ The most important of these evolving efforts was the FATF. The G-7 established the FATF in 1989 and chartered the 16 original member states to adopt, implement, and evaluate international anti-money-laundering standards. The FATF's initial 40 Recommendations, updated in 1996, provided a comprehensive framework for gauging the effectiveness of a state's AML/CTF prevention and enforcement measures in areas such as customer due diligence and recordkeeping, reporting suspicious transactions, regulation and supervision, transparency, dealing with noncompliant countries, and international cooperation.¹⁶ Without a doubt, the 40 Recommendations reflected a "top-down" approach, in that the 16 FATF member states committed to curtailing the flow of dirty money, set clear prevention and enforcement standards, and then put pressure on nonconforming states to

rein in rogue banks and other financial institutions that were facilitating money laundering, either through omission or commission.¹⁷ Unquestionably, the FATF has effectively put a bright spotlight on states and financial entities with slipshod AML/CTF regimes, and this contributed to the environment that made the section 311 action against BDA effective. A detailed 2004 study published by the well-regarded Institute for International Economics concluded that the evolving international AML regime “over the past 15 years has changed how banks and other financial institutions do business.”¹⁸ States that fail to meet FATF standards jeopardize access to lucrative financial markets and systems, and this provides a powerful incentive to avoid and curb illicit financial behavior. While this approach has been valuable in setting and establishing international AML/CTF standards, it is important to underscore that the FATF has no formal enforcement mechanisms and the foundation of its effectiveness is derived from the consensus of the expanding number of FATF member states and its ability to name and shame.¹⁹

Yet despite this success in setting enhanced international anti-money-laundering prevention and enforcement standards, the March 2000 *National Money Laundering Strategy (NMLS)* recognized that the authority of the secretary of the treasury to protect the US financial system from dirty money was not “as robust as it could be.” The *NMLS* correctly identified a gap between the nonbinding informational advisories about specific jurisdictions or financial institutions and the powerful authorities available to the secretary under the IEEPA to impose full-scale sanctions. Thus, the *NMLS* identified the passage of legislation designed to fill this gap with “targeted, narrowly tailored, and proportional” actions against money laundering threats as a goal.²⁰ Consequently, the Treasury Department worked closely with the Congress to develop legislation to bridge this gap.

Although the Clinton administration was successful in garnering international cooperation to combat money laundering and financial crimes, it was less successful in achieving its anti-money-laundering goals in Congress. In the summer of 2000, H.R. 3886, the International Counter-Money Laundering and Foreign Anti-Corruption Act of 2000 was voted out of Rep. Jim Leach’s (R-IA) House Banking Committee by an overwhelming bipartisan vote of 31–1, but it never made it to the House floor for a vote.²¹ On the Senate side, Senator Kerry concurrently introduced similar legislation, S. 2972. This bill never made it past the fierce opposition of Senator Phil Gramm (R-TX), chair of the Senate Banking

Committee.²² Although these legislative proposals failed, they contained the provisions that later became section 311 of the Patriot Act and consequently represent significant milestones.

The Purpose of Section 311

William F. Wechsler, the special adviser to the secretary of the treasury, testified in June 2000 before the House Committee on Government Reform, Subcommittee on Criminal Justice, Drug Policy, and Human Resources, and strongly endorsed H.R. 3886. He highlighted the importance of the bill's central provision that would authorize the secretary of the treasury to "designate a foreign jurisdiction, a foreign institution or a class of international transactions as being a primary money laundering concern."²³ This designation would provide the secretary the authority, in consultation with the chair of the Federal Reserve and other appropriate officials, to impose one or more targeted actions, including provisions for additional recordkeeping and reporting, identification of beneficial owners and those using correspondent or payable-through accounts, and restricting correspondent relationships with money-laundering havens and rogue foreign banks.

When Senator Kerry introduced S. 2972 on the Senate floor, he recalled that the BCCI investigation demonstrated that "rogue financial institutions have the ability to circumvent the laws designed to stop financial crimes." Moreover, echoing the words of the 2000 *NMLS*, he noted that S. 2972, by giving the secretary of the treasury the authority to designate financial entities as "of primary money laundering concern" and providing a range of targeted authorities, bridged the gap between nonbinding financial advisories and draconian IEEPA sanctions. The overarching purpose of this provision was, according to Kerry, to "prevent laundered money from slipping undetected into the US financial system and, as a result, increase the pressure on foreign money laundering havens to bring their own laws into line with international money laundering standards."²⁴

With a new administration and a new Congress in January 2001, these proposals died. Highly skeptical about the Clinton administration's approach to money laundering and financial crimes, Treasury Secretary Paul O'Neill sent mixed messages about the new administration's attitude toward the Clinton Treasury Department's multilateral approach and legislative strategy.²⁵ Not surprisingly, the Bush administration's 2001 *NMLS*

made no mention of the legislative initiatives that the Clinton administration had pursued so assiduously. However, the Bush administration's evolving uncertainty toward the Clinton administration's AML/CTF legacy ended abruptly on 9/11. From that point forward, it fully embraced the Clinton administration's AMF/CTF policies and worked with the 33 FATF member states to update the 1996 40 Recommendations to cover terrorist financing through Eight Special Recommendations.²⁶ This sudden change in attitude created the conditions that allowed the language of H.R. 3886 and S. 2972 to resurface in the Patriot Act's Title III, section 311 provisions.

Senator Kerry, speaking on the Senate floor during the final debate on the Patriot Act, remarked that the money laundering provisions in Title III were the "culmination" of over 10 years of work.²⁷ He was right. The Senate debates on 11 and 25 October 2001 on the Title III provisions recapitulated earlier arguments for enhanced AML/CTF provisions that grew out of the BCCI scandal investigation and the Clinton administration's efforts. At no point in these debates, or in earlier debates or discussions regarding the provisions that became section 311, did anyone suggest that section 311's purpose was to be a nonproliferation bargaining chip or an instrument of coercive diplomacy.

The Application of Section 311

As noted at the outset of this article, the Treasury Department, through the FinCEN, made full use of this new authority and has initiated 11 separate section 311 designations. Some designations targeted the financial systems of entire countries, such as Ukraine and Burma, because their protection and enforcement frameworks were inadequate and vulnerable to exploitation by criminals and terrorists. In other cases, the section 311 designations focused on specific financial entities, such as the Latvian financial institutions, Multibanka and VEF Banka, and the Commercial Bank of Syria. All these actions were consistent with the original intent of section 311, as well as the evolving FATF AML/CTF standards. In fact, each of the 11 designations references the FATF standards as the normative benchmark.

These actions demonstrate both the protective nature as well as the rehabilitative potential of section 311. In the case of Ukraine, the government took prompt remedial actions to update its money laundering laws

to empower financial intelligence units, lowered the suspicious transactions reporting thresholds, criminalized money laundering, and improved customer due diligence. Thus, the original 2002 designation of Ukraine as a primary money laundering concern was rescinded in April 2003. However, the Burmese government failed to respond adequately, and in April 2004 the Treasury Department issued a final designation that imposed the harshest of the special measures available and essentially cut Burma off from US financial institutions. In the case of Multibanka, prompt and effective remedial actions by the Latvian government as well as Multi-banka corrected the protection and enforcement deficiencies. Consequently, Treasury ultimately withdrew the finding against Multibanka in July 2006. However, in the cases of VFB Banka and the Commercial Bank of Syria, Treasury issued final rules, in July and March 2006 respectively, that cut them off from US financial institutions.²⁸

We can now return to the section 311 designation of BDA as “of primary money laundering concern.” As a start point, it is important to note and understand that the Bush administration was simultaneously pursuing two parallel lines of effort vis-à-vis North Korea. The first focused on North Korea’s clandestine nuclear weapons programs and the second on its pervasive illicit crime-for-profit activities.

The first line of effort is well known. Following the fall 2002 revelation that North Korea had a clandestine uranium enrichment program and the subsequent collapse of the much-maligned 1994 Agreed Framework, the Bush administration initiated, in August 2003, regional multilateral talks to negotiate an end to North Korea’s nuclear weapons programs. These six-party talks produced the February 2007 agreement that committed North Korea to freeze, disable, and declare all its nuclear programs.

The second effort, less well known but equally important to this story, predates the six-party talks and led to the section 311 designation of BDA as “of primary money laundering concern.” In early 2002, Assistant Secretary of State for East Asian and Pacific Affairs James A. Kelly and Deputy Secretary of State Richard Armitage tasked David Asher, Kelly’s senior adviser, to study, investigate, and develop policies to counter North Korea’s illicit activities. This tasking led to the establishment of an extensive interagency effort—the Illicit Activities Initiative (IAI)—that spanned 14 government departments and agencies, involved approximately 200 officials and analysts, and included cooperation with private industry, foreign governments, and international organizations.²⁹

These two parallel lines of effort intersected, or as National Defense University professor Michael J. Mazarr recently put it, “crashed into each other,” when the Treasury Department designated BDA as “of primary money laundering concern” on 15 September 2005 in the midst of the promising fourth round of six-party talks in Beijing.³⁰ After rather unproductive rounds in August 2003, February 2004, and June 2004, this round produced a statement of principles and thus seemed to offer a tangible expectation of future progress. In spite of this, the next round of talks in November 2005 stalled and sputtered, as the biggest issue was now North Korea’s consternation over the designation of BDA and the freezing of its funds by Macau. A recent and very detailed study of the ongoing Korean nuclear crisis by Yoichi Funabashi depicted the lead North Korean negotiator, Kim Gye-gwan dramatically comparing financial flows to the circulation of blood in the body, that if clogged would stop the heart. Funabashi then quoted a Japanese delegation member’s observation of Kim’s behavior: “It sounded like a cry squeezed out from deep inside his body. I thought that was the first occasion that North Korea allowed itself to expose its true weakness.”³¹

Unquestionably, the North Korean economy is weak. Although North Korea recovered from the famine it endured in the mid-1990s, it remains a state unable to provide basic necessities for the majority of its citizens. The population’s pain is not distributed equally, as this supposedly classless society features a rigid class system that favors a privileged few. Indeed, in this bleak land of pervasive poverty, the privileged leaders of the bureaucracy and the military have access to foreign cars, imported food, medicines, and other luxuries. These privileged elites—the heart of the North Korean regime—are sustained in part by the illicit financial flows generated by North Korea’s shadowy criminal activities.³²

The six parties would not meet again until December 2006, and in the intervening year North Korea launched a Taepodong-2 missile (July) and tested a nuclear weapon (October). Although it is not fair to conclude that the BDA designation led directly to the breakdown in the talks, it is fair to say that the BDA action became a prominent variable in North Korean–US relations.

North Korea came back to the table in December 2006 and in February 2007 agreed to a two-phase plan based upon the September 2005 statement of principles to freeze, disable, and declare all its nuclear weapons programs.³³ The public record is not clear on the diplomatic twists and

turns that ultimately brought North Korea back to the table, although Chinese pressure in the aftermath of its nuclear test, new UN sanctions, and a strong desire to regain access to its frozen assets appear to have been significant factors.

The 13 February 2007 agreement among North Korea, the United States, China, Japan, South Korea, and Russia did not mention the BDA funds or any related financial issues. Nevertheless, the United States and the North Korean representatives had side discussions on the frozen \$25 million, and it is clear that the return of these funds to North Korea was an implicit part of this agreement. Although the Treasury Department issued its final section 311 rule on BDA on 19 March 2007 “to help ensure that Banco Delta Asia is denied access to the US financial system, as well as to increase awareness within the international financial community of the risks and deficiencies of Banco Delta Asia,” it was simultaneously working to facilitate the relocation of the \$25 million.³⁴

The awkward task of transferring the \$25 million to North Korea and others caught in this tangled financial web turned out to be a more difficult operation than originally anticipated. The \$25 million was distributed among 52 accounts, including 17 with clear ties to North Korea, and no reputable financial institution wanted to handle money tainted by North Korea’s illicit activities.³⁵ It took four months for the State and Treasury Departments to arrange the transfer with the complex involvement of the central banks of Macau and Russia, the Far Eastern Commercial Bank, a private bank in Vladivostok, and the Federal Reserve Bank in New York. As this intricate financial and diplomatic transaction unfolded, the North Koreans held up executing the initial phase of the February 2007 agreement, which required them to freeze (“shut down and seal”) their nuclear facilities at Yongbyon and invite the IAEA back to monitor the freeze. In late June, when the funds finally were transferred, North Korea promptly began to comply with the terms of the February agreement, clearly demonstrating that these funds had indeed become a powerful bargaining chip and a tool of coercive diplomacy.

Assessment: A New Policy Model?

James R. Wilkinson, chief of staff to Treasury secretary Henry M. Paulson, provided the following early assessment of the BDA saga: “The international community now clearly understands just how potent our

financial actions can be. . . . Our sanctions programs are designed to combat illicit behavior and help achieve political movement.”³⁶ Although his observation is not without merit, the policy lessons are more complex. Wilkinson correctly notes that financial instruments are powerful tools, and indeed the international community was watching. Yet, when he talks about “sanctions programs designed to combat illicit behavior and help achieve political movement,” he is simultaneously using the language of AML/CTF and a traditional sanctions regime. As a result, his assessment unintentionally draws our attention to the practical problems with using section 311 simultaneously as an AML/CTF tool and an instrument of coercive diplomacy.

The need for international cooperation to combat illicit financing, highlighted in the BCCI investigation, reinforced by the Clinton administration, and belatedly but wholeheartedly embraced by the Bush administration after the trauma of 9/11, is a central tenet of the international AML/CTF regime. Underlining this level of cooperation among responsible states and the international financial community is the understanding that these standards embodied principally in the FATF recommendations are not situational. Deputy Assistant Treasury Secretary for Terrorist Financing and Financial Crimes Daniel Glasser has correctly stated in congressional testimony that “FATF sets the global standard for combating terrorist financing and money laundering.”³⁷ But, as already noted, it is a standard maintained and enforced by consensus and the ability to name and shame. Thus, routinely turning international financial standards into situational instruments of diplomacy, no matter how worthy the objective, could well undermine these evolving standards of financial behavior critical to the protection of our financial system and ability to choke off financing for terrorism and other illicit activities. Widely accepted, tough AML/CTF international financial standards reduce the places that purveyors of nefarious activities (drug traders, terrorists, WMD proliferators) can safely hide and move their dirty money. While, in the end, the Treasury Department issued a final section 311 rule on BDA essentially denying it access to the US financial system, the fact that it was concurrently facilitating the relocation of \$25 million of largely illicit funds out of BDA back into North Korean and other hands undercuts the spirit of these norms.

Consequently, the apparent success of the BDA actions could establish—if misunderstood—an unfortunate precedent. The risk here is that current and future policy makers could reasonably but dangerously conclude that

section 311 is an effective tool of coercive diplomacy. As we have seen, Treasury's section 311 designation was successful because of the swift reaction of the international financial community. Paradoxically, the routine use of section 311 as a tool of coercive diplomacy to achieve situational political ends could well undercut the international financial standards that contributed to its effectiveness against North Korea in the first place. This is not simply a matter of the United States maintaining the moral high ground. The evolving international financial standards—embodied mainly in the FATF—have changed the way reputable banks and other financial institutions do business. Moreover, FATF standards are maintained by consensus and the ability to name and shame bad actors. Thus, the United States needs to be careful that its actions do not undermine the international consensus essential to an effective AML/CTF regime.

This in turn highlights another practical matter associated with using section 311 as a bargaining chip or tool of coercive diplomacy. Traditional trade, travel, or financial sanctions—either codified in statute or established in executive orders—allow policy makers to respond to changing strategic circumstances. Although adjustments to traditional sanctions are not always easy or timely, they can be turned off, modified, or calibrated, depending on the behavior of the target and our strategic objectives. However, the financial chain reaction that Treasury's section 311 designation of BDA sparked was beyond its ability to turn off, modify, or calibrate. As a result, it took a creative and intricate financial and diplomatic effort to cash in our bargaining chips (the \$25 million) in order to get North Korea to agree to freeze, disable, and declare its nuclear weapons programs and facilities. The other problem is, of course, if North Korea backslides on its February 2007 obligations, the United States has no way to take the money back.³⁸

It is also important in any assessment of the BDA saga to consider how the isolated and economically destitute North Korean regime was uniquely vulnerable to targeted financial actions. Although the North Korean economy is in shambles with widespread malnutrition and pervasive poverty, its privileged elites live well and depend, in part, on the proceeds from the illicit trade that BDA facilitated to maintain itself. The regime's leader, Kim Jong-Il, is a totalitarian dictator who maintains a long-time horizon; rules without the consent of the people; has total control of the government and all aspects of fiscal, monetary, and taxation policies; and maintains control by maximizing the loyalty of key elites and repressing the gen-

eral population. In short, Kim Jong-Il's priority is preserving the regime and not the welfare of his people.³⁹ As Kim Gye-gwan's agitated response revealed, the section 311 action that cut off the regime from the international financial system, directly threatened the regime elites and thus gained unexpected leverage in a way that years of broad-based trade and financial economic sanctions never did. However, expecting section 311 designations or other targeted financial actions to generate the same dramatic response from more complex and less-isolated regimes such as Iran, with competing centers of political and economic power and multiple links to the international financial community, is unrealistic.

Finally, it is not clear that the administration originally intended to use the section 311 designation of BDA as a bargaining chip or tool of coercive diplomacy. The two parallel interagency efforts, the IAI and the six-party talks, appeared to intersect unexpectedly in 2005. There are three possible explanations for the awkward timing of the section 311 designation. First, it was a deliberate effort to undermine the six-party talks. Second, the Bush team did not fully synchronize these two parallel efforts, and the timing was accidental. Third, senior policy makers synchronized the parallel diplomatic and financial efforts but never anticipated the impact the BDA designation would have on the international financial community and the blowback into the six-party talks. Perhaps the answer is a combination of all of these explanations. We do not fully know. Whatever the explanation for the timing, policy makers skillfully improvised, made a virtue out of necessity, took advantage of the situation, and got North Korea back to the negotiating table and on the path to freezing, disabling, and declaring its nuclear weapons programs. Unfortunately, in the interim between the suspension of the talks in November 2005 and the February 2007 agreement, North Korea launched a Taepodong-2 missile and tested a nuclear weapon.

In sum, while the use of section 311 against BDA does indeed offer an example of "how potent our financial actions can be," it does not offer a model for future actions. Beyond the practical challenges of using section 311 as a traditional sanction, its continued use as a tool of coercive diplomacy to achieve situational political ends could well undercut the evolving international financial standards that contributed in part to its remarkable effectiveness against North Korea. Moreover, North Korea was a uniquely vulnerable target because of the nature of its totalitarian regime, its profound isolation, and its economic destitution. Finally, section 311's role

in coercing North Korea to modify its behavior is a case of strategic serendipity, as it appears that US policy makers exploited the unintended consequences of the initial BDA designation to achieve their nonproliferation goals vis-à-vis North Korea. In short, the unexpected success of the BDA designation in changing North Korea's behavior was the result of a unique confluence of financial and geopolitical circumstances that policy makers likely cannot duplicate. ■■■

Notes

1. Public Law 107-56—Oct. 26, 2001, 115 Stat. 299, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_public_laws&docid=f:publ056.107.pdf.

2. See the FinCEN Web site, http://www.fincen.gov/reg_section311.html, for an updated list of ongoing section 311 actions. This Web site provides links to the *Federal Register* announcements of section 311 findings, notices of rule making, final rules, and rescinded designations. The FinCEN has issued final rules in six cases and has not issued any new findings since 2005.

3. Notices, *Federal Register* 70, no. 181 (Tuesday, 20 September 2005), 55216.

4. Raphael Perl and Dick K. Nanto, *North Korean Crime-for-Profit Activities* (Washington, DC: Congressional Research Service [CRS], 16 February 2007), 1.

5. Donald Greenless and David Lague, "Trail Led to Macao as the Focus of North Korean Corruption," *New York Times*, 13 April 2007.

6. Dick K. Nanto and Emma Chanlett-Avery, *The North Korean Economy: Leverage and Policy Analysis* (Washington, DC: CRS, 26 August 2008), 54.

7. Alexander George, *Forceful Persuasion: Coercive Diplomacy as an Alternative to War* (Washington, DC: US Institute for Peace, 1991), 5. Dr. George uses the case study method to develop a detailed theory of coercive diplomacy that identifies key variables, conditions, and strategies. For a number of useful case studies on the use of coercive diplomatic strategies, see Robert J. Art and Patrick M. Cronin, eds., *The United States and Coercive Diplomacy* (Washington, DC: US Institute of Peace Press, 2003).

8. John Kerry, *The New War: The Web of Crime that Threatens America's Security* (New York: Simon and Schuster, 1997), 15.

9. Jonathan Beaty and S. C. Gwynne, "The Dirtiest Bank of All," *Time*, 29 July 1991, <http://www.time.com/time/magazine/article/0,9171,973481,00.html>.

10. Senate Committee on Foreign Relations, *The BCCI Affair: A Report to the Committee on Foreign Relations United States Senate*, "Executive Summary," prepared by Hon. John Kerry and Hon. Hank Brown, 102d Cong., 2d sess., Senate Print, 102-40, http://www.fas.org/irp/congress/1992_rpt/bcci/.

11. For an excellent overview of transnational crime as a security threat, see Roy Godson, "Transnational Crime, Corruption and Security," in *Grave New World: Security Challenges in the 21st Century*, ed. Michael E. Brown (Washington, DC: Georgetown University Press, 2003), 259-78.

12. Remarks by President Clinton to UN General Assembly, 22 October 1995, <http://clinton4.nara.gov/WH/New/other/unspeech.html>.

13. Ibid.

14. William F. Wechsler, "Follow the Money," *Foreign Affairs* 80, no. 4 (July/August, 2001): 48-49.

15. Ibid., 48.

Using the Patriot Act to Turn North Korea's Dirty Money into a Bargaining Chip

16. Peter Reuter and Edwin M. Truman, *Chasing Dirty Money: The Fight Against Money Laundering* (Washington, DC: Institute for International Economics, 2004), 81–87.
17. Wechsler, “Follow the Money,” 49.
18. Reuter and Truman, *Chasing Dirty Money*, 6.
19. FATF members: Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Denmark, European Commission, Finland, France, Germany, Greece, Gulf Cooperation Council, Hong Kong, Iceland, Ireland, Italy, Japan, Kingdom of the Netherlands, Luxembourg, Mexico, New Zealand, Norway, Portugal, Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States.
20. *The National Money Laundering Strategy for 2000* (Washington, DC: Department of the Treasury, 2000), 58, <http://www.treasury.gov/press/releases/docs/ml2000.pdf>. The Money Laundering and Financial Crimes Strategy Act of 1998 directed the development of an annual money laundering strategy (Public Law 105-310-October 30, 1998, 112 Stat. 2941), http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=105_cong_public_laws&docid=f:publ310.105.pdf. The first *NMLS*, published in September 1999, focused on improving domestic law enforcement, enhancing regulation, strengthening partnerships with state and local governments, and promoting international cooperation.
21. See bill summary for H.R. 3886 at <http://thomas.loc.gov/cgi-bin/bdquery/z?d106:HR03886:@@L&summ2=m&>.
22. See bill summary for S. 2972 at <http://thomas.loc.gov/cgi-bin/bdquery/z?d106:SN02972:@@L&summ2=m&>.
23. William F. Wechsler, “Testimony before the House Committee on Government Reform, Subcommittee on Criminal Justice, Drug Policy and Human Resources,” 23 June 2000, <http://www.treasury.gov/press/releases/ls732.htm>.
24. Senator John Kerry, “Introduction of S. 2972: The International Counter-Money Laundering and Foreign Act of 2000,” *Congressional Record Online*, 27 July 2000, <http://www.gpoaccess.gov/crecord/00crpgs.html>.
25. Jesse S. Morgan, “Dirty Names, Dangerous Money: Alleged Unilateralism in US Policy on Money Laundering,” *Berkeley Journal of Law* 21, Issue 3 (2003): 786–90; and Wechsler, “Follow the Money,” 55–56.
26. The FATF adopted Eight Special Recommendations on Terrorist Financing in October 2001. It added a ninth recommendation in October 2004. See Reuter and Truman, 139–48 for a discussion of the Eight Special Recommendations and US-led efforts to combat terrorism financing. The FATF 40 Recommendations as well as the Special Recommendations are available on the FATF Web site, <http://www.fatf-gafi.org>.
27. Senator John Kerry, “USA Patriot Act of 2001,” *Congressional Record Online*, 25 October 2001, S11026, <http://www.gpoaccess.gov/crecord/01crpgs.html>.
28. See the FinCEN Web site, http://www.fincen.gov/reg_section311.html.
29. David L. Asher, “The Impact of U.S. Policy on North Korean Illicit Activities,” Heritage Lecture 1024, *Heritage Foundation Online*, 23 May 2007, <http://www.heritage.org/Research/AsiaandthePacific/hl1024.cfm>.
30. Michael J. Mazarr, “The Long Road to Pyongyang: A Case Study in Policymaking without Direction,” *Foreign Affairs* 86, no. 5 (September/October 2007): 75–94. Mazarr provides a useful overview of the Bush administration’s struggle to reconcile the desire for a regime change and a change of behavior. He argues, as do a number of other authors, that this produced an inconsistent and erratic policy vis-à-vis North Korea.
31. Yoichi Funabashi, *The Peninsula Question: A Chronicle of the Second Korean Nuclear Crisis* (Washington, DC: The Brookings Institution, 2007), 412.

32. Nanto and Chanlett-Avery, "The North Korean Economy," 6–11.
33. Media Note, "North Korea—Denuclearization Action Plan" (Washington, DC: Department of State, Office of the Spokesman, 13 February 2007), <http://merln.ndu.edu/archivepdf/northkorea/state/80479.pdf>.
34. *Federal Register* 72, no. 52 (Monday, 19 March 2007): Rules and Regulations, 12732.
35. Steven R. Weisman, "How the US Turned North Korean Funds Into a Bargaining Chip," *New York Times*, 12 April 2007.
36. *Ibid.*
37. Press release, "Testimony of Daniel Glaser, deputy assistant secretary (Terrorist Financing and Financial Crimes) US Department of the Treasury before the Senate Committee on Banking, Housing, and Urban Affairs, 12 September 2006," <http://www.treas.gov/press/releases/hp93.htm>.
38. See Steven Lee Myers, "In Setback for Bush, Korea Nuclear Talks Collapse," *New York Times*, 11 December 2008, for an update on the ongoing struggle to implement the 2007 agreement. North Korea continues to resist signing a final inspection and verification plan.
39. The ideas for this analysis are drawn from Gary M. Shiffman, *Economic Instruments of National Security: Influencing Choices of Leaders* (New York: Palgrave Macmillan, 2006), 38–58.