

# CRS Report for Congress

## North Korean Counterfeiting of U.S. Currency

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# North Korean Counterfeiting of U.S. Currency

## Summary

The United States has accused the Democratic People's Republic of Korea (DPRK or North Korea) of counterfeiting U.S. \$100 Federal Reserve notes (supernotes) and passing them off in various countries. This is one of several illicit activities by North Korea apparently done to generate foreign exchange that is used to purchase imports or finance government activities abroad.

Although Pyongyang denies complicity in any counterfeiting operation, at least \$45 million in such supernotes of North Korean origin have been detected in circulation, and estimates are that the country has earned from \$15 to \$25 million per year over several years from counterfeiting. The illegal nature of any counterfeiting activity makes open-source information on the scope and scale of DPRK counterfeiting and distribution operations incomplete. South Korean intelligence has corroborated information on North Korean production of forged currency prior to 1998, and certain individuals have been indicted in U.S. courts for distributing such forged currency. Media reports in January 2006 state that Chinese investigators have independently confirmed allegations of DPRK counterfeiting.

For the United States, North Korean counterfeiting represents a direct attack on a protected national asset; might undermine confidence in the U.S. dollar and depress its value; and, if done extensively enough, potentially damage the U.S. economy. The earnings from counterfeiting also could be significant to Pyongyang and may be used to purchase weapons technology, fund travel abroad, meet "slush fund" purchases of luxury foreign goods, or even help fund the DPRK's nuclear program.

U.S. policy toward the alleged counterfeiting is split between law enforcement efforts and political and diplomatic pressures. On the law enforcement side, individuals have been indicted and the Banco Delta Asia (BDA) bank in Macao (a territory of China) was named as a primary money laundering concern under the Patriot Act. This started a financial chain reaction under which banks, not only from the United States but from other nations, have declined to deal with even some legitimate North Korea traders. North Koreans appear to be moving their international bank accounts to Chinese and other banks. In June 2007, the \$25 million in BDA accounts had been transferred to a bank in Russia for DPRK use. This issue had been holding up progress in the six-party talks on North Korea's nuclear program. The \$25 million has been released, but the financial sanctions remain in place. It is not known whether North Korea currently is engaged in supernote production, but such notes suspected to be from earlier production runs reportedly are readily available in a Chinese town just north of the DPRK border.

The political/security track attempts to stop the alleged counterfeiting activity through diplomatic pressures, the Illicit Activities Initiative, and direct talks with North Korea through a working group on U.S. financial sanctions that in December 2006 first met alongside the six-party talks. In these talks, the U.S. side stated that U.S. sanctions on Banco Delta could be resolved if North Korea punishes the counterfeiters and destroys their equipment. This report has been replaced by CRS Report RL33885, *North Korean Crime-for-Profit Activities*, and will not be updated.

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# North Korean Counterfeiting of U.S. Currency

The United States has accused the Democratic People's Republic of Korea (DPRK or North Korea) of counterfeiting U.S. \$100 Federal Reserve notes (supernotes) and passing them off in various countries. This is one of several illicit activities by North Korea apparently done to generate foreign exchange that is used to purchase imports or finance government activities abroad.

The purpose of this report is to provide a summary of what is known from open sources on the DPRK's alleged counterfeiting of U.S. currency, examine North Korean motives and methods, and discuss U.S. interests and policy options.

Although Pyongyang denies complicity in any counterfeiting operation, estimates are that at least \$45 million in such supernotes of North Korean origin are in circulation and that the country has earned from \$15 to \$25 million per year over several years from counterfeiting.<sup>1</sup> South Korean intelligence has corroborated information on past production of forged currency — at least until 1998 — and several U.S. court indictments indicate that certain individuals have been accused of distributing such forged currency more recently.

## U.S. Interests and Actions

For the United States large-scale counterfeiting of U.S. currency, whether done by North Korea or not, has a direct bearing on U.S. interests. The counterfeiting, itself, could undermine confidence in the U.S. dollar and, if done extensively enough, potentially damage the U.S. economy. It also is a direct attack on a protected asset of the United States and a violation of U.S. and other laws. If being done by the DPRK government, it violates accepted international norms. It also could affect the willingness of financial institutions in certain areas to accept legitimate U.S. currency, or it might induce them to impose surcharges when exchanging certain U.S. banknotes for their currency.

In a broader sense, the counterfeiting, to the extent that North Korea is the nation involved, arguably affects U.S. national security. North Korea is a Stalinist regime with self-announced aspirations to become a nuclear power. It is led by a communist dictator with a taste for luxury imports and need to subsidize his inner circle of supporters and broader ranks of party cadres. Yet the North Korean economy scarcely produces enough to feed its population and incurs a billion-dollar

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<sup>1</sup> See section "Amount of Bogus U.S. Currency," below.

trade deficit each year. Proceeds from counterfeiting could be used to maintain the regime's power or contribute to instability in East Asia.

The United States is ratcheting up a two-pronged approach to stem the alleged North Korean counterfeiting of U.S. currency. The first is through law enforcement initiatives. The second is through political and diplomatic efforts. The immediate goal is to bring a verifiable halt to both the production and distribution of bogus U.S. currency by North Korea. In the broader perspective, curbing North Korea's illicit activities is one piece of an overall U.S. strategy to halt Pyongyang's nuclear weapons program, to defuse tensions in Northeast Asia, and to induce the DPRK to adopt policies less inimical to its own people, the region, and the world.

U.S. law enforcement actions to curb the alleged counterfeiting led to financial measures taken by the United States in September 2005 to prevent the country from laundering proceeds from its alleged illicit activities through Macao's Banco Delta Asia (BDA). As discussed in the section on policy implications below, this action froze some \$25 million in North Korean accounts in that bank and caused financial institutions in other countries also to close many of their North Korean accounts, even those for legitimate business. For the year following the financial restrictions, they have been Pyongyang's main complaint and the reason it had given for boycotting the six-party talks on North Korea's nuclear programs. Even after returning to the talks in December 2006, Pyongyang refused to discuss denuclearization officially until the Banco Delta financial sanctions were lifted.<sup>2</sup> On February 13, 2007, however, as a sideline to a new six-party agreement, the United States reportedly assured North Korea that it would settle the BDA issue. It took until June, however, for the \$25 million to be transferred through the New York Federal Reserve Bank to a bank in Russia. North Korea confirmed its receipt on June 25, 2007.

A redesign of the U.S. \$100 bill is currently in progress to include enhanced technologies to deter counterfeiters. The Department of the Treasury expects the newly redesigned \$100 note to begin circulating in FY2009.<sup>3</sup> However, bills previously produced, are expected to remain in circulation for the foreseeable future making it possible for the DPRK to continue to circulate earlier production runs of its counterfeit supernotes.

## Limits on Information

Because counterfeiting is a form of clandestine criminal activity, a goal of those engaged in it is that it remains clandestine and undetected to the maximum extent possible. Thus, to the extent that the United States and other countries have information on the scope and scale of DPRK counterfeiting and distribution

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<sup>2</sup> Kyodo World Service. 6-way Talks' Delegates Leave Beijing After 5-Day Discussions. December 23, 2006. Note: The United States does not consider the actions to be sanctions, but North Korea has characterized them as such.

<sup>3</sup> Department of the Treasury, Bureau of Engraving and Printing Budget Statement, FY2008, February 9, 2007.

operations, such information is likely to be incomplete. As the DPRK is a relatively closed society, information on any production of counterfeit U.S. currency there — other than that received from defectors — is likely to be the product of intelligence sources and methods. Hence, it is unlikely that such information would be made public for fear of compromising ongoing intelligence gathering operations.

On the other hand, involvement of DPRK citizens and officials in the distribution of so called “supernotes” is more readily demonstrated once criminal investigations have been completed, arrests have been made, indictments issued, and convictions and/or confessions obtained. Indeed, a number of such indictments have been issued, and presumably a number of ongoing investigations remain in the pipeline. U.S. officials appear to be increasingly sensitive to a need to support public allegations with the weight of *de facto* legal evidence — fueling speculation that “Noreiga-type” criminal indictments<sup>4</sup> against the North Korean leadership may be a policy option under active consideration.

Also at issue is the credibility of information provided U.S. authorities by the South Korean government and its National Intelligence Services in matters involving Pyongyang’s criminal activities. Whereas in past years Seoul’s reporting on such matters was considered highly reliable, some now suggest downplaying the scope of any such activity better dovetails with the goals and objectives of Seoul’s more recent conciliatory unification policy vis-a-vis the North.

## **The Need to Counterfeit Currency**

North Korea needs to raise approximately \$1 billion per year to fund its merchandise trade deficit.<sup>5</sup> The DPRK imports more than it exports and must generate enough foreign exchange to cover the difference through some means — either legal or illegal. Legal means include borrowing, foreign investments, foreign aid, remittances from overseas Koreans, selling military equipment not reflected in trade data, and by selling services abroad. Illegal methods include the counterfeiting of hard currency, illegal sales of military equipment or technology, sales of illegal drugs or counterfeit cigarettes and pharmaceuticals, or by shipping illegal cargo between third countries. The country also can dip into its meager foreign exchange reserves. North Korea considers the United States to be a hostile nation and often takes actions commensurate with that policy.

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<sup>4</sup> Pichirallo, Joe. “Indictments Depict Noriega As Drug-Trafficking Kingpin; U.S. Had Long Backed Panamanian Leader.” *The Washington Post*, February 6, 1988. pg. a.01.

<sup>5</sup> Note that such estimates of scale of the DPRK’s foreign exchange deficit may be exaggerated as the amount may be offset by undetermined amounts of aid from the Peoples Republic of China.

## Alleged Areas of DPRK Criminal Activities

Allegations of North Korean drug production, trafficking, and crime-for-profit activity have become the focus of rising attention in Congress, the Administration, and the press, as well as in the diplomatic community.<sup>6</sup> Areas of DPRK criminal activity commonly cited include production and trafficking in: (1) heroin and methamphetamines; (2) counterfeit cigarettes; (3) counterfeit pharmaceuticals (for example “USA” manufactured Viagra); and (4) counterfeit currency (e.g., U.S. \$100 bill “supernotes”).<sup>7</sup>

DPRK production and trafficking of “supernotes” have been addressed in 2006 by both National Intelligence Director John Negroponte and President George W. Bush. In a January 26, 2006, White House Press Conference, President Bush — in commenting on the issue of income generated by North Korean criminal activity — remarked:

When somebody is counterfeiting our money, we want to stop them from doing that. And so we are aggressively saying to the North Koreans, just — don’t counterfeit our money. And we are working with others to prevent their illicit activities.<sup>8</sup>

Shortly thereafter, National Intelligence Director John Negroponte, in testimony before Congress, stated that North Korea “produces and smuggles abroad counterfeit U.S. currency as well as narcotics and other contraband.”<sup>9</sup>

In a Senate Committee on Government Affairs hearing in 2003, William Bach, the Director of the Office of African, Asian and European Affairs in the Bureau for International Narcotics and Law Enforcement Affairs of the U.S. Department of State, stated:

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<sup>6</sup> See generally CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael Perl.

<sup>7</sup> See CRS Report RL33885, *North Korean Crime-for-Profit Activities*, by Raphael F. Perl and Dick K. Nanto. In July 2004, for example, the U.S. Secret Service reportedly uncovered a network selling counterfeit North Korean made cigarettes, pharmaceuticals, and \$100 bills. See Frederik Balfour et. al., “Fakes,” *Business Week*, February 7, 2005. Criminal indictments subsequently ensued. See generally: BBC News, “What is a superdollar?,” June 20, 2004.

<sup>8</sup> Press conference of the President, January 26, 2006, p.9. [<http://www.whitehouse.gov/news/releases/2006/01/20060126.html>]

<sup>9</sup> See testimony of John Negroponte before the Senate Intelligence Committee on the issue of Worldwide Threats to the United States, February 2, 2005. Note that Negroponte’s remarks came at a time when the six-party talks on North Korea’s nuclear ambitions remained stalled over North Korea’s insistence that the United States remove proposed Treasury Department sanctions against Banco Delta Asia for its alleged role in laundering proceeds of DPRK criminal activity and distributing of DPRK produced counterfeit U.S. currency. See “North Korean Counterfeiting Complicates Nuclear Crisis,” by Martin Fackler, *New York Times*, January 29, 2006, p. 3.

The U.S. Secret Service Counterfeit Division is aware of numerous cases of counterfeiting with North Korean connections. Typical of such cases was one reported in Macao in 1994, when North Korean trading company executives, who carried diplomatic passports, were arrested for depositing \$250,000 in counterfeit notes in a Macao bank. There are numerous other counterfeiting incidents with links to Macao banks, North Korea, and North Korean diplomats.<sup>10</sup>

The State Department's 2006 *International Narcotics Control Strategy Report* released by the Bureau for International Narcotics and Law Enforcement Affairs states that, for decades, citizens of the DPRK "have been apprehended trafficking in narcotics and engaged in other forms of criminal behavior, including passing counterfeit U.S. currency." These have been carried out in league with criminal organizations around the world.<sup>11</sup>

Counterfeiting of foreign currency is apparently a phenomenon that is not new to the government of North Korea. Seoul's War Memorial Museum reportedly contains DPRK-manufactured South Korean currency from the 1950's, the production of which reportedly continued into the 1960s.<sup>12</sup> South Korean media reports cite a 1998 South Korean National Intelligence Service (NIS) Report to the effect that North Korea forges and circulates U.S. \$100 banknotes worth \$15 million a year. Subsequent reports to the South Korean National Assembly in the same year and in 1999 are cited in the media as stating that North Korea operates three banknote forging agencies and that more than \$4.6 million in bogus dollar bills had been uncovered on thirteen occasions since 1994.<sup>13</sup>

Subsequent press reports (of February 2, 2006) cite a Uri Party Member of Parliament's account of a closed briefing by South Korea's National Intelligence Service to members of Korea's National Assembly to the effect that North Koreans

<sup>10</sup> Bach, William. Hearing Testimony. Drugs, Counterfeiting, and Weapons Proliferation: The North Korean Connection. Hearing Before the Financial Management, the Budget, and International Security Subcommittee of the Committee on Governmental Affairs, United States Senate 108<sup>th</sup> Congress, First Session, S.Hrg. 108-157, May 20, 2003. p. 6.

<sup>11</sup> U.S. Department of State, Bureau for International Narcotics and Law Enforcement Affairs. *International Narcotics Control Strategy Report — 2006*. March 2006. Part II. The section in the 2006 report on the DPRK was repeated in the 2007 report because no new information had been received.

<sup>12</sup> See "The 'Soprano State?' North Korean Involvement in Criminal Activity and Implications for International Security," by Sheena E. Chestnut (hereinafter cited as *Chestnut*), Stanford University Honors Thesis, May 20, 2005, p.81 citing Cumings, Bruce, *Korea's Place in the Sun: A Modern History* (Norton, New York) 1997, and Michishita, Narushigwe, "Calculated Adventurism: North Korea's Military-Diplomatic Campaigns," *Korean Journal of Defense Analysis*, Vol. XVI, No.2, Fall 2004. Note that the term "Soprano State" was originally coined by *U.S. News and World Report* investigative journalist David Kaplan in 2003; see "The Far East Sopranos," by David E. Kaplan, *U.S. News and World Report*, January 27, 2003.

<sup>13</sup> See "Seoul's U-Turn on N. Korean Counterfeiting Could be Fatal," *Chosun Ilbo* (English Edition), December 25, 2005. The title of the 1988 report is cited as "A New Threat in the 21<sup>st</sup> Century: Realities and Responses to International Crimes."



were arrested abroad for counterfeiting offenses in the 1990's but that the Service had no evidence of the North making bogus currency after 1998.<sup>14</sup> Informed South Korean sources have confirmed the above stated content of the briefing, but insist that the NIS lack of hard evidence of DPRK supernote production after 1998 should not necessarily be construed to mean that such activity has ceased. Post-1998 South Korean media reports note that South Korean authorities have continued to seize bogus U.S. currency — including 1,400 counterfeit U.S. \$100 bills in April 2005, but that they have not traced the source.<sup>15</sup> Subsequent press reports state that the United States has provided South Korea with examples of DPRK source counterfeit 2001 & 2003 series \$100 notes. Moreover, the U.S. has reportedly determined that at least \$140,000 worth of counterfeit notes seized by South Korean police in April 2005 was manufactured in the DPRK as part of a batch produced in 2001, and distributed by Pyongyang.<sup>16</sup>

On June 13, 2003, South Korea, the United States and Japan held a North Korea policy coordination group meeting and announced an agreement that reportedly stated, “The three countries’ delegations express concern about the illegal activities of organizations in North Korea, including drug smuggling and money counterfeiting.”<sup>17</sup> Moreover, media reports on January 20, 2006, stated that Chinese investigators have independently confirmed allegations of DPRK counterfeiting.<sup>18</sup>

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<sup>14</sup> See “Korea Exchange Bank cuts ties with Macau bank accused of laundering money for North Korea,” *Associated Press Report* (Seoul) February 3, 2006. See also “No sign of North Korea making fake bills since 1998: spy agency,” *Yonhap*, February 3, 2006. Note that media reports contain at least a handful of reports by defectors that lend credence to the notion that the DPRK produced counterfeit greenbacks under government direction prior to 1996. For a consolidated overview of such reports see Sheena Chestnut, *Soprano State*, pp. 86-89.

<sup>15</sup> See “Seeking international cooperation to stop manufacturing of North Korea’s money,” *Chosun Ilbo* (Internet Version), December 27, 2005. Media report suggestions that the DPRK may have ceased production of counterfeit greenbacks prior to the end of 1998, however, may be contradicted by at least one defector who fled the North in 2000. According to one press report, the defector, a chemist connected to the Sean Garland case, was reportedly part of a team of North Korean experts ordered to produce fake U.S. \$100 bills. However, what is publically known about him, his activities, and their connection to the DPRK regime appears at this point to be anecdotal and sketchy at best. See “Counterfeiting cases point to North Korea,” by Josh Meyer and Barbara Demick, *L. A. Times*, December 12, 2005. Note that often statements by individuals termed “North Korean defectors,” have been considered unreliable when it comes to intimate knowledge of highly secretive, closed, DPRK programs.

<sup>16</sup> See “U.S. says S. Korea fake notes made in North,” by Jon Herskovitz and Jack Kim, Reuters, February 27, 2006. Accounts in subsidiaries of the Bank of China, Hong Kong have been frozen as a result of reported links to the DPRK’s trade in supernotes, and other criminal activities. See “HK link to Pyongyang ‘supernotes’ N Koreans have cut counterfeit deals in the city, with payments made via Bank of China subsidiary,” by Greg Torode, *South China Morning Post*, February 26, 2006.

<sup>17</sup> See “Seeking international cooperation to stop manufacturing of North Korea’s money,” *Chosun Ilbo* (Internet Version), December 27, 2005.

<sup>18</sup> See “North Korean Counterfeiting Complicates Nuclear Crisis,” by Martin Fackler, *New* (continued...)

Arrests and indictments point to DPRK trafficking in bogus U.S. currency as recently as 2005. In August 2005, federal law enforcement authorities completed two undercover operations in New Jersey and in California which focused on the activities of members of China's Triad criminal syndicates. The operations, named Royal Charm and Smoking Dragon, reportedly netted some \$4 million in supernotes believed to be of North Korean origin. Illicit narcotics, and counterfeit brand cigarettes and pharmaceuticals were seized as well. U.S. government authorities indicate there is the potential that ensuing trials and/or the plea bargaining process will reveal direct links between some of the smugglers and North Korean officials or government entities.<sup>19</sup>

One of the indictments issued in the above cited cases identifies Chao Tung Wu, a Taiwanese in custody for dealing in counterfeit bills, and alleges that he told undercover agents that the government of a nation — identified in the indictment as “country 2” — was producing counterfeit notes.<sup>20</sup> Country two has been widely cited in the media as being North Korea. Another law enforcement operation led to the arrest in Northern Ireland of Sean Garland, a leading member of an Irish Republican Army faction on charges of circulating more than \$1 million of supernotes (believed to be DPRK government produced) in Britain and Eastern Europe.<sup>21</sup> A request for his extradition to the United States ensued in mid-October 2005.

A Stanford University Honors Thesis Researcher, Sheena Chestnut, lists thirteen reported incidents since 1994 of North Korean involvement in smuggling/distributing counterfeit U.S. currency. All of these incidents allegedly occurred in either Asia or Europe. In them, the use of DPRK diplomatic passports and the involvement of DPRK diplomats, embassy personnel, and DPRK government trading company officials connect most of these incidents to the government of North Korea in varying degrees. Taken collectively, the link is seen as being even stronger. Of these 13 incidents, six have occurred since 1999, the time after which the NIS reportedly is unable to conclude that the DPRK continued *producing* counterfeit

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<sup>18</sup> (...continued)

*York Times*, January 29, 2006, p. 3.

<sup>19</sup> See generally, remarks of Acting Assistant Attorney General, John C. Richter of August 22, 2005. [[http://www.usdoj.gov/criminal/pr/speeches/2005/08/2005\\_4193\\_rmrksOprSmokngDrgnNroylChrm082405O.pdf](http://www.usdoj.gov/criminal/pr/speeches/2005/08/2005_4193_rmrksOprSmokngDrgnNroylChrm082405O.pdf)]

<sup>20</sup> See “Arrest ties Pyongyang to counterfeit \$100 bills,” by Bill Gertz, *Washington Times*, September 20, 2005, p. A1.

<sup>21</sup> See “North Korean Counterfeiting Complicates Nuclear Crisis” by Martin Fackler, *New York Times*, January 29, 2006, p. 3. See “Garland stands accused by US over counterfeit made in North Korea,” *Irish Times*, October 17, 2005. Garland was arrested October 7, 2005, as a result of pending U.S. proceedings against him. See also Department of Justice Press Release of October 8, 2005, on Arrest of Leader of Irish Workers Party.

notes.<sup>22</sup> As recently as March 2006, counterfeit supernotes were reportedly seized by police in Hong Kong from a Chinese-American man in transit from Macau.<sup>23</sup>

In April 2006, a Korean reporter claimed in an article in a South Korean newspaper that obtaining fake \$100 bills that likely were manufactured in North Korea was a “piece of cake” in the Chinese town of Dandong just across the DPRK’s northern border. According to the reporter, counterfeit bills similar to real currency fetch about 40% of their face value. Carefully manufactured \$100 supernotes go for \$60 to \$70 each. North Koreans refer to the counterfeit dollars as “kattalio” and the business of dealing in them as “the kattalio game.” After the Banco Delta financial sanctions, the article states that Pyongyang proclaimed that anyone involved in illegal drugs or fake notes would be severely punished. In March 2006, two men convicted of such activities were publicly executed. Since the Banco Delta sanctions, the number of counterfeit notes circulated through North Korea reportedly has dropped.<sup>24</sup> However, it may be that the number of counterfeit notes circulating within North Korea has increased since imposition of the Banco Delta sanctions.<sup>25</sup> Another newspaper article reported that in the North Korean counterfeit currency market, a printed counterfeit \$100 bill trades at 30% of its face value while electronically copied currency made with color copy machines trades at 10% of its face value.<sup>26</sup>

## Amount of Bogus U.S. Currency

The amount of alleged DPRK-produced counterfeit currency in circulation is unknown. U.S. officials have been quoted citing a figure of \$45 million since 1989.<sup>27</sup>

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<sup>22</sup> See *Chestnut*, pp. 144-145. The South Korean media reports that authorities there had discovered 1,400 supernotes (presumed to be of DPRK origin) in April 2005, but little more is known about such reports. See “DPRK’s manufacturing of counterfeit money was common sense within the National Intelligence Service,” *Chosun Ilbo* (Internet Version) December 27, 2005.

<sup>23</sup> Torode, Greg. “Fake US Supernotes Find Their Way to HK. Pyongyang’s Counterfeit Bills Are Seized from American in Transit.” *South China Morning Post*, March 5, 2006, p. 3. Supernotes have reportedly shown up on 2005-2006 in Peru, Paraguay, Mongolia, Hong Kong, and Ethiopia.

<sup>24</sup> Kwak Tae-chung. Getting North Korean-made Counterfeit Notes is a “Piece of Cake” — Supernotes Identical to Real Ones Circulated Through the North Korea-China Border — The Powerful Economic Sanctions by the United States Has Reduced the Quantity. *Seoul Weekly Dong-A*, April 25, 2006, pp. 30-31. Original article in Korean, translated by the Open Source Center as ROK Weekly on Decreases in Circulation of DPRK-made Illegal Products in China.

<sup>25</sup> See Interview with Kansai University’s Professor (Young Hwa?) Lee carried by Japan’s TBS-TV, in an interview during a program on “Narcotics Economy in the Making of North Korea,” January 16, 2007, 17:30-18:30 local time.

<sup>26</sup> “Smuggler’s Tale: The Chinese Connection.” *Dong’A Ilbo* (Internet version) January 27, 2006. Reported by Open Source Center.

<sup>27</sup> See Sanger, David E., “U.S. Is Shaping Plan to Pressure North Korea,” *New York Times*, (continued...)

Presumably this is the amount detected by the Federal Reserve. Officials familiar with the bogus currency in question, however, note its exceptional quality — so good that many cashier-level bank employees would likely not be able to detect the forgeries. This raises speculation that North Korea — if it is indeed producing the fakes — might need somehow to mark the currency to be able to identify its own bogus notes after production.

The amount of money that the bogus supernotes allegedly bring to the coffers of the North Korean government is unknown as well. Hence, estimates of the profit such transactions bring to the Pyongyang regime — to the extent they are based on open source material — are speculative at best. Amounts commonly cited, which take into account many factors, range from \$15 million to \$25 million in profit per year for several years.<sup>28</sup>

## Denial of Counterfeiting by North Korea

The DPRK has consistently denied allegations of state involvement in criminal activity, specifically in any counterfeiting activity, and it has vowed to resist U.S.

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<sup>27</sup> (...continued)

February 14, 2005, p. A-1. Note that this amount is more likely to be \$48 million, although apparently not publically cited.

<sup>28</sup> See discussion in CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael Perl. See also CRS Report RL32493, *The North Korean Economy: Background and Policy Analysis*, by Dick Nanto and Emma Chanlett-Avery. For the \$15 million figure on counterfeiting, see *Korea Herald*, November 16, 1998. See also, “Is Your Money Real?”, *Newsweek*, June 10, 1996, p. 10. According to some sources, income from counterfeiting is considerably higher, i.e. \$100 million. (See May 20, 2003 congressional testimony of Larry Wortzel of the Heritage Foundation.) It is said that the U.S. detects somewhere around \$3-4 million per year in DPRK origin supernotes. Rough calculations of the total amount of DPRK bogus supernotes in circulation in recent years are achieved by multiplying this figure by a factor of 3 or 4 for an estimate of \$9-16 million being placed in circulation per year. However, the exact amount remains elusive given the fact that much of the currency is passed in remote places and arguably banks have no financial incentive to report such forgeries if they can pass them on. Data on amounts of U.S. dollars counterfeited are not widely publicized so as not to undermine confidence in the U.S. dollar. North Korean counterfeit U.S. \$100 notes have been detected in at least 14 countries including the United States since the 1970’s according to media reports. On June 20, 2004, the BBC aired a “Superdollar” special which traced counterfeit \$100 bills from North Korea to an official IRA source in the U.K. Reportedly millions of fake \$100 bills were laundered through a *bureaux de change* in Britain. In July, 1996, a former member of the Japanese Red Army, traveling on a DPRK diplomatic passport was arrested in Thailand while trying to pass counterfeit U.S. \$100 bills. See “Japanese Fake Bill Suspect Had N. Korean Passport,” *Kyodo News*, July 5, 1996. For data on other forms of DPRK criminal/smuggling activity, see *Avoiding the Apocalypse: The Future of the Two Koreas*, by Marcus Noland, Institute for International Economics, Washington, D.C., June 2000, p.119. U.S. military sources reportedly estimated DPRK income from counterfeiting of U.S. currency at \$15-20 million for the year 2001. See “N.K. Exported \$580 Million Worth of Missiles to Middle East,” *Seoul Yonhap* (English), May 13, 2003, citing Japanese *Yomiuri Shimbun* report of May 12, 2003.

Pressure over the matter.<sup>29</sup> A January 24, 2006 commentary carried by the state-run Korean Central News Agency reported that Pyongyang “does not allow such things as bad treatment of the people, counterfeiting, and drug trafficking.”<sup>30</sup> In what may be an indication of DPRK willingness to curb any illicit counterfeiting activity, the DPRK Foreign Ministry announced on February 9, 2006, that “there is no evidence proving (North Korea’s) issue of counterfeit notes or money laundering” but that the country “will as ever actively join the international actions against money laundering.... It is the consistent policy of the (North Korean) government to oppose all sorts of illegal acts in the financial field.” The Foreign Ministry spokesman went on to say that the DPRK has “perfect legal and institutional mechanisms to combat such illegal acts as counterfeiting notes and money laundering, and any illegal acts are liable to severe punishment.”<sup>31</sup>

## State-Sponsored Counterfeiting?

Assuming that production of bogus U.S. currency is actually taking place in North Korea, some suggest that this does not necessarily mean that such activity is being done under government sponsorship, direction, or supervision. They argue that counterfeiting is a criminal phenomenon that is widespread throughout the world, and it is rarely, if ever, state-sponsored. Others say that there may be merit to such arguments, but North Korea could be an exception to any such norms.

It can be said that it is widely acknowledged that the Pyongyang regime engages — or has engaged — in a broad range of *other* crime for profit activity. Hence, inhibitions against counterfeiting may not be strong. The sophisticated type of equipment reportedly required for the production of supernotes is generally tightly controlled and generally restricted for sale to governments. Finally, North Korea is a closed authoritarian regime, and, as such, it is unlikely that any counterfeiting activity — which requires centralized production — would not be government sponsored, or at some point, come under government control.

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<sup>29</sup> A Swiss report on North Korean counterfeiting is reported to have expressed serious doubt that North Korea is capable of manufacturing the fake bills, which it said were superior to the real ones. See Hall, Kevin G., *Swiss Authorities Question U.S. Counterfeiting Charges against North Korea*, McClatchy Newspapers, May. 22, 2007. [[http://www.mcclatchydc.com/staff/kevin\\_hall/v-print/story/16472.html](http://www.mcclatchydc.com/staff/kevin_hall/v-print/story/16472.html)]

<sup>30</sup> This is but one of a string of DPRK denials. David L. Asher, former Coordinator of the State Department’s North Korea Working Group, in his February 1, 2006 remarks to the American Enterprise Institute cited another DPRK denial: “We had neither counterfeited currency nor gotten involved in any illegal trafficking.”

<sup>31</sup> See KCNA (official North Korean News Agency) broadcast of 1006 GMT, February 9, 2006. Reported in “North Korea vows to join international anti-money laundering drive,” *MSN News*, February 9, 2006, and untitled AP report from Seoul of February 9, 2006. Statements by a DPRK Foreign Ministry spokesperson are typically reserved for high level communications with the outside world. Reuters and Agence France Presse (AFP) reported on the broadcast as well.

## A Summary of Main Points

Information publically available suggests an expansion in both the scale and scope of North Korean cash-generating, criminal activity. This possibly indicates a situation in which criminal activity is playing an increasingly pivotal role in supporting North Korea's fragile economy.<sup>32</sup>

It is widely acknowledged that undetermined millions of dollars of so-called U.S. \$100 supernotes are currently in circulation. Given the sophistication of the bills, many have concluded that they are government produced. The government of North Korea has a demonstrated history of engaging in criminal activity to raise cash. It arguably has the disposition, opportunity, and technical means to produce forged supernotes.

Past production by North Korea of forged U.S. currency — at least until 1998 — has been reported by South Korea's National Intelligence Service. Indications of Pyongyang's more recent production of forged U.S. currency have seemingly been posited by defectors, and by Chinese investigators as well.

Many observers are convinced that the DPRK has been counterfeiting U.S. currency as matter of state policy. However, it is not fully clear from public sources whether North Korean state enterprises have continued to produce bogus dollars after 1998. At issue here is whether bills now being circulated are new or solely from stashes of earlier production runs. There appears to be a reasonable case that North Korea has continued to counterfeit U.S. currency since 1998. Also, not clear or publically announced, is the extent to which Pyongyang may have counterfeited — or may be counterfeiting — currencies other than the dollar.<sup>33</sup>

As North Korea is a secretive and closed society, activity taking place within the country, such as *production* of bogus foreign currencies — to the extent that such activities exist — may be difficult to demonstrate publically without compromising fragile intelligence sources and methods. In contrast, *distribution* of counterfeit U.S. currency is likely to take place in countries where the money can purchase items of value, i.e., more open and economically successful societies.<sup>34</sup> Numerous arrests

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<sup>32</sup> See CRS Report RL32493, *The North Korean Economy: Background and Policy Analysis*, by Dick Nanto and Emma Chanlett-Avery, January 2005. For a discussion of U.S. response options reportedly reviewed see "U.S. is Shaping Plan to Pressure North Korea," by David E. Sanger, *New York Times*, February 14, 2005, A-1.

<sup>33</sup> Note for example, that one operation against what is believed to be North Korean linked contraband smugglers reportedly netted not only some \$4 million in supernotes, but also \$700 in counterfeit U.S. postage stamps. See "Crime does pay for North Korea," by Peter Brooks, *Boston Herald* (op-ed), January 17, 2006.

<sup>34</sup> Note that press reports indicate that the U.S. Secret Service estimates \$43.4 million in counterfeit currency was circulated in the United States in 2004 alone. It is estimated that \$700 billion in genuine U.S. currency exists worldwide. Generally, disclosure that large amounts of U.S. currency in use worldwide might be bogus would likely be seen not to serve the best interests of the nation. As a result, some suggest the United States may be

(continued...)

outside the United States and recent indictments clearly involve individuals with links to the government of North Korea or its state-run enterprises.<sup>35</sup> This being the case, it is difficult to conclude that the government of North Korea has not been involved — at least until very recently — in distributing bogus U.S. currency.

## Policy Implications

For the United States the North Korean counterfeiting of U.S. currency combined with secondary effects has a direct bearing on U.S. interests. Counterfeiting of one nation's currency by another generally is considered to be an act of economic warfare — a direct attack on the U.S. financial system.<sup>36</sup> There is a large difference between criminal counterfeiting by private parties and that done or sanctioned by a nation. The counterfeiting, itself, might undermine confidence in the U.S. dollar and, if done extensively enough, potentially damage the U.S. economy. If the extent of counterfeiting were in the range of \$15 million to \$25 million per year, however, this would represent a relatively small amount compared with the total U.S. supply of currency or the amount circulating abroad. As of February 2006, currency in circulation — that is, U.S. coins and paper currency in the hands of the public — totaled about \$780 billion. Since 1994, the value of currency in circulation has risen at the rate of 6.5% per year, mostly stemming from foreign demand. The U.S. Federal Reserve estimates that between one-half and two-thirds of the value of currency in circulation is held outside the United States.<sup>37</sup> In the United States, most domestic transactions (by value) are done either electronically or by checks, not cash. As of December 2004, 72% of the value of currency in circulation consisted of \$100 notes, the denomination allegedly counterfeited by the DPRK.<sup>38</sup>

Counterfeiting also can reduce the confidence by foreigners in the dollar. The dollar has become the predominant medium of exchange in international transactions. Such degraded confidence in the dollar usually can be manifested either by a surcharge on certain denominations when converting dollars to foreign exchange or in certain denominations of the dollar not being accepted at all. Currently, this affects Americans and other holders of dollar currency who rely on cash for transactions rather than credit cards, checks, or bank transfers. If the counterfeiting were to become extensive enough, however, it might depress the overall exchange value of the dollar.

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<sup>34</sup> (...continued)

downplaying the scale of alleged DPRK counterfeiting activity — but nevertheless according it the high policy priority the actual level of such activity warrants.

<sup>35</sup> See footnote number 198.

<sup>36</sup> Asher, David L. "The North Korean Criminal State, its Ties to Organized Crime, and the Possibility of WMD Proliferation." The Nautilus Institute. Policy Forum Online 05-92A: November 15th, 2005.

<sup>37</sup> The Federal Reserve Board. Currency and Coin Services. On Internet at [<http://www.federalreserve.gov/paymentsystems/coin/default.htm>]

<sup>38</sup> The Federal Reserve Board. Currency in Circulation: Value. On Internet at [<http://www.federalreserve.gov/paymentsystems/coin/currcircvalue.htm>].

Even though the suspected amount of counterfeiting by the DPRK is relatively small when compared with all U.S. currency in circulation, its importance to Pyongyang and the ruling communist party could be significant. It apparently helps fund travel abroad, meet “slush fund” purchases of foreign goods, and subsidize the lifestyles of the privileged class in Pyongyang.

Even though the macroeconomic effect of a counterfeiting operation generating around \$15 million to \$25 million per year is minor, counterfeiting, itself, is a violation of U.S. law. The Treasury, including the Secret Service, and the Federal Reserve have primary responsibilities for addressing the counterfeiting of U.S. currency. The Federal Reserve’s role is to distribute and ensure the physical integrity, including the authenticity, of U.S. currency. The Secretary of the Treasury is responsible for issuing and protecting U.S. currency. The Bureau of Engraving and Printing produces the currency. It has announced that one of its priorities for FY2007 is to redesign the \$100 note.<sup>39</sup> The Secret Service conducts investigations of counterfeiting activities, provides counterfeit-detection training, and is responsible for anticounterfeiting efforts abroad.<sup>40</sup>

So far, the United States had taken a two-pronged (but overlapping) approach toward North Korea’s alleged counterfeiting activities: law enforcement and political/security pressures. The law-enforcement prong involves prosecuting or sanctioning individuals and/or institutions involved in the distribution of the bogus currency.

## **Law Enforcement and the Banco Delta Asia Action**

On September 15, 2005, the U.S. Treasury imposed USA PATRIOT Act Section 311 designations against Banco Delta Asia (BDA) in Macau. In the action, Treasury stated that the bank was a “primary money laundering concern” because, among other findings, sources indicated that “senior officials in Banco Delta Asia are working with DPRK officials to accept large deposits of cash, including counterfeit U.S. currency, and agreeing to place that currency into circulation.”<sup>41</sup> On September 20,

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<sup>39</sup> The Department of the Treasury. *Budget in Brief FY2007*. P. 87.

<sup>40</sup> U.S. General Accountability Office. Testimony. Counterfeit U.S. Currency Abroad: Observations on Counterfeiting and U.S. Deterrence Efforts. February 27, 1996 (GAO/T-GGD-96-82).

<sup>41</sup> The Department of the Treasury. Treasury Designates Banco Delta Asia as Primary Money Laundering Concern under USA Patriot Act. Press Release JS-2720. September 15, 2005. See *Federal Register*, Vol. 70 No. 181, September 20, 2005 (Notices), p. 55214. The finding asserts that at least one regular North-Korean-front client of BDA was widely reported to be conducting “numerous illegal activities, including distributing counterfeit currency and smuggling counterfeit tobacco products” for over a decade. See also Department of Treasury Press Release of September 15, 2005 (JS-2720), on Treasury Designation of Banco Delta Asia as a Primary Money Laundering Concern and Treasury Dept. FINCEN Advisory of December 13, 2005, on Guidelines to Financial Institutions on the Provision of Banking Services to North Korean Government Agencies and Associated Front Companies Engaged in Illicit Activities which encourages financial institutions (continued...)



2005, the Financial Crimes Enforcement Network of Treasury imposed special measures against Banco Delta Asia that prohibited U.S. institutions or agencies from opening or maintaining correspondent accounts on behalf of BDA and required covered financial institutions to exercise due diligence to ensure that no correspondent account is being used indirectly to provide services to BDA.<sup>42</sup>

The U.S. action against Banco Delta Asia caused an avalanche of responses both in financial and political circles. It caused such a run on accounts at the bank that the government of Macau had to take over BDA's operations and place a temporary halt on withdrawals. According to press reports, the Macau government shut down all North Korea-related accounts including those belonging to 9 DPRK banks and 23 DPRK trading companies. These reportedly included accounts from the core organs of the North Korean Regime.<sup>43</sup> When details of the accounts reached Kim Jong-Il, he reportedly was surprised to find that some accounts had been kept secret from him and some account-holders either did not exist or had already died.<sup>44</sup>

The financial effects of the BDA action were larger than expected. The crackdown also spread around the region, with Chinese, Japanese, Vietnamese, Thai, and Singaporean banks making life much tougher for North Korean account holders. In Macau, the North Korean trading firm used by Pyongyang as a de facto consulate rolled up its operations as the Macau government placed Banco Delta Asia into receivership. Not only has the action deprived major DPRK companies of an international financial base and cut into the secret personal accounts of the Pyongyang leadership, but it appears to have obstructed some legitimate North Korean trade. DPRK banks and traders reportedly are having difficulty finding other lenders to conduct their overseas business. Banks from other nations (such as the United Overseas Bank of Singapore and the Korea Exchange Bank of South Korea) have moved to sever contacts with North Korea, fearing that they, too, could face U.S. legal action.<sup>45</sup>

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<sup>41</sup> (...continued)

worldwide to take precautions that they are not used as a conduit for the laundering of proceeds of DPRK illicit activities.

<sup>42</sup> See *Federal Register*, Vol. 70 No. 181, September 20, 2005 (Notice of Proposed Rulemaking) p. 55217ff.

<sup>43</sup> See *Wall Street Journal Asia*, "North Korea's economy feels fallout of U.S. move-Lenders sever ties after sanction threat against Macau bank," by Gordon Fairclough, February 14, 2006. Note that as generally private North Korean individuals do not hold accounts outside the country, widespread speculation exists that the nine individual accounts seized belong to the upper echelons of the DPRK elite. The U.S. has accused Banco Delta Asia of accepting and circulating DPRK origin supernotes.

<sup>44</sup> General Secretary Kim Did Not Know the Existence of Some North Korean Accounts Frozen in Macau. *Sentaku*, July 1, 2007, p. 21. (Original in Japanese, translated by Open Source Center, article No. JPP20070728032001)

<sup>45</sup> Fairclough, Gordon. "Politics & Economics: Banks Cut Ties to North Korea — U.S. Threat Toward One Lender Has Surprisingly Big Ripple Effect." *The Wall Street Journal*, February 14, 2006. P. A6.

On March 7, 2006, North Korea's Li Gun (head of the North America division of North Korea's Foreign Ministry) met with Assistant U.S. Treasury Secretary Daniel Glaser at the United Nations in New York as part of a back channel for communicating with each other.<sup>46</sup> The U.S. side spent about 20 minutes explaining its actions against Banco Delta Asia and what it expected from the DPRK. The DPRK reportedly suggested several actions to resolve the issue and for it to return to the six-party talks (including the lifting of the financial sanctions on Banco Delta Asia, forming a joint U.S.-North Korean task force to examine the counterfeiting concerns, giving North Korea access to the U.S. banking system, and providing North Korea with technical help on identifying counterfeit bills).<sup>47</sup> Separately, the U.S. ambassador in Seoul indicated that Washington wanted Pyongyang to prove that tools used to counterfeit U.S. currency had been destroyed as evidence that North Korea had abandoned such illegal activities.<sup>48</sup>

In December 2006, North Korea agreed to return to the six-party talks, but during the talks Pyongyang refused to discuss denuclearization officially until the Banco Delta financial sanctions were lifted.<sup>49</sup> Pyongyang, however, did send the president of the Foreign Trade Bank of North Korea (Oh Gwang-chul) along with other financial experts to meet with Deputy Assistant Treasury Secretary Daniel Glaser in the first meeting of a working group on U.S. financial sanctions that met alongside six-party talks. A second meeting was held in January 2007. In these talks, the U.S. side reportedly stated that the BDA issue could be resolved early if North Korea punished the counterfeiters and destroyed their equipment.<sup>50</sup> This was viewed by some as an easing of the U.S. position as it linked the BDA action to the six-party talks and opened the possibility for resolving the BDA issue in order for the talks to go forward. The Bush Administration had held that the U.S. financial sanctions against Banco Delta for collaboration with North Korean criminal activities were a separate issue from the nuclear negotiations.

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<sup>46</sup> U.S. Department of the Treasury. Treasury Officials Brief North Koreans on Actions to Stem DPRK Illicit Financial Activity. Press Release JS-4099, March 7, 2006. "N. Korea Agrees to Discuss Counterfeit Issue with U.S." *The Chosun Ilbo*. (Digital edition) February 24, 2006.

<sup>47</sup> Kessler, Glenn. N. Korea Sets Terms for Return to Nuclear Talks. *The Washington Post*, March 9, 2006. P. A16. DPRK Reportedly Proposed 'Method' to Resolve Financial Dispute, Waits for US Response. Open Source Center report of Yonhap news article: N. Korea Vows Not To Join Nuclear Talks Unless U.S. Sanctions Are Lifted, March 8, 2006. Center-Left ROK Daily Carries Exclusive Interview With DPRK Delegate to New York Meeting. Open Source Center report of article in *Seoul Hankyoreh* (Internet version) in Korean. March 8, 2006.

<sup>48</sup> Herskovitz, Jon and Jack Kim. U.S. Says S. Korea Fake Notes Made in North. Reuters News, February 22, 2006.

<sup>49</sup> Kyodo World Service. 6-way Talks' Delegates Leave Beijing After 5-Day Discussions. December 23, 2006. Note: The United States does not consider the actions to be sanctions, but North Korea has characterized them as such.

<sup>50</sup> U.S. Offers Compromise Over N. Korea's Dollar Forgeries. *Chosun Ilbo* (Digital Chosun), December 20, 2006.

On February 13, 2007, a new six-party agreement on North Korea's nuclear program and energy needs was concluded.<sup>51</sup> In announcing this Agreement, Assistant Secretary of State Hill pledged to settle with North Korea within 30 days the issue of U.S. financial sanctions against the Banco Delta bank and the freezing of North Korean accounts of \$25 million in Banco Delta. After several failed attempts to transfer the \$25 million, the DPRK recovered its funds in June 2007 when the New York Federal Reserve Bank agreed to transfer them through its facilities to a bank in Russia. (The transfer through the Federal Reserve Bank arguably made the funds no longer illicit.) This allowed the DPRK to proceed with its commitments under the February 13 agreement.

Although the \$25 million in the BDA accounts has been released, the financial sanctions still remain. It is yet unclear, therefore, what the impact of the release of funding will be on the DPRK's ability to conduct future banking transactions. Will the DPRK be given a clean bill of health by the international banking community? Also to be determined is the impact of the release of such funds on any future attempts by the United States to signal to the international banking community that a nation, individual, or corporate entity — is suspect of, or involved in — illicit activity. Will the United States be viewed as using the banking system for political purposes and, thereby, eroding some of the goodwill it has with the international banking community?

## **Political/Security Measures**

The political/security prong attempts to stop the alleged counterfeiting activity by changing the cost-benefit calculus of decision makers in Pyongyang. The strategy is to increase costs and reduce benefits in order to induce decision makers to halt the activity. The inducements used are aimed primarily at raising costs and include the Illicit Activities Initiative, the Proliferation Security Initiative, diplomatic pressures, as well as possible military threats and other policy related measures.

The Illicit Activities Initiative, coordinated by the U.S. Department of State, is aimed precisely at North Korea's alleged counterfeiting and other illicit activities. It is being developed in cooperation with other nations.<sup>52</sup> The Proliferation Security Initiative (PSI) is part of the larger counter proliferation effort worldwide and aimed at more countries and groups than just North Korea — but the DPRK does receive a particular focus. The PSI activity has received support from more than 60 countries and more formal participation from 11 countries, particularly Japan, Australia, the United Kingdom, France, Germany, Italy, and Spain. Under the PSI, participating countries cooperate to prevent transfers of weapons of mass destruction-related items

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<sup>51</sup> For details, see CRS Report RL33567, *Korea-U.S. Relations: Issues for Congress*, by Larry A. Niksch.

<sup>52</sup> James A. Kelly. An Overview of U.S.-East Asia Policy, Testimony before the House International Relations Committee, Washington, DC. June 2, 2004.

to or from nation states and non state actors of proliferation concern. It does this through intelligence sharing, diplomatic efforts, law enforcement, and interdiction.<sup>53</sup>

Policymakers reportedly are divided on the ultimate goal of squeezing North Korea on its alleged illicit activities. A group of policymakers (sometimes referred to as the “hawks”) favoring regime change seeks ultimately to induce a crisis within the DPRK that would lead to the downfall of Kim Jong-il. One way to achieve this is to cut off the money the DPRK generates from counterfeiting, selling illicit drugs, and exporting missiles. A second group of policymakers more in favor of engagement, seeks to resolve the North Korean problem mainly by negotiations. Its goal is to change the “bad behavior” of the DPRK by bringing the country into the circle of peaceful nations and inducing it to act in accord with international standards.<sup>54</sup> Each group backs initiatives to curb Pyongyang’s alleged counterfeiting, but each sees the measures in a different light.

Some observers surmise that the financial action against Banco Delta Asia announced on September 15, 2005, fell too close to the September 19 joint agreement by the DPRK, the United States, and other participants in the six-party talks to be a coincidence. At the end of this fourth round of talks, the DPRK signed an agreement that set out a “visionary view of the end point of the process of the denuclearization of the Korean Peninsula.”<sup>55</sup> These observers opine that the action was backed by so-called “hawks” in the Bush Administration to scuttle progress being made on the diplomatic front. The United States had known about the counterfeiting and money laundering activities for years. Why wait, they say, until the middle of a round of the six-party talks to take action?<sup>56</sup> Pyongyang used the Banco Delta Asia action as a pretext to stay away from the six-party talks and then to delay implementing the February 13 six-party agreement by several months. Other observers state, however, that law enforcement efforts have a timetable of their own and that the Banco Delta Asia action occurred after a three-year investigation when the evidence gathering and other preparations were complete.

The position of the United States is that counterfeiting is an illegal activity that cannot be allowed to continue. In order to keep the six-party talks moving ahead, the United States arranged for the \$25 million in BDA accounts to be released, but still maintains the designation of BDA as a money laundering concern. The South Korean government also has taken a firm position on the counterfeiting issue. It has clearly communicated to North Korea that such illicit activities are not acceptable and that Pyongyang should unequivocally turn away from such illicit behavior once

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<sup>53</sup> U.S. Department of State. Bureau of Nonproliferation. The Proliferation Security Initiative (PSI) (Fact Sheet). May 26, 2005. Congressional Research Service report RS21881, *Proliferation Security Initiative (PSI)*, by Sharon Squassoni.

<sup>54</sup> Sanger, David. Questions Without Answers: the Korean Conundrum [Review]. *The New York Times*, January 19, 2006. Pg. E.9.

<sup>55</sup> U.S. Department of State. North Korea-U.S. Statement. Press Statement 2005/T13-29, September 19, 2005.

<sup>56</sup> See, for example: Choe, Sang-Hun. Roh Warns U.S. Over N. Korea. Blunt Speech Shows Rift Between Allies. *International Herald Tribune*, January 26, 2006, pg. 1.

and for all.<sup>57</sup> Seoul reportedly has tried in vain to reach a compromise with the United States to consider Pyongyang's counterfeiting activities illegal conduct by individual North Korean firms and not by the government of the DPRK.<sup>58</sup> One observer stated that the bigger question being asked by China and South Korea is why is the United States has been chasing after North Korea's "loose change" when the country is making plutonium, the real currency of state power?<sup>59</sup>

## Policy Responses

The response by other nations to the alleged counterfeiting by the DPRK is intertwined with other strategic and political interests. In the case of South Korea, although the country has reluctantly supported the U.S. position on the counterfeiting issue, the country has different interests. While Washington is using both law enforcement and political means to place financial pressure on Pyongyang, Seoul is looking for some compromise. The basic interests of the Bush Administration lie in stopping the proliferation of weapons of mass destruction, fighting terrorism, and protecting U.S. currency. South Korea, under President Roh Moo-hyun, has placed priority on attaining regional peace, regional prosperity, engagement, and eventual long-term unification with the DPRK.<sup>60</sup>

Since Portugal has returned Macao to China, Beijing now has supervisory responsibility over Banco Delta Asia. China has been attempting to modernize its banking system, and for one of its banks to be accused of money laundering clearly does Beijing no good. This places pressure on China to ensure that Banco Delta Asia and other banks are clean. Immediately after the Banco Delta action, major Chinese banks dealing with foreign exchange reportedly refrained from transactions with North Korean-related firms.<sup>61</sup> China conducted a three-month investigation of the accusations against Banco Delta Asia that, according to South Korean diplomatic sources, confirmed the suspicions. However, a confidential audit of the BDA by Ernst & Young ordered by Macanese banking regulators reportedly found no evidence that the bank knowingly laundered counterfeit U.S. currency on behalf of

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<sup>57</sup> Ambassador Lee Tae-sik's Speech Given at the St. Regis Hotel (Washington, DC). The Korea-US Alliance - A Partnership for the Future, February 7, 2006. Korea Economic Institute. [<http://www.keia.com/2-Publications/2-6-Other/LeeTSspeech.pdf>]

<sup>58</sup> ROK Editorial Says ROK-US 'Discord' Over DPRK Counterfeiting 'Worrisome.' *Dong-A Ilbo*, in Korean, January 25, 2006, p. 31. Translation by the U.S. Embassy in Seoul. Provided by Open Source Center.

<sup>59</sup> Hayes Says Counterfeiting Issue Sidetracks Nuclear Negotiations. *Nautilus Weekly*, February 27 - March 3, 2006. Quote by Nautilus Institute Executive Director Peter Hayes speaking on Chicago Public Radio's Worldview Program.

<sup>60</sup> Reuters. Crackdown on North Korea Strains US-South Ties. January 28, 2006.

<sup>61</sup> Chinese Banks Cut Transactions with North Korea-related Firms (From Kyodo News Service). BBC Monitoring Asia Pacific. March 13, 2006.

North Korea.<sup>62</sup> China reportedly tried to convince North Korea, however, that it needed to take steps in the matter.<sup>63</sup>

North Koreans also are reportedly attempting to circumvent the financial measures, but they have declined to disclose how they are doing it.<sup>64</sup> Traditionally, North Koreans have used Chinese banks for many of their international transactions, and some surmise that Kim Jong-il's trip to southern China in January 2006 may have included an attempt to move some North Korean accounts to a financial institution there. The U.S. Treasury has said that some reports suggest that North Korean agencies have been transferring assets to banks in China.<sup>65</sup> Others note that Austrian banks have not refrained from making transactions with North Korea. Financial transactions with North Korea apparently still can be done through Austria and Switzerland.<sup>66</sup>

Japan also seeks to defuse tensions with the DPRK, but Japan has cooperated with the United States in both the Proliferation Security and Illicit Activities Initiatives. In talks in February 2006 on normalization of relations with Pyongyang, Japan announced that it intended to take up North Korea's illicit activities, including counterfeiting, in order to strengthen policy coordination with the United States and the European Union.<sup>67</sup>

The U.S. Congress will likely continue its interest in this topic including oversight of Bush Administration actions, holding hearings to clarify U.S. policy, or using the congressional pulpit to send messages to North Korea.<sup>68</sup> Congress may explore possible criminal charges against Kim Jong-il in a manner similar to those against Manuel Noriega, the former leader of Panama, for drug trafficking. Other policy levers using human rights or other issues also could be employed. The United States has suggested to the DPRK that it join the Asia-Pacific Group on Money Laundering (APG), a 30-member group (including the United States, Japan, and South Korea) launched in 1997 as a sub-organization of the Organization of Economic Cooperation and Development. It is aimed at preventing illegal financial

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<sup>62</sup> Hall, Kevin G. *Macau Bank Audit Comes Up Clean*, *News & Observer*, Raleigh, N.C., April 17, 2007. pg. A.3. (The audit was obtained by the McClatchy Newspapers.)

<sup>63</sup> ROK Daily Cites Diplomatic Source: PRC Confirms DPRK Money-Laundering in Macau Open Source Center report of article by *Chosun Ilbo* (WWW-Text in English), January 11, 2006. [*Chosun Ilbo* headline: "China Finds N.Korea Guilty of Money Laundering"]

<sup>64</sup> Fifield, Anna. "North Korea Is 'Looking to Beat' US Financial Sanctions." *Financial Times*, March 13, 2006. P. 1.

<sup>65</sup> Treasury Issues Advisory on North Korean Banking. Bulletin News Network, the White House Bulletin, March 16, 2006.

<sup>66</sup> Major Chinese Banks Refrain From Dealing with N. Korean Firms. Kyodo News. March 13, 2006.

<sup>67</sup> Japan to raise North Korea's alleged laundering, drug trafficking in talks (From Kyodo News Service), BBC Monitoring Asia Pacific, February 1, 2006. p. 1.

<sup>68</sup> For legislation, see; CRS Report RL33567, *Korea-U.S. Relations: Issues for Congress*, by Larry A. Niksch.

activities in the Asia-Pacific region and would subsequently require the disclosure of all of the DPRK's illicit financial activities.<sup>69</sup> North Korea experts believe, however, that it will not be easy for the North to join the 30-member group.

The current strategy of the Bush Administration appears to be to pressure North Korea on its illicit activities but put top priority on the diplomatic process. Since, the effects of the BDA action had Pyongyang scrambling, the fact that the Bush Administration eased its financial pressure on North Korea enough for the six-party talks to go forward indicates that it has decided that the nuclear issue takes priority over punishment at this time. The BDA action (combined with UN sanctions prohibiting exports of luxury goods to the DPRK) seemed to generate results because they harmed the North Korean elites, including Kim Jon-Il, directly. Policies aimed at an economic collapse or regime change in North Korea, however, appear to be off the table at this time — partly because neither China nor South Korea thinks an economic collapse or regime change is likely to result from economic sanctions and neither country desires to deal with the economic and political effects that would follow should such a collapse occur. Both countries are trying to improve the DPRK economy — South Korea through investing in special industrial zones (such as the Kaesong Industrial Complex<sup>70</sup>) and China through direct investment in manufacturing and in providing equipment to businesses in North Korea.

How the broader strategic considerations will govern future responses to the problem of North Korean counterfeiting of U.S. currency and other crime-for-profit-activity is now unclear. What is clear is that the BDA sanctions made Pyongyang more willing to meet and talk seriously with the United States and other of the six-party countries and they provided real evidence to Pyongyang that flaunting international laws and norms can cause serious negative consequences for its inner circle of elites. In U.S. discussions with the DPRK on the normalization of relations, ceasing any counterfeiting of U.S. currency would seem to be *sine qua non*.

There is some concern, however, that the settlement of the \$25 million in BDA accounts may have elevated the Russian presence in the six-party talks.<sup>71</sup> A report from the July 2007 six-party sessions indicates, however, that the Russian delegate was on vacation and had a special envoy attend in his place.<sup>72</sup>

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<sup>69</sup> U.S. asks NK to Join Int'l Group on Money Laundering. Yonhap English News. March 12, 2006.

<sup>70</sup> See CRS Report RL34093, *The Kaesong North-South Korean Industrial Complex*, by Dick K. Nanto and Mark E. Manyin.

<sup>71</sup> Hiraiwa, Shunji. What Russia Aims for After the North Korea Issue, *Tokyo Toa*, July 1-31, 2007, pp. 8-9 (in Japanese, translated by Open Source Center, Document No. JPP20070724038002).

<sup>72</sup> Kasahara, Toshihiko and Shoji Nishioka, Six-Party Talks Resume After Four-Month Hiatus; Talks Settling Down to US, DPRK Taking Lead; Russian Representative Absent, *Mainichi Shimbun*, July 19, 2007 (Nikkei Telecom 21 Database Version, in Japanese, Translated by Open Source Center, document No. JPP20070719036001, Japan: Six-Party Talks Resume with US, DPRK Apparently Taking Lead).

Some suggest, moreover, that transferring the funds through the New York Federal Reserve Bank to a bank in Russia for transfer to the DPRK presents the image that the U.S. government could have “violated” specific financial sanctions imposed on North Korea. On June 12, 2007, a group of House Republicans led by U.S. Representative Ileana Ros-Lehtinen, asked the Government Accountability Office to evaluate whether the BDA transfer was consistent with U.S. anti-money laundering and counterfeit laws.<sup>73</sup> In response to the transfer of the \$25 million back to North Korea, Representative Ed Royce stated that the action “will undermine the very tools that it has used to effectively go after proliferators and state sponsors of terrorism.”<sup>74</sup>

The U.S. side also ultimately linked the BDA law enforcement action to the denuclearization issue in the six-party talks despite early insistence that the two issues were separate and independent. The U.S. side had been critical of the DPRK for refusing to proceed with the six-party talks until the BDA issue was resolved. The effect of acceding to Pyongyang’s demands in this case seems to have increased the level of trust and confidence between the two countries, but it also could indicate to Pyongyang that the United States had lost confidence in one of its own policies.<sup>75</sup>

The implications for U.S. policy of the BDA action go beyond the problems with the DPRK. The Patriot Act has provided the United States with a powerful tool to disrupt the financial underpinnings of unsavory regimes or hostile groups. The use of this tool is still under development, and it is not clear whether it should be employed as an end in itself or as a tactical weapon that is part of a larger strategic plan with ample coordination between the Departments of the Treasury, State, and Defense.

U.S. law enforcement actions against foreign banks and their operations, moreover, have far reaching consequences for an industry that often prefers to be secretive and has operational interests that often compete with each other. Banks must provide service to customers of all kinds and take a loss on counterfeit currency found that is surrendered to government authorities. At the same time they may be asked to cooperate in enforcing laws that may hurt their customers or reduce their earnings. BDA-type actions (which can be seen as sending mixed signals or which are followed by about-face changes in policy) also give rise to the question of what

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<sup>73</sup> Letter to David M. Walker, Comptroller General of the United States from Ileana Ros-Lehtinen, Christopher H. Smith, Dan Burton, Edward R. Royce, Mike Pence and Joseph R. Pitts. June 12, 2007. The letter asks the General Accountability Office to “evaluate whether State Department and Treasury Department actions undertaken to facilitate the transfer of North Korean funds are fully consistent with the enforcement of Section 311 of the Patriot Act and with the sanctions regime imposed under the UN Security Council Resolution 1718...”

<sup>74</sup> Rep. Royce Reacts to Reports of North Korean Funds Transferred Through United States Bank, US Fed News Service, Including US State News. Washington, D.C, May 11, 2007.

<sup>75</sup> Yi, Yo’ng-hwa. Evaporation of Suspicions Over DPRK’s Highly Enriched Uranium Program Starts Bush Administration’s “Inevitable Slide,” *Sapio*, July 25, 2008, pp. 8-10 (in Japanese, translated by Open Source Center, document No. JPP20070718036002, Japan: Academic Explains Reasons for US-DPRK “Honeymoon Relationship”).



effect they might have on U.S. leverage with the banking community and on cooperation from banks on other international problems. At issue here is whether in the future, foreign banks will be as willing to take measures that will be unpopular with their customers given the risk that the United States may at some point reverse course because national security interests or diplomatic exigencies hold sway?

Central to the policy debate is the issue of “crying wolf” and U.S. credibility. If the BDA case and the North Korean counterfeiting issue are downplayed in order for the six-party talks to go forward, will future U.S. law enforcement concerns be taken seriously? Next time international cooperation from the banking community is required to restrict criminal conduct, to what degree will the United States be perceived as just a lone wolf “howling in the wind?”