

# BEYOND SANCTIONS

*Understanding how North Korea circumvents sanctions offers key insights into the world of WMD finance—and ways to stop other would-be proliferators*

*By Farnaz Alimehri*

When the United Nations Security Council released the Panel of Experts' Midterm Report on August 30, 2019, the findings showed that despite the numerous sanctions placed on the Democratic People's Republic of North Korea (DPRK), the country "still enjoys ongoing access to the international financial system". By using an elaborate system of intermediaries, shell/front companies, and illicit trade, the DPRK is able to exploit gaps in member states' financial systems and circumvent financial sanctions imposed by the UN Security Council. This suggests that international sanctions imposed by the UN with partial or no effective national legislation within member states are not effective at isolating a country. Furthermore, the DPRK's ability to navigate and exploit the international financial system illustrates the difficulty of detecting proliferation financing, which is the act of providing funds or financial services for the development of weapons of mass destruction (WMD).

The weaknesses of international sanctions become more evident as North Korea, a globally recognized pariah state, continues to evade the most restrictive international and unilateral sanctions in the world. Rough estimates suggest that the DPRK produces billions of dollars annually through its extensive networks, with suspected estimates putting the country's profits at \$1.2-2.3 billion from overseas laborers and an estimated \$2.3 billion from exports such as coal, iron ore, textiles, and seafood products.

North Korea's evasion tactics serve as good examples because they expose the vulnerabilities of the UN sanctions regime. Furthermore, the country's use of illicit trade and finance networks demonstrates the challenges financial institutions face in enforcing counter-proliferation finance measures, especially since sanctions on the DPRK are the world's most comprehensive. Other countries sanctioned internationally might seek to exploit these same weaknesses and manipulate the international financial system in the same way.

Therefore, it is imperative to develop a basic understanding of illicit networks



by looking at North Korea's evasion of sanctions, and to employ internationally recognized guidance to challenge proliferation finance. The first steps are to: identify common tactics proliferators use for illicit trade and finance networks to fund WMD programs; detail member states' obligations to UN Security Council resolutions; and highlight a few internationally recognized best practices that will help member states meet their obligations under UN sanctions and resolutions.

△ North Korean leader Kim Jong Un looks at a rocket warhead tip after a simulated test of atmospheric re-entry of a ballistic missile, Pyongyang, March 15, 2016. *KCNA/Files/Reuters*

### **Illicit Trade and Finance Network Tactics**

Countries that seek an indigenous capability to manufacture or stockpile WMDs rely on trade and finance. While the trade of goods and money for the purposes of developing a WMD capability is prohibited under international law (UNSC Resolution 1540), many proliferators use legitimate methods to gain access by using common evasion tactics, taking advantage of the globalization of modern trade and gaining access to the international finance system, which would otherwise be blocked.

Globalization and modernization have led to complex supply chains, where parts of a single commodity can be constructed in several different countries around the globe. This complexity makes it easier to hide illicit trade, as goods and money are moving rapidly through the hands of buyers, sellers, and intermediaries.

North Korea's activities illuminate common tactics employed by proliferators to acquire goods and money. According to the Center for Advanced Defense Studies, "North Korea is highly dependent on foreign sourcing of sophisticated

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technology, dual-use items, and currency." One way in which the DPRK evades sanctions is with intermediaries, such as "commercial facilitators or regime agents". These actors use the complexity of the global trade system to their advantage, disguising the ultimate beneficiary of their goods or transactions. The state also employs front and shell companies to cover for the revenues it generates through trade and labor and the wares it acquires illegally. Another commonly used tactic to acquire goods and money is ship-to-ship transfers, wherein

vessels clandestinely transfer goods and bulk cash while in transit. Finally, the use of false flags, flown on ships to hide their country of origin, and falsified paperwork allow proliferators like the DPRK to participate in global trade.

A recent example of North Korea's sanctions evasion was expounded upon in the March 2018 UN Panel of Experts Report, which identified two ships, *Lighthouse Winmore* and *Billions No. 18*, linked to a known DPRK-associate, Shih-Hsien Chen. Both tankers were registered under false flags, and took part in illicit transfers of marine diesel to DPRK-flagged tankers. Chen worked through three separate front companies and other intermediaries to orchestrate the transfers. Ultimately, *Lighthouse Winmore* and *Billions No. 18* were placed on the UN North Korean Sanctions List.

These tactics underscore how proliferators work through an elaborate network to conduct illicit trade and access the international financial system. For the private and public sector, counter-proliferation finance is a relatively novel field compared to other known forms of money laundering and terrorist financing, but many of the schemes employed by proliferators to evade sanctions and international laws are not. Furthermore, these networks are not invulnerable. In fact, they have many weaknesses that counter-proliferators can target for disruption. A robust analysis of known North Korean networks led the Washington-based Center for Advanced Defense Studies to conclude that many of the different players in the illicit networks are interconnected and often led by key individuals and companies. Recognizing the role these individuals play, the tactics proliferators like the DPRK commonly use, as well as the illicit networks in other countries can provide member states with some of the tools needed to meet their international obligations.

### **Member States' Obligations**

Article 24 of the UN Charter empowers the Security Council to protect

international peace and security. The succeeding article obliges member states to carry out Security Council decisions, including enforcing sanctions on states such as North Korea. Thus, if the UN Security Council imposes sanctions, member states are obligated to enact provisions within their national legislation that enforce these resolutions.

Beginning in 2004, UNSC Resolution 1540 required “all states to adopt and enforce appropriate laws ... as well as other effective measures to prevent the proliferation of [nuclear, chemical or biological] weapons and their means of delivery”. While this resolution is specifically aimed at preventing non-state actors from acquiring WMDs, the stipulation that states must adopt measures to counter the finance of proliferation makes this resolution potentially quite disruptive to proliferating states as well. This is because state and non-state actors may and often do use the same tactics. Moreover, after the passing of this resolution, the Financial Action Task Force (FATF, a 39-member inter-governmental body established in 1989 to combat money laundering, terrorist financing, and other related threats to the integrity of the international financial system) started incorporating proliferation financing into their work in 2007 and subsequent policy recommendations in 2012.

In the case of Pyongyang, member states are required to implement measures to counter proliferation finance both because of international sanctions and because of the aforementioned Security Council resolution. In the 2019 Midterm Panel of Experts Report, the UN affirmed that, “there is an obligation for countries to implement targeted financial sanctions without delay against persons and [designated] entities”. However, the report noted that there was “insufficient implementation by Member States of their obligation to freeze all assets controlled by designated entities or members of the Government of the Democratic People’s Republic of Korea that are engaged in violation or evasion of any of the sanctions measures.” Specifically, the report highlighted the problem of financial institutions only closing accounts, rather than freezing the assets of the involved individuals. This continues to be an issue because DPRK diplomats continue to open and manage accounts in multiple countries, enabling them to conduct business on behalf of their country, including circumventing sanctions.

The challenge with implementing UN Security Council resolutions is that they often have no teeth unless members states also adopt and implement national policies to help enforce the international law domestically. The lack of adoption and implementation does not necessarily reflect a lack of political will, but rather the numerous factors that make it

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difficult to enforce any policy, such as political turnover and lack of financial and labor resources.

To demonstrate the significance of national legislation, look to 2013 when the Panama Canal Authority seized a North Korean ship, the *Chong Gong Gang*. Underneath ten thousand tons of sugar, customs officials found Cuban surface-to-air missiles and fighter jets, old remnants from the Cold War. Though this interdiction has come to be hailed internationally as a success story, the case elucidated many gaps within Panama's domestic legislation. Principally, under Panamanian law at the time, it was difficult to determine who had jurisdiction over the case, which led to a legal battle within the country. The captain, the first officer, and the political officer were eventually charged with arms trafficking, but the North Koreans were able to pay a fine to release their ship. With the release of their ship, the North Koreans were able to continue to circumvent international sanctions, and transport goods and money to the regime. Aside from prosecuting the arms trafficking, no obvious attempts have been made to interdict the payments the North Koreans made to the Cubans for this shipment, though it has been identified that the money was routed through multiple countries, including Russia and Singapore.

### Highlighting Best Practice

Recognizing lack of capacity as a problem in countering proliferation finance, many organizations worldwide are starting to offer support to member states. Sharing red flags and identifying best practices for both private and public sector actors supports the policies and procedures that are necessary to enforce states' international obligations. States and private organizations continue to view FATF's voluntary policy recommendations as the standard to aim for.

Concerning the DPRK, the FATF states, "Countries need to cooperate and coordinate between relevant authorities on the development and implementation of policies and activities to combat proliferation finance and share relevant

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information." Within the past year, the FATF has released several guides that provide more information on how to counter proliferation finance within specific sectors, such as risk-based approach guidance for accounting professionals, to help them assess the likelihood that their services could be used to circumvent sanctions and fund proliferators.

A key takeaway from the recommendations is that member states must designate a competent body or bodies within their governments that have the legal authority to implement and enforce targeted financial sanctions. If a member state establishes

more than one authority, that state should also establish plans for interagency coordination. The designated authority or authorities will thereby implement principles of counter-proliferation finance and enforce sanctions by freezing designated accounts—as mentioned by the 2019 Midterm Panel of Experts Report—and take steps to ensure that citizens within their countries are not aiding and abetting any entities sanctioned by the UN. Importantly, the FATF specifically calls for establishing communication mechanisms between the public and private sectors, including filing reports when suspicious activities are identified and when the funds of identified individuals have been frozen.

### **Enforcers Needed**

The rules of counter-proliferation finance are not static. Proliferators are constantly seeking new tools and tactics to evade international sanctions. This discussion only scratches the surface of the problem. Yet, it has sought to provide a general description of common tactics used by illicit trade and finance networks. Analyzing the real work of a known proliferator like North Korea demonstrates that illicit trade and finance networks use legitimate methods to bypass international sanctions. Furthermore, by analyzing the obligations Security Council resolutions impose on member states, we can see the challenges some face when attempting to enforce these resolutions nationally. As noted, the states are obliged to take substantial measures to disrupt the work of individuals acting on behalf of sanctioned entities, but often their efforts fall short of denying access completely. Most often, this is due to insufficient resources and support to meet the desired expectations.

Among the few internationally recognized best practices provided by the FATF to assist member states in meeting their responsibilities to enforce Security Council resolutions, the main recommendation asserts that states should designate a competent authority or authorities to enforce and implement counter-proliferation finance. It is certainly important to have international laws and national policy to help counter proliferation finance, but, for it to be effective, someone needs to be the enforcer. 