

Gangster Regime:

How North Korea Counterfeits United States Currency



Prepared by the Staff of U.S. Rep. Ed Royce (CA-40)

March 12, 2007

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March 12, 2007

The Honorable Tom Lantos
Chairman
House Foreign Affairs Committee
2170 Rayburn Building
Washington, D.C. 20515

The Honorable Ileana Ros-Lehtinen
Ranking Member
House Foreign Affairs Committee
B-360 Rayburn Building
Washington, D.C. 20515

Dear Chairman Lantos and Ranking Member Ros-Lehtinen:

I write to bring your attention to the enclosed staff report, *Gangster Regime: How North Korea Counterfeits United States Currency*.

I directed my staff to compile this report in response to the February 13th agreement at the six-party talks. As Members of the Committee consider this agreement and the challenges posed by North Korea, this report should be of interest. Through open-source material, it provides a comprehensive look at the scope of North Korean counterfeiting of United States currency and its implications for the economic and national security of the United States. The staff provides a dozen recommendations that are worthy of our consideration. For your interest, also included is a recent opinion piece I wrote for the *Wall Street Journal* on this topic.

Like you, I am pleased to see some measure of progress on the Korean Peninsula. Yet, we must not forget how we got this far, through concerted pressure, or the criminal nature of the North Korean government.

Sincerely,

A handwritten signature in black ink that reads "Ed Royce". The signature is written in a cursive, flowing style.

EDWARD R. ROYCE



“Financial sanctions imposed by America for [Kim Jong-Il’s] other illicit activities, from missile peddling to currency counterfeiting, helped get his attention. Their ripple effects have put lots of other banks and companies around the world off doing business with North Korea. Even as other trade sanctions on North Korea are lifted, there should be no let-up on curtailing its criminal activities.”

-- The Economist, editorial, February 17, 2007



Purpose and Scope

On February 13, 2007, the United States, North Korea, China, South Korea, Japan, and Russia reached an agreement on the future of North Korea's nuclear weapons program. In return for a suspension of its activities at Yongbyon - used by North Korea to produce weapons-grade plutonium - North Korea would receive 50,000 tons of heavy fuel oil. Further inducements of political, economic, and humanitarian assistance are to be provided as North Korea carries out commitments to declare all nuclear activities and eventually dismantle its nuclear weapons program.

It appears that the United States made an essential concession to pave the way for this agreement. Since September 2005, North Korean officials have been enraged over actions taken by the U.S. Treasury Department to blacklist Macau-based Banco Delta Asia, which had been complicit in North Korean money laundering and counterfeiting of United States currency. Assistant Secretary of State Christopher Hill, the U.S. negotiator at the six-party talks, made a commitment to "resolve" the issues surrounding Banco Delta Asia within 30 days. It remains unclear how this dispute will be "resolved."

The purpose of this report is to examine through open-source material the extent of North Korean counterfeiting to better assess potential U.S. concessions in this area and to make appropriate recommendations.

The staff would like to acknowledge the work of the Congressional Research Service. Raphael Perl and Dick Nanto's *North Korean Counterfeiting of U.S. Currency* provides an excellent jumping off point for those looking to explore this topic.



Executive Summary

Large-scale counterfeiting of U.S. currency by North Korea is a direct attack on a protected asset of the United States – an act of economic warfare – and a violation of U.S. law that could potentially deeply impact U.S. interests throughout the world. Left unchecked, the counterfeiting could potentially weaken confidence in the U.S. dollar, damaging the economy. In national security terms, proceeds from counterfeiting and other illicit activities help Kim Jong-Il maintain his grip on power and further his nuclear weapons and missile programs, which contribute to instability in Northeast Asia.

The following are key findings of this report:

- Criminal activity is playing a prominent role in supporting the North Korean state. North Korea generates \$500 million in profit annually from its illicit activities, with the criminal sector identified as responsible for 35 to 40 percent of North Korea's exports.
- North Korea's criminal activity has cemented its ties to international criminal organizations, giving the country access to a vast smuggling network that could allow it to move almost anything in or out of the country, including weapons of mass destruction.
- The United States Government, through investigative and forensic analysis, has made definitive links between North Korea and the production of high quality counterfeit bills, a.k.a. "Supernotes." The United States has found that these notes are "produced and distributed with the full consent and control of the North Korean government."
- North Korea is the first country to counterfeit another state's currency since Hitler's Germany, an act that can be described as no less than economic warfare.
- North Korea's counterfeiting network is global in scope. According to the United States Secret Service, "The Supernote investigation is an ongoing strategic case with national security implications. This investigation has spanned the globe, involving more than 130 countries and resulting in more than 170 arrests."
- \$50 million in North Korean origin Supernotes have been seized from circulation since 1989. Estimates on the amount of revenue generated from counterfeiting for Pyongyang range from \$15 to \$25 million per year. Given the quality of the notes, which makes detection difficult, the scale of North Korean counterfeiting could be much larger.

- Pressure – not appeasement – on the North Korean regime has worked. The September 2005 designation of Macau-based Banco Delta Asia as a “willing pawn” of the North Korean government in its counterfeiting activity caused significant pain in Pyongyang, and led North Korea back to the negotiating table.
- In a concession to Pyongyang, the United States committed to “resolve the issues concerning Banco Delta Asia” within 30 days of the February 13, 2007, agreement. Regardless of the outcome surrounding Banco Delta Asia, active vigilance against North Korea's robust and global illicit activities is essential.
- Aggressive law enforcement is not adversarial to a diplomatic approach towards North Korea, but in many ways is a key enhancement to U.S. negotiators. Only when the North Korean leadership realizes that its criminal activities are untenable will it have any incentive to change.
- Some may believe that North Korean counterfeiting is a small price to pay when it comes to disarming Pyongyang of its nuclear weapons. Ending North Korea's nuclear weapons program must be the primary objective. But efforts to rein in North Korea's illicit activities make denuclearization of the Korean Peninsula more likely, not less. For ending its counterfeiting and other criminal activity would sever a key subsidy for North Korea's weapons of mass destruction program and force North Korea into international norms. Only then do prospects for peace and security in Northeast Asia have a chance at succeeding.

Recommendations are bolded throughout the report.



The North Korean Criminal State

In order to augment the state's very limited economy, North Korea pursues a variety of illicit and proliferation activities that include: counterfeiting currency, military equipment sales, and sales of illegal narcotics and counterfeit cigarettes and pharmaceuticals. Information in the public domain suggests that such criminal activity is playing a prominent role in supporting the North Korean state, which continues to be listed by the United States as a "state sponsor of terrorism." Estimates, although difficult, suggest that North Korea generates \$500 million in profit annually from its illicit activities, with some estimates reaching \$1 billion.¹ Indeed, the former State Department official who spearheaded U.S. efforts against North Korea's illicit activities has identified the criminal sector as responsible for 35 to 40 percent of North Korea's exports.²

This illicit activity occurs throughout the globe, with state-sponsorship by the North Korean regime making these efforts all the more potent, and troubling. Aided by its diplomatic presence, North Korea's criminal tentacles have reached every continent, including the United States. Besides violations of United States law, of paramount concern is the impact this activity is having on North Korea's weapons of mass destruction and ballistic missile programs. Although direct and verifiable links to North Korea's WMD program are yet to be publicly made, there is little doubt that the regime's criminal activity is providing a significant subsidy to a regime that has pursued nuclear weapons and threatened peace and stability in Northeast Asia. Further, North Korea's criminal activity has cemented its ties to international criminal organizations, such as the Chinese Triads, giving the country access to a vast smuggling network that could allow it to move almost anything in or out of the country, including weapons of mass destruction.

Overall, the reported scale of this [illicit] activity is significant and arguably provides important foreign currency resources to the military-oriented North Korean state.

[North Korean] crime-for-profit activities are reportedly orchestrated by a special office charged with bringing in foreign currency under the direction of the ruling Korean Worker's Party.

Increasing concern exists that North Korean crime-for-profit activity is becoming a "runaway train," gaining momentum, and possibly out of control.³

-- Congressional Research Service, North Korean Crime-for-Profit Activities



North Korea's Global Counterfeiting Network

North Korea has been publicly accused by the President of the United States and the Director of National Intelligence of counterfeiting \$100 Federal Reserve notes, a.k.a. “Supernotes,” and smuggling them abroad.⁴

Given the clandestine nature of North Korean criminal activity and the closed nature of North Korea, it is difficult to gauge the extent of counterfeiting of U.S. currency taking place inside North Korea. Yet, through recent criminal investigations and indictments, one can gather an understanding of North Korea’s global counterfeiting network.

State-sponsorship of the Supernote poses unique and considerable challenges in addressing this issue through traditional law enforcement channels.

*-- United States Secret Service Deputy Assistant Director Michael Merritt
April 25, 2006⁵*

North Korean Supernotes have been reportedly detected in at least 14 countries, including the United States, since its discovery. Large amounts of North Korean-sourced Supernotes have been uncovered in the United States, Japan, South Korea, Taiwan, Ireland, Britain and the Philippines in recent years. In January 2006, Supernotes were apprehended from a Chinese-American in Hong Kong.

Historically, the United States has worked regionally with partners and allies to understand the scope of Pyongyang’s criminal activity. However, after 1998, when President Kim Dae Jung instituted South Korea’s policy of “sunshine” toward North Korea, some suggest that reporting by South Korea’s National Intelligence Service (NIS) downplayed the level of North Korea’s counterfeiting activity.⁶ For instance, the South Korean press reports that a closed briefing given to the National Assembly by the NIS in February 2006 indicated that while North Korea was involved in counterfeiting in the 1990s, South Korean intelligence had no information on such activity post-1998.⁷ However, recent reports indicate that the United States has provided Seoul with evidence of North Korean counterfeited 2001 & 2003 series \$100 notes and has determined that \$140,000 in bogus currency confiscated by South Korean authorities in 2005 was produced and distributed by North Korea. Treasury officials who traveled to Seoul in January 2006 to discuss the counterfeit issue reportedly did not receive a welcome reception.⁸ Such determinations bring into question the seriousness of the South Korean government’s willingness to confront the issue.

North Korean counterfeiting is not only a U.S. concern. China's central bank has warned lenders about an influx of high-quality counterfeit bills that have "flowed into our country from overseas," but such action by Chinese authorities did not occur until after the United States took action against Macau-based Banco Delta Asia (see section below).⁹

The Case of Sean Garland

"The Man with the Hat" demonstrates global dimension of North Korean counterfeiting¹⁰



In October 2005, the Justice Department indicted Sean Garland, the president of an Irish Republican Army (IRA) offshoot, on charges of conspiring with North Korea to put millions in counterfeit U.S. currency into circulation in Eastern Europe and Britain. Garland -- also known as "the Man with the Hat" -- was arrested in Belfast, Northern Ireland during a joint operation conducted by the U.S. Secret Service and local authorities. After posting bail, Garland returned to the Republic of Ireland.

The United States is now seeking his extradition.

According to the indictment, "Quantities of the Supernotes were manufactured in, and under the auspices of the government of the Democratic People's Republic of Korea. Individuals, including North Korean nationals acting as ostensible government officials, engaged in the world-wide transportation, delivery and sale of quantities of Supernotes."

At the time of his arrest, Garland was president of the Irish Worker's Party, the banned political arm of the Official Irish Republican Army (OIRA), which champions a Marxist ideology similar to that of North Korea. According to the indictment, the OIRA split from the IRA in the 1969, and is viewed as one of the more extreme of the IRA splinter groups. In his travels throughout Europe, Garland met with North Korean diplomats and intelligence agents to arrange for the purchase of Supernotes - meeting in Warsaw, Moscow and Minsk, according to the indictment. The BBC program *Panorama* first aired allegations against Garland in June 2004.

Recommendation: Despite the intricacies of politics on the British Isles, and the poor track record of extradition requests between the United States and the Republic of Ireland, the United States should press hard for the extradition of Sean Garland. Under U.S. custody, Garland could shed important light on the North Korean global counterfeit network.¹¹

Recent law enforcement actions serve to gauge the level of North Korean counterfeiting activity and its involvement with international criminal organizations. In August 2005, U.S. authorities completed two undercover operations – codenamed *Royal Charm* and *Smoking Dragon* – which targeted China's Triad criminal organization. The arrests netted \$4.5 million in Supernotes of North Korean origin, along with narcotics, weapons (including shoulder-fired surface-to-air missiles), counterfeit cigarettes and pharmaceuticals that would have been smuggled into the United States. [In 2006, the Subcommittee on International Terrorism and Nonproliferation highlighted the threat from terrorists acquiring shoulder-fired missiles.]¹² Another law enforcement operation resulted in the arrest of Sean Garland on charges of circulating \$1 million in North Korean produced Supernotes throughout Britain and Eastern Europe. Garland is a leading member of an Irish Republican Army faction. [See box above].

Recommendation: South Korea is an ally of the United States, with the U.S. maintaining nearly 30,000 troops on the Korean Peninsula to supplement South Korean defense forces. Yet, the “sunshine” mentality runs deep, and is causing the U.S.-South Korean alliance to falter. The United States should make clear to Seoul that it regards its cooperation on North Korean counterfeiting to be a significant issue in its bilateral relationship.

Recommendation: When possible the Congress should seek information from the Justice Department on criminal proceedings regarding North Korean counterfeiting, including the Royal Charm and Smoking Dragon investigations.



Quantifying North Korean Counterfeiting

Several factors make the amount of North Korean-produced counterfeit currency in circulation difficult to determine. Those familiar with North Korean counterfeits comment on the quality of the product, undetectable to most bank cashiers, as complicating a determination of the extent of bogus North Korean cash. Nevertheless, U.S. officials have cited approximately \$50 million in North Korean origin Supernotes as being seized from circulation since 1989.¹³ That figure may not be a good representation of North Korean counterfeiting, because as one government analyst put it, "We have no idea how much they're counterfeiting, because it's so good."¹⁴ Estimates on the amount of revenue generated for Pyongyang are also highly speculative, with most ranging from \$15 to \$25 million in profit per year from counterfeiting.¹⁵ Yet Dr. Larry Wortzel of the Heritage Foundation has put the profit earned by North Korea from counterfeiting at \$100 million annually.¹⁶

Dr. Kim Holmes of the Heritage Foundation, a former Bush Administration official, has put the totality of North Korea's illicit activities as generating approximately \$500 million a year for the regime.¹⁷ David Asher, who formerly was the lead at the State Department on North Korea's illicit activities, has put the criminal sector as responsible for 35 to 40 percent of North Korea's exports annually.

The relative low level of North Korean bogus bills seized may lead some to argue that the amount of North Korean counterfeiting activity is tolerable. However, there is reason to believe that North Korean counterfeiting could be more extensive than seizure figures suggest. First, given the quality of the notes, (see “Quality over Quantity” section below) it could be that many are being circulated as legitimate currency unbeknownst to holders of the notes. Approximately two-thirds of the \$750 billion in U.S. currency in circulation is held outside the United States.¹⁸ Much of the less developed world would not have the technology to detect counterfeits. Further, banks do not receive compensation for handing over North Korean Supernotes, but take a loss, giving them an incentive to pass on these bills. Lastly, it could be that the United States Government is publicly downplaying the extent of North Korean counterfeiting to avoid undermining confidence in the dollar.

Recommendation: It is uncertain that law enforcement and the intelligence community have a comprehensive understanding of the scope of the North Korean counterfeiting. The Committee should request a full briefing from intelligence officials on the extent of North Korean counterfeiting. If found lacking, the Committee should encourage the Director of National Intelligence to make North Korean counterfeiting a main concern for intelligence analysts.



Quality over Quantity

The Supernote was first detected in 1989 in the Philippines, and is of such high quality that it often goes undetected until it reaches the Federal Reserve Bank. The Secret Service, which has the lead in investigating counterfeit cases, calls the ongoing Supernote investigation – which has touched 130 countries and resulted in 170 arrests -- a “strategic case with national security implications.”¹⁹ Through its investigation, the Secret Service has made “definitive connections” between the Supernotes and North Korea. Showing the ability to adapt and evolve, the Secret Service is continually discovering improved versions of the Supernote. In all, 19 different generations of Supernotes have been detected.²⁰

“Supernotes” refer to both \$100 and \$50 denomination counterfeit notes – from the older series to the newer “big head” notes. The same printing methods used by the Bureau of Engraving and Printing are used to produce the Supernote, which is printed on reverse-engineered paper that is strikingly similar to that of U.S. currency, including its security features. The bills are produced using an intaglio press, which is the most advanced technology available for printing currency. Only a few companies sell this highly sophisticated equipment, and only to governments.

In 1996, for the first time in nearly 70 years, the United States reconfigured the design of its bills, ushering in the “big head” notes. The most sophisticated new security feature is the use of optically variable ink - also referred to as O.V.I. – which increases the cost of producing new notes. New bills (\$10, \$20, \$50, and \$100 denominations) in circulation today feature O.V.I., whereby the denomination number in the lower right-hand corner changes color as it is turned. The United States bought the exclusive rights to a specific color-changing scheme in 1996 from SICPA, the major manufacturer of O.V.I. located in Switzerland. Other countries followed the United States lead, including North Korea, whose currency is *not* a target of counterfeiters. The North Koreans bought a similar color-changing scheme and are believed to have manipulated the ink to match that of United States currency. Anecdotally, those who have compared the real notes with the bogus ones have said that the “defects” of the North Korean bills may appear as “improvements” to the untrained eye. For instance, the clock-tower hands atop Independence Hall appear sharper on the Supernote.²¹ This extreme quality greatly concerns the United States Government.



State sanctioned

North Korea has consistently denied involvement in counterfeiting activity, making pronouncements on state-run media. Its Foreign Ministry spokesman has stated that the country will “join the international actions against money laundering,” has the capacity to deal with counterfeiting, and that “any illegal acts are liable to severe punishment.”²² Some do question whether counterfeiting of U.S. currency in North Korea is state sanctioned. After all, counterfeiting is a criminal activity not usually done at the direction of a sovereign government, especially one as impoverished as North Korea.

Counterfeiting of one country's currency by another is considered an act of economic warfare.²³

Yet for many years, key support agencies of the North Korea leadership -- state companies, the intelligence service, Division 39 (see box below) -- have been connected to the production and distribution of illicit goods. In the past 30 years, North Korea has been linked to over 50 incidents involving drug trafficking in at least 14 countries.²⁴ A significant number of these cases have involved the arrest and detention of North Korean diplomats or state-owned vessels. Given that history, there is little indication that North Korea would be reticent to engage in the counterfeiting of U.S. currency. Indeed, during the Korean War, North Korea copied South Korean currency.²⁵

The U.S. Secret Service has determined through investigative and forensic analysis that these highly deceptive counterfeit notes are linked to the Democratic People's Republic of Korea and are produced and distributed with the full consent and control of the North Korean government.

--Report to Congress: “The Use and Counterfeiting of United States Currency Abroad, Part 3,” September 2006²⁶

An analysis of reported incidents of North Korean distribution of bogus U.S. currency implicates the North Korean government through the use of diplomatic passports, pouches, diplomats, intelligence agents or embassy personnel. Even members of Kim Jong-Il's family have been caught doling out counterfeit currency. According to the Congressional Research Service, there have been at least 13 publicly known incidents of North Korean involvement in the counterfeiting and distribution of U.S. currency since 1994.²⁷ [It is interesting to note that 1994 coincides with the Agreed Framework. According to informed sources, North Korea's involvement in illicit activities *increased* since signing that agreement.²⁸]

The indictments associated with operations *Royal Charm* and *Smoking Dragon* (mentioned above) cites “country 2” as sanctioning the production of counterfeit notes. “Country 2” is widely believed to be North Korea. Through the use of forensic analysis, experts have determined that the North Korea government is involved in their production.

Division 39 of the Korean Worker's Party

*By shutting down Division 39's businesses, "you can shut down Kim Jong-Il."*²⁹



According to high-ranking North Korean defectors, a government bureau – designated “Division 39” – is charged with raising hard currency for the North Korean regime. The office reports directly to Kim Jong-Il and directs a range of activities: from the benign exportation of exotic mushrooms and ginseng, to the illicit activities of producing Supernotes, manufacturing and trafficking drugs, and proliferating weapons technology.

This secretive arm was established in the 1970s by the regime to support Kim Jong-Il's political career, paving the way for his ascendancy. It is reported that citizens are required to donate to the office on national holidays. The cash generated by Division 39 serves as Kim Jong-Il's slush fund, allowing him to buy loyalty, fund illicit activity, and feed his appetite for gambling, alcohol and other aspects of the high life.

With the loss of economic support from Communist states abroad in the early 1990s, Division 39's operations turned to trade in illicit activity and weapons. Reports indicate that Division 39 may have generated as much as \$5 billion for the regime, squirreled away in Asia and Europe. Division 39 is believed to have received well over \$1 billion in payments from South Korean Hyundai Asan Corporation between 1999 and 2001. These payments included a secret payment of \$500 million that Hyundai Asan made to Kim Jong-Il in 2000 to secure his consent to meet with South Korean President Kim Dae Jung in June 2000.³⁰

Given its importance to the regime, one former high-ranking defector remarked that by shutting down Division 39, “you can shut down Kim Jong-Il.”

There have been several incidents and arrests involving North Korean officials distributing Supernotes.³¹ For a small, impoverished country, North Korea has a rather robust, global diplomatic presence with diplomatic missions in over 60 countries around the world. This level of diplomatic presence is even more unusual, given that its embassies reportedly do not receive funding from Pyongyang, but are expected to be profit centers, contributing to the “Party Center” back home.³² North Korea has a long history of exploiting diplomatic immunity to do so. In the 1970s, North Korean diplomats in all four Scandinavian countries were found to be using their tax exemption to purchase large quantities of cigarettes and alcohol and selling them on the black market for a profit. North Korean diplomats have even been found to be trading in ivory and rhino horns, leading the head of the Convention on International Trade in Endangered Species to formally demarche Pyongyang.³³

Countries with a North Korean Diplomatic Mission³⁴

Afghanistan, Algeria, Australia, Austria, Bangladesh, Brazil, Bulgaria, Burundi, Cambodia, Cape Verde, China, Democratic Republic of the Congo, Republic of Congo, Cuba, Czech Republic, Egypt, Equatorial Guinea, Ethiopia, Germany, Ghana, Guinea, Guinea-Bissau, India, Indonesia, Iran, Italy, Ivory Coast, Jordan, Laos, Lesotho, Libya, Madagascar, Malaysia, Mexico, Mozambique, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Peru, Poland, Qatar, Romania, Russia, Rwanda, Singapore, Somalia, South Africa, Sri Lanka, Sweden, Switzerland, Syria, Tajikistan, Tanzania, Thailand, Uganda, the United Kingdom, Uzbekistan, Vietnam, Yemen, Zimbabwe, as well as the United Nations.

The fact that local law enforcement is often unable to carry out full investigations of those who enjoy diplomatic immunity - being forced to simply expel the North Korean diplomats - complicates understanding the full scope of North Korean illicit activities. Illicit activity out of a diplomatic embassy is a violation of Article 31 and 41 of the Vienna Conventions on Diplomatic Relations, which state that commercial, and presumably criminal, activity for profit shall not take place by diplomats and officials must obey the laws of the land in which they are posted.³⁵

The North Koreans have denied that they are engaged in the distribution and manufacture of counterfeits, but the evidence is overwhelming that they are. There's no question of North Korea's involvement.

-- Daniel Glaser, Deputy Assistant Secretary for Terrorist Financing and Financial Crimes, Department of the Treasury³⁶

It is implausible that large-scale criminal activity could take place in a totalitarian state such as North Korea without the knowledge or direction of the regime. Involvement by the government of North Korea in the counterfeiting of U.S. banknotes heightens U.S. concerns, as counterfeiting of one country's currency by another is considered an act of economic warfare.

Recommendation: North Korea is the only country definitively known to counterfeit another state's currency since Hitler's Germany, an act that can be described as no less than economic warfare. The United States should be forthright in describing and denouncing this activity. Papering over North Korean counterfeiting, (i.e. citing North Korea as "country 2" in indictments) only serves to paint a false picture for the American people and the international community of the regime in Pyongyang. The Congress should go on record condemning North Korea's illicit activities in this regard.

Recommendation: As part of the February 13th agreement, five working groups were established, with one "aimed at resolving pending bilateral issues and moving toward full diplomatic relations" between the United States and North Korea.³⁷ North Korea's illicit activities should be a priority in this working group, with the United States making clear that there will be no normalization of relations until North Korean counterfeiting of U.S. currency has ceased.

Recommendation: Given that North Korea has repeatedly violated the Vienna Conventions on Diplomatic Relations – the heart of the international system – the United States should encourage partner nations to be vigilant about North Korean diplomats serving in their country, and support their efforts to expel them if necessary, further sending a message to North Korea that its illicit activities are untenable, and only will serve to bring the country further isolation.

Recommendation: The United States should consider compiling evidence against senior North Korean leaders with a view towards issuing criminal indictments.



Impact on the United States Economy and National Security

Substantial counterfeiting of U.S. currency by North Korea has a direct impact on the interests and security of the United States and constitutes a direct attack on a protected national asset – an act of economic warfare. Counterfeiting has existed for just about as long as paper currency has existed. The Greek island of Samos aimed to destabilize Sparta by counterfeiting their gold coin. During World War II, the Nazis forced Jewish artists and printers to reproduce the British pound and even American \$100 bills.³⁸ North Korea has brought the art of counterfeiting to a new level.

North Korean counterfeiting could weaken confidence in the U.S. dollar, and if done extensively, damage the U.S. economy, with impact felt throughout the world. Total currency in circulation totals approximately \$750 billion, with the Federal Reserve estimating that between one-half and two-thirds is held outside the United States. The dollar is a “global currency,” with some countries adopting it as their own. In recent years, over 70 percent of the value of currency in circulation was in \$100 bills, North Korea’s counterfeit note of choice.³⁹ If estimates of North Korean counterfeit bills hold true, it would constitute a small portion of currency in circulation. However, the disclosure of extensive counterfeiting could also depress the value of the dollar, leading some to believe that the scope of North Korea counterfeiting is being downplayed by United States officials.

If questioning of the legitimacy of U.S. currency becomes widespread, some financial institutions could become unwilling to accept legitimate U.S. banknotes, or charge additional fees when exchanging \$100 bills into local currency.⁴⁰ Further, introduction of Supernotes into a small economy can have significant effects. For instance, after Supernotes began appearing in Ireland in the 1990s, Irish financial institutions declined to exchange \$100 bills. In Taiwan in 2004 and Peru in 2005, financial institutions temporarily refused service on \$100 notes after Supernotes were discovered.

It is principally the North Korean Supernote that has driven the sophistication of the redesign of U.S. currency. The Bureau of Engraving and Printing introduces new currency designs every seven to 10 years to stay ahead of counterfeiters. According to the fiscal year 2008 Budget request, the Bureau’s priorities for the coming year includes the redesign of the \$5 and \$100 notes, with the new \$100 bill to begin circulating in late

2008. The new designs are part of a “multiyear initiative to implement the most ambitious currency redesign in U.S. history.”⁴¹ The cost of redesigning, printing, introducing and removing old notes is not insignificant, and another example of how North Korea counterfeiting impacts the United States.

North Korean counterfeiting and other sources of illicit income are essential to its economy and could have an impact on the national security of the United States. In order to maintain his grip on power, Kim Jong-Il subsidizes his inner circle of party supporters. Proceeds from counterfeiting could be used to maintain control over the state and to contribute to North Korea’s nuclear weapons program. Moreover, counterfeiting, no matter the scale, violates United States law.



U.S. Response: The Illicit Activities Initiative⁴²

In response to North Korea's range of criminal activity, the Administration launched the "Illicit Activities Initiative" in 2003. This interagency group involves over 100 U.S. law enforcement officers, intelligence analysts and policy staff, including members from 14 different government agencies, including State, Treasury, Defense, Secret Service, and the Central Intelligence Agency. Fifteen foreign government partners are also involved in the Initiative. As structured, there is an individual committee dealing with each element of North Korean illicit activity. Under its initial incarnation the head of the group worked on the seventh floor of the State Department, enjoying regular access to Deputy Secretary Armitage. Much of the Initiative’s operations remain classified, but according to former top officials involved in its operations, it has had success.

We instigated and coordinated the interdiction of contraband internationally and helped to shut down front companies and illicit trading networks. We also worked assiduously to provide support to our U.S. law enforcement brethren...The results of these investigations for the most part have yet to see the light of day but I am confident that when they emerge, the allegations of state-led North Korean criminal activity will be more than fully born out.

--David Asher, former Special Coordinator of the Illicit Activities Initiative
Congressional Testimony, April 25, 2006⁴³

The Illicit Activities Initiative was designed to bolster U.S. diplomatic efforts towards North Korea, attacking its illicit hard-currency earnings and allowing the United States to negotiate from a position of strength. However, given the uncompromising nature of law enforcement investigations, it is inevitable that the Initiative ran into resistance from those within the government who feared that confronting North Korean on its criminal activity could undermine the six-party talks.

With a new direction at the State Department, the Illicit Activities Initiative has been downgraded to being run by the Korea Desk, rather than by special appointees. This is a steep fall. As a consequence, the Initiative has lost the coordination and energy that it previously enjoyed.

Recommendation: Aggressive law enforcement is not adversarial to a diplomatic approach towards North Korea, but in many ways is a key enhancement to U.S. negotiators. For only when the North Korean leadership realizes that its criminal activities are untenable will it have any incentive to change. The Illicit Activities Initiative should be reinvigorated, with its staff having sufficient resources and access to decision-makers at the highest levels in appropriate government agencies.

Recommendation: Given the overlap between North Korea's illicit activities and its proliferation of weapons of mass destruction and related technology, the United States should seek closer integration between the Illicit Activities Initiative and the Proliferation Security Initiative with respect to North Korea.⁴⁴

U.S. Response: Banco Delta Asia

In September 2005, after a three-year investigation, the U.S. Treasury Department imposed Patriot Act Section 311 sanctions against Macau-based Banco Delta Asia (BDA). According to the Treasury, BDA was designated a "primary money laundering concern" because "senior officials in Banco Delta Asia are working with [North Korean] officials to accept large deposits of cash, including counterfeit U.S. currency, and agreeing to place that currency into circulation." Indeed, a top Treasury official called BDA a "willing pawn for the North Korean government." [See **Appendix A** for the Treasury Department's release of September 15, 2005.] Banco Delta Asia is a small commercial bank in the Macau Special Administrative Region, China, a region of the world long identified as a haven for money laundering, operating eight branches in Macau, including a branch inside a casino. There are likely other banks employed by North Korea in a similar manner to support its illicit activities. According to Treasury



Undersecretary Stuart Levey, "We believe the North Korean leadership may be hiding significant amounts of money derived from suspect activities in banks around the world, including Europe."⁴⁵

For over 20 years, Banco Delta Asia provided financial services to North Korean government agencies and front companies engaged in illicit activities. According to the

Federal Register notice designating BDA as a primary money laundering concern, "such account holders comprise a *significant* amount of Banco Delta Asia's business."⁴⁶ [emphasis added] On the same day as its designation, Treasury's Financial Crimes

Enforcement Network [FinCEN] issued a proposed rule to impose “special measures” against BDA that, if adopted as final, will prohibit U.S. institutions from opening or maintaining correspondent accounts on behalf of BDA. [Few U.S. financial institutions maintained correspondent accounts for Banco Delta Asia at the time of the proposed rule.] Further, on December 13, 2005, FinCEN issued an advisory to U.S. financial institutions to warn them that North Korea, acting through government agencies and front companies, may be looking elsewhere for banking services after the designation of Banco Delta Asia. Since 2003, the United States has taken similar action against banks in Latvia, Belarus, Syria and Burma suspected of money laundering.

The mere proposal of Treasury action created a run on BDA, which reportedly lost a third of its deposits in six days, forcing the Macau government to seize control. The amount of North Korean assets frozen by local authorities is reportedly \$24 million, a seemingly small amount. However, the action sent an unmistakable message to bankers about the consequences of dealing with the North Koreans that has had far reaching implications. Banks throughout the region (China, South Korea, Japan, Vietnam, Mongolia, Thailand, Singapore) have moved to sever contacts with North Korea. Shortly after U.S. action against BDA, Bank of China shut down accounts tied to North Korea at its Macau branch.⁴⁷ In the wake of North Korea's October 2006 nuclear test, four Chinese commercial banks ceased doing business with North Korea.⁴⁸ China has long served as the gateway for North Korea to the outside world. Countries and businesses dealing with North Korea walked away for fear of being designated as an accomplice to the regime's illicit activity. Indeed, the ripple effect from the BDA case helped to serve as a model for recent actions against Iran, and now possibly Sudan.

Given the regime's counterfeiting of U.S. currency, narcotics trafficking and use of accounts world-wide to conduct proliferation-related activities, the line between illicit and licit North Korean money is nearly invisible.

-- Stuart Levey, Treasury Undersecretary for Terrorism and Financial Intelligence⁴⁹

Some assert that the U.S. action has hampered “legitimate” North Korean trade. Yet, before designating a foreign bank as a “primary money laundering concern” the Treasury Secretary is required to consider the extent to which it is used for legitimate business purposes. The Treasury Department found that, “Although Banco Delta Asia likely engages in some legitimate activity, the Secretary believes that any legitimate use of Banco Delta Asia is *significantly* outweighed by its use to promote or facilitate money laundering and other financial crimes.”⁵⁰ [*emphasis added*] Indeed, top U.S. officials have characterized the line between legitimate and illicit North Korean funds as “nearly invisible.”

Others question the utility of taking such steps against North Korea – pursuing this “loose change” in the middle of the six-party talks. Indeed, the law states that the Treasury Secretary, in consultation with other appropriate agencies, must consider the “effect of the action on the United States national security and foreign policy” when considering taking special measures against a primary money laundering concern. In this case, the government found that, “To the extent that this prevents North Korean front companies

engaged in illicit activities from accessing the U.S. financial system, the proposed action supports and upholds U.S. national security and foreign policy goals.”⁵¹ Further, looking the other way when U.S. laws are being broken, or brushing aside North Korea’s illicit activity for the sake of diplomacy, ignores a fundamental characteristic of the regime. How can a state that is counterfeiting our currency be expected to live up to its commitments made in the February 13th agreement?

What I am worried about as we go forward is that we might get wobbly on this issue [North Korean counterfeiting and Banco Delta Asia]. Because I think we have discovered one of the keys in terms of getting the attention of this regime. We have to continue to demonstrate that unless Kim Jong-Il disarms he will continue to be starved for cash and trade. That is a very important principle. North Korea is susceptible to financial and economic pressure. So let’s keep that up.

-- Rep. Ed Royce to Undersecretary of State Nick Burns
Full Committee Hearing, “North Korea’s Nuclear Test: Next Steps”
November 15, 2006

The Treasury action against Banco Delta Asia struck a nerve in Pyongyang -- leading North Korea to boycott the six-party talks for over a year. It was North Korea's desperation from this financial pressure that led it back to the negotiating table. Reportedly, during seven hours of negotiations on resuming the six-party talks, the North Korean representative's single request was that these financial issues be a part of the discussion. In announcing its return to talks, North Korea's foreign ministry stated that the decision was based "on the premise that the issue of lifting financial sanctions will be discussed and settled."⁵²

During a November 2006 hearing of the House International Relations Committee, the issues surrounding Banco Delta Asia were raised with Under Secretary of State for Political Affairs Nick Burns. Under Secretary Burns testified that, “the easiest way to resolve this is for the North Koreans to stop money laundering...and stop counterfeiting American currency.”⁵³

In what can only be described as a concession to Pyongyang, in connection with the February 13th agreement, the United States committed to “resolve the issues concerning Banco Delta Asia” within 30 days.⁵⁴ Senior U.S. officials have described the issue as being “on a separate track” from the six-party talks and taking place in a “legal channel.”⁵⁵ Yet out of fear of upsetting the North Korean regime, U.S. officials have downplayed the significance of the illegal activities that were taking place at Banco Delta Asia. During a February 22nd speech to the Brookings Institution, Assistant Secretary Hill described the North Koreans as “only depositors in this bank,” and that “our issue was between [the U.S.] Treasury Department and the bank,” essentially distancing his diplomatic efforts from the issue of North Korea’s illicit activities. Yet under questioning from Rep. Ed Royce at the Committee’s February 28th hearing, Assistant Secretary Hill repeatedly assured the Committee that, “we have not, and will not, trade progress on denuclearization by turning a blind eye to some of these other activities.”⁵⁶ However, close scrutiny (box below) reveals a diplomatic sweep under the rug.

A Change in Tune?

*...this is all part and parcel of the same behavior. When you let them get away with counterfeiting someone else's currency, in this case, our currency, you're essentially saying that North Korea can have rules that are different for North Korea from the rest of the world, and I think what North Korea needs to understand is if they do harbor a desire to join the international community, they'd better understand that there are rules and rules that will apply to them, as well as all the other member states.*⁵⁷

- Assistant Secretary Christopher Hill, October 13, 2006

Versus four months later...

*...we have a great interest in trying to get [Banco Delta Asia] resolved. We have a broader interest... in this case, the North Koreans are only depositors in this bank. Our issue was between [the U.S.] Treasury Department and the bank.*⁵⁸

- Assistant Secretary Christopher Hill, February 22, 2007

Shortly after the February 13th agreement, Treasury officials were in Macau to discuss the Banco Delta Asia case with local officials. During the course of Treasury's investigation, over 300,000 documents from the bank were reviewed. Commenting on the investigation, Daniel Glaser, Assistant Secretary of the Treasury for Terrorist Financing and Financial Crimes stated, "Everything that we've seen throughout the course of this investigation has confirmed and reinforced the concerns we initially expressed back in September 2005."⁵⁹ Yet, press reports continue to speculate as to how this issue will be "resolved." Some report that half of the North Korean accounts could be released by local authorities, if found to be "legitimate." There is also still the possibility that the Treasury Department could find that Banco Delta Asia has instituted proper anti-money laundering controls and "rescind" its designation as a "primary money laundering concern." Unknown is the practical impact that "resolving" Banco Delta Asia will have on North Korea. Will the signal be business as usual, or will banks still be too timid to engage with North Korea?

Recommendation: The Treasury Department should finalize its rulemaking with respect to Macau-based Banco Delta Asia, prohibiting U.S. institutions from opening or maintaining correspondent accounts on behalf of the bank. U.S. officials continue to assert that the United States takes North Korean illicit activity very seriously. Such action by the Treasury would put meaning behind those words.

Recommendation: Banco Delta Asia is a small bank. North Korea likely employs other financial institutions both in Asia and Europe to conduct its illicit activities. The Treasury Department should aggressively track North Korea's illicit activity, taking aggressive action against complicit financial institutions as necessary.

Recommendation: The move against Banco Delta Asia demonstrates the power of financial tools that can be deployed against regimes that present a risk to the economic or national security of the United States. Conversely, the United States has had trouble in rallying the international community to take concerted action against such states, while foreign financial institutions have proved to be far more cooperative when faced with the prospect of being shutout of the U.S. market. The United States should use "lessons learned" in the Banco Delta Asia case to continue financial pressure on North Korea, as well as other state sponsors of terrorism.



Conclusion

Some may believe that North Korean counterfeiting is a small price to pay when it comes to disarming Pyongyang of its nuclear weapons. Yet such a position attempts to make a simplistic bifurcation of the two objectives, minimizes the potential impact to the world's economy, and ignores the laws of the United States and the true nature of a North Korean regime that is engaged in what can only be described as economic warfare against the United States. It also sends an unhelpful signal to the North Koreans that as long as they put forth *promises* on their nuclear weapons, the United States will bend on its laws.

Ending North Korea's nuclear weapons program must be the primary objective. But efforts to rein in North Korea's illicit activities make denuclearization of the Korean Peninsula more likely, not less. For ending its counterfeiting and other criminal activity would sever a key subsidy for North Korea's weapons of mass destruction program. It would also condition Pyongyang into respecting international norms. How can we expect a regime that counterfeits our currency to abide by an agreement on its nuclear weapons? Only when North Korea ends its criminal behavior is there prospect for peace and security in Northeast Asia.

Appendix A



September 15, 2005
JS-2720

Treasury Designates Banco Delta Asia as Primary Money Laundering Concern under USA PATRIOT Act

The U.S. Department of the Treasury today designated Banco Delta Asia SARL as a "primary money laundering concern" under Section 311 of the USA PATRIOT Act because it represents an unacceptable risk of money laundering and other financial crimes.

"Banco Delta Asia has been a willing pawn for the North Korean government to engage in corrupt financial activities through Macau, a region that needs significant improvement in its money laundering controls," said Stuart Levey, the Treasury's Under Secretary for Terrorism and Financial Intelligence (TFI). "By invoking our USA PATRIOT Act authorities, we are working to protect U.S. financial institutions while warning the global community of the illicit financial threat posed by Banco Delta Asia."

In conjunction with this finding, Treasury's Financial Crimes Enforcement Network (FinCEN) issued a proposed rule that, if adopted as final, will prohibit U.S. financial institutions from directly or indirectly establishing, maintaining, administering or managing any correspondent account in the United States for or on behalf of Banco Delta Asia.

Banco Delta Asia SARL

Banco Delta Asia is located and licensed in the Macau Special Administrative Region, China. The bank operates eight branches in Macau, including a branch at a casino, and is served by a representative office in Japan. In addition, Banco Delta Asia maintains correspondent accounts in Europe, Asia, Australia, Canada, and the United States.

Deficiencies at Banco Delta Asia noted in the finding include, but are not limited to, the following:

- Banco Delta Asia has provided financial services for over 20 years to Democratic Peoples Republic of Korea (DPRK) government agencies and front companies. It continues to develop relationships with these account holders, which comprise a significant amount of Banco Delta Asia's business. Evidence exists that some of these agencies and front companies are engaged in illicit activities.
- Banco Delta Asia has tailored its services to the needs and demands of the DPRK with little oversight or control. The bank also handles the bulk of the DPRK's precious metal sales, and helps North Korean agents conduct surreptitious, multi-million dollar cash deposits and withdrawals.
- Banco Delta Asia's special relationship with the DPRK has specifically facilitated the criminal activities of North Korean government agencies and front companies. For example, sources show 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.

- One well-known North Korean front company that has been a client of Banco Delta Asia for over a decade has conducted numerous illegal activities, including distributing counterfeit currency and smuggling counterfeit tobacco products. In addition, the front company has also long been suspected of being involved in international drug trafficking. Moreover, Banco Delta Asia facilitated several multi-million dollar wire transfers connected with alleged criminal activity on behalf of another North Korean front company.
- In addition to facilitating illicit activities of the DPRK, investigations reveal that Banco Delta Asia has serviced a multi-million dollar account on behalf of a known international drug trafficker.

Background on Section 311

Title III of the USA PATRIOT Act amends the anti-money laundering provisions of the Bank Secrecy Act (BSA) to promote the prevention, detection and prosecution of international money laundering and the financing of terrorism. Section 311 authorizes the Secretary of the Treasury – in consultation with the Departments of Justice and State and appropriate Federal financial regulators – to find that reasonable grounds exist for concluding that a foreign jurisdiction, institution, class of transactions or type of account is of "primary money laundering concern" and to require U.S. financial institutions to take certain "special measures" against those jurisdictions, institutions, accounts or transactions.

These special measures range from enhanced recordkeeping or reporting obligations to a requirement to terminate correspondent banking relationships with the designated entity. The measures are meant to provide Treasury with a range of options to bring additional pressure on institutions that pose specific money laundering threats.

The Treasury Department has previously identified the following financial institutions as being of "primary money laundering concern," pursuant to Section 311:

- Multibanka and VEF Bank of Latvia in April 2005;
- First Merchant Bank of the "Turkish Republic of Northern Cyprus" ("TRNC") and Infobank of Belarus in August 2004;
- Commercial Bank of Syria and its subsidiary Syrian Lebanese Commercial Bank in May 2004; and
- Myanmar Mayflower Bank and Asia Wealth Bank in November 2003.

The Bush Administration has also taken action, pursuant to Section 311, against the foreign jurisdictions of Burma, Nauru and the Ukraine. The finding of the Ukraine as being of "primary money laundering concern" was lifted after Ukrainian authorities took subsequent and aggressive steps to address the concerns and risks identified in the 311 action.

THE WALL STREET JOURNAL.

March 10, 2007

Kim the Counterfeiter

By Ed Royce

Drinks flowed as North Korea's top negotiator and his American counterpart met in New York this week in celebration of Pyongyang's promise to give up its nuclear weapons. It was hard to believe that just five months ago North Korea actually exploded a nuclear weapon, for which it was roundly condemned. But that condemnation is gone today—as is any frank discussion of the criminal nature of the regime, including its highly sophisticated operation to counterfeit U.S. currency.

Troubling signs indicate that the Bush administration is prepared to push aside North Korea's illicit activities, “resolving” issues surrounding Macau-based Banco Delta Asia, which was found to be complicit in the counterfeit operation. Regardless of the outcome surrounding Banco Delta Asia, active vigilance against North Korea's robust and global illicit activities is essential. Confronting North Korea on its illicit activities, as a study I will release on Monday shows, makes the denuclearization of the Korean Peninsula more likely, not less.

Remarkably, North Korea is the first country since Hitler's Germany proven to counterfeit another's currency. And in a little-noticed report sent to Congress last September, the Treasury Department found that the forgeries, high-quality “Supernotes,”

are “being produced and distributed with the full consent and control of the North Korean government.” This includes both \$100 and \$50 bills, from the older series to the newer “big head” notes. Approximately \$50 million of them have been seized from circulation since 1989.

Estimates on the amount of revenue generated from Pyongyang counterfeits range from \$15 million to \$25 million per year, but the actual amount may be considerably higher. As one government analyst put it, “We have no idea how much they're counterfeiting, because it's so good.” Left unchecked, these counterfeits could eventually weaken confidence in the U.S. dollar, with global consequences. Alarming, some countries—such as Ireland, Taiwan and Peru—have temporarily refused accepting our \$100 bills.

North Korea's counterfeiting network is global, employing a diplomatic presence in more than 60 countries. An IRA splinter group leader has even been arrested for distributing these bogus bills. Including drug trafficking and other illicit activities, the criminal sector is responsible for 35% to 40% of North Korea's exports.

For Kim Jong Il, crime does pay: And given its ties to international criminal organizations, Pyongyang has access to a vast smuggling network that could allow it to move almost anything in or out of the country, including weapons of mass destruction.

Realizing this, the administration stood up the Illicit Activities Initiative in 2003. Its task was to attack the criminal lifeblood of the regime—which it did. The designation of Banco Delta Asia as a “willing pawn” of the North Korean government in September

2005 led banks throughout the region to sever contacts with the country, shaking Pyongyang and leading the regime back to the negotiating table.

When North Korea rejoined the six-party talks, its representative wanted

How North Korea is undermining the dollar.

to discuss one thing: money. Pressure—not appeasement—worked. But in a concession to Pyongyang, the U.S. committed to “resolve the issues concerning Banco Delta Asia” within 30 days of the Feb. 13 agreement.

It is unclear what this will mean exactly—but now that a deal has been made, U.S. officials who once pressed

the case against Pyongyang's counterfeiting are talking about the “broader interest.” They are lately referring to the North Koreans as “only depositors” at Banco Delta Asia, as if Kim Jong Il was attracted by its interest rates. The Illicit Activities Initiative has now become enmeshed in the State Department's bureaucracy, losing the coordination, energy, and access to top officials it previously enjoyed—and losing steam.

Some may believe that tolerating North Korean counterfeiting is a small price to pay for disarming Pyongyang of its nuclear weapons. This discounts the potential impact on the world's economy. It also sends the unhelpful signal to the North Koreans that as long as they make promises on their nuclear weapons, the U.S. will bend on its laws.

Ending North Korea's nuclear weapons program must be our primary ob-

jective. However, the aggressive enforcement of our laws enhances rather than conflicts with the diplomatic effort to do so. Putting a stop to Pyongyang's counterfeit operation and other criminal activities would sever a key subsidy for North Korea's weapons of mass destruction program and frustrate Kim Jong Il's payments to his inner circle. It would also condition Pyongyang into respecting international norms.

Can we really expect a regime that counterfeits our currency to abide by a nuclear weapons agreement? Only when North Korea ends its criminal behavior are prospects for peace and security in Northeast Asia real. Let's help Pyongyang go straight.

Mr. Royce is a member of the House Foreign Affairs and Financial Services Committee.

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