



JANUARY  
2011

## Pressure

*Coercive Economic Statecraft  
and U.S. National Security*

By David L. Asher, Victor D. Comras and Patrick M. Cronin



Center for a  
New American  
Security

## Acknowledgments

We would like to thank our colleagues at the Center for a New American Security (CNAS) for their support and expertise throughout this project. Dr. John Nagl; Dr. Kristin Lord; Matthew Irvine and LCDR W. Ennis Parker, USN were instrumental to our research and writing throughout this study. For their support we are especially grateful.

The CNAS productions staff, notably Liz Fontaine, helped in getting this product in its final form. Dr. Venilde Jeronimo and Catherine Cloud were essential to the development of the study and the resources to carry it out.

In addition, we would like to thank participants in our working groups, some of whom asked to remain anonymous. Among them, the expert review and guidance provided by Leon Fuerth, William Newcomb, William Wechsler, Jonathan Winer and Juan Zarate was invaluable to this study.

We would like to thank the Office of Counternarcotics and Global Threats in the Office of the Secretary of Defense for its support of this project.

The research reported in this document was performed in connection with TO-0236 Contract # DAAB07-03-D-B009/236 and PO#7200007435.

## Note on Methodology

This report's case studies are built on the first-person reflections of practitioners involved in the formulation and implementation of policy. These case studies were expanded and verified through working group sessions involving practitioners and experts in the field. Additionally, the first-person case studies were reviewed by experts prior to publication.

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**CHAPTER I:**  
EXECUTIVE SUMMARY

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Pressure

*Coercive Economic Statecraft and U.S. National Security*



## EXECUTIVE SUMMARY

Over the past decade, the U.S. government has developed a new paradigm for using targeted financial power to achieve national security objectives of critical importance. At the heart of this paradigm is an integrated effort to curtail the financial activity of rogue actors while protecting the integrity of the international financial system. This new paradigm represents an evolution away from classic, broad-based economic sanctions, and toward the employment of precision guided financial measures designed to influence the private sector's willingness to do business with dangerous and defiant actors and regimes.<sup>1</sup> By focusing on a target's finances – from bank accounts to illicit activities designed to raise revenue – these measures expand the range of economic and financial tools that can achieve meaningful changes in behavior, at a lower cost and with less risk than other instruments of national security policy such as military force. The use of targeted financial measures does not obviate the need for economic sanctions but rather adds to their potential effectiveness.

Coercive financial and economic pressure is not an alternative to diplomacy. Instead, it should be part of a comprehensive approach to influence governments that are at loggerheads with the international community, and where other measures are insufficient or inappropriate. Pressure strategies that are well conceived and executed (meaning that they are characterized by clear objectives and a deep understanding of an adversary's vulnerabilities and decision-making calculus) can counter, contain and disrupt dangerous and destabilizing behavior from mass killings to nuclear proliferation. They can also fill a gap between what a government is prepared to do militarily and diplomatically. Additionally, they can have genuine, large-scale effects that, if mounted effectively, can compel defiant states to change their strategic direction.

1. Juan Carlos Zarate, "Harnessing the Financial Furies: Smart Financial Power and National Security," *Washington Quarterly* (October 2009): 43.

The U.S. government, along with other stakeholders in the international system, needs a better understanding of how to best employ these new instruments of pressure and apply lessons learned from previous experiences. Taken together, we refer to the integrated use of financial, law enforcement, and economic elements of pressure strategy as *coercive economic statecraft*.

To capture the lessons of past experiences using coercive economic statecraft, the Center for a New American Security (CNAS) commissioned case studies of the pressure strategy mounted against Kim Jong Il's North Korea from 2002-2006, and of efforts by the U.S. government, in conjunction with the European Union and the United Nations, to pressure the regime of Slobodan Milosevic in Serbia and Montenegro from 1992-1995 – two instances where coercive financial and economic pressure seemed particularly effective in shaping the target state's behavior. A brief case study of the pressure strategy against Iraq following the first Persian Gulf War is also included as an appendix. Together these cases trace the evolution of pressure strategies from the broad use of trade sanctions against Saddam, to the early use of “smart sanctions” against Milosevic's regime, to the non-sanctions based application of financial measures and strategic law enforcement against Kim Jong Il.

These first-person case studies were authored by former U.S. government officials directly involved with these efforts, in cooperation with a working group of former senior officials, academics and CNAS research staff. Although there have been many studies written on instances of coercive statecraft, few if any have been written by the actual architects of such strategies. What makes this report different is that it features first-person case studies written by former practitioners, based on their personal experience in conceiving, planning and executing pressure strategies.

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### **Pressuring Kim Jong Il: The North Korean Illicit Activities Initiative, 2001-2006**

Between 2002 and 2006, the U.S. government carried out a multi-agency and multinational initiative against the illicit activities and finances of the Kim Jong Il regime in North Korea. The Illicit Activities Initiative (IAI) ultimately involved 14 different U.S. government departments and agencies, 15 foreign government partners and more than 200 policy officials, intelligence analysts and law enforcement officers around the world. In addition to wide ranging and sensitive diplomatic engagement, the IAI featured multiple international law enforcement investigations, including two of the largest undercover Asian organized crime cases in U.S. history, and the innovative use of Treasury Department authorities in conjunction with those investigations.

The mandate of the IAI was to develop non-military and non-sanctions based ways and means of pressuring Kim Jong Il to back away from his nuclear weapons development and missile programs, and to disrupt his regime's global web of illicit activities. By undercutting the Kim regime's ability to profit from illicit activities and impeding its misuse of the



international financial and trading system, while also threatening its accumulated fortune deposited in overseas banks, the IAI aimed to create serious and credible leverage over Pyongyang. Moreover, although the IAI aimed to impact directly both the leadership and its associated weapons of mass destruction program, it was also designed to minimize disruption to the lives of average North Koreans who were already suffering as a result of their leadership's economic mismanagement and self-inflicted international isolation.

While this effort did not curtail North Korea's nuclear ambitions, the IAI did drive North Korea out of a range of criminal businesses and cut the nation's illicit trading companies and leadership off from bank accounts around the world. Through the IAI, the U.S. government generated significant diplomatic leverage over North Korea, a point made clear by the regime's reaction to the imposition in September 2005 of the Patriot Act's section 311 against Banco Delta Asia, a Macau bank accused of laundering money for the Kim regime and other North Korea entities. The author argues that had this leverage been sustained and used effectively, North Korea's ability to defy international rules and norms could have been crippled, compelling Kim Jong Il to make a strategic choice toward denuclearization.

### **Pressuring Milosevic: The Development and Implementation of International Sanctions Against Serbia and Montenegro, 1992 -1995**

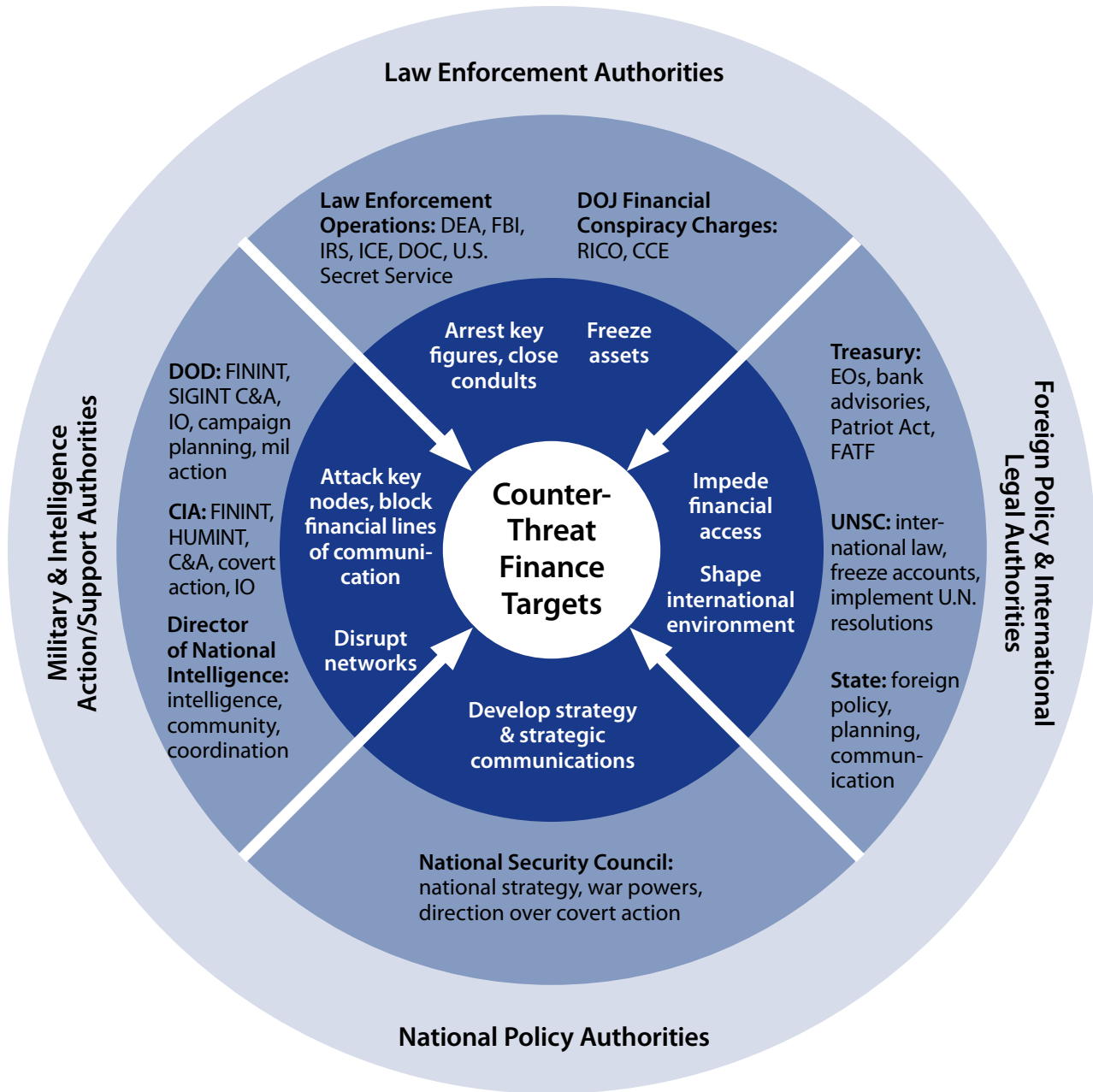
Beginning in May 1992, the United Nations Security Council imposed broad trade, financial and political sanctions against Serbia and Montenegro for their role in provoking and supporting aggression, ethnic cleansing and other atrocities in Bosnia. These initial sanctions were judged ineffective at changing the behavior of former Yugoslav leader Slobodan Milosevic and his allies. At the behest of the United States and others, the U.N. Security Council adopted new measures on November 16, 1992, instituting special licensing

procedures for any transshipment through Serbia of commodities such as iron, steel, chemicals, rubber tires, vehicles, aircraft, coal, oil, gas and petroleum products.

This case study highlights the role of a special U.S. interagency sanctions task force, established early in the Clinton administration to support U.S. government efforts. The task force formulated a new strategy focused on tightening the application of existing sanctions, and identifying new, more stringent sanctions measures to pursue at the U.N. Security Council. Serbia and Milosevic remained the principal focus as the task force targeted the most rigorous application of sanctions against industries, sectors and individuals that acted as the regimes main support pillars. By threatening Milosevic's hold on power, the aim was to pressure him to use his influence to rein in the Bosnian Serb leadership, and simultaneously, to force him back to the negotiating table to end the Balkan conflict.

The task force sought to increase the effectiveness of the existing sanctions and focused on six specific objectives. These included: expansion of the sanctions assistance missions (SAM) and increased technical assistance to the frontline states to improve border controls; cutting off Serbia's access to oil, gas and other essential commodities for industry; hitting Milosevic's supporters in their own pocketbooks by tightening implementation of the financial sanctions; deterring violations through increased penalties, investigations and prosecutions; interdicting all maritime traffic to and from the Montenegrin ports of Kotor and Bar; and cutting off the movement of all maritime vessels deemed to be flagged, owned or controlled by Federal Republic of Yugoslavia (FRY) entities. Special efforts were also undertaken to strengthen the impact of the financial sanctions. This involved identifying and targeting the Milosevic regime's offshore businesses and accounts. Particular effort was also made to restrict the flow of workers' remittances back to Serbia. These remittances were

COUNTER-THREAT FINANCE: BALANCING NATIONAL SECURITY RESOURCES



KEY

C&A: Collection and Analysis

EO: Executive Order

IO: Information Operations

CCE: Continuing Criminal Enterprise

FATF: Financial Action Task Force

RICO: Racketeer Influenced and Corrupt Organizations Act

DEA: Drug Enforcement Administration

FININT: financial intelligence

SIGINT: signals intelligence

DOC: Department of Commerce

HUMINT: human intelligence

UNSC: United Nations Security Council

DOJ: Department of Justice

ICE: U.S. Immigration and Customs Enforcement

being soaked up by the Milosevic regime, which was eager to acquire as much hard currency as possible.

U.N. Security Council Resolution 820, adopted in April 1993, further strengthened the measures against Serbia. The transshipment exclusion was closed and all transshipments, not just key commodities, had to be approved by the U.N. sanctions committee. The task force also won agreement to restrict commercial road traffic to a few major border crossing points for verification and concentrated SAM teams at these crossings. The new resolution also closed the waters off of Montenegro's ports to all unlicensed traffic. The North Atlantic Treaty Organization (NATO) and the Western European Union (WEU) agreed to combine their operations under a single command and control arrangement to police this area. Thereafter, only a few ships ran the NATO/WEU blockade, and those that did remained blocked or scuttled in Bar or Kotor for the duration.

Coupled with intense military pressure on the regime by Bosnian and Croat forces backed by NATO air strikes, the sanctions ultimately forced Milosevic to make a deal and end the war. As the sanctions ate away at Serbia's infrastructure and economy, Milosevic recognized that continued pressure was steadily bringing about a collapse of domestic Serb institutions and potentially his own control. After arduous negotiations at Dayton, Ohio, the presidents of the Republic of Bosnia and Herzegovina, the Republic of Croatia and the Federal Republic of Yugoslavia reached agreement on the Dayton Accords on November 21, 1995, and the fighting in Bosnia stopped. The next day the Security Council adopted Resolution 1022, which formally suspended the sanctions against Serbia.

### Summary of Lessons Learned from Pressure Strategies Against North Korea, Serbia and Iraq

The CNAS working group on coercive economic statecraft identified several key lessons learned from the North Korea, Serbia and Iraq case studies.

**Precision guided financial measures offer an effective means of applying pressure against adversaries.** The U.S. Department of Treasury has taken artful advantage of the central position of the United States within the international financial system to coerce and convince private sector actors as well as governments to cooperatively enforce financial sanctions and deny designated individuals access to banking services. Using finance as a fulcrum, the power of coercive economic statecraft and international sanctions is magnified considerably.

**Foreign financial ministries need to develop authorities and capabilities to defend their own financial systems, as the Treasury Department has done in the United States.** The Treasury Department cannot succeed without partners in the other major global financial centers developing similar intelligence and enforcement capacities.

**Diplomacy must be operational.** If the State Department wishes to participate in managing the use of coercive pressure, it should lead from the front. Neither of the initiatives described in this volume relied on intelligence authorities or clandestine subterfuge. Their international legitimacy was derived both from diplomatic efforts to persuade others, and the opportunity to allow deliberate, transparent law enforcement to work, both internationally and domestically. There is scant affinity in the international system for actors like Slobodan Milosevic, Kim Jong Il and Saddam Hussein. When state and non-state actors are confronted with clear evidence of their illicit behavior through diplomatic channels (as opposed to “intelligence”), the State Department received consistent cooperation from foreign governments.

**The combined force of government and the private sector is powerful.** One of the most powerful levers the United States has in effecting action against adversaries is the power of a self-interested private sector to avoid supporting those identified by the United States and other foreign governments as engaged in criminal activities, support for terrorism or seeking to undermine international security.

**In the United States, the Treasury Department needs to revive the strategic use of section 311 of the USA Patriot Act.** Last used against Banco Delta Asia in Macau in 2005, these anti-money laundering measures can be used against foreign financial institutions and financial systems that are actively involved in money laundering as a primary aspect of their business activity, including governments like Iran and North Korea.

**The employment of Treasury Department authorities and powers of persuasion alone is insufficient if a pressure strategy is to succeed.** As was shown in North Korea, Iraq and Serbia, the State Department can and should play a leading role in the monitoring and enforcement of international sanctions and the integration of pressure strategies within diplomacy. Moreover, most foreign governments employ their foreign rather than finance ministries to pursue sanctions and thus naturally turn to the State Department more than the Treasury Department for leadership. Establishing country specific pressure initiatives coordinated by a high level State Department official who reported to the National Security Council was key in both the North Korea and Balkans cases and remains essential to the success of pressure against Iran and North Korea today.

**The effectiveness of economic coercive statecraft depends on the clarity of the desired end state; the sophistication of planning and integration of domestic and international capabilities and authorities; and the quality of intelligence support for planning, execution and monitoring.** It is also critical to bring in the government’s best and brightest and motivate them. A genuine whole of U.S. government approach and real “coalition of the willing” among like-minded foreign governments are frequently discussed but infrequently accomplished.

**Monitoring the effectiveness of sanctions is critical.** The Iraq case in particular is an instance where the pressure strategy succeeded but, ironically, was perceived to have been a failure. In truth, but only in hindsight, the Iraq sanctions succeeded remarkably, especially from 1991-1996 (before they were significantly watered down by Saddam's bilateral trade arrangements with neighboring countries and the introduction of the United Nations oil-for-food program). Moreover, even with the post-1996 rebound of the Iraqi economy fueled by the lessening of sanctions, the campaign of economic pressure still prevented Saddam from acquiring weapons of mass destruction (WMD). Had policymakers known how well they had defanged Saddam's military there would have been no need for an invasion of Iraq in 2003.

**The international community should develop better means to enforce existing international sanctions.** An effective, independent and small international sanctions monitoring, verification and compliance agency could be established – a sort of International Atomic Energy Agency (IAEA) for economic sanctions. This agency would employ expert teams to monitor trade and financial activities involving sanctions targeted states and issue reports on their degree of compliance. Such teams make the implementation of sanctions more transparent. They can also serve to channel compliance questions directly to enforcement agencies rather than require the use of diplomatic/political channels for handling compliance questions (which tend to politicize the compliance review process).

**The U.S. government should incorporate network and nodal analysis and “effects based” campaign planning into coercive statecraft.** The cases described in this volume drew on the capabilities of Department of Defense and intelligence community organizations, like the Joint Warfare Analysis Center, to assess pressure points. They also incorporated planners from the Joint Chiefs of Staff to map out an interagency campaign of actions. Working group participants felt such detailed planning and assessment will be increasingly critical to the success of coercive initiatives in the future and should be incorporated into the Treasury Department and State Department planning processes.

**Financial targeting, monitoring and analytical efforts should draw on more advanced data mining and network analytical tools and approaches routinely used by the Defense Department, intelligence community and multinational corporations.** Multinational private sector firms have long utilized sophisticated trend analysis and predictive modeling to optimize their supply chains and improve sales. Drawing on the extensive sources of financial data collected by and available to the Treasury Department, the use of network analysis and relational databases can be employed to identify sanctions avoidance, money laundering and illicit financing schemes in ways that other analytical approaches cannot.

**An emphasis on financial sanctions should not blind governments to the need for trade sanctions where appropriate.** European Union trade sanctions on Iran, for example, are likely to have a very substantial impact on Iran's economy and leadership, perhaps even more so than financial sanctions measures. Moreover, most foreign countries, including EU countries, are much better equipped to handle trade-based rather than financial-based, sanctions measures. Their customs and border control services also are well equipped to implement and monitor such sanctions.

**High-level political support is crucial.** In the case of the Serbian sanctions, the effectiveness of the process largely came down to having the staunch backing and direct involvement of Leon Fuerth, a member of the National Security Council principals' committee and national security advisor to Vice President Al Gore. Fuerth took control of the interagency process and brought together normally divided elements of the government. In the case of North Korea, Deputy Secretary of State Richard Armitage was equally important. Although Armitage (who now serves on the CNAS board of directors) did not play a day-to-day role in the effort, his support

## CONTINUED FROM PAGE 11

and timely intervention ensured that regularly occurring obstacles did not derail the effort. He provided clear direction and realistic goals, brought the effort under his office, with the backing of his close friend of 30 years, Assistant Secretary of State for East Asian and Pacific Affairs James Kelly. Armitage also made the IAI one of his priorities globally, seeking out the cooperation of many governments around the world, including Japan, China, Russia and Middle Eastern states.

**Recognize that targeted actors will seek to evade pressure.** International cooperation is vital. Pressure builds over time, and targeted actors will not simply stand still in the face of such pressure. They will actively seek to circumvent the pressure by any and all means available. Democracies do not easily persist in such endeavors, because perseverance requires repeated political interventions to ensure that an uncomfortable policy stays the course.

**Law enforcement remains a neglected tool of national power.** The Departments of Justice, Homeland Security, and Commerce – and their foreign counterparts – should be better integrated into international pressure efforts. The more strategic application of domestic and international laws and legal authorities, including against foreign governments engaged in international criminal activity (“criminal states”) does not politicize domestic law enforcement, but enhances U.S. foreign policy, national security and law enforcement interests by aligning them.

**Banks and bankers that break the law in support of adversaries should be held legally accountable.** Support for the Treasury Department designations process in both the North Korean and Serbia initiatives were actions against those who facilitated financially the regime’s illicit activities. In the case of money laundering for the Iranian government, for example, the Justice Department and the Treasury Department investigated and fined numerous banks for falsifying billions of dollars in wire transfers and “stripping” data from financial accounts corresponding with banks in the United States. Rather than just levying fines, there should be serious prosecutions of these banks and bankers for illicit conduct. Arrests and prosecutions would send a stronger, more credible and effective message to financial institutions that earn billions of dollars per year and see fines as merely “the cost of doing illicit business.”

**The U.S. Treasury Department should create a global financial network operations center for monitoring illicit financial activity.** Although the purpose of the CNAS working group was to review the past rather than consider future challenges, group members raised concerns that in the future, financial “operations other than war” could become outright financial warfare with U.S. financial centers of gravity being targeted by adversaries and access to the international financial system being denied. To prepare for such a possibility, the group proposes a global financial network operations center with the mission of assessing threats to the U.S. financial system, detecting emerging trends and enhancing the effectiveness of pressure programs. Such an information center would provide real-time integration of data and essentially put the Treasury Department on a footing for protecting the U.S. financial system equivalent to the information integration and national threat tracking capabilities within the Departments of Homeland Security and Defense.

**The Department of Defense, via its counter-threat finance (CTF) initiative should expand its assistance to Treasury, Justice, Homeland Security and other agencies as they work to counter the business, financial and logistical support networks of enemy combatants, terrorist organizations and transnational threats.** For the Department of Defense (DOD), CTF constitutes what the military calls an “economy of force” – a way of fighting and defending at relatively low expense – or avoiding the conventional fight altogether. Recent examples, such as the Iraq and Afghanistan Threat Finance Cells, illuminate the success that DOD CTF programs can have on the way wars are fought.



**CHAPTER II:**  
COERCIVE STATECRAFT: AN OVERVIEW

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By Patrick M. Cronin

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## COERCIVE STATECRAFT: AN OVERVIEW

By Patrick M. Cronin

### Introduction

Diplomacy alone is insufficient to protect a nation's interests. For this reason, the United States must also develop the means of deterring, compelling and coercing in order to defend its national security. Such efforts are hardly new, but both the strategic environment and the means of compellence and coercion are evolving. Diplomacy backed by force is increasingly supplemented or even replaced by diplomacy backed by economic sanctions, a crackdown on an adversary's finances, and the use of law enforcement to counter a wide range of illicit activities. Indeed, because of the high degree of economic globalization and expanded economic and financial ties between countries, economic, financial and legal means are likely to be used more frequently in the years ahead.

Yet, at a conceptual level, old theories still apply. As such, this section of the report provides a concise overview of coercive diplomacy, especially within the context of U.S. national security and foreign policy. It summarizes the most important writing on the topic, provides concrete guidelines for national security strategists, and offers considerations for the future use of coercive diplomacy.

### Understanding Coercive Statecraft

Statecraft employs and combines both pressure and persuasion to achieve political aims and uses military, political and economic instruments of power to advance a state's interests and influence the behavior of adversaries and allies alike.<sup>1</sup> While "diplomacy applies this power by persuasive measures short of war,"<sup>2</sup> there is also a long history of coercive force, especially military might, associated with negotiation and diplomatic leverage. This is something that Australian analyst Coral Bell once called the "no-man's-land that lies between defense and diplomacy."<sup>3</sup> The relationship between defense and diplomacy is symbiotic. As Frederick the Great of Prussia opined, "Diplomacy without force is like an orchestra without a score."<sup>4</sup>

Just as coercion and diplomacy have a long if delicate relationship, coercion and economics are also old if odd bedfellows. After all, economics are a natural part of negotiation. It was Adam Smith who noted that man is an animal that makes bargains, “Nobody ever saw a dog make a fair and deliberate exchange of one bone for another with another dog.”<sup>5</sup>

But commerce and deal-making is one thing; the use of economic, trade, financial and legal measures, sanctions and threats, as well as inducements, to advance national security goals is quite another matter. The United States has frequently resorted to economic and trade sanctions, despite the fact that they are widely criticized for being ineffective.<sup>6</sup> Meanwhile, other powers have used their own available economic sanctions, often in the form of withholding resources. For instance, in the 1970s, members of the Organization of Petroleum Exporting Countries (OPEC) used oil as a tool of coercive diplomacy. More recently the Chinese used at least a tacit threat to withhold exports of rare earth metals to Japan and others as a means of coercion with respect to disputed territory in the East China Sea.<sup>7</sup> The United States, the world’s largest economy, has also frequently resorted to trade, economic and financial sanctions on states and other entities whose actions were found objectionable on a variety of grounds. However, too often there has been little if any linkage between the sanctions slapped on a bad actor and the political goals and diplomatic strategy. While there have been some notable cases of more economically-oriented coercive diplomacy on the part of the United States government (with respect to the regimes of Saddam Hussein, Slobodan Milosevic and Kim Jong Il), this dimension of coercive diplomacy remains a relatively understudied phenomenon.

Coercive diplomacy is an attempt to alter a state or non-state actor’s behavior through the threat to use force or through the use of limited force. Obviously

“limited” is in the eyes of the beholder, but a core objective is to avert war, or even serious military escalation, and instead accelerate diplomatic progress on an issue. Ideally, a state would prefer to persuade, not bludgeon, an adversary into shifting course. Diplomacy backed by the threat of force provides a way to make diplomacy more urgent because of the implied threat to punish a failure to comply. As Alexander George wrote, “The logic of coercive diplomacy postulates that such diplomacy will be successful if demands on an adversary are backed with a threat of punishment for noncompliance that will be considered credible and potent enough to encourage compliance.”<sup>8</sup> Reality makes the implementation of coercive diplomacy even more difficult, of course, when one contemplates it not as a solo action but a series of tactical negotiations that might be part of a coordinated coercive diplomacy campaign plan. This report broadens the traditional concept of coercive diplomacy, because it includes what might be dubbed coercive economic diplomacy, since threats of force are in whole or part replaced by economic threats of regime stability and survival. But this interesting twist on coercive diplomacy remains very similar to the traditional notion of strategic coercive diplomacy in just about every other respect.

U.S. thinking about coercive diplomacy developed during the Cold War when the standoff between two nuclear superpowers forced analysts to develop new tools short of war to achieve serious security ends. At the incipient stages of the Cold War, Secretary of State Dean Acheson suggested that muscular diplomacy was needed to persuade an intransigent and opportunistic Soviet Union, “The only way to deal with the Soviet Union, we have found from hard experience, is to create situations of strength.” Acheson focused on shoring up western unity and vulnerabilities that could be easily exploited in order to convince the Russians that serious negotiation was the only realistic policy option for settling a problem.<sup>9</sup> The Cold War

nuclear stalemate between the East and West reinforced concepts of deterrence and how to inhibit an adversary from initiating a deleterious action, particularly a surprise nuclear attack. The problem of developing strategies for limited wars remains a major challenge of statecraft today. But it is no surprise that some of the most vexing cases involving coercive diplomacy center on countries with nuclear ambitions, including Saddam Hussein's Iraq, Iran and North Korea. If limited amounts of force, or just the threat of force, can help to achieve political objectives, how and when can they do so?

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*Coercive diplomacy is an attempt to alter a state or non-state actor's behavior through the threat to use force or through the use of limited force.*

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At times when large-scale military conflict is difficult to fathom, it is necessary to employ alternative concepts for defending less-existential national interests at an acceptable risk. Scholar Thomas Schelling developed the strategic concept of compellence, which encompassed actions to compel or force an adversary to take some desired action, in theory without resorting to major escalation. Whereas deterrence is passive, compellence usually involves initiating an action and tends to be more narrowly circumscribed with respect to its time and place. For Schelling, compellence was a middle ground between defense and offense. Indeed, the concept was rooted in a fundamental understanding of negotiation. As Schelling wrote:

The usual distinction between diplomacy and force is not merely in the instruments, words or bullets, but in the relation between adversaries

– in the interplay of motives and the role of communication, understandings, compromise and restraint. Diplomacy is bargaining ... But whether polite or impolite, constructive or aggressive, respectful or vicious, whether it occurs among friends or antagonists and whether or not there is a basis for trust and goodwill, there must be some common interest, if only in the avoidance of mutual damage, and an awareness of the need to make the other party prefer an outcome acceptable to oneself.<sup>10</sup>

Still, because compellence was not simply passive deterrence, it could be viewed as an offensive type of coercion. Rather than attempting to tell an adversary, "don't even think about it," compellence suggested the more ambitious, "stop what you're doing or else." This prompted Professor Alexander George, who was influenced by the morass in Vietnam, to establish an elaborate and fundamentally defensive theory of coercive diplomacy.

George argued that coercive diplomacy should center on persuading an adversary to do one of three main things:

1. In theory, the easiest goal would be to tell an opponent to stop from undertaking an objectionable action that had not yet been committed. To cite one of today's most challenging aims in coercive diplomacy, this might entail coercing a target to forego constructing a finished nuclear weapon that it has not yet completed or even substantially started.
2. The significantly harder objective would be to ask an adversary to undo some objectionable action already taken. This might include dismantling a nuclear weapon already built, but to take a different real example, it could involve asking a state like Iraq to withdraw its forces from a neighboring state like Kuwait that it has already invaded (as it had in 1990). Of course, Saddam Hussein did not believe that the United States

would really follow through on penalizing it for noncompliance by attacking Iraq, and thus coercive diplomacy in that instance failed to achieve its objective short of war.

3. Arguably the most ambitious objective of coercive diplomacy would be to demand that a regime literally change its composition, including its leadership. Here coercive diplomacy aimed at threatening regime change could, if effectively integrated with a diplomatic strategy, help pressure a rogue regime into changing policy; and, in an extreme case, regime change could be the objective and coercive diplomacy could theoretically shift the weight of political power away from one element of the leadership or society to another individual, ruling clique, military junta or latent political community within a society.

This last potential use of coercive diplomacy would indeed make it an offensive weapon, and George thought that offensive coercive diplomacy was essentially “blackmail diplomacy.”<sup>11</sup> George preferred to place the emphasis on diplomacy rather than coercion, which is why he coined the synonymous phrase “forceful persuasion” to refer to coercive diplomacy.<sup>12</sup>

There are three main strategic approaches to the employment of coercive diplomacy.<sup>13</sup>

First is the ultimatum, which means drawing a red line, setting an absolute deadline for action, and threatening a penalty for not heeding the demand. History is littered with ultimata, a classic description of which can be found in the famous Melian Dialogue within *The Peloponnesian War* by Thucydides. Athens confronts the people of the island of Melos with this stark choice about its fate: join the Athenian empire arrayed against Sparta or face annihilation. As the Athenians punctuate a long dialogue with the Melians, “Think over the matter, therefore, after our withdrawal, and reflect

once and again that it is for your country that you are consulting, that you have not more than one, and that upon this one deliberation depends its prosperity or ruin.”<sup>14</sup>

Second is employing coercive diplomacy to test an adversary, something George dubbed “try-and-see.” This could involve issuing an ultimatum but without setting a firm deadline or a specific punishment; or it might involve simply increasing pressure on a target actor. Either way, the intention would be to exert coercion to inform and hopefully advance the next step, for instance, through a better understanding of an opponent’s intentions, sensitivities and way of thinking. In recent years, the United States has frequently resorted to “try-and-see” coercive diplomatic pressure in protracted negotiations designed to curb Iran’s nuclear ambitions. One challenge of this approach is achieving a clear understanding of whether the pressure is working and more generally what kinds of results it is engendering, both intended and unintended. As the case studies of this report will make clear, there have been times when policymakers clearly did not understand the impact of their own coercive diplomacy. It is not enough to have an impact, but a coercer must understand what it is achieving and how to manipulate the results for larger strategic objectives.

Third is to apply graduated pressure, which George labeled, the “turning of the screw.” This strategy involves communicating at the outset to the target that pressure and punishment will gradually be ratcheted up if the target does not comply. The application of ascending amounts of pressure on an adversary has come to typify the U.S. approach to coercive diplomacy. In most cases such pressure has started with some form of economic sanction. In fact, in the second half of the 20th century, economic sanctions preceded military conflicts involving the United States more than 60 percent of the time.<sup>15</sup> However, there is a substantial difference between economic and financial sanctions, possibly

imposed by the legislative branch of government on a bad actor, and the deliberate pursuit of an actor's illicit activities as part of a larger coercive diplomacy strategy. Indeed, the main thrust of this report is to help U.S. officials reassess what impediments stand in the way of utilizing these largely law-enforcement and economic tools of power to augment the ability of the U.S. government to achieve important security objectives without having to choose between the bad options of resorting to war or appeasing a rogue actor.

Recently, some scholars have differentiated compellence from "strategies of leverage" designed to provoke an adversary, polarize an adversary's constituents and mobilize communities (domestic and international) against an adversary.<sup>16</sup> This body of thought can be especially helpful in thinking about what amounts to a diplomatic campaign over time: The intermediate aim is seldom to achieve a knockout blow or decisive end to a dispute as to make incremental gains in achieving an indirect strategy. For example, by provoking an adversary to react in a certain manner, a coercer may be able to build a critical international coalition in support of sustaining a pressure strategy; similarly, by dividing a leader or an element of the leadership from other centers of power and legitimacy within a target state, a coercer may be able to achieve credibility needed to convince a bad actor that his power is indeed threatened by noncompliance. These types of objectives could well be intrinsic to the three outlined above by George. Clearly, George has enumerated how coercive diplomacy can advance a variety of non-military strategic objectives: e.g., drawing a line, buying time to explore a negotiated settlement, retaliating and engaging in a test of an adversary's capabilities.<sup>17</sup> The use of coercive statecraft for all of these types of goals, whether against a state or a non-state actor, opens new vistas for considering the utility and value of coercive measures that incorporate economic and financial tools.

## Past Uses of Coercive Diplomacy

Winston Churchill once wrote, "In history lies all the secrets of statecraft." While an appreciation of history is seldom the strong suit in U.S. decision-making, there are some notable studies about the United States' experience with coercive diplomacy from which busy policymakers can usefully draw lessons and best practices. George pioneered much of the work with a study on seven case studies, including: the United States' confrontation with an expansionist Japan in the 1930s, the 1961-62 crisis in Laos involving the breakdown of a tenuous cease-fire, the 1962 Cuban missile crisis, the 1965 confrontation with North Vietnam that led to a much wider and deeper American role in the war, dealing with Nicaragua's revolutionary Sandinista government after its takeover in 1979, the growing confrontation with Libya in the early 1980s, and the 1990 Persian Gulf crisis precipitated by Iraq's invasion of Kuwait.<sup>18</sup>

A study of post-Cold War instances when the United States employed coercive diplomacy is illustrative.<sup>19</sup> The case studies, overseen by Brandeis University Professor Robert J. Art and this author, include: containing Iraq in the aftermath of the 1991 Gulf War throughout the 1990s, confronting warlords in the midst of humanitarian operations in Somalia in 1992-93, reinstalling order in Haiti in 1994, averting war with North Korea while attempting to freeze its nuclear weapons program in 1993-94, suppressing aggression and human rights abuses in Bosnia in 1995 and Kosovo in 1999, staring down the Chinese across the Taiwan Strait in 1996, and dealing with non-state terrorist organizations in the late 1990s. In analyzing why the United States had such difficulty in converting its preponderant power into diplomatic power (unqualified success was achieved only in the Haiti and Bosnia cases), the study suggested recurring challenges impeding success.

Three key impediments to the effective use of coercive diplomacy recur: the basic difficulty

intrinsic to compellence, the credibility problem of threatened or demonstrative uses of force, and the relative resolve involved between an adversary and the coercer.<sup>20</sup>

First, notwithstanding George's insistence that coercive diplomacy could be differentiated from compellence, coercive diplomacy remains at least a brand of compellence. Moreover, compellence is inherently challenging because of the ambition of its objective. Whereas deterrence attempts to dissuade an adversary from changing its behavior, compellence attempts to have an adversary change a behavior that is considered objectionable. Affecting changes in the behavior of an opponent is difficult because there is greater loss of status for the target if it changes its policy in the face of compellent action than if it does not change its behavior in the face of a deterrent threat. Beyond this, the target country is likely pursuing the "objectionable" behavior out of a sense of vital interest that could not be easily dissuaded from. From a coercer's point of view, states often appear to pursue irrational ends, but in the right context, the irrational may simply be perceived necessity.

Second, threats of force and demonstrative uses of force typically are less effective than actually using force to punish an adversary. This is not to assert that force usually prevails, either. Instead, the point is to be clear that when a state seeks to avert conflict by adopting a risk-minimizing strategy, then it is a good bet that the target will know that the penalty for noncompliance is likely to be something short of war. A punishment strategy attempts to change an adversary's behavior by raising the costs of its continuing resistance. In contrast, a risk strategy threatens punishment if the target does not comply. But a risk strategy is difficult to apply because the infliction of pain is more effective than the promise, and potentially dubious promise, of pain. Because coercive diplomacy is predicated on only the threat of force or the limited use of force, by definition it cannot produce as

much punishment or pose as great a risk as can large amounts of force. It is conceivable, however, at least in some situations, that financial and economic sanctions, properly targeted at specific key actors and assets, could create the equivalent of surgical military attacks on a target that even threaten regime survival. For instance, what if some kleptocratic regime perceived a real possibility that it could find all of its assets suddenly frozen or gone? If such a threat seemed credible to the regime, surely this extreme application of coercive economic diplomacy might have considerable purchase, so to speak, over the regime's decision-making calculus.

Third, uses of coercive diplomacy, as with crises in general, can be a way of measuring the comparative strength of wills between two actors. In a contest of wills, the intensity of an adversary's resolve may well be superior to that of a coercer. This is almost surely the case when the United States faces a smaller but distant and determined opponent set on a particular policy out of a conviction that it is pursuing an absolutely vital goal. Because the goal is unlikely to threaten the existence of the United States, difference of resolve may be the norm. Furthermore, because resolve is singularly difficult to estimate beforehand, the coercer may underestimate its opponent and have to apply ascending degrees of force.

For these three reasons, as well as others, coercive diplomacy remains a notoriously difficult, if still useful, tool of statecraft. On the one hand, if it succeeds coercive diplomacy can produce a relatively low cost way to resolve or manage an enduring or emerging security challenge. On the other hand, if coercive diplomacy fails, it leaves two disagreeable options: to climb down and lose face or to escalate and risk outright war. Hence, it behooves the policy community to undertake coercive diplomacy only after it has thought through both the plausibility of achieving the objectives and the consequences of failing to do so.

All of this begs the question as to how to define success. On the one hand, the successful employment of coercive diplomacy hinges on a realistic, specific policy aim or aims; even so, it can be difficult to determine cause and effect, as coercive diplomatic measures represent only one portion of what could be influencing an individual leader or regime. On the other hand, narrowly defined success may still lead to strategic defeat or a costly, Pyrrhic victory. Coercive diplomacy can be the means to a specific policy objective or a general approach to an adversarial regime; it can pursue very ambitious goals of regime change or policy reversal or a less ambitious goal, such as not taking an action. It can be part of a one-time gambit or just a facet of a long-term diplomatic campaign plan that successfully integrates all instruments of policy, including often overlooked legal, law enforcement and economic and financial tools.

### Five Guidelines for Coercive Diplomacy

Below are five guidelines for the employment of coercive diplomacy:

**Select realistic objectives:** The more ambitious the objective, the less chance of achieving success. It is easy to overreach in one's ambitions without having a plausible chance of success. Financial and economic coercive diplomacy may well be able to apply greater pressure on an adversarial leadership and its key constituents, but it is more likely to succeed when seeking less ambitious objectives (such as demanding an opponent not take some undesirable future action) rather than more ambitious goals (such as undoing an action already taken or altering the makeup of an authoritarian government).

**Give persistent urgency to coercive demands:** A critical facet of influence involves convincing a target of the urgency of decision or action. Coercive diplomacy is more likely to be persuasive when the target believes that time is not on its side. Financial and economic sanctions can

be phased in over time and take time to have an impact (like medieval siege warfare or a blockade). In this sense, coercive economic diplomacy can be scaled up and down to correspond to actions taken by the adversary. However, they also can be hard to trigger decisive action on the part of the target state, and even when action is triggered it may well be a resort to force on the part of a less powerful state feeling that it is backed into a corner but protected in the likely conviction that the United States does not really seek to go to war. Thus, Saddam Hussein appears to have believed that the United States would stop short of invading the country; he was wrong, but U.S. leaders were wrong in thinking that he had not already forfeited his nuclear ambitions. Coercive demands must appear urgent to the target and must be capable of persisting over time, even in the face of an adversary's predictable attempt to circumvent pressure.

**Make punishment credible:** An adversary must believe that noncompliance will bring a real and crippling penalty. Because military threats are difficult to make credible except in extreme circumstances, economic and financial coercive punishment may be far more attractive. The North Korean example of seizing leadership assets held in Banco Delta Asia may not have engendered the desired response from Pyongyang, but the record suggests that those financial resources did indeed matter dearly to Kim Jong Il's regime.

**Complement penalties with inducements:** Coercive diplomacy strategies tend to be more successful when carrots and not just sticks are used to achieve a defined goal. Although Niccolò Machiavelli was writing about how a ruler gains power, his thoughts also apply to bargaining and diplomacy in general, "Injuries ... should be inflicted all at the same time, for the less they are tasted, the less they offend; and benefits should be distributed a bit at a time in order that they may be savored fully."<sup>21</sup> To the extent that is true,

force should be used sparingly and decisively; and economic and financial instruments are cleverly ambiguous policy tools, because they can quickly change from incentive to disincentive. Financial and economic sanctions are also sticks that imply benefits; because if economic sanctions are compelling, economic benefits may be equally compelling to an actor.

**Be willing to follow through:** The use of coercive diplomacy involves a careful calculus regarding what happens if an adversary does not comply. The political will and capacity to use force if needed and to see through what is likely to be an unpopular policy within a democracy is something most adversaries appear to measure. Bluffing is hard; as with poker, effective bluffing means sometimes demonstrating that you are not bluffing.

### Considerations for the Future

As the United States considers more frequent and effective use of coercive diplomacy using law enforcement, economic and financial instruments of statecraft, it will need to adjust both its thinking and its capabilities.

Decision makers should bear in mind how coercive economic diplomacy augments other options, especially employing just the threat or demonstrative use of force, and what value it adds to help achieve a strategic objective. By looking anew at coercive diplomacy strategies through the lenses of economics and finance, it may be possible to develop different types of strategies to help forcefully persuade an adversary to not adopt an undesirable posture, reverse an objectionable action, or even shake up the internal politics of a regime. For instance, financial and economic coercive diplomacy may be especially useful for trying to discombobulate or neutralize a particular organization such as military-economic unity within a state or a non-state actor such as a drug cartel.

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*poker, effective bluffing means*

*sometimes demonstrating that you are not bluffing.*

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Policymakers should also consider reaching into an adversary's decision-making calculus and process. Tracking the money of a state can illuminate important relationships, reveal illicit networks, shine a spotlight on regime corruption and otherwise bring new dimensions of understanding to decision-making circles in adversarial countries. Certainly targeted economic sanctions have for some years tried to isolate the leadership of rogue actors to minimize the pain imposed on the innocent populace; unfortunately, the nature of authoritarian governments is such that most resources are at their disposal, and thus they can pass along the most pain to citizens.

To understand an adversary's calculus means beginning with the classical strategic maxim of understanding one's enemy. How well do we understand the strategy and stratagems of our adversary? Are they acting rationally and do we understand their rationality? In some cases, a defiant regime, even one that might be acting rationally, may opt for simply buying time and avoiding compliance or agreement. In fact, game theory tells us that a position based on intransigence can often be successful. It may be a false assumption that both major parties in a dispute or negotiation actually wish to achieve an accord; in some cases,



the strategy of one party may be only to buy time and to subvert any agreement, and thus success is defined as avoiding agreement rather than achieving it. In addition, while some countries may seek nuclear weapons to provide insurance against perceived threats, game theory can also point to prisoners' dilemmas and the paradoxes of undesirable situations where each party has a personal incentive to do something that ultimately leads to a result that is bad for everyone when everyone similarly does what his or her personal interest dictates.<sup>22</sup>

Sober consideration of what constitutes success in coercive statecraft, as well as the need to understand a foe and its decision-making, underscores the extraordinary reliance on high quality intelligence and analysis. At a minimum, detailed, on-the-ground, vetted and crosscutting intelligence is essential to executing economic and financial coercive diplomacy. Coercive economic diplomacy places a premium on understanding the adversary, his or her strengths and weaknesses, ways of thinking under pressure, and economic pressure points. Enormous intelligence spadework is required to understand an adversary and his network of economic and financial centers of gravity. Given the impediments to a clear understanding of authoritarian societies and actors, however, there will remain sharp limits on the knowledge that can be gleaned from the outside. How and to what extent can these barriers be overcome?

Policymakers also need to think about pressure strategies as a continuum of coercive measures, followed by attempts to circumvent and counter those measures, followed by redoubled, tightened and strengthened measures, and so on. While the coercer's pressure may require highly complex schemes, the adversary may find blunt but effective ways to dodge the turn of the economic screws. At the least, the target can be expected to do everything possible to ease pressure. As soon as the United States settles on a comprehensive coercive

diplomacy strategy, it ought to consider red teaming the strategy through the eyes of its potential adversary to understand the types of countermeasures and circumventions that may be used to defeat it.

Finally, new thinking must be brought to bear about how to tap all the relevant instruments of government and society to forge an effective coercive strategy. What new actors, especially those in law enforcement and the private sector but perhaps also in the body politic of an adversary, are essential to a greater reliance on economic and financial elements of coercive diplomacy? Coercive diplomacy that utilizes economic and financial levers will probably bring the U.S. government into closer alignment with elements of national and local law enforcement, as well as the private sector. When these communities converge, however, legal, bureaucratic, cultural and other barriers may impede the kind of close cooperation that may be needed to bring about success. Governments have difficulty with effective cooperation across similar departments at the federal level; the challenge of cooperating with very different actors obviously compounds the challenge. Interagency thinking is in vogue today, but such comprehensive approaches are especially important in integrating economic and trade measures, counter-threat financial steps, and law enforcement.

The United States needs to integrate all the relevant tools at its disposal more successfully in the pursuit of clear political objectives when faced with dangerous, recalcitrant actors. To do this, decision makers in Washington need to better understand whole-of-government, strategic coercive diplomacy campaign plans that force the U.S. government to act in concert, and perhaps force allies to act more in tandem. Among other things, this study may help to illuminate some of the value derived from coercion as part of a bargaining strategy with a bad actor and provide concrete lessons from the past in how to do so.

## ENDNOTES

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4. Quoted in Robert A. Pastor, "The Delicate Balance between Coercion and Diplomacy: The Case of Haiti, 1994," in Robert J. Art and Patrick M. Cronin, eds., *The United States and Coercive Diplomacy* (Washington: U.S. Institute of Peace Press, 2003): 119.
5. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Chapter II, [http://www.online-literature.com/adam\\_smith/wealth\\_nations/2/](http://www.online-literature.com/adam_smith/wealth_nations/2/).
6. This is one of the main points made by Richard H. Haass, ed., *Economic Sanctions and American Diplomacy* (New York: Council on Foreign Relations, 1998): 1. Note that throughout this paper the term sanction has two meanings: a broad general term to denote an array of penalties, including attempts to control an adversary's finances as well as traditional trade sanctions; and a specific reference to the legal prohibition or denial of trade and economic assistance, as in the denial of most-favored trade status or the cutoff of foreign assistance.
7. Daniel Yergin places OPEC's use of an oil embargo into a broad context in his book, *The Prize: The Epic Quest for Oil, Money, and Power* (New York: Simon and Shuster, 2008): 587-589. Regarding China's apparent threat to hold back rare-earth metals, see, among others, "China's Rare-Earth Power," *The Washington Post* editorial (28 October 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/10/28/AR2010102806319.html>.
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12. Alexander L. George, *Forceful Persuasion: Coercive Diplomacy as an Alternative to War* (Washington: U.S. Institute of Peace Press, 1991).
13. Alexander L. George, "Theory and Practice," in Alexander L. George and William E. Simons, eds., *The Limits of Coercive Diplomacy* 2nd edition (Boulder, CO: Westview Press, 1994): 7-8.
14. Robert B. Strassler, ed. *The Landmark Thucydides: A Comprehensive Guide to the Peloponnesian War* (New York: The Free Press, 1996): 355-356.
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17. Alexander George, "Theory and Practice," in Alexander L. George and William E. Simons, eds., *The Limits of Coercive Diplomacy* 2nd edition (Boulder, CO: Westview Press, 1994): 7-9.
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21. Niccolo Machiavelli, *The Prince, Ch. VIII, found in The Portable Machiavelli*, edited and translated by Peter Bondanella and Mark Musa (New York: Penguin Books, 1979): 107.
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**CHAPTER III:**  
PRESSURING KIM JONG IL: THE NORTH KOREAN ILLICIT  
ACTIVITIES INITIATIVE, 2001-2006

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By David L. Asher

J A N U A R Y 2 0 1 1

Pressure

*Coercive Economic Statecraft and U.S. National Security*



## PRESSURING KIM JONG IL: THE NORTH KOREAN ILLICIT ACTIVITIES INITIATIVE, 2001-2006

By David L. Asher

### Introduction

Between 2002-2006 the U.S. government organized a multi-agency and multinational initiative to restrict the illicit activities and finances of the Kim Jong Il regime in North Korea, formally called the Democratic People's Republic of Korea (DPRK). The Illicit Activities Initiative (IAI) sought to pressure Kim Jong Il to back away from his nuclear development and proliferation programs. It aimed to undercut the Kim regime's ability to profit from illicit activities. By impeding the regime's misuse of the international financial and trading system and threatening its accumulated fortune deposited in overseas banks, the initiative sought to create leverage over Pyongyang, without resorting to conventional coercive strategies – such as large-scale threats of military attack – or employing broader economic sanctions (for which it would be difficult to garner international support, let alone effectively enforce).<sup>1</sup>

As a senior advisor to former Assistant Secretary of State for East Asian and Pacific Affairs James Kelly, I led this initiative under Kelly's direction. I also served as the North Korea working group coordinator, reporting directly to former Deputy Secretary of State Richard Armitage, and in 2004-2005, co-chaired a special policy coordinating committee at the National Security Council called the North Korean activities group (NORKAG). William Newcomb, a 31-year veteran of the intelligence community, served as deputy. The North Korea working group, which included six assistant secretaries level officials and the State Department chief of staff, was designed to enhance interagency coordination for the IAI and the six-party (DPRK, China, the United States, Russia, South Korea and Japan) talks.

A diplomatic campaign complemented the IAI's pressure campaign. This included the development of a "roadmap for transformation of international relations with the DPRK in the context of denuclearization," a sweeping package of incentives that would eventually be put on the table in the six-

party talks. Rather than engage in typical tit-for-tat diplomacy, the working group aimed for a true “grand bargain” and designed the six-party talks to provide a comprehensive security guarantee that could give North Korea confidence that it could transform and survive, even as we drained its reservoir of illicitly generated funds.<sup>2</sup>

North Korean leaders had long felt they could operate outside of the law by making commitments regarding the nuclear program publicly and simultaneously breaking them clandestinely. It was a trap that the United States fell into for decades. Through the IAI we developed the ability to counter the DPRK’s strategy without the use of kinetic force by taking advantage of its leadership’s reliance on offshore banks for managing its illicit activities. Essentially, the U.S. approach against North Korea was “self-sanctioning” – it was the DPRK leadership’s behavior that boxed it in. If North Korea stopped relying on illicit activities and financing and started following international rule of law and standards of behavior, it would not be subject to punishment and would reap considerable benefits. But if it did not change, North Korea would dramatically increase its self-isolation. To make our positive diplomatic intentions clear, the United States put a comprehensive offer on the table in the six-party talks to help the nation open up and transform its economy and financial system if it gave up its nuclear weapons program and began conducting its international relations in a normal fashion. If North Korea would play by the rules, it had a choice and a way forward. The North Koreans knew this but chose instead to systematically break the rules.

The IAI had substantial impact containing and pressuring a regime without resorting to force or traditional economic sanctions. It drove North Korea out of a range of criminal businesses and cut off its illicit trading companies and leadership from bank accounts around the world. Based on reports at the time, it caused Kim Jong Il and his associates



\* North Korean nuclear reactor at Yongbyon.

to genuinely fear for their regime’s survival, question the confrontational model they had used for interacting with the world and at least consider a bolder transformation. As part of the IAI, the U.S. Treasury Department demonstrated its capabilities to engage in financially targeted regulatory actions and official designations – the ability of the department to freeze assets of individuals or groups involved in terrorism or illicit activity. The IAI also illuminated the power of Justice Department investigations to apply pressure against “criminal states” like North Korea, which survive on illicit sources of funding. However, what gave the departments of Treasury and Justice “lines of operation” true global strategic power and influence was their central planning, coordination, support and synchronization – along with many other agencies and foreign governments – by, through, and

with the office of the secretary of state. As with the sanctions on former Yugoslav leader Slobodan Milosevic, which are also described in chapter IV, the IAI provided another, unfortunately rare, case of operational diplomacy carried out by the State Department.<sup>3</sup>

The IAI was of unusual scale, scope and complexity compared to other coercive diplomacy efforts. The IAI eventually came to involve 14 different U.S. government departments and agencies, 15 foreign government partners and more than 200 policy officials, intelligence analysts and law enforcement officers around the world (though the core coordination group numbered around 50 people).<sup>4</sup> Remarkably, given the scale and scope of the endeavor, the effort was conducted almost entirely outside the public view until close to its end.

### **Origins of the Illicit Activities Initiative**

Four factors led to the IAI's creation:

- A looming breakdown in the 1994 Agreed Framework, an agreement that sought to replace North Korean nuclear production with more proliferation-resistant light water reactors, and a likely nuclear breakout by the DPRK thereafter.
- The unacceptability of military strike options on the Yongbyon nuclear facility due to the risk of wider regional conflagration and the need to develop non-kinetic ways and means of countering the regime and containing its proliferation activities.
- A growing realization that, even in the midst of the Agreed Framework, North Korea was engaged clandestinely in highly enriched uranium procurement as well as nuclear and missile proliferation in the Middle East.
- A recognition that the DPRK's leadership relied heavily on illicit income, making it vulnerable to pressure from law enforcement agencies and Treasury Department efforts to restrict its access to banking.

A North Korea policy review completed by the George W. Bush administration in June 2001 favored continuation of major aspects of the Clinton-era approach that mixed multilateral diplomacy with continued deterrence.<sup>5</sup> Although much attention has been paid to the debate and divisions within the Bush national security team on North Korea policy, there was more consensus about the darkening reality of relations with North Korea than has been hitherto assumed. The major differences of opinion were about what to do in reaction to growing tensions on the peninsula as well as disturbing revelations of nuclear proliferation and procurement that together ran straight at the heart of the Agreed Framework agreement, the International Atomic Energy Agency and the Missile Technology Control Regime (an informal association of countries seeking to control the proliferation of weapons of mass destruction). Bush administration debates over North Korea strategy ultimately came down to disagreement over what tools could be applied to manage a bleak, deteriorating and highly irritating situation. Views were divided about whether the United States should make unilateral threats to use military power and economic sanctions, versus whether the United States should focus on multilateral diplomacy and “smart power” pressure – combining the use of hard and soft power. However, there was broad consensus that a new, sharper edged approach was warranted to cut into Kim Jong Il's ability to coerce the United States more than the United States could coerce Kim Jong Il.

### **Uncovering the Pressure Points**

In the fall of 2001, it grew increasingly evident to those responsible for North Korea policy at the State Department that the Agreed Framework was, in the words of Assistant Secretary James Kelly, “heading for a train wreck.” This was partly due to the unwillingness of powerful voices on Capitol Hill and within the White House to continue to financially underwrite the development of light-

water nuclear power reactors in the North, in the eastern port city of Sinpo, despite existing U.S. obligations to do so. The bigger reason was the unwillingness of North Korea to accept the inspections needed to verify that it was upholding the framework. These inspections had to occur before the transfer of a significant portion of equipment and technology necessary to complete the Kumho light-water reactors could take place. As the difference widened between the inspections and the implementation deadlines of the framework, the situation deteriorated.<sup>6</sup>

In October 2001, Assistant Secretary Kelly instructed me to pull together an informal working group to identify economic levers that could be used to influence North Korea, both positively and negatively. The State Department began a comprehensive review of information surrounding the North Korean economy with the goal of identifying elements of an alternative to the Agreed Framework. This new framework would focus on economic development and non-nuclear sources of energy, in exchange for Pyongyang maintaining a cap on its nuclear program.

As part of the research, the 2001 working group launched a comprehensive study of North Korea's energy needs, including its ability to utilize power from the light-water reactors that were under construction. It became apparent that the electrical grid in North Korea was seriously dilapidated, disconnected and not capable of taking the power that was to be produced from Kumho. Yet, there also was no parallel effort underway to upgrade the existing grid to peacefully use the light-water reactors as a power source. To make it a credible source of electricity, such a project to create electrical grids should have started in synch. The implication, of course, was that light-water reactors, while "proliferation resistant," were not proliferation proof and that these reactors, like those at Yongbyon, were destined to become nuclear bargaining chips in the hands of the North

Koreans (and it was ironic that we would be the ones building and handing over such nuclear bargaining chips).

As another part of this research project, economist William Newcomb of the State Department's bureau of intelligence and research assessed North Korea's economy and balance of trade. Newcomb illustrated North Korea's remarkable state of industrial decline. Strangely, although nominal industrial output had fallen as much as 70 percent from 1990 levels, and traditional trade consequently was in tatters, some aspects of the economy had not completely collapsed. In fact, the citizens of Pyongyang seemed relatively well fed and apparently more prosperous than in years past and there were markets around the major cities selling shelves of foreign-sourced consumer goods. It was a perplexing set of circumstances.<sup>7</sup>

One of the other remarkable points that Newcomb raised was that North Korea had a mysteriously large black hole in its trade accounts. Even though there were not reliable North Korean economic statistics, one could construct a North Korean balance of trade and crudely estimate its balance of payments by working with partner country data (so called "mirror statistics"). When Newcomb did this he showed that North Korea apparently had been running for several years a trade deficit of roughly 800 million dollars and a current account deficit of 500 million dollars. This estimate even adjusted for our best guess of military export earnings, non-monetary gold sales and back-channel assistance from South Korea, China and Japan. In fact, the deficit was a chronic feature of North Korean payments accounts, but in years past it had been more or less covered by the estimated flow of remittances from Japan. By the mid-to-late 1990s, the amount of these remittances from Japan had shrunk significantly. Since North Korea had not been able to arrange more than the occasional, modest loan on international markets for more than two decades, it made no sense that it could sustain such deficits



without inducing inflation. Some dark matter, in effect, had to be filling the void.<sup>8</sup>

In December 2001, we began a process of mapping the regime's financial and business relationships around the world, including sources of illicit financing that were probably offsetting a large part of the black hole in the balance of payments. It occurred to us from the start that if we could isolate those finances and funding streams, we would be able to apply highly targeted pressure to a degree never before attempted against a regime. We also realized that North Korea did not have a real banking system – its banking system was outside of North Korea, with its leadership and trading entities relying on places like Macau, Vienna, Singapore, Zurich and London to manage their money.<sup>9</sup>

In the spring of 2002, we received an eye-opening briefing from the U.S. Secret Service on North Korea's counterfeiting of the U.S. dollar, the production and distribution of so-called super-notes. We learned that since the late 1980s, North Korea had become the world's best counterfeiter of 100 dollar bills, using the same type of optically variable ink and intaglio presses used to manufacture genuine U.S. currency. Although the Secret Service assured us that the total amount of notes in circulation was relatively small, they also explained the potential for that amount to escalate rapidly. They also presented us with incontrovertible evidence of North Korean government orchestration and oversight in the notes design, manufacture, distribution and profit – with distribution to criminal groups typically occurring via senior officers at embassies and via state trading companies. We even saw surveillance photographs of members of the ruling elite passing the notes themselves in banks and casinos – a clear implication of their knowledgeable involvement. There was no doubt the “supernote conspiracy” extended to the top of the Kim Jong Il regime.<sup>10</sup>

Although North Korean counterfeiting of the dollar was outrageous and provocative, it provided a starting point for considering how law enforcement could be used as a source of leverage against the regime's overseas finances. It occurred to us that exposing and prosecuting state involvement in transnational crime could be an effective means to freeze funds, block leadership assets and support future U.N. actions should North Korea abandon the Agreed Framework. The Secret Service briefing convinced us to begin a much wider effort to develop an informational baseline on North Korea's involvement in illicit activities. We began to task the collection and analysis of information from all agencies, including law enforcement agencies.<sup>11</sup>

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Our research identified that North Korea, directly or via its organized crime proxies, was engaged in a remarkably wide range of illegal activities, including: heroin dealing in the Russian far east and the Australian southeast; selling cocaine in Latin and South America; distributing super-notes, counterfeit cigarettes and even counterfeit Viagra everywhere from Macau to Manila and

Lima to Los Angeles; trafficking methamphetamines in Tokyo and Taipei; conveying African rhino horn and elephant tusks into southern China and Vietnam for sale; smuggling or holding humans for prostitution or forced labor in China, Cambodia and the Middle East; and perpetrating insurance fraud in financial centers around the world, including London, Dusseldorf and Seoul. North Korea appeared to be involved in every type of major international illegal activity. Almost everywhere we saw organized crime, we also saw weapons trafficking – everything from light arms to ballistic missiles. Although those networks were typically distinct – with weapons trading (though not always) occurring through a different constellation of companies from those involved in criminal activity, we increasingly feared that North Korea could use its criminal networks to traffic or steal weapons of mass destruction (WMD) or other sensitive technology.<sup>12</sup>

North Korea not only tolerated this activity; it perpetrated it. Indeed, North Korea's political and military leaders, up to the level of Kim Jong Il, as well as the regime's key support organs, are both the beneficiaries and ultimate drivers of illicit activity. A large body of public testimony by defectors, law enforcement investigative data and declassified intelligence has long highlighted the criminal role of organizations such as the Operations Department of the Korean Workers' Party, the Military Security Command, Office 35 (the external intelligence service), Office 39 (Kim Jong Il's finance arm), the Reconnaissance Bureau and even North Korea's central bank. Likewise, a long list of government trading companies had been publicly implicated, ranging from the flagship Daesong Trading Company and the infamous Zokwang Trading in Macau to Nanam Pharmaceutical Company (which apparently manufactures narcotics in the same facilities used to produce licit drugs) and the military-run Rungra 888 trading company, which makes and sells counterfeit cigarettes.<sup>13</sup>

These illicit businesses are the elite's largest sources of income. Private industry investigations estimate that North Korea's gross revenue from counterfeit cigarettes alone amounts to between 550-700 million dollars per year, making the DPRK the number two counterfeit cigarette producer in the world (after China). Although it is hard to pin down exactly the total scale of North Korea's illicit activity, we made a rough estimation by working backward through partner-country trade statistics and drawing on reported law enforcement seizures. Based on these methods, the sum of activity was in the range of 450-550 million dollars per year – roughly accounting for the persistent gap in the balance of payments. This may not sound like much, but it was as much as 35-40 percent of North Korean exports and a much larger percentage of its total net cash earnings (conventional trade profit margins are low, but the margin on illegal businesses is very high).<sup>14</sup>

Finally, we found that the profits of criminal activities as well as weapons proliferation were for the most part placed into foreign bank accounts including accounts associated with certain leaders, state organizations and state trading companies. Criminal investigations could be used as a tool against the illicit backbone of Kim Jong Il's "palace economy."<sup>15</sup>

Current events helped to demonstrate to policymakers and the initially skeptical intelligence community that the United States was trying to negotiate a nuclear arms deal with a North Korean regime that had become a "criminal state."<sup>16</sup> For example, in December 2001, Japanese coast guard vessels detected a North Korean spy ship infiltrating Japanese territorial waters. Japanese coast guard and police authorities believed the ship was on a mission to deliver drugs to a Japanese organized crime group. The Japanese authorities chased the spy ship for several days at the end of which a gun battle erupted as the North Koreans fired on the Japanese cutter as it attempted to approach.

Retaliatory fire from the Japanese ship sunk the North Korean vessel and everyone aboard died. Floating in the water after the ship went down were cases of foreign branded cigarettes, believed to be counterfeit. When the ship subsequently was raised authorities recovered the bodies of eight people, two antitank rocket launchers, two portable shoulder-launched anti-aircraft missiles, a recoil-less rifle, three machine guns and four automatic rifles. They also discovered the cell phone number of a known ethnic Korean drug trafficker residing in Japan, Woo Si Yun.<sup>17</sup> Japanese police began to brief us on what they had known for several years – that North Korea had become the largest exporter of methamphetamines to Japan and a close partner of Japanese organized crime.

The connections between the spy ship and drug trafficking were made public on March 13, 2007, when the Tokyo District Court sentenced a pleasure boat operator, Osamu Gonda, to 13 years in prison for smuggling nearly a billion yen worth of methamphetamines from North Korea into Japan. Gonda, along with two accomplices, Woo and Katsuhiko Miyata, were found to have been involved in a series of major at-sea transfers in 2001-2002 between North Korean government vessels and a fishing boat captained by Gonda. Among the transfers was an attempt to rendezvous with the spy ship, a drop-off the Japanese coast guard derailed by sinking the ship.<sup>18</sup> As a February 2007 submission by the Japanese government to the financial action task force (FATF) concludes, “It turned out that the ship used in the case of methamphetamine smuggling at the offshore of Kochi prefecture in 1998 and the spy ship which committed suicidal explosion at the southwestern waters of Kyushu in December 2001 were identical.”<sup>19</sup>

Information about North Korea’s involvement in the drug trade started to emerge from South Korea as well. In November 2001, South Korean authorities seized 91 kilograms (about 200 pounds) of methamphetamine off the Chinese flagged

cargo ship, *MV Chu Xing*, after its arrival from Nampo, North Korea. It was discovered that *Chu Xing*, which made regular runs back and forth from Nampo, was likely conveying similarly sized shipments on a regular basis right into South Korea’s biggest port, and that the source of the methamphetamines was inside North Korea. Unfortunately, in the interest of maintaining dialogue between the two Koreas this information was kept from the public.<sup>20</sup>

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The largest impetus for what would become the Illicit Activities Initiative came from sensitive information that emerged late in the fall of 2001 indicating that North Korea had partnered with elements of the A.Q. Khan nuclear proliferation network. In the late spring of 2002, there were also hints that North Korean procurement agents were engaged in the active purchase of the key ingredients for a clandestine uranium enrichment program. The growing fears of nuclear proliferation and North Korea’s development of intermediate-range missiles – with nuclear payload delivery capability – and another *Taepo-dong*

missile test created a sense of genuine crisis inside the National Security Council (NSC). It became clear that North Korean proliferation was accelerating into high gear and doing so in collaboration with potential enemies in the Middle East.

Some in the U.S. government started to discuss preemptive military options. Former Secretary of Defense Donald Rumsfeld briefed the president (apparently without coordinating with the secretary of state) on the Pentagon's operational plan for defending South Korea in the event of a North Korean attack – the so-called 5027 war plan. In September 2002, Deputy Secretary of State Armitage and Assistant Secretary Kelly – knowing that a military conflict with North Korea, even if “successful,” would result in certain disaster for U.S. allies in Japan and Korea – asked us to speed up the search for serious non-kinetic options, while also ordering a step up in diplomatic engagement both with allies via the United States-Japan-South Korea trilateral cooperation and oversight group (TCOG) and through an attempt to engage North Korea directly, such as Assistant Secretary Kelly's visit to Pyongyang in October 2002.

As the startling admission of North Korea's highly enriched uranium program emerged in the global media and with the Agreed Framework collapsing, our effort began. In November 2002, we held the first working group meeting with interagency participants at the State Department on North Korean illicit activities. Juan Zarate and Daniel Glaser participated from the Treasury Department. To significantly complicate North Korea's access to the international financial system, Juan Zarate proposed using the USA Patriot Act section 311 against a North Korea-linked bank flagrantly involved in money laundering and other suspicious banking practices on behalf of Pyongyang. Section 311 is a special provision of the counterterrorism law for use against institutions engaged in money laundering and illicit finance and serves to cut them off from access to the U.S. financial system.

In addition, Bruce Swartz, Deputy Assistant Attorney General for International Affairs at the Justice Department, pledged to support reviving the Secret Service counterfeiting investigations and look into other regime criminal activities.

### **The Illicit Activities Initiative**

By the beginning of 2003, our understanding of the North Korean regime's finances and illicit activities had advanced to a level that allowed an international initiative to be mounted. In March 2003, Deputy Secretary of State Armitage formally requested the deputy attorney general that the Justice Department look into the issue of North Korean criminal violations of U.S. and international law. He also asked that a State Department-Justice Department working group on North Korea law enforcement be established. The Justice Department soon appointed a prosecutor named Suzanne Hayden, who was charged with pursuing the evidence trail wherever it might lead.<sup>21</sup>

In April 2003, the IAI was formally established under the auspice of the East Asia policy coordination committee. Additionally, established in the fall of 2003, the North Korea working group oversaw the IAI and provided policy-planning support for the six-party talks. I was appointed special coordinator of this working group and William Newcomb from the State Department's bureau of intelligence and research, as deputy. The working group operated out of an office on the State Department's seventh floor and had the authority to represent the State Department at meetings related to our work at the NSC.

The IAI was never designed as an alternative to diplomacy. Assistant Secretary Kelly and I considered our work in the six-party talks, in which I participated as his senior advisor, to be of paramount importance. We felt that the United States needed a strong two-track policy, with both tracks directed toward creating the

## Principles of Economic Coercive Action

Whether pursuing Kim Jong Il, Slobodan Milosevic, A.Q. Khan or al Qaeda, roughly the same organizational methodology and principles of coercive operations can be observed:

- Target money, the *sine qua non* of an organization's existence.
- To effectively apply coercive pressure:
  - » Focus on finances as a primary target.
  - » Target financial nodes, actors and organizations that are most important to the organizations ability to function, especially their "soft operational" underbelly (financiers, banks, front companies, accountants, lawyers, administrative personnel, etc.).
  - » Channel effects across their financial order of battle (i.e., target against and across a model of how the opponent organization is financed and financially operates).
- » Attack the opponent's "business model" as well as businesses.
- » Synchronize activities within distinct time and space to amplify the effects of actions.
- » Draw on a deliberate planning matrix and campaign plan to maintain discipline and effect.
- » Aim to affect key people and organizations in the target countries: Make it personal for those you are trying to coerce.
- » Leverage law enforcement evidence to underline legitimacy of actions and create coalitions.
- » Channel activities and finances to locations where you have operational advantage.
- » Aim for lasting disruption, not just interruption.
- » Increase costs, reduce access to capital and "squeeze" financial resources to limit freedom to operate.
- Wage a campaign, not just a series of "battles," creating a unified, whole-of-government plan that builds cascading effects against an opponent to shock (create a temporal reaction of surprise and uncertainty), shudder (create fear "the wall may come down and cause people to flee) and, if needed, shatter (break their internal confidence, cohesion and will to fight).
- Organize to collect and analyze the necessary information to plan operations and assess overall campaign progress. The conventional intelligence community is not configured to perform the requisite financial and complex network analyses required.

grounds for a transformed relationship with North Korea. On track-one, the United States needed an empowered negotiator, equipped with a broad series of transformational incentives to push the denuclearization process forward in concert with the other parties. On track-two, the United States needed a process that would hold the North Koreans to accepted standards of behavior in the international community by enforcing domestic and international laws and compelling (or coercing) the DPRK to change its

activity. Coordination and synchronization would be key to maximizing synergies between the two approaches without either weakening or undermining the other.<sup>22</sup>

The ultimate goal of the IAI was explained clearly by Assistant Secretary Kelly at a sub-policy coordination committee meeting held at the State Department on June 1, 2003. The IAI's purpose was to pursue North Korea state involvement in criminal and illicit weapons trading activity to develop the leverage via law enforcement investigations,

Treasury Department designations, partner country liaison and international legal measures to counter, contain, influence and, if needed, apply decisive pressure on the regime's illicit activities and finances.<sup>23</sup>

Between the spring of 2003 and summer of 2005, working group members briefed and enlisted the cooperation of about 15 different governments and international organizations. We developed a range of sophisticated policy options and plans, including the carefully planned use of the USA Patriot Act section 311 and other tools to cut off North Korea's access to its network of illicit banking partners around the world. We instigated and coordinated the interdiction of contraband globally and helped to shut down front companies and illicit trading networks. The initiative also worked assiduously to provide support to U.S. law enforcement colleagues. As noted before, the IAI spawned multiple, large-scale international criminal investigations. These involved the U.S. Secret Service, the FBI, the Drug Enforcement Administration, Immigration and Customs Enforcement, and the Bureau of Alcohol, Tobacco, Firearms and Explosives, as well as many foreign partners.

### Early-Stage Success: *Pong Su* Heroin Bust April 2003

In March-April 2003, we supported successful operations by the Australian government against *MV Pong Su*, a North Korean Worker's Party ocean freighter involved in "illicit operations." Australian Special Forces interdicted the *Pong Su* off the coast of Melbourne. The ship had brought 150 kilograms of pure heroin – produced in North Korea – all the way to Australia's shores for distribution by a Chinese organized crime group (125 kilograms were recovered). This was the largest heroin seizure in Australian history and was worth roughly 150 million U.S. dollars. When interrogated, a crew member asserted that the drugs had been loaded on the ship and hidden in a secret compartment (then welded shut), at the port of Nampo in North Korea before



The North Korean ocean freighter *MV Pong Su* was captured by Australian government in spring 2003 carrying 150 kilograms of heroin.

(DAVID L. ASHER/CNAS)

it embarked on its long southward voyage.<sup>24</sup> It also reportedly carried large amounts of arms that had been dumped overboard while the ship was being pursued. The seizure of the *Pong Su* load was a significant financial blow for the North Korean regime. More shocking (and as revealed subsequently in the Australian media), the Australian Federal Police believed the *Pong Su* heroin may have been intended as a "trial run" – the first of a series of larger heroin shipments into Southeast Asia, with two more 500 kilogram shipments soon to be en route if the first trial proved successful.<sup>25</sup> If delivered, these drugs would have had a street value of more than one billion U.S. dollars. Australia, which had only allowed North Korea to open an embassy several months before, was shocked by the way the DPRK treated its newfound friend.

### Japan

The closest foreign government partner of the IAI was the government of Japan. From the start, Japan, which was confronting its own brewing crisis with North Korea over the DPRK's abduction of Japanese citizens in the 1970s and '80s, was quietly interested in joining our effort to crack down on North Korea's illicit activities. In April 2002,

## Illicit Activities Initiative Planning

### Mission:

- Develop non-kinetic courses of action to contain, counter, deny and influence the government of North Korea to abandon nuclear weapons and compel a shift in strategic direction toward the outside world.

### Course of Action:

- Understand regime vulnerabilities inside-out and create an order of battle based on what mattered most to Kim and regime survival so as to create pressure to compel behavioral transformation.

### Means:

- Exploit North Korean political-military leadership's reliance on illicit sources of finance and overseas banks; develop precise intelligence on regime finances "the palace economy" (500 million - 1 billion dollars).
- Develop novel ways and means to influence positively and negatively - using finance as the fulcrum and law enforcement as "pointy end of the spear."
- Develop true effects-based targeting across the U.S. government and the international community: Employ subtle, sophisticated and sublime ways and means.

### Approach:

- Apply economy of force approach to containment and disruption: Target the network rather than "do interdictions."
- Use instruments of national power available: Sum of all parts equals more than individual efforts in isolation.
- Tightly coordinate and plan across the inter-agency and with foreign government partners so as to maximize lines of effect.

Japanese authorities raided Ashikaga Bank and banned it from remitting funds to North Korea. This action was important because Ashikaga was the only Japanese bank that had a correspondent banking relationship with the DPRK and had long acted as a funnel for funds generated by North Korean-linked organized crime activity in Japan (including the operation of Pachinko parlors, brothels and narcotics trafficking). The bank also had been systematically bilked of capital by North Korean linked fraudulent real estate schemes and speculative lending. It was to fail in 2004.

Early in 2003, we engaged in a dialogue with the Japanese Foreign Ministry on North Korea contingency planning to include stepped up trade sanctions and law enforcement. We also had discussions with the Ministry of Finance on revising Japan's foreign exchange law to curtail remittances to North Korea.

In April 2003, the Japanese government enacted comprehensive enforcement measures, including banning port visits of *MV Mangyongbong-92* passenger ferry (North Korea's main means of moving Japanese goods, contraband and money) and cutting off direct currency remittances. These actions severely curtailed the 200-300 million dollars in revenue being sent to the DPRK annually by members of the North Korean Residents Association in Japan (*Chosen Soren*). The government of Tokyo and the Japanese National Tax Administration also began vigorously pursuing *Chosen Soren* for tax evasion while the Ministry of Economy, Trade and Industry began an aggressive wave of actions against North Korean front companies in Japan, including breaking up an elaborate procurement ring for DC power stabilizers destined for North Korea's uranium enrichment program. Finally, Japanese police set up a North Korea crimes task force (drawing on evidence gathered from 1500 kilograms of North Korean methamphetamine seized in Japanese waters by Japanese police and coast guard).<sup>26</sup>

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The summer of 2003 was particularly important to the IAI's success. In mid-July, a large interagency delegation (including myself) – comprising policy, law enforcement and other government agency representatives – traveled to five Asian countries over two weeks. At each stop we met with interagency task forces assembled by our foreign government hosts that corresponded to our own. Our law enforcement participants, in particular, benefited from the doors opened to foreign policing services and intelligence services and several partners launched major investigations of their own in coordination with the U.S. task force. As a result of briefings we received and intelligence leads, we identified that some of the “Chinese” contraband we saw coming into the United States was actually produced in North Korea but moved via organization crime through Chinese ports. We also learned that Asian police had long seen a partnership emerging between the Triads (Chinese criminal organizations) and the North Korean government.

The working group simultaneously reached out to European community colleagues and governments and developed several important partnerships.

Perhaps most significant was an agreement by the Government of Austria to investigate North Korea's main financial front in Europe, Golden Star Bank, for its involvement in WMD procurement, intelligence operations, counterfeit currency distribution, money laundering and other illicit finance activities. As a result of the investigation, Golden Star was forced to suspend its operations in June 2004. In addition to impairing North Korean procurement activity, this was a substantial blow to North Korean Office 39 and likely affected Kim Jong Il personally since Golden Star allegedly managed some of his personal fortune.<sup>27</sup>

#### **Interagency Planning and Coordination via the North Korea Activities Group**

What made the IAI particularly powerful was the development and employment of an effects-based plan that targeted specific regime elements involved in illicit activities and increased the pressure on actors, nodes and networks in linked stages organized around a matrix. We believed that by linking U.S. government and private sector partner actions in a distinct time and space and stringing out effects both globally and across what may be referred to as a financial “order of battle,” we could maximize the disruptive effects on the North Korean regime. This matrix was revised over time and became much more formalized once the North Korea activities group was established at the NSC in 2004. Brigadier General John Allen, then-executive director for East Asia and Pacific Affairs in the Office of the Secretary of Defense, led an effort with joint staff planners to take our matrix and make it into a serious Defense Department-style plan. The plan contained lines of operation using finance, law enforcement and policy in tight orchestration and had three stages designed to ramp up pressure on the regime in order to help compel or coerce a change in their behavior, enhance containment (if needed), and increase U.S. leverage in the six-party talks. In essence, the plan aimed to impart a degree of pain and disruption



for each element depending on illicit financing in the DPRK regime, including those immediately subordinate to Kim Jong Il himself.

Important details of the plan were revealed in a *New York Times* article on February 14, 2005, based on interviews with the national security advisor and others on his staff. As the article states:

In the months before North Korea announced that it possessed nuclear weapons, the Bush administration began developing new strategies to choke off its few remaining sources of income, based on techniques in use against al Qaeda, intelligence officials and policy makers involved in the planning say. The initial steps are contained in a classified “tool kit” of techniques to pressure North Korea that has been refined in recent weeks by the National Security Council. The new strategies would intensify and coordinate efforts to track and freeze financial transactions that officials say enable the government of Kim Jong Il to profit from counterfeiting, drug trafficking and the sale of missile and other weapons technology. Some officials describe the steps as building blocks for what could turn into a broader quarantine if American allies in Asia – particularly China and South Korea – can be convinced that Mr. Kim’s declaration on nuclear weapons last week means he must finally be forced to choose between disarmament and even deeper isolation. China and South Korea have been reluctant to impose penalties on the North.<sup>28</sup>

### **The Illicit Activities Initiative and Strategic Law Enforcement**

Probably the most unique accomplishment of the IAI was the strategic use of law enforcement and financial designation of legal authorities from the departments of Justice and Treasury. We enjoyed a powerful reservoir of trust with both departments and were able to leverage the Justice Department’s criminal law enforcement process to support Treasury designations, which in turn strategically

supported further criminal investigations. The IAI helped produce two of the largest undercover organized crime investigations in U.S. history: operations “Royal Charm” and “Smoking Dragon.” In the fall of 2003, an elaborate sting operation was launched via FBI undercover agents in Atlantic City, N.J.; Las Vegas and Long Beach, Calif. to begin doing significant business with North Korea via its Chinese organized crime partners (this sting ended up reaching high up into the North Korean government as well as into Chinese military intelligence).

“Royal Charm” was centered on a false-front Mafia group in northern New Jersey, reminiscent of the one on the hit television show, the Sopranos. This mafia front-family had been established in the late 1990s as part of an FBI ruse to penetrate the counterfeit cigarette trade between China and the United States, but was expanded rapidly as linkages to North Korea became apparent (industry sources had discovered that contraband produced in North Korea was falsely labeled as coming from China and shipped through Chinese ports to escape scrutiny). The criminals on the East Coast were engaged in a partnership with another group on the West Coast, who were targets of a related investigation, “Smoking Dragon.”<sup>29</sup> Interestingly, the same FBI undercover agents who were working on “Royal Charm” were simultaneously engaged in another undercover investigation against the Gambino crime family. The fact that they had credibility as truly “made men” associated with the heart of La Cosa Nostra in the United States likely added to their success at convincing the North Koreans and their Chinese organized crime partners.<sup>30</sup> As one of our lead agents told us at the time, “we learned that Kim Jong Il was a huge fan of the Sopranos so we gave him what he dreamed of.”

Through “Royal Charm” and “Smoking Dragon,” an expansive network in the United States linked to North Korean and Chinese criminal partners

was documented. This network, as the unsealed indictments show, was engaged in selling tens of millions of dollars per year of contraband – everything from counterfeit U.S. currency and postage stamps, counterfeit U.S. branded cigarettes and state tax stamps, counterfeit Viagra, ecstasy, meth-amphetamines and heroin. More startling was the sale by North Korean agents of large quantities of AK-47s, machine guns and rocket-propelled grenades destined for the United States. At one stage, the gangsters even offered to sell a large number of QF-14 shoulder-launched missiles (man-portable air-defense systems or manpads) – information that when brought to the NSC in the aftermath of 9/11 caused quite a stir.<sup>31</sup>

Another revelation from the “Royal Charm” and “Smoking Dragon” investigations was the extent to which North Korea has become a major source of counterfeit cigarettes, with containerized cargo frequently coming from the ports of Najin and Nampo for shipment via major ports in China and South Korea throughout the world. In fact, we learned that domestically produced counterfeit cigarettes were likely the single largest export, by value, for North Korea. As a June 2005 report by the Consortium of Asian Tobacco Manufacturers starkly lays out North Korea’s status as a counterfeit cigarette producer:

The Democratic People’s Republic of Korea (DPRK) has emerged in the past five years as one of the principal sources of counterfeit international brand cigarettes. Reporting from informants, undercover investigators, and industry insiders indicates that between 10 and 12 factories are – or recently have been – actively producing counterfeit cigarettes in the country. Six of these factories are located in P’yongyang or its suburbs, while as many as six are in or near the Raijin area on the north east coast of the DPRK. We assess that total production from these factories could equal some 41 billion sticks, or four million master cases, annually...

Reporting from [industry] intelligence sources, as well as information generated during the course of conducting controlled buys, indicates that DPRK-origin counterfeits have been selling at between US\$130 to US\$180 per master case [at] a nearby Asian port (Busan, Manila, or Kaohsiung). At these rates, the [North Korean counterfeit cigarette industry] could generate between US\$520 to US\$720 million in gross revenue annually.<sup>32</sup>

From 2003-2005, in parallel and in support of the U.S. law enforcement investigations, several leading members of the international cigarette industry commenced their own sophisticated undercover investigation into this trade. In addition, the IAI’s departments of Justice and State team began targeting containers of counterfeit cigarettes coming out of North Korea in partnership with South Korea and via “Operation Crocodile,” an intra-Asian police effort against counterfeit products. In conjunction with “Operation Crocodile,” in September 2004, working with South Korea and U.S. customs we orchestrated an interdiction against the *Chu Xing* at the port of Pusan (the ship that had twice before been caught ferrying narcotics and other illicit goods for export from North Korea). Perhaps not surprisingly, it was carrying multiple containers of counterfeit cigarettes en route to Southeast Asia.

Most surprising was the extent to which we traced North Korean counterfeit cigarettes coming into the United States itself. By the end of the investigations, North Korean Marlboros had appeared in more than 20 states. In California alone, in 2005 customs authorities seized more than one billion North Korean-produced counterfeit cigarettes. One reason for successful penetration of the U.S. market was that, as with the counterfeit supernotes, the quality of North Korea’s counterfeit cigarettes was remarkably high. As a 2006 *Wall Street Journal* article commented, “Packs of fake Marlboros seized in Miami even included forged pamphlets

## North Korea and the Vienna Conventions

Over the last three decades, agents, officers and business affiliates of North Korea have been implicated in hundreds of public incidents of crime around the globe. Incidents of illicit activity have occurred on every continent and almost every DPRK embassy in the world has been involved at one time or another. Indeed, North Korea is perhaps the only country in the world with embassies and overseas personnel that are expected to contribute income to the “party center,” not rely on central government funds for their official activities. Such repeated illicit actions from diplomatic premises amount to a serial violation of both articles 31 and 41 of the Vienna conventions on diplomatic relations, which respectively convey that 1. commercial, and most certainly criminal, activities for profit shall not be conducted by accredited diplomats or via accredited facilities, and 2. officials posted abroad must obey the laws of the nation to which they are posted. North Korea is in serial breach of both articles provision of the Vienna conventions.

If Justice Department criminal prosecutions had been successful – and had the DPRK continued to defy the world at nuclear gunpoint – the legal cases in the United States, Japan and Europe could have laid the ground for seeking the freezing and forfeiture of regime funds and an attempt to revoke North Korea’s commercial and intelligence presence in embassies around the world. The forfeiture effort would have relied on the use of U.N. Mutual Legal As-

sistance Treaty requests and appeals under the U.N. Convention against Corruption (UNCAC). We could have targeted the assessed financial proceeds generated by North Korea’s illicit activities and damages for the cost imposed on the U.S. government from having to redesign the dollar. Moreover, a case could have been made in the International Criminal Court that North Korea had, in essence, become a criminal state – violating its international legal obligations under the Charter of the United Nations and the Vienna Conventions so severely that its diplomatic accesses would be radically circumscribed unless and until its behavior had changed.

### Highlights of the United Nations Convention against Corruption:

- Entered into force in December 2005; signed by 128 countries.
- **Prevention:** each state party mandated to establish and promote effective practices aimed at the prevention of corruption.
- **Criminalization:** The Convention requires countries to establish criminal and other offences to cover a wide range of acts of corruption. The Convention goes beyond previous instruments of this kind, criminalizing not only basic forms of corruption such as bribery and the embezzlement of public funds, but also trading in influence and the concealment and laundering of the proceeds of corruption. Offences committed in support of corruption, including money-laundering and obstructing justice, are also dealt with. Convention offences also deal with the problematic areas of private-sector corruption.

- **International cooperation:** Countries agreed to cooperate with one another in every aspect of the fight against corruption, including prevention, investigation and the prosecution of offenders. Countries are bound by the Convention to render specific forms of mutual legal assistance in gathering and transferring evidence for use in court, to extradite offenders. Countries are also required to undertake measures that will support the tracing, freezing, seizure and confiscation of the proceeds of corruption.

- **Asset recovery:** In a major breakthrough, countries agreed on asset recovery, which is stated explicitly as a fundamental principle of the Convention. This is a particularly important issue for many developing countries where high-level corruption has been plundered the national wealth, and where resources are badly needed for reconstruction and the rehabilitation of societies under new governments.

urging smokers to visit a website to find information about the health dangers of cigarettes and the admonition, “Don’t Litter” on the side of the box. Some also have copies of state tax stamps.”<sup>33</sup>

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*Perhaps the biggest legacy of the IAI may be the way it helped demonstrate the power and effectiveness of the Treasury Department as an important player in U.S. national security policy and strategy.*

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The “Royal Charm” investigation culminated in a much-publicized event, a “wedding,” in which the supposed daughter of the FBI undercover “mob boss” was to be married on a yacht, the Royal Charm, moored in Atlantic City harbor. Unwittingly, dozens of suspects flew in from across the United States and Asia to attend the nuptial celebration. Instead of riding in their limousines to the yacht, they found themselves being taken to the Newark, N.J. courthouse to be booked. Among them was Jyimin “Jimmy” Horng – who with his accomplice Co Khan, also known as “Keith” Tang, had arranged large shipments of North Korea supernotes and methamphetamines into the United States and planned to sell a range of weaponry to the U.S. undercover agents with the help of generals from “two unnamed countries.”<sup>34</sup>

As the IAI began to succeed in stifling North Korea’s criminal network, the Justice Department increased its pressure and operations.

On August 8, 2005, for the first time in history, a government was named in a federal indictment for counterfeiting of the dollar. As the Justice Department indictment of Sean Garland and other members of the Irish Republican Army for their partnership in the criminal distribution of counterfeit U.S. currency read:

Beginning in or about 1989, and continuing throughout the period of this Indictment, a type of high-quality counterfeit \$100 floating-rate notes began to be detected in circulation around the world. Their high quality made it particularly difficult for them to be detected as counterfeit by untrained persons. The United States Secret Service initially designated these counterfeit notes as “C-14342” and they came to be known as “supernote” or “superdollar.” Quantities of the supernote were manufactured in, and under the auspices of the government of, the Democratic People’s Republic of Korea (“North Korea”). Individuals, including North Korean nationals acting as ostensible government officials, engaged in the worldwide transportation, delivery, and sale of quantities of supernotes.<sup>35</sup>

On October 7, 2005 Northern Ireland’s Police Service accompanied by U.S. Secret Service agents arrested Garland in Belfast, Ireland. His extradition remains pending.

### **The Treasury Department and Section 311: Planning Banco Delta Asia**

Perhaps the biggest legacy of the IAI may be the way it helped demonstrate the power and effectiveness of the Treasury Department as an important player in U.S. national security policy and strategy in applying pressure against a defiant and dangerous regime. A key to the Treasury Department’s contribution to the IAI was its employment of the USA Patriot Act section 311 and range of targeted executive orders, advisories to the financial community and Office of Foreign Assets

Control (OFAC) designations. As Deputy Assistant Secretary of the Treasury Daniel Glaser explained in June 2006:

Section 311 authorizes the Secretary of the Treasury to designate a foreign jurisdiction, financial institution, or type of transaction as a “primary money laundering concern.” Once designated as such, the Treasury Department may take a range of regulatory actions to protect the U.S. financial system, up to and including requiring U.S. financial institutions to terminate correspondent relationships with a designated entity. Such a measure effectively cuts the designated entity off from the U.S. financial system. This defensive regulatory measure has a profound effect, not only in insulating the U.S. financial system from an identified illicit finance risk, but also in putting the global system on notice of such a threat as well.<sup>36</sup>

On September 15, 2005 the Treasury Department designated a small Macau bank, Banco Delta Asia (BDA), under section 311, specifically citing the role the bank played in facilitating North Korean illicit activities, including money laundering. The 311 triggered a run on BDA that forced the Macau government to take it over. Chinese authorities also froze roughly 25 million dollars in North Korean funds at the bank. Moreover, effectively compelled by Treasury Department warnings of North Korean illicit financial activity and fearful of themselves being targeted under section 311, financial institutions around the world began to systematically cut off North Korea’s access.<sup>37</sup>

Although a strange sort of mythology has emerged around the BDA action – that it was somehow unexpected in impact or was “ill-planned” – this was not at all the case. In fact, in close partnership with Juan Zarate and Danny Glaser at the Treasury Department, the use of section 311 was meticulously planned by a small

group that met frequently for nearly two years. Macau had long been a central financial element in United States and foreign government law enforcement investigations and operations “Royal Charm” and “Smoking Dragon” were adding to the body of evidence. Moreover, our financial mapping exercise had provided a detailed understanding of North Korean institutions, companies and individuals doing business in Macau. Early on, the BDA was identified with another larger institution as leading financial hubs for North Korea’s Office 39, Office 35 and trading companies linked to those offices and other direct support elements of Kim Jong Il’s “palace economy.” We had evidence on specific banks where North Koreans laundered illicitly garnered funds with the knowledge and complicity of the institutions (who in some cases would deliberately “strip” information from North Korean wire transfers in order to conceal their nature). Banco Delta Asia was particularly attractive because it was a classic “convergence target” – a crossroads between illicit finance, leadership finance and institutional complicity.<sup>38</sup> It was small enough that its elimination would not threaten the U.S.-China financial relationship but large enough – at least from Pyongyang’s perspective – that it would send a clear message of what scholar Thomas Schelling called “compellence to Kim Jong Il.”

Banco Delta Asia also had an important impact on China’s decision-making, as we had hoped. Although the Chinese government publicly expressed surprise and dismay, we had held advanced consultation with a number of Chinese officials earlier in 2005 and raised our concerns over North Korea financial and proliferation activities in Macau in sidebars during the six-party talks in 2004. We never flagged specific banks but we made clear that unless China cracked down on North Korea’s illicit financial relations in Macau and elsewhere in China we might eventually need to take unilateral action.<sup>39</sup>

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*Thanks to the strong steps taken by Undersecretary Stuart Levey and his Treasury Department team after the designation, bankers globally were sent a wake-up call and North Korea quickly lost ready access to hundreds of millions of dollars in bank accounts.*

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As a result of the section 311 designation, in addition to freezing 25 million dollars in North Korean funds at the bank, as White House spokesman Tony Snow later confirmed, China took other, more significant, actions against North Korean illicit funds in Macau.<sup>40</sup> As part of the planning, we had factored in China's likely response, hoping that it would act out of concern that more significant economic entities would otherwise be affected by further U.S. regulatory action. For example, the role of several Macanese banks in North Korean illicit activity had been documented in law enforcement investigations, whose indictments, not coincidentally, had been unsealed two weeks before – a fact of which Chinese authorities were well aware. Other information was also readily available thanks to a South Korean investigation into the hundreds of millions of dollars of bribes deposited into North Korean bank accounts to buy the 2000 Korean summit. One of these banks was getting ready for a multibillion dollar initial public offering of its stock, a stock listing that might have been affected if the bank continued to do business with North Korea and tarnished its reputation. Chinese authorities also realized they needed to improve Macau's anti-money laundering

and financial supervision compliance record in order to maintain and attract billions of dollars in U.S. investment in the Macau gaming industry. Freezing funds linked to illicit activities or controlled by the perpetrators of illicit activities is a significant responsibility for any nation committed to upholding international money laundering standards.<sup>41</sup>

If it came down to either being able to successfully conduct international banking from Macau – and develop a hugely lucrative gaming industry – or protect an already frayed banking relationship with North Korean criminals, we were confident leading into the BDA action that Chinese bankers and regulators would follow their bottom line and implement their commitment to uphold global standards.

The BDA action was intended as a weapon to keep in reserve for a time when the diplomatic process had broken down rather than in the middle of the six-party talks. Moreover, a key aspect of the BDA action was always supposed to be the unveiling of evidence linking senior members of the North Korean regime and its criminal partners to the illicit activity voluminously documented in the “Royal Charm” and “Smoking Dragon” cases as well as the U.S. Secret Service's then 16-year-long investigation into North Korean counterfeiting of the dollar. This evidence, which has been verified by grand juries, proved beyond any doubt that the North Korean government, all the way up to the highest levels, was at the center of a global criminal conspiracy. It would have pointed clearly at the role of Macau banks and bankers in the process of laundering illicit funds for the Kim Jong Il regime. That information would have further legitimized the 311 action in the public eye amidst controversy surrounding other aspects of the USA Patriot Act and provided objective context. Unfortunately, rather than bring forward the evidence in the wake of the August 2005 arrests, the Justice Department was instructed by the NSC to, in effect, bury the

evidence and keep it out of court, masking the role of the North Korean government so as “not to embarrass it” during the talks. At the same time, the Treasury Department was instructed to go ahead with the 311 designation as planned (though without the evidentiary backbone).<sup>42</sup>

There are various theories for why the 311 was used during the talks:

- Certain people – who understood the likely implications – decided to use the BDA action as a means to stop U.S. Ambassador Christopher Hill from consummating an agreement with North Korea.
- The State Department and the NSC, having stood down the North Korea working group and North Korea activities group as “artifacts of the (Colin) Powell policy,” did not understand the implications or the planned sequencing of the actions (likely an excuse for Ambassador Hill, who never seemed to grasp the IAI or want to be briefed on key developments).
- The Treasury Department, which had long delayed the action due to the “Royal Charm” and “Smoking Dragon” investigations, was determined to go ahead on schedule and as planned (and felt it had the responsibility for protecting the U.S. financial system from what it knew to be hundreds of millions of dollars of illicitly generated funds crossing through Macau banks each year into the world banking system, whether the State Department liked it or not).

Whatever one’s interpretation of the facts surrounding the designation, the impact of using section 311 of the USA Patriot Act was as predicted and planned: It was a financial shot heard round the world for North Korea. Thanks to the strong steps taken by Undersecretary Stuart Levey and his Treasury Department team after the designation, bankers globally were sent a wake-up call and North Korea quickly lost ready access to hundreds of millions of dollars in bank accounts.

### **North Korea’s Reaction to Banco Delta Asia and the Beginning of the End of the Illicit Activities Initiative**

North Korea’s reaction to the BDA designation was not surprising, especially given the awkward timing of the designation. The regime suddenly signed the denuclearization agreement that Ambassador Hill had been struggling to conclude for weeks (quite possibly coerced to do so by the pressure of the 311) and immediately walked out of the talks (perhaps more to undo the 311 than to comply with his denuclearization program). Presumably knowing full well that the United States now had remarkable leverage over its access to the global financial system and had caught its officials in the act of involvement in an organized criminal conspiracy on multiple continents, the North Koreans spent the next year and a half bitterly demanding their money back, while likely waiting (and dreading) the next blow that would force their hand.

The Banco Delta Asia designation unfortunately marked the apogee of the IAI. As soon as he became assistant secretary, Ambassador Hill took steps to eliminate the IAI, the North Korea working group and the North Korea activities group. We were on the way out the door as the Section 311 and law enforcement actions were all coming together. Ambassador Hill had come in convinced that pressure would get in the way of “dialogue.” This is ironic given the important role that coercive statecraft played in laying the grounds for the Dayton Accord Ambassador Richard Holbrooke had negotiated in 1995 with Ambassador Hill as an assistant.

Unfortunately, what followed was a breakdown in coordination and a failure to capitalize on a fountainhead of opportunities. Under the leadership of Undersecretary Levey and Deputy Assistant Secretary Glaser, and backed by Juan Zarate at the NSC, the Treasury Department expanded its campaign to compel banks to follow on from the BDA actions and exercise “know your customer”

diligence over known or suspected North Korean bank accounts linked to illicit activities. The Treasury Department campaign crippled much of North Korea's global financial access. But the State Department struggled to come up with a way of bringing North Korea back to the negotiating table to implement the denuclearization declaration and bury the "criminal issue." Meanwhile, the NSC did not choose to integrate the successful Treasury Department initiative with a plan for equally effective diplomacy. Per the plan, there should have been an orderly process of managing "dialogue" and "pressure" yet what occurred was a battle between departments of State and Treasury. Rather than take advantage of the significant opportunities the Treasury Department engendered, the State Department tried to trash them. This was a major change from the State Department of Colin Powell and Armitage, where these departments had been firm partners with the departments of Treasury and Justice.

The denouement for the North Korea pressure campaign came when Pyongyang engaged in a nuclear test on October 9, 2006 – a desperate gambit that, amazingly, succeeded. Rather than amp up the financial pressure on Pyongyang, the United States capitulated. After getting a token sanctions resolution passed at the United Nations and naming several North Korean companies under an expanded executive order, in March 2007 the United States painstakingly (and embarrassingly) orchestrated the return of the criminally tainted North Korean funds at BDA and went back to the negotiating table with a significantly weaker hand. North Korea's brand of coercive diplomacy had, yet again, succeeded while U.S. leverage was essentially thrown away.<sup>43</sup>

The limits of the president's approach to North Korean counter-proliferation was made all the clearer by events soon to occur in the Middle East. Just after midnight (local time) on September 6,

2007, Israeli Air Force jets and Special Forces commandos attacked a site code-named "the Orchard," located on the Euphrates River in Syria's eastern desert near Al Kibar. At this site the government of North Korea was building a nuclear reactor, possibly in partnership with others, modeled on the Yongbyon reactor. This reactor complex was completely destroyed, the evidence buried, and discussion of what was found suppressed by the Bush NSC. In fact, in the president's recent memoir, Bush explains that he had actually opposed the attack since it was unclear to him that the facility was related to North Korean nuclear proliferation.<sup>44</sup>

### **Illicit Activities Initiative Failures**

Undoubtedly, the biggest disappointment in my four years of working on North Korea policy during the Bush administration was that the White House did not adopt a rigorous approach to containing, countering and disrupting North Korea's proliferation networks in the Middle East. Although, via the IAI, we worked closely with foreign government to pursue North Korean trading companies on tax evasion, financial fraud and illicit use of maritime insurance, we never were given sufficient latitude to have a deeper and sustained counter-proliferation impact and on repeated occasions were waved off from taking actions that were well within our mandate and authorities. Use of the proliferation security initiative against North Korea – which we strongly advocated for – was also remarkably circumscribed.

Taking a strong line against North Korea's WMD proliferation was one of the only issues where all the key players of foreign policy in the Bush administration's first term – other than the president and national security advisor – agreed. Secretary Powell, Deputy Secretary Armitage, Vice President Richard Cheney, Under Secretary of State John Bolton, Assistant Secretary of State John Wolf, NSC Senior Director Robert Joseph,



## Israeli Reaction to the Democratic People's Republic of Korea's Proliferation



These undated images released April 24, 2008 by the CIA show overhead views of a covert nuclear reactor built on the Euphrates River in Syria's eastern desert near Al Kibar. The reactor is shown before its destruction on the left and after its September 6, 2007 destruction by Israeli forces on the right.

(ASSOCIATED PRESS/CIA)

Deputy Secretary of Defense Paul Wolfowitz, Assistant Secretary of Defense Peter Rodman, and the intelligence community all concurred that serious action was warranted but opposition persisted at the very top. On multiple occasions we at the State Department – via the deputy secretary and in concert with the assistant secretaries for East Asia, intelligence and non-proliferation – made formal proposals to the NSC to pursue North Korea's nuclear trading network, including its now publicly designated leader Yun Ho-jin,<sup>45</sup> in the same fashion as the successful disruption effort that had been mounted against the A.Q. Khan network. In fact, Secretary of State Powell underlined the importance of an aggressive counter-proliferation approach against North Korea in his final meeting with President Bush, to no avail.<sup>46</sup>

As events that later unfolded in Syria illuminated, and as the recent revelations of an active North Korean enriched uranium program underline, the DPRK was in no way seriously constrained in its

proliferation activity by its international commitments, pledges to the six-party talk members not to proliferate, or by the muted U.S. invocation of the use of military force to retaliate or use of the proliferation security initiative to police such proliferation. The president singled out North Korea as a member of the “axis of evil” but failed to act when we started to see real change. The reason why Bush refused to support what in hindsight seems an effort of critical importance remains a mystery, but perhaps the failure to find WMD in Iraq had shattered his confidence in intelligence surrounding counter-proliferation.

### Conclusion

Despite many twists and turns, the North Korea IAI demonstrated the power of coercive economic pressure against a government that is defying international law, norms and standards of behavior. It also showed that a combination of strategic law enforcement and counter threat finance could be applied meaningfully within a policy context that while coercive in terms of up-front measures

was still ultimately diplomatic in nature. The IAI was both an alternative to regime change or military confrontation and a “deal with the devil” approach to North Korea that had been tried many times and always failed. As tough as this approach seemed to some, we were merely reacting to North Korean transgressions of international and domestic law. If North Korea suddenly decided to become a non-nuclear state characterized by lawful behavior in the international system, it would have been granted normal rights and privileges. The United States did not have a “hostile policy” toward North Korea. The United States was simply no longer prepared to put up with North Korea’s hostility, criminality and extortionate behavior. Why such a policy was equated with being hard line remains hard for me to grasp. Looking at the facts that have emerged, one could surmise that we should have been far tougher than we actually were.

### **Illicit Activities Initiative Accomplishments**

- Tens of millions of dollars frozen (BDA, Middle East).
- Hundreds of millions of dollars immobilized.
- Billions of dollars identified as linked to criminal activities.
- Five global North Korean related organized crime investigations successfully completed, 200+ criminals arrested around the world, including nearly 100 in the United States.
- Members of the North Korean leadership and organized crime partners successfully indicted under RICO and USC section 18-470 laws.
- String of front companies stopped under money laundering and tax evasion statutes (from Tokyo to Taipei, Dubai to Dusseldorf).
- Stimulation of internal dissension/ fear of regime continuity (triggering defections/internal arrests).
- Generation of dramatic leverage that could have led to a historic diplomatic process.

## ENDNOTES

1. David L. Asher, "Statement Before the Subcommittee on Federal Financial Management, Government Information, and International Security Senate Homeland Security and Government Affairs Committee" (25 April 2006).
2. Ibid.
3. Another example of operational diplomacy during the Bush administration was the effort mounted against the A.Q. Khan network, an effort that was brilliantly run by Assistant Secretary John Wolf (whose office was strategically located across the hallway from mine). The Khan effort and the IAI had many synergistic elements and we coordinated closely with Assistant Secretary John Wolf in trying to pursue the North Korean elements of the network.
4. Getting the "right people in the right jobs" is essential to success. In the North Korea case, progress was made possible by people like my deputy at the State Department, William Newcomb. It was Newcomb who organized the intelligence community to produce a type of complex business analysis that is rarely their forte. The same goes for a team of un-nameable heroes in the intelligence frontlines commanded by Joe Detrani and assisted by North Korea analyst Syd Seiler. Similarly, fortunately Bruce Swartz and Suzanne Hayden at the Justice Department were there to oversee, advise and encourage remarkable agents from four different law-enforcement agencies, unaccustomed to working cases jointly, to not only do that but also work seamlessly with foreign counterparts. Finally, Stuart Levey, Juan Zarate and Danny Glaser at the Treasury Department helped preside over a "revolution in financial affairs" in the fight against terrorism, proliferation and crime. Participants in the NORKAG had a sense of common mission, trust and friendship that is hard to underscore; vital from the view of practitioners, and yet easily overlooked by academic assessments of coercive diplomacy.
5. President George W. Bush, "Statement on Completion of the North Korea Policy Review" (6 June 2001), <http://www.presidency.ucsb.edu/ws/index.php?pid=45819>. "Over the past several months, my administration has been reviewing our policy towards North Korea. We have recently discussed the results of our thinking with our close allies, South Korea and Japan. We have now completed our review. I have directed my national security team to undertake serious discussions with North Korea on a broad agenda to include: improved implementation of the Agreed Framework relating to North Korea's nuclear activities; verifiable constraints on North Korea's missile programs and a ban on its missile exports; and a less threatening conventional military posture. We will pursue these discussions in the context of a comprehensive approach to North Korea, which will seek to encourage progress toward North-South reconciliation, peace on the Korean Peninsula, a constructive relationship with the United States, and greater stability in the region. These are the goals South Korean President Kim Dae-jung and I discussed during his visit here last March. I look forward to working with him. Our approach will offer North Korea the opportunity to demonstrate the seriousness of its desire for improved relations. If North Korea responds affirmatively and takes appropriate action, we will expand our efforts to help the North Korean people, ease sanctions, and take other political steps. I have asked Secretary of State Powell to outline our approach to South Korean Foreign Minister Han when they meet tomorrow here in Washington, and we will also inform our allies in Japan."
6. James. A. Kelly, Prepared Remarks and Q&A before the Senate Foreign Relations Committee, "Regional Implications of the Changing Nuclear Equation on the Korean Peninsula" (12 March 2003).
7. David L. Asher, "The North Korean Criminal State, its Ties to Organized Crime, and the Possibility of WMD Proliferation," Policy Forum Online 05-92A, Nautilus Institute (15 November 2005).
8. Ibid.
9. The financial tracking exercise was briefed by senior officials at the White House in January and February 2005. David Sanger, "U.S. Is Shaping Plan to Pressure North Koreans," *The New York Times* (14 February 2005). Note that reporting on North Korea's illicit use of offshore financial centers was extensive and surprisingly detailed, including well before we started the IAI; see "Money Trail," by Jay Solomon, *The Wall Street Journal* (14 July 2003): A1; David E. Kaplan, "The Wiseguy Regime," *U.S. News & World Report* (15 February 1999): 36-39; "N. Korea Said To Be in Drug Business," *Washington Times* (26 February 1995): A-1; "Drug Trafficking by North Korean Service," *Moscow-Interfaks* (22 June 1997); "Kim Chong-il's Fund Manager Commits Suicide," *Tokyo Sankei Shimbun* (29 December 1998); "North Korean Business: Drugs, Diplomats and Fake Dollars," *Associated Press* (24 May 1998); "Seoul Says N. Korea Increasing Opium Output for Export," *Kyodo* (8 June 1993); "DPRK Officially Involved in Drugs, Counterfeiting," *Digital Chosun Ilbo* [South Korea] (12 November 1996); "DPRK Defectors Attest to Realities of DPRK System," *Seoul Tong-A Ilbo*, (14 February 1996): 5; "N.Korea Accused of Promoting Opium Farms," *Seoul Chosun Ilbo* (7 August 1994).
10. The Secret Service provided briefings to *The New York Times* in 2006 spelling out these points and others, see Stephen Mihm, "No Ordinary Counterfeit," *The New York Times Magazine* (23 July 2006).
11. Stephen Mihm, "No Ordinary Counterfeit," *The New York Times Magazine* (23 July 2006).
12. In 2005, Sheena Elise Chestnut was able to document all of the key findings on North Korea's ties to transnational crime with open source information as part of her senior thesis.
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14. The most systematic examination of North Korea's balance of payments has been done by Stephan Haggard and Marcus Noland of the Peterson Institute. See Stephan Haggard and Marcus Noland, "North Korea's External Economic Relations," Working Paper (Washington: The Peterson Institute, August 2007).
15. Donald Greenlees and David Lague, "The Money Trail That Linked North Korea to Macao," *The New York Times* (11 April 2007), <http://www.nytimes.com/2007/04/11/world/asia/11cnd-macao.html?pagewanted=print>.
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18. Marcus Warren, "Japan sinks North Korea spying ship," *The Telegraph* (24 December 2001), <http://www.telegraph.co.uk/news/worldnews/asia/northkorea/1366227/Japan-sinks-North-Korea-spying-ship.html>.
19. Japanese FATF submission on North Korean illicit activities and compliance with anti-money laundering standards (Tokyo: February 2007).
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21. Details of the IAI have come out in the authors approved testimony multiple articles, see, for example, David Rose, "North Korea's Dollar Store: Office 39, North Korea's billion-dollar crime syndicate, pays for Kim Jong Il's missiles and cognac. Why did the Bush White House choose not to shut it down?" *Vanity Fair* (August 2009).
22. David L. Asher, "Statement Before the Subcommittee on Federal Financial Management, Government Information, and International Security Senate Homeland Security and Government Affairs Committee" (25 April 2006).
23. Jay Solomon and Gordon Fairclough, "North Korea's Counterfeit Goods Targeted—U.S. Seeks to Curb Illicit Business in Cigarettes, Drugs, Currency to Augment Diplomacy," *The Wall Street Journal* (1 June 2005): 1.
24. Testimony of Pete Prahar, U.S. Department of State, Senate Committee on Homeland Security (25 April 2006). "Four individuals charged in connection with the incident - three ethnic Chinese criminals who formed the shore party receiving the drugs, and one individual from *Pong Su* - plead guilty to involvement with narcotics trafficking and are serving sentences of 17-21 years in Australia. The captain of *Pong Su*, his first officer, the ship's navigator, and a "political secretary" (a member of ruling Korea Workers' Party), charged in connection with the heroin importation, were acquitted after trial in Australia. Australian authorities have since sunk the *Pong Su*, because it was seized while involved in criminal activity."
25. Keith Moor, "Big guns called in to catch *Pong Su*," (Melbourne) *Herald Sun* (7 March 2006).
26. Sachiko Sakamaki and Doug Struck, "Japan Cracks Down on Firms Tied to North Korea," *The Washington Post* (21 May 2003).
27. Michael Leidig, "Austria accuses North Korean bank of spying," *The Telegraph* (23 July 2003). According to this article the Austrian report stated: "There are detectable efforts by the North Korean secret services to place its agents in diplomatic and non-diplomatic positions in Austria. The camouflage for these activities is Europe's only established branch of the North Korean state bank, which is located in Vienna, as well as martial arts clubs established around the country." It added that the North Koreans are "finding it increasingly difficult to raise the finances to fund the further development of weapons of mass destruction, as well as for the modernization of middle-range missiles, and are looking increasingly to the West for the needed know-how and technical components, which means it is vital for Austria to make sure it keeps a close eye on North Korean representatives."
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32. Production of Counterfeit Cigarettes in the Democratic People's Republic of Korea, Report by Consortium of Asian Tobacco Manufacturers (29 June 2005).
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34. "Smugglers Laundered Cash in Macau," Taiwan, *UPI* (25 August 2005). "Two Asian men accused of smuggling weapons and counterfeit bills into the United States laundered \$1.15 million in Macau bank accounts," U.S. investigators said. Co Khanh Tang and Jyimin Horng are among 87 alleged members of a criminal syndicate accused by the U.S. government of smuggling weapons, counterfeit money, drugs and fake cigarettes into the country, the South China Morning Post reported Thursday. Agents arrested 59 people last weekend, most of them in a New Jersey sting operation that lured suspects to a mock wedding party aboard a luxury yacht. Tang and Horng reportedly received \$1.15 million from undercover law enforcement agents in exchange for \$3.35 million of high-quality counterfeit dollars." The men also received a \$50,000 deposit toward a \$1 million shipment of arms, including 75 anti-tank missiles, 50 rocket-propelled grenade launchers, 1,200 AK-47 assault rifles and various other firearms, the newspaper said. Horng allegedly planned to smuggle the weapons into the United States with the help of two military generals in two unnamed countries. Tang and Horng had payments deposited into a Bank of China account in Macau and an International Bank of Taipei account in Taiwan, the report said. Spokesmen at both banks declined to say whether the accounts had been frozen."
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36. Prepared Remarks by Deputy Assistant Secretary Daniel Glaser Terrorist Financing and Financial Crimes - *Before the Financial Crimes Forum for Asia/Pacific* (5 June 2006), <http://www.ustreas.gov/press/releases/js4305.htm>.
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38. David Rose, "North Korea's Dollar Store: Office 39, North Korea's billion-dollar crime syndicate, pays for Kim Jong Il's missiles and cognac. Why did the Bush White House choose not to shut it down?" *Vanity Fair* (August 2009).

39. This section draws on Statement of David L. Asher, Before the U.S.-China Economic and Security Review Commission (14 September 2006), [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_09\\_14wrts/06\\_09\\_14\\_asher\\_statement.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_09_14wrts/06_09_14_asher_statement.php).

40. "U.S. Welcomes China's 'Affirmative Steps' on N. Korea," *Reuters* (26 July 2006), [http://today.reuters.com/news/articlenews.aspx?type=politicsNews&storyid=2006-07-26T142312Z\\_01\\_N26323282\\_RTRUKOC\\_0\\_US-KOREA-NORTH-CHINA-USA.xml&src=rss](http://today.reuters.com/news/articlenews.aspx?type=politicsNews&storyid=2006-07-26T142312Z_01_N26323282_RTRUKOC_0_US-KOREA-NORTH-CHINA-USA.xml&src=rss).

41. Ibid.

42. David L. Asher, "The North Korean Criminal State, its Ties to Organized Crime, and the Possibility of WMD Proliferation," Policy Forum Online 05-92A, Nautilus Institute (15 November 2005).


43. See Maureen Fan, "Deal on Funds Removes Hurdle To N. Korea Talks," *The Washington Post* (19 May 2007).

44. David E. Sanger and Mark Mazzetti, "Israel Struck Syrian Nuclear Project, Analysts Say," *The New York Times* (14 October 2007); President George W. Bush, *Decision Points* (London: Random House, 2010): 421-422. In his memoir, *Decision Points*, President Bush writes that Prime Minister Olmert requested that the U.S. bomb the Syrian site, but Bush refused, saying the intelligence was not definitive on whether the plant was part of a weapons program. However, Bush also explains Olmert did what he thought was better for his people. For quite detailed public information on what was called "Operation Orchard," see [http://en.wikipedia.org/wiki/Operation\\_Orchard#cite\\_note-17](http://en.wikipedia.org/wiki/Operation_Orchard#cite_note-17).

45. Yun was recently designated by the Department of the Treasury, Office of Foreign Assets Control on August 30, 2010 under executive order 13224. For a profile of Yun Ho Jin and his supposed father in law, Chung Byon-ho, see Jay Solomon, "North Korean Pair Viewed as Key to Secret Arms Trade," *The Wall Street Journal* (31 August 2010): 1.

46. We knew there would be "turf issues" with expanding the aperture of the IAI, but argued that whether counter-proliferation should be functionally integrated into the NORKAG, under the proliferation security initiative or some other aegis, there had to be a counter-proliferation effort at least as robust as the IAI.





**CHAPTER IV:**  
PRESSURING MILOSEVIC: FINANCIAL PRESSURE AGAINST  
SERBIA AND MONTENEGRO, 1992-1995

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By Victor D. Comras

J A N U A R Y 2 0 1 1

Pressure

*Coercive Economic Statecraft and U.S. National Security*





## PRESSURING MILOSEVIC: FINANCIAL PRESSURE AGAINST SERBIA AND MONTENEGRO, 1992-1995

By Victor D. Comras

### Introduction

In May 1992, the United Nations Security Council imposed broad trade, financial and political sanctions against Serbia and Montenegro for their role in provoking and supporting aggression, ethnic cleansing and other atrocities in Bosnia. It quickly became clear that the Security Council measures were not being applied effectively and that the sanctions were not moderating Serb conduct in the Bosnia crisis. Neighboring countries also proved politically and logistically unable to effectively control the movement of goods and commodities crossing Serbia's borders.<sup>1</sup>

Further complicating the implementation of sanctions was Serbia's position as the major transportation hub for much of southeastern Europe, notably via the Danube River. The Security Council's May 30, 1992 resolution had exempted transshipment cargo from sanctions which allowed goods to transit Serbia.

In an effort to strengthen the U.N. sanctions, acting U.S. Secretary of State Lawrence Eagleburger advocated placing Sanctions Assistance Mission (SAM) teams composed of seasoned customs and border control officers at key border crossings. These officers were recruited from participating member countries of the Conference on Security and Cooperation in Europe (CSCE) (subsequently known as the Organization on Security and Cooperation in Europe (OSCE) based in Vienna). They were charged with monitoring commercial traffic and identifying and stopping contraband moving in and out of Serbia. They were assigned to Romania, Bulgaria, Macedonia, Albania and Hungary; teams were subsequently assigned also to Ukraine and Croatia.

### SANCTIONS TASK FORCE AND STRONGER SANCTIONS: 1993

The incoming Clinton administration placed further emphasis on enforcing the U.N. sanctions. Leon Fuerth, Vice President Al Gore's national security

advisor, established a special interagency sanctions task force to support U.S. government efforts. Task force members were drawn from U.S. agencies and offices, and this author was appointed director.

The task force formulated a new strategy focused on channeling U.S. resources and influence to tighten the application of existing sanctions, and sought to identify new, more stringent sanctions measures. The aim was to severely impact those sectors and individuals that supported the Milosevic regime in order to pressure Milosevic to rein in the Bosnian Serb leadership.

Efforts to increase the effectiveness of the existing sanctions focused on six objectives: tightening border controls; cutting off Serbia's access to oil, gas and other essential commodities; bolstering financial sanctions on Milosevic's supporters; prosecuting and penalizing sanctions violators; cutting off all maritime traffic to and from the ports of Kotor and Bar; and interdicting all Federal Republic of Yugoslavia (FRY) controlled vessels.

A special effort was made to strengthen the impact of the financial sanctions by identifying and targeting the Milosevic regime's offshore businesses and accounts. The U.S. government also attempted to restrict the flow of workers' remittances back to Serbia. The Milosevic regime soaked up these remittances in order to acquire badly needed hard currency.

The sanctions reached their apex in December 1993 and the Milosevic regime began to actively seek sanctions relief. The flow of goods in and out of Serbia had been cut by more than 75 percent and real income had contracted by more than 50 percent. Hyperinflation had taken hold and the Serbian dinar had become valueless. But the Clinton administration held back, waiting for some specific changed policy vis-à-vis the Bosnian Serbs. Unfortunately this intense sanctions pressure did not hold.



#### **AFTERMATH: SERBIAN REACTION AND THE DAYTON PEACE ACCORD, 1994-1995**

In January 1994, Serbia took steps to mitigate the damage from sanctions, issuing a new dinar, tying it to the German mark and introducing new austerity measures to slow inflation. In February, Greece unilaterally imposed a total trade embargo on Macedonia. Being a landlocked country with few trading options, Macedonia immediately reopened its borders with Serbia.

As a result of these developments amid growing sanctions fatigue, the main focus of the task force began to perceptively switch in the spring of 1994 from sanctions intensification to sanctions maintenance and management.

Despite leakage, the stringent sanctions on Serbia continued to eat away at Serbia's infrastructure and economy. Prospects grew particularly grim for Serbia in September 1995, as the country found itself once again facing a serious oil and gas

shortage with winter just around the corner. Serbia was already experiencing serious power outages. Its treasury was near empty and the Russians had again turned off the gas flow as a result of nonpayment. At the same time, in Bosnia the tide of war was turning as a result of an alliance of Bosnian and Croat forces supported by NATO air strikes. Milosevic knew that he needed to make a deal. Nevertheless, he pressed America's chief negotiator, Ambassador Richard Holbrooke, to first allow oil and gas shipments into Serbia before going to Dayton, Ohio for the 1995 peace accord. Holbrooke complied, effectively ending the application of this key trade restriction.

After arduous negotiations at Dayton, the presidents of the Republic of Bosnia and Herzegovina, the Republic of Croatia and the Federal Republic of Yugoslavia reached agreement on the Dayton Accord on November 21, 1995, and the fighting in Bosnia stopped. The next day the Security Council adopted Resolution 1022 formally suspending the sanctions on Serbia. As this report outlines, the effective employment of sanctions on Serbia and Montenegro throughout this period was a major factor in bringing Milosevic to Dayton.

### **Background**

In May 1992, the United Nations Security Council imposed sanctions against Serbia and Montenegro based on its determination that "the situation in Bosnia and Herzegovina and in other parts of the former Socialist Federal Republic of Yugoslavia constituted a threat to international peace and security." The crisis in Yugoslavia had been growing for some time. European countries, including Germany, France, Great Britain and Italy initially insisted that the issue be handled, to the fullest extent possible, within the community of European states, and were reluctant to refer the matter to the Security Council for action. Only when it became clear that European leaders were unable to cope with the crisis, and under great

pressure from the United States, was the matter finally referred to the Security Council. This was the start of an epic tussle that led the United States, in conjunction with western Europe and Russia, to take over the management of the Yugoslav crisis and to develop and use sanctions as one of their most effective tools.

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### **FRACTURING OF THE BALKANS**

The genesis of the breakup of the Socialist Federal Republic of Yugoslavia (SFRY) can be traced back to the mid-1980s. The signs of the growing crisis in Yugoslavia had been plain to see well before any conflict began. The death of Yugoslav strongman, Josif Broz Tito in 1980 had loosened the reigns that had held the six republics and two autonomous regions together, setting in motion a growing competition among the constituent republics for resources and for political representation.

The 1980s economic downturn in Europe hit Yugoslavia hard and by 1985, the region was in deep economic crisis. Economic tensions between the republics were further exacerbated by growing nationalist rivalries, based, in significant part, on religious and linguistic differences between the republics (and in the autonomous region Kosovo where Albanians had come to outnumber Serbians).

The rise of Milosevic to leadership in Belgrade, his oppression of Kosovo's majority Albanian population in the name of Serbian nationalism, and his formation and leadership of the very nationalist Socialist Party of Serbia in 1990 added new force to the already mounting centrifugal pressure from Croat and Slovene nationalists. While Croats and Slovenes constituted a majority in their own home republics, they were minorities in the federated Yugoslavia where Serbians constituted more than half of Yugoslavia's total population. Cognizant of what was going on in Kosovo and fearful of being dominated by Serbian nationalists, Croatian and Slovenian nationalist leaders were determined to prepare for secession and exercise greater autonomy from the SFRY central government. Milosevic and the predominantly Serbian Yugoslav Army (JNA) were determined to resist.

Croatia and Slovenia formally broke from Yugoslavia on June 25, 1991 and declared their independence from the SFRY. The Yugoslav federal government immediately declared the independence moves illegal and armed clashes broke out between JNA units and territorial forces in Slovenia. Fierce gunfire also broke out a few days later in Croatia. The first in a series of Yugoslav wars began.

#### **INEFFECTIVE EUROPEAN RESPONSE**

The Yugoslav crisis broke at roughly the same time as Europe's great debate over the Maastricht treaty, which envisioned a common European foreign policy and the eventual adoption of a common European currency. Some European leaders saw the crisis as an opportunity to demonstrate that the European community had matured sufficiently to address such issues, that it could adopt and pursue a common policy, and use its influence and leverage effectively. They believed it was a chance for Europe to show that it could take the lead on what they viewed as an internal European crisis. These voices did not want to look to the United States for leadership or guidance. On this, the

U.S. administration agreed. From the outset, then Secretary of State James Baker indicated the United States would follow Europe's lead and play only a supportive role.

The initial consensus among European leaders was that Yugoslavia should remain united. Both European and U.S. policymakers were concerned that the breakup of Yugoslavia might stimulate other nationalist secessions in the newly emerging countries of eastern Europe and from the Soviet Union. A series of transatlantic meetings were held starting in the spring of 1991 to deter such secessions. During deliberations, it became increasingly clear that the Europeans themselves were divided over what, if any, action to take. Most were reluctant to use any meaningful political or economic leverage in their dealings with Yugoslavia, Serbia, Croatia or Slovenia or on core issues. Early on, Europe's leaders ruled out armed intervention. Under such conditions a common European position on refusing to recognize the breakaway states quickly came undone. Germany broke ranks with the community and recognized Slovenia and Croatia on December 23, 1991. The other European Union members subsequently followed suit.

During this period of turmoil Macedonia also chose to withdraw from the SFRY and did so peacefully on September 8, 1991. That left predominantly Muslim Bosnia partnered with Croat-dominated Herzegovina the choice of going it alone in a Yugoslavia dominated by Serbian majorities in Serbia and Montenegro, or also opting for independence. On December 20, 1991, the presidential council of Bosnia-Herzegovina decided to ask for EU recognition of its independence. The Serb members of the presidency voted against the secession decision. The next day the parliament of the Serbian people in Bosnia declared their own "Republic of the Serbian People" which they intended would become a part of Serbia proper. The Bosnian government moved forward on its independence referendum on March

1, 1992, and was subsequently recognized by the European Union on April 7, 1992. Two days later, fighting erupted between Serbian soldiers and Bosnian militia, setting off the worst conflict in Europe since World War II.

The international community was slow to react to the deteriorating situation in Bosnia-Herzegovina, where three-way interethnic violence began to flare between the Serb, Croat and Bosnian communities in early 1992. The European Union initially sought to take on a monitoring and mediating role, and indicated that it would deal with each of the parties in an even handed manner. In 1991, the U.N. Security Council, at the behest of the United States and the European Union, adopted Resolution 713, imposing an arms embargo on all of the republics. However, this evenhandedness soon gave way to a realization that Serbian forces were continuing to pursue their military advantage aggressively with JNA support and to employ brutal tactics including ethnic cleansing.

### **An Initial Round of European Sanctions**

The use of sanctions in the Yugoslav crisis began as part of a carrot-and-stick approach to get the parties to sign on to the EU-sponsored peace plan. On October 29, 1991, the foreign ministers of the EU countries met in Brussels and decided to impose economic sanctions against any republic that did not accept a European Union's proposed peace plan put forth by former NATO Secretary General Lord Carrington of Great Britain. The EU plan called for sovereignty and independence for the republics, the protection of human rights and special status for certain groups and areas where other national or ethnic groups formed the majority (e.g., the Serbs in The Krajina). It also called for the restitution of the autonomous status of Kosovo and Vojvodina.

The plan was greeted positively by Slovenia, Croatia, Bosnia and Macedonia, but rejected by Milosevic. His rejection led the EU to initiate

its own very limited economic sanctions on November 8, 1991. The measures included the elimination of all economic and technical assistance, a cutoff of textile and other commodity import quotas, and the elimination of trading preferences (most favored nation and the general system of preferences). U.S. officials followed suit with similar sanctions. Although feelings were already running high in the United States over Serbian brutality in Croatia and Bosnia and Serbian repression in Kosovo, Baker wanted to make sure that the United States did not get out ahead of the Europeans.

### **THE EMERGENCE OF AMERICAN LEADERSHIP IN THE BALKANS**

By the spring of 1992, American news media were regularly filing reports on atrocities being committed by Bosnian Serb forces and their engagement in what could only be classified as ethnic cleansing. This outrageous conduct caught the attention of the American public, who began pressing for something to be done. The war also became an issue in the 1992 Democratic primary and the presidential election debates.

In May 1992, Baker traveled to Europe to attend a conference convened in Lisbon, Portugal for pledging assistance to the states newly emerging from the former Soviet Union. But, Bosnia was also high on his agenda. He had been pushing European leaders to no avail to impose more stringent measures against the Serbs in order to reign in the fighting. When the Europeans again failed to act, he became determined to take action on his own, and preemptorily announced a number of steps the United States would take against the Milosevic regime. He also directed the State Department to seek broad trade and other sanctions against the rump SFRY.

Standing before a press gaggle in Lisbon on May 24, 1992, Baker announced the United States would immediately cut back the level of its

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*To the fullest extent possible, it was important to de-politicize implementation and enforcement issues. The best way to do that was to hold companies rather than countries responsible for sanctions violations.*

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diplomatic presence in Belgrade, cut off all contacts with the JNA, close Yugoslav consulates in the United States, and block Serbia-Montenegro from being recognized as the continuation state of Yugoslavia. He also announced that the United States had decided to seek Security Council chapter seven sanctions against Serbia-Montenegro and the Bosnian Serbs.

Baker had some sharp words for his hesitant European hosts: “Anyone who is looking for reasons not to act or arguing somehow that action in the face of this kind of a nightmare is not warranted at this time – I think that in the view of all of us in the civilized world at least – is on the wrong wavelength.”<sup>2</sup>

When questioned by a reporter whether the United States would consider using force to intervene Baker responded:

There will be no unilateral use – *no unilateral use* – of U.S. force. As we have said before, we are not and we cannot be the world’s policeman. Before we consider force, it seems to me, we ought to exhaust all of the political, diplomatic and economic remedies that might be at hand ... I would be even more encouraged if, coming out of the

meeting on (next) Tuesday, there were a willingness on the part of our European colleagues to act. (*emphasis added*)<sup>3</sup>

Baker was adamant that the United States would no longer simply follow Europe’s lead. Rather, the United States would independently push for a more rigorous way of dealing with the crisis. And, this meant that the State Department and other U.S. foreign policy-related agencies would now begin to engage directly in the formulation and application of policies to deal with the Yugoslav crisis.

### **Designing U.N. Sanctions on the Socialist Federal Republic of Yugoslavia**

The task of drafting the Security Council resolution announced by Baker in Lisbon fell initially to the State Department’s Bureau of International Organization Affairs, with support from the European Bureau and the Office of East-West Trade in the Economic Business Bureau. I was the director of that office and had the lead line responsibility in the State Department for managing the international implementation of U.S. export control and sanctions measures. Under intense pressure to work quickly, we put together a draft resolution along the lines of that previously used for Iraq sanctions. Those sanctions involved the application of broad political, economic and trade sanctions that were meant to deter, isolate and punish the target state. There was no thought at that time of designing more limited or targeted sanctions. Rather, the administration wanted sanctions that would completely isolate Serbia and that would have a dramatic and immediate impact. There were, however, some serious complicating factors that had to be considered. The Danube River, a traditional link for trade traffic between western and eastern Europe, flowed through Serbia. Likewise, Greece’s rail and road connections with the rest of Europe also ran through Serbia. And, the heavily traveled Adriatic Sea was also very difficult to police without unduly disrupting maritime commerce.

On May 30, 1992, the Security Council adopted Resolution 757, with two countries, China and Zimbabwe, abstaining. The resolution directed all countries to completely cut off trade with Serbia and Montenegro (FRY), except for food and medical supplies; to impose a flight ban on FRY-owned (registered) aircraft; to ban their nationals from using FRY-flagged ships or aircraft; to prohibit all financial transfers (including cash transfers) to the FRY; and to freeze any economic asset in their territory belonging to FRY entities. Diplomatic representation was to be reduced to a minimum and scientific, technical, cultural and sports cooperation halted.

The sanctions resolution, however, also contained a major loophole which seriously undercut their effectiveness. Taking into account Serbia's position as a regional transit hub, paragraph six of the resolution exempted from the controls all commodities and goods that were transshipped through the FRY. This provision was viewed as necessary to take into account the impact the sanctions measures might otherwise have on neighboring country trade, particularly that of Greece, Macedonia and Danube riparian states. The Yugoslav Sanctions Committee (which had previously been established to monitor the arms embargo) was directed to issue guidelines to regulate such transit traffic, but, in fact, was only able to produce some very general hortatory statements in this regard. Clearly lacking was any effective methodology, monitoring mechanism or system of accountability that could identify, segregate and control cargoes originating in or destined for Serbia and Montenegro as opposed to cargoes that were legitimately transiting the FRY. And, trade with Serbia and Montenegro actually increased over the next several months.

The failure of the U.N. sanctions to have the bite intended caused considerable angst in Washington. The United States even went so far as to raise the issue in the Security Council and to criticize

publicly Italy, Greece and other European countries for failing to take the steps necessary to make the sanctions work. An indignant Italy responded by recalling its ambassador in Washington for "consultations."

Acting Secretary of State Lawrence Eagleburger made effective implementation and enforcement of the sanctions one of his core objectives for the August 26-27, 1992, London Conference on Yugoslavia. I was included as a member of his delegation to advise and assist on the sanctions issue, and was asked to put together a series of steps on sanctions implementation that Eagleburger might push for at the conference. Eagleburger's statement reflected my recommendations. He made it clear that sanctions enforcement had to change dramatically:

... we must resolve no longer to tolerate continuing and flagrant violations of the sanctions regime. Several steps are necessary. One, the UN Sanctions Committee transshipment guidelines must be strengthened to include strict documentation and inspection procedures. Two, in agreement with the Government of Romania, we will move quickly to place multinational sanctions monitors in Romania. The United States is ready to contribute experts and equipment to this operation. Similar arrangements should also be established in other areas bordering Serbia-Montenegro, including Hungary, Bulgaria, Albania, and Macedonia. Three, we must implement new measures to eliminate violations occurring via the Danube River.<sup>4</sup>

The idea of putting together an effective monitoring capability along the borders of Serbia and Montenegro came from brainstorming discussions within my office when it had become clear that confronting our allies simply would not work. To the fullest extent possible, it was important to depoliticize implementation and enforcement issues. The best way to do that was to hold companies

rather than countries responsible for sanctions violations. Sanctions violations should be treated like smuggling and handled as a customs function, and that required bringing transparency to what was actually crossing Serbia's borders. However, we recognized that considerable political clout might be necessary to assure that all countries participating in the effort manifested the necessary "political will" to succeed.

Left on their own, neighboring countries and their customs services would have been unable and unlikely to carry out such tasks given political, personnel and resource constraints. Government and customs officials and personnel in these countries, at that time, were largely under-motivated, under-trained and underpaid, and could too easily be corrupted. For this purpose the United States needed some strong political and economic incentives, and a core of experienced, committed and highly trained customs officers to oversee what was really happening. The trade-off for the local governments and customs services would be the benefits they gained from the infusion of resources, training, equipment, recognition and from the respect they gleaned from working in close cooperation with a corps of international customs officers. From the outset we championed the idea of both catering to, and co-opting the local government officials and customs services by treating them as full partners (including offering them increased perks, training and mission trips to other countries in Europe and the United States).

Negotiating such an arrangement at the London Conference proved to be much more difficult than anticipated. Support for the concept had to be earned and thought had to be given on how to institutionalize such an undertaking. From the outset U.N. Secretary General Boutros Boutros-Ghali insisted such an operation could only be conducted under U.N. auspices. But quickly establishing such a monitoring arrangement within the framework of the United Nations would have

been extremely difficult, and, undoubtedly, would have politicized the monitoring function and/or denuded its effectiveness. Certainly, that has been the experience with U.N. sanctions committees and monitoring groups since then. Getting the U.N. secretary general to go along with the creation of a monitoring system outside of the United Nations was also going to prove quite difficult. His representative at the conference was instructed to squelch this approach as soon as Boutros-Ghali heard of it. Such sanctions monitoring, Boutros-Ghali maintained, would necessarily require prior Security Council approval and had to remain under Security Council (sanction committee) direction and control.

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Eagleburger was just as adamant that the monitoring mechanism we proposed had to remain outside of U.N. control. He threatened to walk from the conference if Boutros-Ghali continued to object. I was authorized to convey this message directly to Boutros-Ghali's representative. Under such pressure, the secretary general finally caved in, and agreed not to openly oppose such arrangement.



Rather, he would leave it to the Security Council to determine whether or not the Yugoslav Sanctions Committee would countenance and cooperate with such an arrangement. It finally did.

The neighboring states (other than Romania) were also very cautious about accepting these proposals but agreed to consider them. They all had a common interest in bringing Serbia to heel, but only Romania had agreed outright to our proposal.

After much discussion a compromise agreement was finally reached to establish a separate, informal sanctions liaison group that included the United States, the European community and the Commission on Security and Cooperation in Europe (CSCE), working under the auspices of and reporting to both. Appropriate partner states would assure that the U.N. Security Council and its FRY sanctions committee were informed of the sanctions liaison group and SAM activities. Additionally, the European Community agreed to establish a Sanctions Coordination and Communication (SAMCOM) center in Brussels to support these efforts. A link would subsequently also be established between the sanctions assistance missions in the field through SAMCOM to the U.N. sanctions committee in New York.

The decisions taken to strengthen sanctions implementation at the London Conference constituted a special section of the conference's final document. The final document reflected that "the relevant governments" had agreed to:

- "Implement an agreed action plan to ensure the rigorous application of sanctions.
- Enforce sanctions on the Danube, consistent with their view that riparian states have the authority and obligation to do so.
- Provide practical advice, manpower and equipment to help neighboring countries to enforce sanctions rigorously.
- Contribute experts to advise on the application of sanctions in all neighboring countries to take part in the monitoring missions which will be established in the neighboring countries to ensure full implementation of sanctions.
- Ask the Security Council to:
  - » Take necessary measures to tighten up the application of sanctions in the Adriatic.
  - » Prevent illegal transfer of financial assets to Serbia and Montenegro; and eliminate diversion of goods in transit.

Conference parties have asked the European Community and the CSCE to coordinate all necessary practical assistance to all neighboring countries.”<sup>5</sup>

The sanctions improvements negotiated at the London Conference and in subsequent organizational meetings in Vienna represented the first steps in what would become, perhaps the most successful use of economic sanctions in modern history. For the first time stringent sanctions measures had been combined with a system for effective sanctions oversight and management. For the first time, methodology was in place to identify those violating the sanctions and to hold them accountable. In my view, this sanctions program gave the West its greatest lever over Milosevic and Serbia, and induced him, finally, to come to the negotiating table.

### **Making the New Sanctions Monitoring Arrangements Work**

Building an effective international monitoring mechanism could not be accomplished overnight. Yet arrangements were made quickly to send survey teams out to each of the frontline states. These assessment teams were composed of knowledgeable border control, customs and foreign office (or, in the case of the United States, State Department) officials drawn principally from the United States and Great Britain, but also including members

from Germany, Austria and Italy. They were asked to determine the personnel and resources that would be needed to staff an effective local monitoring system. They also identified many of the major sanctions-busting routes that needed to be plugged.

A special meeting was convened at the CSCE (OSCE) headquarters in Vienna on September 28, 1992, to collate the findings of the assessment missions and determine an initial monitoring deployment plan. The first countries identified for such missions were Romania, Bulgaria, Macedonia, Albania and Hungary, and a recruitment call to staff the missions with seasoned customs and border control officers was put out to all OSCE members.

Despite the limited availability of trained personnel and needed resources, it was agreed that SAM teams should be deployed immediately while further recruitment was proceeding. Lead countries were also selected for each frontline state and were given responsibility to gather the necessary resources and recruits to man the missions. Germany took the lead in Bulgaria, Canada in Macedonia, Italy in Albania, the United Kingdom in Hungary, and the United States in Romania. The first teams arrived in Bulgaria, Hungary and Romania in October 1992, and by January 1993, SAM teams were up and running in all the frontline states. These were small teams, ranging in size from five to 15 members. These numbers fell considerably short of the numbers needed to monitor the major border crossings effectively. Therefore, the teams initially used roving patrol tactics visiting border crossings on a staggered basis, but as frequently as possible.

While the SAM teams had no direct authority to enforce the sanctions measures, they were able to report suspected sanctions violations directly to SAMCOM in Brussels via a secure voice and facsimile communications system. They were also able to advise local customs officers concerning potential violations, for example, which cargoes

should be stopped for inspection. The local customs officers were fully aware that laxness on their part might well be reported back to their own headquarter superiors.

While the overall effectiveness of these initial SAM operations was seriously constrained by their small size and lack of resources, they were, nevertheless, able to demonstrate the value of the approach. As of January 28, 1993, some 772 suspected sanctions violations had been reported to SAMCOM and 1173 requests had been forwarded by SAMCOM to suspected origin countries for investigation.

The reports generated by these initial SAM teams underscored and clarified the need for further action to curtail ongoing trade with Serbia, including the flow of oil, gas and other petroleum products vital to Serbia's industry and economic activity. Their reports provided the evidence needed to seek a new Security Council resolution to deal with this problem. They indicated that Serbia was taking full advantage of the resolution's transit provisions to channel its own exports and imports to and from Bulgaria and Macedonia via road and rail, or via ships in and out of the ports of Bar and Kotor. Commodities, including oil, were also being brought in by ships and tankers, by barge traffic up the Danube, and by rail and tanker truck from Bulgaria or across Macedonia from the port of Thessalonica, Greece.

#### **U.N. SECURITY COUNCIL RESOLUTION 787: INCREASING THE PRESSURE**

It was clear that a new U.N. Security Council resolution would be needed to close these major loopholes. It was also clear that much more was necessary to enhance the SAMs and related sanctions cutoff activities.

Based on the information provided by the SAMs, the Security Council adopted U.N. Security Council Resolution 787 on November 16, 1992.

The resolution imposed new restrictions on cargo transiting Serbia and Montenegro, requiring that commodities such as iron, steel, other metals, chemicals, rubber tires, vehicles, aircraft and motors, coal, oil, gas and petroleum products could only be transhipped through Serbia and Montenegro with the specific authorization of the U.N. sanctions committee. Such approval would only be granted on a case-by-case basis, and a special sanctions committee license would have to accompany the shipment.

The resolution also authorized: “States, acting nationally or through regional agencies or arrangements, to use such measures commensurate with the specific circumstances as may be necessary ... to halt all inward and outward maritime shipping in order to inspect and verify their cargo and destinations and to ensure strict implementation of the [sanctions].”<sup>6</sup> Similar authority was also given to Danube riparian states to halt, inspect and detain suspect barge traffic.

Recalling that Resolution 757 had previously directed that no dealings be permitted with FRY flagged vessels, the new resolution further clarified that “any vessel in which a majority or controlling interest is held by a person or undertaking in or operating from the Federal Republic of Yugoslavia (Serbia and Montenegro) shall be considered ... a vessel of the Federal Republic of Yugoslavia ... regardless of the flag under which the vessel sails.”

Serbia now began to find itself increasingly cut off from European and other markets and from the financial and technical assistance upon which it previously heavily depended. Serbian companies also found it increasingly difficult to make deals with overseas companies or to enter into financial transactions. Serbia’s access to spare parts and raw materials was also more restricted. By December 1992, despite the continuing flaws in the sanctions, the Serbian economy was beginning to feel the pinch.

### **The Perspective in Washington**

On his return from the London Conference, Eagleburger established a special team of senior State Department officials under the direction of Ambassador Warren Zimmerman to monitor the Yugoslav situation and determine steps to deal with Serbia and with the growing catastrophe in Bosnia. I was put in charge of monitoring and reporting to the group on sanctions related developments, and on the progress U.S. agencies were making in recruiting and stationing the sanctions assistance missions overseas. While these missions were not yet effective in stemming the flow of goods in and out of Serbia, they provided critical information on the problems faced and what steps remained necessary. A series of options were developed to deal with these issues. Nonetheless, the fall presidential elections and pending change of administration after the election of Bill Clinton in November 1992 put many of these new initiatives on hold.

President Clinton had raised Bosnia during his campaign and was committed to taking a number of new initiatives to deal with the crisis in his new administration. Incoming Secretary of State Warren Christopher presented the new administration’s six-step strategy in a speech delivered on February 10, 1993. Among other things, it called for new “actions to tighten the enforcement of economic sanctions, increase political pressure on Serbia, and deter Serbia from widening the war.”<sup>7</sup>

The president called on Vice President Al Gore’s senior national security advisor, Leon Fuerth, to take charge of the sanctions and to turn them into an effective tool in dealing with Serbia. I was summoned to Fuerth’s office to discuss possible next steps for reaching this objective.

### **Establishment of the Serbia Sanctions Task Force**

After my meeting with Fuerth, I was assigned to prepare a paper detailing the steps necessary to put in place a stringent and effective series of

sanctions measures against Serbia. The paper reviewed Serbia's salient economic pressure points and vulnerabilities. It included a review of Serbia's industrial and resource base, and its external trade activities and trading partners. It also recommended that we concentrate on identifying Milosevic's principal support pillars and specially target their economic activities and overseas accounts. Fuerth accepted the paper and approach, and decided to establish an interagency task force to support these activities. He asked the secretary of state to set it up under State Department auspices and recommended me as its director.

The task force was formally established in the State Department's operations center on February 12, 1992, and began operations immediately. Its staff included officers assigned from interested bureaus in the State Department (European and Eurasian Affairs, Political-Military Affairs, Economic and Business Affairs, International Organizations, and Intelligence and Research) and other departments and agencies including the Department of Defense, the Treasury Department, the Commerce Department, Customs and Border Protection, the Central Intelligence Agency, the Defense Intelligence Agency and the National Security Council. Their duties included providing real time agency/bureau input to the work of the task force as well as liaison back to their agency or bureau to assure they were also fully informed concerning task force's activities relevant to them. Officers were also brought in from additional agencies to handle specific issues, as necessary.

While the task force was based in the State Department, I reported directly to Fuerth. I was also empowered, under Fuerth's authority, to bypass interbureau/interagency clearances for messages to the field, including instructions that dealt directly with sanctions-compliance issues. Fuerth and I met on a daily basis (either in his office or via secure teleconference) to discuss sanctions-related

matters. We also received daily intelligence briefings, either together or separately. As expected, this format generated considerable interagency frictions. The more serious problems were kicked up to White House meetings of the deputies or principals. But Fuerth almost always got his way.

Fuerth and I worked out a two-track strategy to increase pressure on the Milosevic regime:

1. Channeling U.S. resources and influence to tighten the application and enforcement of the existing sanctions.
2. Identifying more stringent sanctions measures that could be applied through a new U.N. Security Council resolution, if and when it appeared likely that such a resolution could be adopted.

We recognized that Serbia and the Milosevic regime had to remain the main focus of our sanctions efforts since that was the principal moving force behind the Bosnian Serbs. In any event, sanctions focused against the Bosnian Serbs would have had relatively little impact given the conditions already prevailing within Bosnia. At one point in 1994, Milosevic sought to obtain sanctions relief by ostensibly imposing his own sanctions on the Bosnian Serbs. Those sanctions quickly proved to be nothing more than a façade, although they did earn Milosevic a few thousand barrels of oil, ostensibly for "humanitarian purposes."

Our agreed strategy also recognized that our main task was to target the most severe application of the sanctions against those industries and sectors that represented the real support pillars of the Milosevic regime. We needed to threaten Milosevic's own hold on power if we were going to truly influence him to bring his pressure to bear on the Bosnian Serb leadership.

Our efforts to increase the effectiveness of the existing sanctions focused on six specific objectives:

1. Expand of the sanctions assistance missions and increased technical assistance to the front-line states to improve border controls.
2. Cut off Serbia's access to oil, gas and other industry essential commodities.
3. Hit Milosevic's support mechanism in their own pocketbook by tightening implementation of the financial sanctions.
4. Deter violations through increased penalties, investigations and prosecutions.
5. Interdict all maritime traffic to and from the ports of Kotor and Bar.
6. Halt the movement of all maritime vessels thought to be flagged, owned or controlled by FRY entities.

The U.S./European Community/CSCE sanctions liaison group met at our behest in Vienna on March 5, 1993, and again on April 2, to approve a number of our proposals for enhancing sanctions enforcement.

### **Strengthening the Sanction Assistance Missions**

Our first task was an expansion of the sanctions assistance missions. We instructed our embassies in all CSCE capitals to push for increased SAM personnel, resource and funding commitments. In May 1993, Fuerth and I, along with other members of the task force, went on a round robin mission to several European capitals to brief them on sanctions enforcement efforts and to win their support for greater SAM resources. Our SAM expansion plan called for the deployment of a minimum of 135 sanctions monitors in the front-line states. This would permit 24-hour coverage at the key border crossings. We eventually achieved pledges for 185 sanctions monitors coming from more than 20 different countries. For our part, we increased the U.S. SAM commitment from 10 to 27 customs officers. We also took a number

of steps to upgrade SAM team communication and mobility capabilities with new vehicles, radio and facsimile equipment, and began to introduce secure computerized technology to link SAMCOM with the U.N. sanctions committee in New York.

A proposal was also formulated by our European partners in February 1993, to appoint a senior Italian diplomat as special sanctions coordinator. His principal role would be to chair and represent the sanctions liaison group in discussions with governments and other international organizations. After a short internal debate as to whether such a position would dilute U.S. influence in managing the SAMs, and a special interview held with the proposed candidate, Fuerth agreed to the arrangement. I developed a very close working relationship with the new sanctions coordinator and, thereafter, we worked hand in hand.

We also championed an increased U.S. effort to bolster the ability of the frontline states to implement the sanctions more effectively. This included the provision of equipment and customs and border control officer training locally, and in the United States and Europe. These measures had lasting benefits for the frontline states well beyond the termination of the Serbia sanctions program.

### **Curtailling Serbia's Access to Oil, Gas and Other Essential Commodities**

Despite the sanctions, Serbia continued to arrange oil import deals in Bulgaria, Greece, Romania, Ukraine and Russia. U.N. Security Council Resolution 787 had prohibited the transshipment through the FRY of key commodities such as iron, steel, chemicals, vehicles, aircraft and energy supplies, without prior U.N. sanctions committee approval. Such approval involved the issuance of special, case-by-case transshipment licenses that had to be prominently displayed and/or presented when crossing in or out of the FRY. Yet, despite

these new requirements, the transit traffic exemption continued to constitute a major loophole used by Serbia and friends to circumvent the sanctions. We were determined to close this loophole and took steps to streamline and more closely control sanctions committee issuance of transshipment authorizations, and to insist that shipments to and through Serbia be carefully verified to assure they did not include contraband.

The Serbs were finding it too easy to circumvent the U.N. licensing system through the repetitive use or fraudulent replication of sanctions committee licenses. A license verification system was needed urgently and we immediately contracted the Volpe National Transportation Systems Center to develop such a verification system. We also pressed for and obtained U.N. sanctions committee approval for the installation and use of the system. We donated a series of computers to the sanctions committee, SAMCOM and the SAM teams for this purpose and securely linked the system through Inmarsat, an independent global mobile satellite company. Thereafter, each license granted by the sanctions committee was serially recorded in the system on issuance. The SAM teams could then access this information on a real time basis to determine the bona fides of any license or cargo. They also entered a notation in the system when such licenses were presented to prevent them from being used again or duplicated.

We won approval from the sanctions liaison group and the frontline states to restrict commercial road traffic to a few major border crossing points for verification. All commercial traffic was to be turned back by customs officers at any unapproved border crossing point. We also instituted the practice of turning back all Serbian-owned commercial vehicles and trains. Border control officers were instructed to closely inspect all vehicles, commercial or private, if the registration, insurance or other documents indicated possible Serbian ownership.

We paid special attention to the movement of barge traffic along the Danube. With increased resources SAM teams were deployed to the Ukraine where they could check cargo being loaded for transport upriver. SAM teams were also staged at the Danube locks in Romania, just below Serbia. Romania also agreed to close the Iron Gate locks to all Serbian owned tugs and barges.

At a meeting with the Western European Union (WEU) in Brussels in April 1993, Fuerth authorized me to press the WEU to take on direct responsibility for policing the Danube. They subsequently agreed to deploy a small WEU flotilla on the Danube in Hungary as well as in Romanian Danube waters just below Serbia. These riverboats added a new capability to stop and search suspect barges plying the Danube.

U.N. Security Council Resolution 820, which was adopted in April 1993, finally closed the transshipment exclusion by requiring that all transshipments receive prior sanctions committee approval. Nevertheless, we still needed to apply great diplomatic pressure on Greece and Macedonia to stop the oil from flowing north by rail from Thessalonica into Serbia. Reports received from the U.N. Preventive Deployment Force in Macedonia (UNPREDEP) stationed along the border periodically indicated, however, that undeclared tank car trains were seen crossing the border in both directions. Nevertheless, we knew we were having some success by the number of oil-carrying mule caravans that were also spotted.

### **Cutting Off Maritime Traffic to and from Federal Republic of Yugoslavia Ports**

Maritime traffic in and out of the Montenegro ports of Bar and Kotor continued to hamper the effective implementation of sanctions well into the fall of 1993, and periodically thereafter. Serbia used these ports to export some of its more important hard currency earners, such as textiles,

lumber and specialized timber. It also used these ports to bring in oil and other essential industrial commodities.

NATO and the WEU deployed ships to the Adriatic beginning in July 1992, to implement the arms embargo and the sanctions measures contained in Resolution 757. These efforts were upgraded after the adoption of Resolution 787 in November 1992, which authorized the interdiction forces to “use such measures commensurate with the specific circumstances as may be necessary... to halt all inward and outward maritime shipping.” Nevertheless, it continued to prove extremely difficult to police the Adriatic Sea sufficiently to stop and inspect all such traffic. Sanctions-busting ships would regularly declare for other benign ports and then pull into Kotor or Bar at the last moment. Small tankers would hug the Albanian coast to prevent inspection by NATO or WEU ships whose operations were confined to international waters.

The opportunity to deal with this situation finally presented itself in April 1993, when the Security Council responded to the latest round of Serbian atrocities, including the Srebrenica massacre. It adopted U.N. Security Resolution 820 on April 17, 1993, which reflected a number of measures we had worked on during the previous three months. These new measures reflected the most stringent sanctions measures ever adopted by the Security Council. Paragraph 28 put in place a blanket prohibition on all commercial maritime traffic entering the territorial sea of the Federal Republic of Serbia except when authorized on a case-by-case basis by the sanctions committee, or in case of force majeure. Any ship found in this area without a license was, ipso facto, violating the sanctions and could be detained.

Following up on this new measure NATO and the WEU agreed to combine their operations under a single command and control arrangement under the

name “Sharp Guard.” Thereafter, only a few ships ran the NATO/WEU blockade and they remained blocked or scuttled in Bar or Kotor for the duration.

### **Targeting the Federal Republic of Yugoslavia’s Maritime Fleet and Other Modes of Transportation**

U.N. Security Council Resolution 820 also provided us with a firmer basis on which to move in common against all FRY vessels and other commercial means of conveyance.

Paragraphs 24 and 25 broadly directed that countries “impound all vessels, freight vehicles, rolling stock and aircraft,” belonging to the FRY, and authorized them to be seized and forfeited if they were found to be used to violate any of the sanctions measures. The Serbia sanctions task force devoted considerable time and resources following up on this directive. Every FRY owned or operated vessel, including Danube river barges, was traced and the information on its location passed to all relevant ports to assure that the vessels were either denied entry or impounded. This included impounding several FRY vessels in our own East Coast ports. However, this gave rise to a new set of issues with regard to the disposition of the crews on board, and the costs of maintenance. Local solutions had to be devised on case-by-case basis.

In response, Serbian bargemen threatened to block all Danube river traffic passing through Serbia, and were periodically able to do so. Such crises were only resolved under threat of possible military action.

### **Strengthening Financial Sanctions**

We resolved to strengthen the impact of the financial sanctions imposed by Resolutions 757, 787 and 820. We were intent on hitting Milosevic and the financial backers of his regime in their own pocketbooks. Since we had blocked so much of Serbia’s domestic industrial activity our focus expanded

also to Serbia's extensive overseas business entities. We knew that the Milosevic regime relied heavily on funds generated by these offshore businesses, as well as from remittances from overseas FRY workers. Their activities had become Serbia's principal source of hard currency badly needed by the FRY to finance its acquisition of key commodities such as oil, military equipment and other items in circumvention of the sanctions. The FRY also engaged in a widening range of illicit activities that included counterfeit goods, cigarette, drugs and arms smuggling. Part of this cash was used to finance regime activities while part lined the pockets of those involved.

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*The effective application of sanctions must take into account the humanitarian implications and impact of the measures imposed.*

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But, getting a handle on Serbia's international financial activities proved to be among the most difficult challenges the task force faced. Banking secrecy laws and the complexity of monitoring money laundering activities and international transfers posed major impediments for effective sanctions enforcement. At the time they underscored the need for greater international financial oversight and, in many cases, the lack of sufficient domestic authority to regulate such activities.

We asked the intelligence community to identify and trace Serbia-related financial transactions and accounts. The U.S. Treasury Department's Office of Foreign Assets Control (OFAC), under the leadership of R. Richard Newcomb, played a major role in this effort.

Domestically, the Treasury Department acted quickly to identify and freeze FRY financial and other assets in the United States. And, task force resources were also used to quickly identify and designate the key FRY financial players (entities and individuals) in Serbia and abroad. A list of blocked persons and specially designated nationals was issued pursuant to U.S. executive order 12934 which included members of the Bosnian Serb military or paramilitary forces or civilian authorities, or those who were determined to be located in or controlled from the Federal Republic of Yugoslavia, or acting for or on behalf of the FRY government. This list was updated regularly.

Despite these efforts we knew that the FRY continued to conduct a substantial number of financial transactions using numbered and fictitious named bank accounts in Cyprus, Russia and elsewhere. While the U.S. banking system was generally susceptible to regulatory oversight and compliant with OFAC regulations, this was not the case, in the early 1990s, overseas, where strict bank secrecy was upheld. And, a number of overseas banks, including in Europe, did little to search for, or block, such FRY-related accounts. With these factors in mind we sought, in Resolution 820, to clarify and further broaden national obligations to block all Serbia related financial activities.

We made a special effort to limit the flow of worker and other family remittances to amount commensurate with normal family expenditures and humanitarian requirements. We knew that the regime required that all hard currency remittances be exchanged for growing worthless dinars, providing an important source of hard currency for the needs of the Milosevic regime and its support for the war in Bosnia. Electronic and other financial transfers of such remittances were severely limited by EU countries in frequency and amount, and instructions provided to border control officers to inspect and limit the amount of



cash that could be conveyed across the border. But the latter was a largely futile technique for stopping such flows.

### **Increased Penalties for Violations**

The failure of a number of Serbia's traditional trading partners to investigate sanctions-compliance cases referred to them by SAMCOM, or to impose substantial penalties for violations constituted a serious problem throughout the run of the Serbia sanctions. While most EU member countries acted responsibly, others did little to freeze Serbia's business activities or assets, or to stop their companies or financial institutions from engaging in proscribed activities. Greece, Cyprus and Russia were major culprits, but were not alone in leaving most reported sanctions violation cases unpunished. The task force constantly sought to pressure these governments to take firmer action, but with only modest success. Our best weapon was the transparency that the SAM teams provided in identifying contraband cargo and our ability to "name and shame" those responsible. The seizure of contraband cargo at the border also constituted a "penalty" that deterred several companies. Yet, sanctions-busting remained big business, particularly as the sanctions regime began to loosen in the spring of 1994.

### **Humanitarian Issues**

The effective application of sanctions must take into account the humanitarian implications and impact of the measures imposed. The Milosevic regime was quick to detour the impact of the sanctions wherever possible onto the most vulnerable segments of their population, including the elderly, children, handicapped and infirmed, as well as those out of favor with the governing authorities. This became their most powerful propaganda tool in responding to the sanctions, and was used successfully to obtain energy sanctions relaxation, particularly during the winter months. Fuerth and I discussed these issues on a regular basis.

It was clearly incumbent on the task force to consider the humanitarian impact of any of the sanctions measures imposed. We raised no question about the importation of food, medicine or medical equipment to Serbia, although we insisted that cargo be closely inspected at the border to halt contraband. We loudly criticized Serbia for cases where they were known to export their own similar pharmaceuticals, which they claimed were in short supply at home because of the sanctions. We also had to contend with various requests from European groups seeking permission to provide relief oil shipments to communities in Serbia hard hit by the winter cold. It often proved difficult to distinguish between the bona fides of such shipments. We believed that the best way to handle this problem was to insist that those involved publicly acknowledge and take responsibility for the delivery of such shipments to the intended destinations.

One of the hardest issues posed concerned the supply of gas from Russia via Hungary. The bulk of this gas was consumed in the industrialized Vojvodina region (which also had its own gas reserves). But gas was also essential for heating in other parts of Serbia and in Bosnia. The question was whether the Bosnian Serbs would allow the gas to also flow to the Bosnians in Sarajevo. Apparently they would not.

The Russians were reluctant to curtail the flow of gas to Serbia so long as Serbia was willing to pay for it. They would turn the gas off when Serbia fell into deep arrears, and turn it back on when payments were eventually made. Hungary was finally persuaded in early 1994 to shut off the pipeline connection to Serbia when it became clear that the Bosnian Serbs were blocking the onward flow to Sarajevo. Ambassador Richard Holbrooke finally ordered the gas line restored in September 1995 in an effort to convince Milosevic to come to Dayton, Ohio for the peace accord.

### **The Apex of Serbian Sanctions**

Despite these weaknesses, the combined application of trade and financial sanctions was clearly having a significant impact. Yugoslavia's gross domestic product (GDP) fell by more than 30 percent in 1993.<sup>8</sup> According to CIA estimates, the overall economy, industrial production and real income had all contracted by more than 50 percent. Private economists put the unemployment figure at greater than 40 percent. A FRY federal bureau of statistics report indicated that retail prices had soared as the Yugoslav dinar lost virtually all value. The black market rate for dinars in mid-September 1993 was 3,200,000,000 to the dollar. It would reach 30 billion to the dollar before the end of the year.<sup>9</sup>

In November 1993, Milosevic began to signal that he was interested in pursuing discussions on the lines of the latest Owen-Stoltenberg proposals for a settlement of the Bosnian conflict. While Bosnian Serb forces still held the upper hand, Milosevic was under intense pressure domestically to seek relief from the sanctions. Winter was fast approaching, oil, coal and other sources of energy were in very short supply, hyperinflation had made the dinar valueless, and unemployment and food shortages were increasing, causing local disturbances. Milosevic apparently felt that he had to deal.

EU counterparts began engaging in a dialogue with Fuerth and the task force on possible sanctions relaxation measures that might be offered to Milosevic as a further inducement. Trade seepage was at its lowest point. But, Washington first wanted to see some pull back by the Bosnian Serbs before engaging in such discussions with Milosevic. Therefore, Washington signaled to the United States/European Union/Russia Contact Group that the time was not yet ripe.

It was the task force's assessment at that time that the sanctions had reached their apex, with close monitoring and tight controls being exercised along the borders of Serbia, on the Danube and in

the Adriatic. However, there were growing signs of sanctions fatigue in the frontline states and other indications that this situation might not hold for much longer.

### **Sanctions Begin to Loosen**

The end of 1993 brought some very difficult times for Serbia and its leadership. But, the new year seemed to bring a degree of sanctions relief. On January 24, 1994, the FRY replaced the old dinar with a new "super dinar" under a plan designed by retired World Bank economist Dragoslav Avramovic, a past president of the National Bank of Yugoslavia. The new dinar was linked directly to the German mark. The Milosevic regime also pledged to limit further printing of dinars by tying further dinar issuance to direct foreign currency and gold backing. While this operation brought a halt to the hyperinflation that Serbia had suffered, the new Serbian currency was left in short supply. This resulted in an increased reliance on German marks for both domestic and international dealings. This, in turn, placed new emphasis on Serbia's illicit trade activities and the regime's need to soak up hard currency remittances.

Further sanctions relief was obtained on February 17, 1994 when Greece unilaterally imposed a total trade embargo on Macedonia in its growing dispute of the latter country's constitutionally adopted name. Being a landlocked country with few trading options, Macedonia immediately re-opened its borders with Serbia in defiance of the sanctions, pleading they had no other option. Macedonia was eventually coaxed, under considerable pressure from the United States and the European Union, into limiting trade to and through Serbia to those items originating or terminating in Macedonia. Nevertheless, considerable sanctions leakage was allowed to occur. Serbia took full advantage to bring in as much oil for the winter as possible. Macedonia only returned into full compliance with the sanctions regime after the Greek embargo was lifted in 1995. According to official Serbian

data, the Serbian economy took a jump up in 1994 and grew by 6.5 percent. We now had to count on longer-term economic attrition and infrastructure deterioration to reconstitute the sanctions pressure required to bring the Milosevic regime to heel.

A serious divergence also developed between the task force and Holbrooke, who took over as the U.S. member of the contact group in the summer of 1994 and maneuvered himself into a solo role as the West's principal interlocutor with Milosevic. These differences became acute as Holbrooke sought to use sanctions relaxation as an inducement to Milosevic to come to Dayton, Ohio for peace talks.

Beginning in the summer of 1994, the main focus of the task force switched from sanctions intensification to sanctions management. Maintaining the integrity of the sanctions would remain the principal challenge right up to the Dayton Accords. Further task force efforts would be focused on upgrading and replacement recruitment for the SAMs, logistical and training support for local customs officials, upgrading border control and inspection facilities and training and logistical support for local customs officers. Interdiction and inspection operations in the Adriatic and on the Danube were also maintained. And work continued on identifying and closing Serbian overseas operations and accounts.<sup>10</sup>

An assessment report on the impact of the sanctions on Serbia prepared by the CIA in June 1996 found that the Serbian economy only started again into a downward economic spiral in late 1994. By that time Serbia had lost most of its traditional customers to the newly emerging eastern European and trans-caucus states. With a lack of spare and replacement parts, Serbia's industrial and transportation infrastructure was also starting to crumble. Rapid inflation was also starting to take hold. Belgrade's Institute of Economics reported that, by October 1995, real income had declined a further one-third since December 1994.<sup>11</sup>

Prospects were particularly glum in September 1995 as the country found itself, once again, facing a serious oil and gas shortage with winter just around the corner. Serbia was already experiencing serious power outages. The treasury was near empty and the Russians had again turned off the gas flow for nonpayment.

At the same time, the turning tide of war in Bosnia, created by the alliance of Bosnian and Croat forces and supported by NATO air strikes, had forced the Bosnian Serb leadership into accepting Milosevic as the principal deal maker on their behalf. They knew they could not withstand the Bosnian/Croat/NATO onslaught without Milosevic's support, and could not salvage a peace independently. Milosevic had their unchallenged mandate.

Milosevic knew also that he needed to make a deal to get the sanctions off Serbia's back. The sanctions had kayoed his country's economy and sapped the energy of what was once the strongest power in the Balkans. But, his stated precondition in negotiations was that sanctions be lifted (including on oil) and gas begin to flow.

### **Dayton and the Suspension of the Sanctions**

A deep split developed between Holbrooke and those administering the sanctions as to whether the gas and oil embargo should be suspended, as demanded by Milosevic as his precondition for coming to Dayton. Holbrooke convinced the Clinton administration that the time was right for serious talks to end the Bosnian War and that lifting the oil embargo was worth the gamble. The sanctions supporters argued that once suspended, the sanctions would be extremely difficult to restore. In the meantime Milosevic would fill his oil reserves and we would lose much of the real leverage we had to negotiate a fair deal for the Bosnians. On the one hand, a peace agreement was achieved at Dayton. Yet, one can question whether the terms of the Dayton Accords might have been better if the sanctions lever was still in place up until the agreement was actually reached.

It should be recalled that none of the fighting had spread to Serbia, and there had been no air strikes against targets in Serbia proper. Serbia was under no direct military threat. The only real pressure on Milosevic was the sanctions, and he needed to make a deal. Sanctions, as much if not more than any other factor, brought Milosevic to Dayton.

On November 21, 1995, the presidents of the Republic of Bosnia and Herzegovina, the Republic of Croatia and the Federal Republic of Yugoslavia reached agreement on the Dayton Accords and the fighting in Bosnia stopped. The next day the U.N. Security Council adopted Resolution 1022 formally suspending the sanctions on Serbia.

Serbia now found itself in a deep economic ditch. It would only be able to dig itself out with the provision of substantial trade concessions and economic assistance. The withholding of such trade concessions and assistance now constituted the “outer wall” of a new set of sanctions that would remain in place until Milosevic was turned over to The Hague for trial. These “outer wall” sanctions would be filled in with a new set of sanctions measures as the Milosevic regime drifted into a new expanded conflict in Kosovo.

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*Serbia was under no direct military threat. The only real pressure on Milosevic was the sanctions, and he needed to make a deal. Sanctions, as much if not more than any other factor, brought Milosevic to Dayton.*

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## Kosovo and the Onset of Financial and Economic Warfare

After negotiations with Milosevic failed to stop the growing war in Kosovo, the Clinton administration decided to enhance sanctions against Yugoslavia in June 1998. The Kosovo pressure campaign marked the start of a much more sophisticated approach to targeted sanctions and “effects-based” operations against financial, business and leadership targets tied to the regime, drawing on the network-mapping capabilities of the Department of Defense’s Joint Warfare Analysis Center (JWAC).

Under the leadership of Ambassador Robert Gelbard, and subsequently of Ambassador James Dobbins, a State Department team formed to interact with a European contact group, and to investigate the organization of a pressure strategy for dealing with Milosevic. As the United States began to prepare a military response to Serbia’s own use of force in Kosovo, I was assigned the task of developing a series of sanction measures that could be imposed on the Milosevic regime in the absence of Security Council action.

The strategy called for maintaining the outer wall of sanctions, withholding assistance for rebuilding damaged bridges, roads, etc., while also expanding “inner-wall actions” by impeding Serbia’s ability to bring in needed commodities, particularly oil and petroleum products, and by targeting the financial and economic support base of key Milosevic cronies and associates. The latter involved convincing EU mem-

ber countries to join the United States in designating (placing on a so-called “black list”) a number of high profile Serbian companies and individuals closely identified with the Milosevic regime. U.S. and EU entities were prohibited from engaging in transactions with such “black listed” Serbian individuals and entities. Subsequently, the European Union agreed to expand the transaction prohibition by shifting to a so-called “white list” approach. This involved prohibiting transactions with all Serbian entities except those specifically “white listed” as having distanced themselves from the Milosevic regime. This action was intended as a further incentive for companies to withdraw their support for Milosevic. According to journalist William Arkin, this was done in a highly sophisticated and meticulously planned manner around a list of concentrically linked operations, dubbed “Operation Matrix.” Via the matrix, beginning in the runup to the Kosovo war in March 1999, financial actions were synchronized with information operations, special operations, strategic bombing of key facilities, and the use of both black lists and white lists (white lists specifically exempted individuals and entities the United States and NATO wanted to support from sanctions and the threat of military force). Moreover, realizing that Serbia was moving its backing offshore to venues like Cyprus, the U.S. Treasury Department actively flexed its OFAC muscles to induce banks to freeze assets, even where U.S. law did not necessarily apply

(apparently, bankers realized that failure to cooperate could compel the Treasury Department to find reasons to cut off their access to the U.S. financial system in retaliation).

The effectiveness of these non-kinetic operations remains largely unstudied. However, participants in the process describe it as the “closest thing” under the Clinton administration to what the Bush administration was later to employ against the finances of al Qaeda and against the Kim Jong Il regime in North Korea.<sup>12</sup>

-Victor Comras

## ENDNOTES

1. At the request of the Center for a New American Security (CNAS), I prepared this report concerning the international sanctions program directed at the Milosevic regime in Serbia from 1992 through 1995. It describes the sanctions program's rationale, development, implementation, and policy implications. In preparing this paper I have relied principally on my own recollections, refreshed by a review of my own personal notes and papers. As requested, I have described my own personal involvement and experiences related to the development and implementation of these measures. I agreed to prepare this paper also in the belief that a detailed description of our efforts to apply sanctions effectively against Serbia might impart relevant and useful insights with regard to the application of current and future sanctions programs.

2. Secretary of State James Baker, "Remarks at Lisbon Conference on Assistance to the New Independent States" (24 May 1992), <http://journals.cambridge.org/action/displayAbstract;jsessionid=CD2D26FA77DA89988ABBE4454ACBE661.tomcat1?fromPage=online&aid=4184344>.

3. Ibid.

4. Acting Secretary of State Lawrence S. Eagleburger, "Statement at the London Conference General Debate" (26 August 1992).

5. Resolution of London Conference on the Crisis in the Former Yugoslavia (26-27 August 1992). U.S. Department of State Dispatch Supplement, Vol. 3, No. 7, <http://dosfan.lib.uic.edu/ERC/briefing/dispatch/1992/html/Dispatchv35up7.html>.

6. U.N. Security Council Resolution 787 (1992). Operation Joint Endeavor, <http://www.nato.int/for/un/u921116a.htm>.

7. Secretary of State Warren Christopher, "New Steps Toward Conflict Resolution in the Former Yugoslavia" (10 February 1993), <http://dosfan.lib.uic.edu/ERC/briefing/dossec/1993/9302/930210dossec.html>.

8. Milica Delevic. "Economic Sanctions as a Foreign Policy Tool: The Case of Yugoslavia," *International Journal of Peace Studies* (January 1998), Vol. 3, No. 1.

9. Ibid.

10. In April 1994, I was assigned to Skopje, Macedonia as the first U.S. chief of mission of the U.S. liaison office, which was subsequently upgraded to embassy status in September 1995. I continued to observe and play a direct role in issues related to the Serbia sanctions program, and subsequently took charge of Serbia sanctions during the 1999 Kosovo War.

11. Charles J. Kacsur Jr. "Economic Sanctions Targeting Yugoslavia," U.S. Army War College (22 January 2003).

12. William Arkin, "The Cyber Bomb in Yugoslavia," *The Washington Post* (25 October 1999), <http://www.washingtonpost.com/wp-srv/national/dotmill/arkin.htm>; William Arkin and Robert Windrem, "The Other Kosovo War," *Special to MSNBC* (29 August 2001), <http://seclists.org/isn/2001/Aug/193>; Andrew J. Bacevich, Eliot A. Cohen, eds. *War over Kosovo: Politics and Strategy in a Global Age* (New York: Columbia University Press, 2001).

# Appendix

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PRESSURING SADDAM: 1991-2003 –  
A FAILURE TO RECOGNIZE SUCCESS

79

By David L. Asher

J A N U A R Y 2 0 1 1

Pressure

*Coercive Economic Statecraft and U.S. National Security*





## PRESSURING SADDAM: 1991-2003 – A FAILURE TO RECOGNIZE SUCCESS

By David L. Asher

Another important case study of coercive diplomacy is the international sanctions against Saddam Hussein's Iraq from 1991-2003. The Iraq case is full of lessons and insights and offers a unique look at the potential of sanctions against a hydrocarbon-rich authoritarian regime seeking weapons of mass destruction. Although many instances of coercive diplomacy fail, the case of Iraq provides an instance where the pressure strategy succeeded but ironically was perceived to have been a failure at the time. In truth, but also in hindsight, the Iraq sanctions succeeded, especially from 1991-1996, before they were significantly watered down by Saddam's bilateral trade arrangements with neighboring countries and the introduction of the United Nations oil-for-food program. Moreover, even with the post-1996 rebound of the Iraqi economy fueled by the lessening of sanctions, the campaign of economic pressure against Saddam still prevented him from acquiring weapons of mass destruction (WMD). Had policymakers known how well they had defanged Saddam there would have been no need for an invasion of Iraq in 2003.

The conclusions of CIA lead investigator Charles Duelfer in his comprehensive 2004 report based on captured records and detailed on-the-ground investigations inside Iraq underscore the then unknown real impact of sanctions:<sup>1</sup>

- Saddam's primary goal from 1991-2003 was to have U.N. sanctions lifted, while maintaining the security of the regime. Saddam sought to balance the need to cooperate with U.N. inspections to gain support for lifting sanctions while preserving Iraq's intellectual capital to produce WMD, all with a minimum of foreign intrusiveness and loss of face. Indeed, this remained the goal to the

1. Charles Duelfer, *Comprehensive Report: DCI Special Report on Iraq's WMD* (30 September 2004), [https://www.cia.gov/library/reports/general-reports-1/iraq\\_wmd\\_2004/index.html](https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/index.html).

end of the regime. Launching any WMD program, conspicuous or otherwise, risked undoing the progress achieved in eroding sanctions and jeopardizing a political end to the embargo and international monitoring.

- The introduction of the U.N. oil-for-food program (OFF) in late 1996 was a key turning point for the regime. The program rescued Baghdad's economy from a terminal decline created by economic sanctions. The regime quickly came to see that OFF could be corrupted to acquire foreign exchange both to further undermine sanctions and to provide the means to enhance dual-use infrastructure and potential WMD-related development.
- By 2000-2001, Saddam had managed to mitigate many of the effects of sanctions and undermine their international support. By the end of 1999, Iraq was within striking distance of a de facto end to the sanctions regime, both in terms of oil exports and the trade embargo.<sup>2</sup>

### Lessons from the Iraq Sanctions

The Iraq case is important not simply because of similarities to current or future scenarios, but because it provides an unprecedented opportunity to study the strategic effects and challenges of economic sanctions from the vantage point of those seeking to compel through economic pressure and those seeking to counter that pressure.

The Iraq case also illustrates that well-planned economic pressure, applied short of catastrophic economic collapse, can compel effective WMD disarmament and monitoring. But, it also suggests that these measures, in the case of Saddam's 1994 deployment of heavy divisions along the Kuwaiti border, were backed by a credible threat of military force. However, the Iraq case also underscores the

fact that economic pressure works only so long as it can be maintained. Once pressure starts to slip the adversary can become emboldened or worse, the trend can continue to a point where the pressure becomes too weak to compel the target country. By 1996, Saddam had reached a point where the sanctions were eroding and he knew it.

The Iraq sanctions case also underlines that economic pressure is difficult to maintain especially if the target state is:

- A major energy exporter and important energy supplier of U.N. Security Council (UNSC) permanent members.
- Willing to allow citizens' well-being to deteriorate to defy sanctions and generate sympathy.
- Surrounded by relatively poor or corrupt neighbor states willing to circumvent sanctions.

The Iraq case carries important lessons to be considered in the case of Iran. These lessons underline the potential clout of employing the sort of smart sanctions and targeted actions within a carefully planned strategic campaign that the Treasury Department has been orchestrating against the Iranian regime. They also suggest that a much larger whole-of-government approach ultimately will be needed, backed by persistent, adaptive and aggressive international sanctions, perhaps similar to the quarantine of UNSC resolution 687. Finally, such sanctions should also be backed by the credible threat of military force. Policymakers may or may not wish to adopt these draconian measures for dealing with Iran; but the alternatives to doing so may be even less acceptable in the long run.

2. Charles Duelfer, *Comprehensive Report: DCI Special Report on Iraq's WMD* (30 September 2004), [https://www.cia.gov/library/reports/general-reports-1/iraq\\_wmd\\_2004/index.html](https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/index.html).

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ISBN 978-1-935087-43-4

5 0999 >



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